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Net Worth at Birth:
Creating a National System for Savings and Asset Building with Children's Savings Accounts

By Reid Cramer[1]

Achieving security in today's economy requires not just a job and growing income, but increasingly on the ability to accumulate a wide range of assets. Yet many Americans have low asset holdings and many children are disadvantaged from the start of their lives relative to those children born into affluence. Regrettably, the asset-building system already in place that facilitates wealth creation disproportionately benefits those households with higher incomes, better job benefits, and larger income tax liabilities. Lower-income families are offered fewer—and less attractive—ways to build wealth. Enabling all Americans the opportunity to take full advantage of our prosperous society will require the development of more inclusive asset building policies.

One promising idea to expand opportunity and broaden asset ownership is to endow every newborn with a Children's Savings Account (CSA).[2] This "accounts-at-birth" approach represents a social investment in every child at the same time as it gives the child a stake in broader society. Each child will grow up knowing they will have a modest pool of resources at their disposal to help them succeed. For low-income Americans, CSAs will provide a means to develop savings and assets—an opportunity not offered by existing public policy. Over time, these accounts could evolve into a universal system through which all Americans would meet their lifelong asset needs, helping them accumulate the resources necessary to make productive investments. Beyond the individual benefits, investing in children can have large multiplier effects, especially when it is linked to increasing social engagement and expanding opportunity. In the long run, building wealth through CSAs and other means has the potential to help break the vicious cycle of intergenerational poverty.

In July of 2004, a bipartisan coalition of legislators introduced a bill in both houses of Congress to create a national system of children's savings accounts.[3] The America Saving for Personal Investment, Retirement, and Education Act ("The ASPIRE Act") would provide each newborn child with a "KIDS Account" and an initial endowment of $500. Beyond the initial endowment, each account would be supported by incentives to encourage additional savings. Account resources would be restricted to asset building purchases, such as post-secondary education, first-time homeownership, or retirement security. While there are many different ways in which to structure a CSA proposal, the ASPIRE Act is likely to serve as the vehicle around which future CSA discussions occur.

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1 Reid Cramer is Research Director of the Asset Building Program of the New America Foundation. An earlier version of this paper was initially published by the New America Foundation in March of 2004.

2 Boshara's (2003c) proposal was called American Stakeholder Accounts. Also see Curley & Sherraden (2000) and Goldberg & Cohen (2001).

3 The ASPIRE Act was initially sponsored by Senators Rick Santorum (R-PA), Jon Corzine (D-NJ) and Representatives Harold Ford, Jr. (D-TN), Phil English (R-PA), Thomas Petri (R-WI), and Patrick Kennedy (D-RI). The bill was reintroduced in 2005 (S.868 and H.R. 1767) with Senators Charles Schumer (D-NY) and James DeMint (R-SC) as additional co-sponsors.

Moving an ambitious policy proposal through the political process requires more than a good idea. Subjecting compelling concepts to scrutiny helps identify issues to address and the challenges to overcome. Serendipity and strategy play a role as well in determining whether a proposal achieves sufficient political traction; but before any legislative maneuvers are contemplated, it is advantageous to consider the policy choices that must be made to refine and optimize any policy proposal.

This paper intends to review and consider the broad array of policy design choices that will give any CSA proposal its ultimate shape and direction. And since policy is not made in a political vacuum, the discussion of program design is preceded by an analysis of the political rationale underpinning CSAs. Fortunately previous analytical work has been conducted which provides a solid foundation for pursuing both tracks of this inquiry.[4] New research and recent developments in the field, both in the United States and abroad, have added to the knowledge base from which this proposal can draw. This includes the expanding track record of Individual Development Account (IDA) programs that continue to provide insights into the impact of incentives and financial education on the savings patterns of lower-income families as well as the experience of the United Kingdom in implementing a national, universal system of children's savings accounts, called the Child Trust Fund.

The first section of the paper presents an outline of the main elements of the ASPIRE Act proposal and a discussion of the current policy context. A review of the past proposals, current public sector programs, and private sector initiatives helps build a case for some type of children's account system. Recognizing that that there are many forms such a system can take, the paper's second section examines in detail the range of policy design, program implementation, and fiscal policy choices that have to be made in constructing a system of Children's Savings Accounts. The paper concludes with an examination of the broader issues of an account-based approach to asset building and considers the benefits and challenges of constructing such a system at birth. All told, it is hoped that an extended review of the far-reaching issues involved in implementing a universal system of child accounts will aid policymakers and advocates as they consider supporting such a proposal in its path through the political and legislative process.

PART I: THE PROPOSAL AND POLICY CONTEXT

A. The ASPIRE Act and KIDS Accounts: A Prototype Proposal

There are multiple ways to design Children's Savings Accounts depending upon the public resources available and the ultimate ranking of strategic goals. For the sake of clarity, a prototype proposal is described here modeled on the ASPIRE Act which creates a network of KIDS Accounts, while a more in-depth discussion of potential program features is presented later in the paper.[5] The prototype proposal is intended to distill the most current analytical thinking about how to create a large scale system of accounts while keeping the implementation as simple and transparent as possible.

At its core, the prototype proposal depends on the creation of an account for every newborn. Participation would be mandatory and eligibility would be universal. Any child with a Social Security number would have an account opened automatically when their number is issued. Each account would be endowed with an initial contribution provided by the federal government with the opportunity for additional contributions. The system would be run by a newly-created entity called the KIDS Account Fund. Parents and legal guardians will serve as account custodians and make investment decisions until

4 Goldberg & Cohen (2001) present a detailed exploration of providing children savings account benefits through the tax code.

5 Details of the ASPIRE Act and legislative language can be found at Aspireact.org.

the accountholder reaches the age of 18. The account holder custodian decide how money in the KIDS Account is invested, choosing among a small set of investment options.

1. **Contributions**

Each account will be endowed with a one-time $500 contribution. Children living in households earning below the national median income will be eligible for both a supplemental contribution of up to $500 at birth as well as the opportunity to earn $500 per year in matching funds for amounts saved in the account. Voluntary, private contributions of up to $1,000 a year may be made to the account to facilitate asset accumulation. These contributions can come from any source, including the accountholder, family members, friends, employers, or non-profit organizations.

2. **Withdrawals**

Rather than facilitate consumption, CSAs are designed to promote asset accumulation. Therefore, accountholders can only use the resources that accrue in the accounts for specific purposes. When children enter adulthood, they would gain access to their account resources to use for asset building investments, such as paying for post-secondary education, buying a home, or saving for retirement. Rules governing distributions will be similar to existing Roth IRA rules where accountholders withdrawals are tax-free but they are reported to the IRS and subject to audit.

B. The Policy Rationale

By almost any standard, the United States has been particularly successful at generating wealth. The interaction between the country's political and economic system has created a foundation for wealth creation on a massive scale, producing some of the world's largest corporations and richest families.[6] Beyond the fortunes of the rich, the rise of a broad middle class is one of the major social achievements of the United States as the sharing of wealth has ensured that a majority of citizens have a stake in the functioning of the economy and society as a whole. Through an array of policies and programs, the public sector has played a significant role in the both the expansion of wealth and its distribution. American history is marked by a series of major policy initiatives that have successfully expanded ownership of capital and promoted stakeholdership.

Historic initiatives, such as the Homestead Act of 1862, The GI Bill of 1944, and the creation of the Federal Housing Administration (FHA) in 1934, have expanded access to important elements of wealth creation and produced tangible results. By providing land to those that would go west, stake a claim, and work it for five years, the Homestead Act provided an opportunity to build wealth by developing property. Of the million and a half people that successfully took the government up on its offer, passing this wealth and property on to the next generation proved to be one of the most enduring legacies of the Act.[7] The GI Bill offered veterans grants to pay for training and higher education, loans for setting up new businesses, and mortgages to purchase homes. Through this law, some $14.5 billion was spent by the federal government between 1944 and 1956 benefiting almost 8 million veterans.[8] A congressional report has estimated that the GI Bill generated returns of up to seven dollars for every dollar invested, an impressive performance by any standard.[9] In addition to the economic multiplier effects, the influx of

6 Kevin Phillips (2002).

7 Williams (2003) estimates that up to one-quarter of the adults in the U.S. potentially has ancestors that can trace their legacy of asset ownership to the Homestead Act.

8 Skocpol (1996).

9 Subcommittee on Education and Health of the Joint Economic Committee (1988).

veterans permanently transformed the American university system, creating “an avenue for mass mobility rather than gentlemanly certification.”[10] The FHA was created to help many Americans purchase a home. Through its mortgage insurance and other financing products, FHA has played a role in the country’s rising homeownership rate, which reached an all-time high of 68% in 2002.[11]

Each of these efforts was grounded in the twin objectives of ownership and opportunity. The underlying assumption being that ownership creates stakeholders and expanding opportunities for people to accumulate productive assets has broad social and economic benefits. The role of public policy in encouraging asset building continues to this day; it is a hallmark of the prevailing policy framework which identifies wealth creation as a central policy objective.

Many of the policy levers used to achieve these ends are promoted through the tax code. Tax expenditure programs in the guise of tax deductions, tax credits, preferential tax rates, tax deferrals, or income exclusions are a primary vehicle for achieving these policy objectives. Collectively, they subsidize a broad range of activities, including many asset building investments such as mortgage payments, business investments, retirement savings, and educational expenditures. The value of these asset building tax expenditure programs exceeds $300 billion on an annual basis.[12] Although these tax expenditures may subsidize worthy activities and generate sizeable social and economic returns, they are not accessible to a large number of citizens that would benefit from them the most. Many lower-income households do not have large enough tax liabilities to take advantage of these tax expenditure programs. Not surprisingly, 90 percent of the benefits in the two largest tax expenditure categories (homeownership and retirement) reach households with incomes above $50,000 a year.[13]

Table : Value of Select Asset Building Expenditures, Fiscal Year 2007
(in millions of dollars)

Housing	
Deductibility of Mortgage Interest on Owner Occupied Housing	79,860
Deductibility of Property Tax	12,810
Capital Gains Exclusion on Home Sales	43,900
Exclusion of Net Imputed Rental Income on Owner-Occupied Housing	33,210
Investment: Commerce	
Capital Gains	26,760
Capital Gains Exclusion of Small Corporation Stock	260
Step-Up Basis of Capital Gains at Death	32,460
Carryover Basis of Capital Gains on Gifts	640
Exclusion of Interest on Life Insurance Savings	20,770
Education	
HOPE Tax Credit	3,060
Lifetime Learning Credit	2,020
Coverdell Education Savings Account (formerly Education IRA)	110
Deductibility of Student Loan Interest	810
Deductibility of Higher Education Expenses	--
State Prepaid Tuition Plans	620
Retirement: Income Security	
Net Exclusion of Pension Contributions: Employer Plans	52,470
Net Exclusion of Pension Contributions: 401(k) Plans	39,800

10 Skocpol (1996) cites the statistics that only 9 out of 100 young people attended college in 1939, but the rate doubled by 1947.

11 U.S. Department of Housing and Urban Development (2003).

12 There are several methods for estimating the value of tax expenditures; the two most common measures described by the Office of Management and Budget (2003) are revenue losses and budget outlay equivalent. These estimates will vary from one another depending upon the specific activity and tax treatment.

13 U.S. Congress Joint Committee on Taxation (2002).

Net Exclusion of Pension Contributions: IRAs	5,970
Net Exclusion of Pension Contributions: Savers Credit	830
Net Exclusion of Pension Contributions: Keough Plans	10,670
TOTAL	**366,920**

Source: Office of Management and Budget, Executive Office of the President. Budget of the U.S. Government, Fiscal Year 2007, Analytical Perspectives. Table 19-1.

Federal policy has historically discouraged asset building among households with fewer resources. Not only has the structure of tax expenditure programs denied benefits to poorer households but anti-poverty policy efforts have been, and remain, focused on facilitating income maintenance and short-term consumption. In this spirit, many federal programs impose asset limits as an element of means-testing program eligibility. The unintended consequence of this approach is that it creates a disincentive to engage in the types of activities which can help a family move up and out of poverty, namely savings and asset building.

Consequently, the benefits of stakeholding, which have made a difference for many American families, have not been experienced by all. Millions of Americans live in households with few or no assets. One-quarter of white children and half of non-white children grow up in households without any significant levels of savings or resources available for investment.[14] This represents an important dimension to the problem of inequality, which is usually discussed in terms of income. Wealth inequality is more severe than income inequality. According to the 2001 Survey of Consumer Finances, conducted by the Federal Reserve, the top 10 percent of households in the U.S. ranked by income earn 44 percent of the nation's income but own 57 percent of total family net worth.[15] In contrast, the bottom 60 percent earn 22 percent of the nation's income and own less than 17 percent of the nation's wealth.[16]

The pattern of wealth distribution is instructive because it reflects inequalities which have formed over an extended period of time. Today two-thirds of wealth is held by households with incomes in the top 20%.[17] Yet the more pressing issue from a policy perspective is the plight of those households that are asset poor, possessing insufficient resources to sustain a household through any extended period of economic disruption.[18] Research on asset poverty has focused on developing measures of economic vulnerability that can provide an accounting of households without a stock of resources to survive a loss of income.[19] Haveman and Wolff have estimated that the number of asset poor households with precarious resource shortages substantially exceeds the official poverty rate, and that the disparity has grown over the last twenty years. In 1998, one out of eight Americans were officially classified as poor, 34.3 million people or 12.7% of households, but the ranks of the asset poor included one of every four, 69.1 million people or 25.5% of households.[20] And that disparity has grown. Between 1983 and 1998, income poverty declined about 16 percent, while asset poverty rose 14 percent.[21]

While there are many indicators which reflect the relatively high concentration of wealth in the U.S., measures of asset poverty are instructive because they identify a clear challenge. Rather than penalize

14 Shapiro (2002).

15 Aizcorbe, Kennickell, and Moore. (2003).

16 Aizcorbe, Kennickell, and Moore. (2003).

17 Aizcorbe, Kennickell, and Moore. (2003).

18 Oliver and Shapiro (1997) first proposed a definition for asset poverty in their 1997 book, Black Wealth/White Wealth. They defined "resource deficient" households as those without enough net financial worth reserves to survive three months at the poverty line.

19 Haveman and Edward (2000) have built upon this approach and used existing data sources to estimate a series of asset poverty measures.

20 Haveman and Wolff (2000).

21 Haveman and Wolff (2000).

those with wealth, policies need to identify ways to create opportunities for those without resources to save and accumulate assets.

The value of assets is based not only on the economic security they provide but in how they enable people to make investments in their future and exert a stake in the broader society that income alone cannot provide. Michael Sherraden, author of *Assets and the Poor*, observes that, "Few people have ever spent their way out of poverty. Those who escape do so through saving and investing for long-term goals."[22] Oliver and Shapiro write that "Wealth is a particularly important indicator of individual and family access to life chances…It is used to create opportunities, secure a desired stature and standard of living, or pass class status along to one's children."[23] Recent research efforts have increasingly supported these claims with a growing body of evidence.[24] In a review of the literature on the effect of asset holding, Scanlon and Page-Adams found that much of the research focused on the impacts of homeownership, but a number of other studies focused on assets in the form of savings, net worth, or small business ownership. Despite the variety of asset measures used in this literature, they concluded that together financial and property assets appear to have positive effects on economic security, household stability, physical health, educational attainment, and civic involvement.[25] This conclusion has also been supported by work in the United Kingdom which examined that effect of assets on life chances and found a "persistent effect of assets on a number of outcomes, which were impervious to a wide range of controls," and "the assets effect was sustained, with employment, psychological health, belief in the political system and values, all appearing to be enhanced by assets."[26]

Thus, the body of evidence that links asset holding with positive outcomes is significant, growing, and has been shown to work for both the poor and non-poor alike. Recent findings from a national demonstration project of matched savings accounts for low-income individuals found that program participants responded positively to savings incentives, overcoming doubts among policymakers as to whether the poor could save.[27] The research results do not in and of themselves justify a rejection of income maintenance programs, but they provide support for building on approaches that combine an income and assets perspective.

In many ways asset building policies can be conceptualized as an investment strategy, with large multiplier effects for the entire economy. Modest investments in children can grow, and with responsible stewardship can provide a means of ensuring that every citizen is afforded opportunities to succeed. As such, CSAs are intended to play a role in supporting the achievement of diverse national policy objectives, including the promotion of child welfare, the increase in the national savings rate, the enhancement of financial literacy, the incorporation of the unbanked into the financial mainstream, and the support of educational achievement. These are broad and worthy objectives; fulfilling any of these goals would represent a major societal achievement. Yet the success of this effort could be found at the household and community level. Each child will grow up knowing there is an account with their name on it that can be used as they mature to help them make productive investments. These accounts provide a vehicle to enhance civic engagement and social participation. Through the universal approach of

22 Sherraden (1991).

23 Oliver and Shapiro (1997), page 2.

24 Scanlon and Page-Adams (2001).

25 Scanlon and Page-Adams (2001).

26 Bynner and Despotidou (2001).

27 Key findings from Saving Performance in the American Dream Demonstration: A National Demonstration of Individual Development Accounts (Shreiner, Clancy and Sherraden, 2001) include the observation that the majority of people who participated in the demonstration were savers; and program characteristics, such as match rate, financial education, and use of direct deposit, are linked to savings performance.

CSAs, every child will have both an incentive to achieve and the awareness that they have a stake in the society as a whole.

The policy rationale supporting the CSA proposal is to provide a foundation for a broad account-based asset building system. Governed by a uniform set of rules and administrative structures that would serve as the “plumbing” to support a national system of accounts, and universally accessible to each and every child, these accounts will help integrate the currently disparate account-based vehicles at the same time as they guarantee everybody is included in the system. In the last thirty years there has been a profusion of asset-building accounts, including 401(k)s, Individual Retirement Accounts (IRAs), Roth IRAs, Coverdell Educational Savings Accounts, Section 529 Plan Accounts, Medical Savings Accounts, and proposed individual accounts in Social Security. While this has represented a shift toward asset-based policy, the implementation of these efforts has been considerably more regressive than the proceeding social insurance and means-tested transfer programs developed since the New Deal.[28] As a universal program, the accounts-at-birth approach offers each child an economic opportunity to participate in asset building, and also provides an opportunity to construct an integrated system for managing account-based asset building on a large scale. The importance of this achievement may be profound as it provides a unifying structure to integrate the asset building policies currently spread throughout the tax code.

C. The Policy Context, Historic and Contemporary

The Children’s Savings Accounts proposal is innovative in many respects, but it has historic precedents both here and abroad. There are several policy traditions within which this proposal should be considered: stakeholder proposals, savings incentives, and aid to children.

Internationally, the United Kingdom has recently embarked on an effort to unite all three with the implementation of a national system of Child Trust Fund accounts. Every child born in the UK after September 2002 is eligible to receive a voucher of 250 pounds and an additional 250 pounds if they live in lower-income families, which will be invested to ensure that all children have a financial asset when they reach adulthood.[29] Similarly, Singapore has begun to promote assisting children with savings and financial incentives in the form of a “baby bonus” deposit at birth and a matched savings Children’s Development Account program.[30] Although these incentives are part of a pro-natal policy where benefits apply only to the second and third child, they represent use of an account-based system to provide support for families with children and create a foundation for a national system of stakeholding and asset building. While the U.S. has successfully employed a range of stakeholding policies, the universal nature of these two efforts sets them apart from what has been achieved here. Despite the absence of such a universal children’s savings account program in the U.S., there have been a range of proposals, historic and contemporary, that have signaled the promise and potential of this idea. In fact, as a sign of political success, the last ten years has produced an increasing number of account-based proposals. The fate of these proposals should be examined closely in order to understand the current policy terrain and provide insights in how to potentially structure a children’s account system.

1. A Founding Precedent

Even before many of the stakeholder policies that encouraged homeownership, investment, and savings, took shape in the 20th century, one of the most influential founding fathers expounded a universal stakeholder proposal. In one of his last great pamphlets, *Agrarian Justice*, Thomas Paine argued for the

28 Sherraden (2003).

29 HM Treasury (2003).

30 Sherraden (2001).

creation of a national fund from which each citizen would be given an asset pool upon entering adulthood to formalize equal citizenship.[31]

Paine believed individuals should be offered opportunities to participate in the creation of economic wealth and he was concerned with the effects of pervasive poverty on social cohesion. The 15 pounds sterling he proposed every adult receive upon reaching the age of 21 would be enough to get them started in an occupation or economic endeavor. He thought that rather than allowing people to suffer deprivation and then asking society to intervene, it would be more logical to intervene beforehand. Paine wrote, "Would it not, even as a matter of economy, be far better to adopt means to prevent their becoming poor?"[32] Given society's role in creating affluence, Paine funds his proposal by proposing a 10% tax on inherited property, so the wealth of one generation can endow the next. A key element to the proposal is its universality, where the grant is provided as a right of citizenship for all, regardless of wealth or poverty. Paine's concept is distinct from other forms of universal social insurance because the plan enforces a particular social message; each endowment functions as an investment and an opportunity. He argued:

> A plan upon this principle would benefit the revolution by the energy that springs from the consciousness of justice. It would multiply also the national resources; for property, like vegetation, increases by offsets. When a young couple begin the world, the difference is exceedingly great whether they begin with nothing or with fifteen pounds apiece. With this aid they could buy a cow, and implements to cultivate a few acres of land; and instead of becoming burdens upon society… would be put in the way of becoming useful and profitable citizens.[33]

The provision of resources to buy a cow is not all that different from other more modern stakeholding policies that encourage business investment, home purchase, or land development.

2. Public Sector Efforts

Beyond stakeholding and citizenship, CSAs should be compared with government policies that provide financial resources to families with children. Historically, grants to children are intended to provide income security, and thus have taken the form of ongoing children's allowances. Following the Second World War, child allowance programs began to expand worldwide. Most of these focused on social policy with the primary objective of ensuring the welfare of children. A few programs were focused on pro-family or pro-natal objectives. In the United States, the Aid to Families with Dependent Children (AFDC) began as a small, emergency program during the New Deal in 1935, and was greatly expanded in the 1960s through court intervention, establishing an entitlement to assistance for low-income families that qualified. The purpose of this program was to provide financial assistance to needy, dependent children. While this type of effort is basically an income transfer program, receiving benefits is contingent upon characteristics or behavior of the family. AFDC regulations included provisions regarding work requirements and eligibility standards. This program was replaced by Temporary Assistance for Needy Families (TANF) in 1996, a block grant to states to provide time-limited cash assistance for very-low-income families as they prepare to enter the work force. Assistance remains

31 Thomas Paine's essay on Agrarian Justice was written in 1795-96 and introduces the broad themes of rights and reciprocity, security and humanity, and poverty and social justice. He proposes "to create a national fund, out of which there shall be paid to every person, when arrived at the age of twenty-one years, the sum of fifteen pounds sterling, as a compensation, in part for the loss of his or her natural inheritance, by the introduction of the system of landed property."

32 Paine (1795).

33 Paine (1795).

linked to recipient behavior and the statutory goals have been expanded to encompass broader social goals such as reducing out-of-wedlock pregnancies and encouraging two-parent families.

Neither AFDC nor TANF are universal programs that provide consistent, direct support to families with children. Among the developed world, the U.S. is the only country without such a program.[34] In the United Kingdom, for example, every family is eligible for the Child Benefit, which is a per child family allowance paid directly to each family.[35] Single parent households receive a slightly higher allowance, but each child in every family is eligible for this universal benefit. This is in addition to a child tax credit and a working family tax credit available to lower-income households. In the UK, the tax credits and child benefit are paid throughout the year as income supports rather than a lump sum asset payment.

The idea of providing a child allowance in the United States has been considered in recent years and, in fact, received bipartisan support. In 1989 the National Commission on Children was convened by President Reagan and Congress to explore policy proposals to improve the welfare of children. Their final report issued two years later declared that "Investing in children is no longer a luxury, but a national imperative."[36] One of the Commission's central recommendations was a $1,000 refundable child tax credit for families in-need. This proposal is distinguished from the child allowance programs of Europe because it was not intended to be universal and it uses the tax code to deliver its benefits. A smaller version of this proposal was later implemented by President Clinton in 1997 with a $300 per child tax credit for dependent children below the age of 13 for families with incomes under $75,000.

Since this child credit was not refundable, families only benefited if they had sufficient tax liabilities to take advantage of the deduction. Today the Child Tax Credit is more generous, having been expanded as part of changes to the tax code in 2001 and 2003, and is scheduled to increase to $1,000 per child by 2010. The current structure of the Child Tax Credit makes it refundable for some, but not all, lower-income families; millions of low-income working families with children continue to receive no benefit from the policy.[37] Refundable tax credits are a valuable tool for providing benefits to lower-income families because they allow the amount in excess of a household's tax liability to be received in a refund check from the Treasury. If a family has no federal tax liability, as is the case with many working, low-income families, increasing the size of a non-refundable tax credit provides zero benefit.[38]

Prior to the expansion of the Child Tax Credit, low-income families with children received tax benefits from three primary sources: the Dependent Exemption, the Child and Dependent Care Tax Credit, and the Earned Income Tax Credit (EITC).[39] While all three of these sources benefit families with children, the first two are not refundable and thus have the greatest usefulness for middle- and upper-income families with tax liabilities.

The Dependent Exemption allows taxpayers to lower their taxable income for each dependent child, which lowers the overall tax bill.[40] The Child and Dependent Care Tax Credit, created in 1986, does the

34 Curley and Sherraden (2000).

35 According to the Inland Revenue, the child benefit in the UK is currently £16.05 per week for the eldest child and £10.75 per week for each other child, worth approximately $1,330 and $900 respectively each year.

36 National Commission on Children (1991).

37 Lee and Greenstein (2003).

38 According to Greenstein and Lee (2003), the 2003 legislation that accelerated the schedule to increase the Child Tax Credit provided fewer benefits to lower-income households because it did not accelerate the increase in the credit's refundability.

39 Haveman (2003).

40 For 2003 returns, each dependent exemption allows a filer to cut taxable income by $3,050.

same for employment-related child care expenses.[41] The EITC is a refundable credit, so families with tax liabilities less than the value of their eligible credit receive the difference as a government payment in the form of a tax refund.[42] Created more than twenty years ago, it was greatly expanded in the mid-1990s and has received bipartisan support as an alternative to welfare assistance programs that promotes workforce participation. The EITC provides over $30 billion annually to lower income workers and represents a significant source of financial resources for beneficiaries, most of whom receive EITC benefits in a lump sum after filing their tax return. Research on the EITC program has confirmed its effectiveness as a work incentive, and participation of eligible households, estimated at over 80%, is relatively high when compared with other assistance program in the U.S.[43] However, even an impressive take-up rate should be compared with other universal benefit programs in other countries. For example, the UK's Child Benefit has a take-up rate of over 98%.

The main distinction between the set of child benefit and child allowance programs described above and the CSA approach is the focus on long-term savings rather than immediate consumption. Several legislative proposals have been made in recent years which also connect support for children through savings vehicles tied to specific uses, including retirement, education, and first home purchase. These proposals were often presented in the context of a debate over reforming Social Security, but collectively they reflect a degree of bipartisan support for the concept of children's savings accounts. Although these proposals differ in their detail, each makes the connection between the welfare of children and lifelong security.

The most widely-recognized scheme was KidSave. Initially advocated by Senator Bob Kerrey (D-NE) in 1995, the concept of KidSave was to create individual retirement savings accounts to supplement Social Security. Various funding mechanisms were considered, including direct deposits of federal money, a tax credit for parents, and family contributions, but in each scenario, resources were placed in an Individual Retirement Account (IRA) for children. Similar to the conventional IRA, taxes on the principal and interest would be deferred until they were withdrawn. Withdrawals before the age of 59 would be subject to a penalty similar to those governing the traditional IRA. One version of the proposal permitted a child to borrow from their account temporarily in the form of a ten-year loan in order to pay for post-secondary educational expenses without incurring a tax penalty. There were several innovative features of the KidSave proposals, but the most historic might have been the requirement that the Social Security Administration open and endow an account for every newborn. By 2000, the KidSave proposal had an impressive array of bipartisan co-sponsors.

Another and in some ways more comprehensive proposal was made by Representative Amo Houghton (R-NY), who proposed to establish a Child Retirement Account for every citizen under the age of 6. The retirement account allowed borrowing to support higher education and first-time home purchase, but it also called for the U.S. Treasury to contribute $1,000 to each child's account every year until the age of 6. The program would be universal in the sense that it would be open to all and provide access to an asset building mechanism regardless of family status or behavior. Initially proposed in 1997, this bill was never acted upon by the House Ways and Means Committee. Two years later, Senator Bill Frist (R-TN) introduced a version of this bill which allowed parents to open and contribute to child savings

41 In 2003, the Child and Dependent Care Tax Credit provides a maximum credit of $3,000 for one dependent and $6,000 for two or more dependents for employment-related child care.

42 The EITC functions as a work incentive because it adds 40 cents to every dollar of earning up to about $10,000 for families with two or more children. It has a maximum benefit of $4,000. The credit is phased out beginning when the taxpayer's income exceeds $13,520 at a rate of 21.06 percent in families with two or more children. It is completely phased out when this family's modified adjusted gross income reaches $33,178. (Office of Management and Budget 2003)

43 Scholz (1994).

accounts within the Roth IRA structure; these accounts could be used for the broad purchases outlined in Houghton's bill without the direct federal cash contributions. Recently Senator Baucus (D-MT) reintroduced this concept of creating a Roth IRA for children in his Savings Competitiveness Act (2006), called Youth Savings Accounts.[44]

Table: Summary of Recent Children's Savings Account Proposals in U.S.

Proposal	**Sponsor**	**Bill (Year)**	**Purpose and Key Feature**
Children's Financial Security Act of 1997	Rep. Houghton (R-NY) Rep. Kennelly (D-CT)	H.R. 194 (1997)	To enhance the financial security of children by providing for contributions by the Federal government to Child Retirement Accounts. Qualified distributions include first-time home purchase and higher education expenses.
Social Security KidSave Accounts Act	Sen. Kerrey (D-NE) Sen. Moynihan (D-NY) Sen. Breaux (D-LA) Sen. Lieberman (D-CT)	S. 2184 (1998)	To amend the Social Security Act to provide each American child with a KidSave Account, distributions permitted when individual begins to receive social security benefits.
KidSave Accounts in The Social Security Solvency Act	Sen. Kerrey (D-NE) Sen. Moynihan (D-NY)	S. 21 (1999)	To amend the Social Security Act to provide each American child with a KidSave Account.
Child Savings Account Act	Sen. Frist (R-TN)	S. 1013(1999) S.1013 (1999)	To amend tax code to promote lifetime savings by allowing people to establish child savings accounts within Roth IRAs and by allowing the savings to be used for education, first-time home purchases, and retirement.
Social Security KidSave Accounts Act	Sen. Kerrey (D-NE) Sen. Santorum (R-PA) Sen. Moynihan (D-NY) Sen. Grassley (R-IA) Sen. Breaux (D-LA)	S. 3200 (2000)	To amend the Social Security Act to provide each American child with a KidSave Account, and for other purposes.
America Saving for Personal Investment, Retirement, and Education Act ("The ASPIRE Act")	Sen. Rick Santorum (R-PA) Sen. Jon Corzine (D-NJ) Rep. Harold Ford (D-TN) Patrick Kennedy (D-RI) Phil English (R-PA) Thomas Petri (R-WI)	S. 2751 H.R. 4929 (2004)	To encourage savings, promote financial literacy, and expand opportunities for young adults by establishing a KIDS Account for every newborn child.

44 Another recent proposal was the 401Kids Family Savings Act (2006). Introduced by Representative Clay Shaw, Jr., this proposal would convert Coverdell Education Savings Accounts into "401Kids Savings Accounts" which would have expanded uses and the ability to be rolled over into a Roth IRA. Furthermore, Senator Jeff Sessions (R-AL) is preparing to introduce a bill that would establish savings accounts for children at birth as well as for those currently in the work force.

While none of these efforts resulted in enacted legislation, the profusion of congressional activity since the mid-1990s reflects a large degree of interest in the potential of child savings accounts and the search for viable mechanisms to deliver savings opportunities for children.[45]

For a coalition of bipartisan members of Congress, this search led to the introduction of the ASPIRE Act in July of 2004. Sponsored by Senators Rick Santorum (R-PA) and Jon Corzine (D-NJ), along with Representatives Harold Ford, Jr (D-TN), Patrick Kennedy (D-RI), Phil English (R-PA), and Thomas Petri (R-WI), the ASPIRE Act would create a universal system of children's savings accounts in order to encourage savings, promote financial literacy, and expand opportunities for young adults. It is the fullest statement of an account-at-birth approach focused on asset building objectives. Account uses would not be restricted to retirement security but could also be used on human capital investments and home purchase. In addition to the initial contribution, it has several progressive features, most notably a one-time supplemental contribution and annual matching contributions for children in families earning under the national median income.

The litany of these legislative proposals corresponded with a period of time when Congress was also actively creating new savings vehicles tied to specific purchases, particularly saving for education and retirement. These proposals were often account-based and employed tax preferences.

Table: Federally-Sanctioned Savings Accounts

	Year Created	**Tax Treatment**
Tax-Preferred Savings Accounts		
Archer Medical Savings Accounts	1996	Tax deductible contributions, earnings, and distributions tax-free for qualified expenses.
Coverdell Education Savings Accounts	1997	Tax-free earnings and withdrawal for qualified expenses.
Qualified Tuition (Section 529) Plans	1996	Tax-free earnings and distributions for qualified expenses.
Individual Retirement Accounts		
Traditional IRA	1974	Tax deductible contributions; distributions before age 59 ½ subject to penalty, exceptions for health insurance, education, and first-time homeownership.
Nondeductible IRA	1974	Contribution limit applies to sum of all IRA contributions.
Roth IRA	1997	Contribution limit applies to sum of all IRA contributions. Tax-free earnings and withdrawals for qualified expenses.
Defined Contribution Plans		
401(k)	1978	Contributions are tax-deductible, distributions are taxed. Distributions allowed upon employment termination or when participant reaches age 59 ½.
403(b)	1958	Contributions are tax-deductible, distributions are taxed.
Government 457	1978	Contributions are tax-deductible, distributions taxed. Distributions are allowed upon employment termination or when participant reaches age 70 ½.
SIMPLE IRA	1996	Contributions are tax-deductible, distribution rules same

45 Another set of proposals focused on introducing refundable tax credits linked to educational objectives. The Education for the Twenty-First Century Act was introduced by Senator Tom Daschle (D-SD) to create a refundable tax credit of up to $1,500 per academic year. The Act would have provided additional tax deductions of up to $10,000 per student for higher education costs as well as tax deductions for interest paid on student loans. A similar approach was proposed in the House of Representatives by Representative Joseph Pitts (R-PA) to create an annual refundable credit of up to $450 per child to pay for educational expenses.

		as traditional IRAs.
SIMPLE 401(k)	1996	Generally same as 401(k) with additional limits on the employer deduction.
Salary Reduction Simplified Employee Pension (SARSEP)	1986	Contributions are tax-deductible, distributions are taxed.

Source: Burman, Leonard, Gale, William, and Orszag, Peter (2003). "The Administration's Savings Proposals: A Preliminary Analysis." *Tax Notes*. March 3, 2003.

While taxpayers had been able to deduct expenses for higher education from their tax liability for many years, there were few federal programs available to them to help them save for college. In 1997 Congress created a new savings vehicle, modeled on the IRA, tailored to educational objectives. Coverdell Education Savings Accounts initially allowed taxpayers to contribute up to $500 annually (since expanded to $2,000 annually) to an account for each child under the age of 18. These accounts are governed by rules similar to the Roth IRAs, contributions are nondeductible but withdrawals are tax-free as long as the funds are used to pay for educational expenses. Two other tax credits were created along with the Education Savings Accounts. The first is the HOPE Tax Credit, which is a non-refundable credit that allows for a maximum credit of $1,500 against college expenses for the first two years. The second is the Lifetime Learning Credit, which offers a 20% non-refundable tax credit for the first $10,000 of educational expense.[46] While both of these credits are non-refundable, restricting their value for lower-income taxpayers, they have income limits. This distinguishes them from the Section 529 Plans which were created in 1996 but expanded greatly in 2001.

Table: Value of Select Educational tax Expenditures by Year(s)
(in millions of dollars)

	FY 2003	FY 2004-2008
HOPE Tax Credit	3,520	14,230
Lifetime Learning Credit	2,250	14,110
Educational Individual Retirement Account	100	1,730
Qualified Tuition (Section 529) Plans	340	2,840
TOTAL	**6,210**	**32,910**

Source: Office of Management and Budget, Executvie Office of the President. Budget of the U.S. Government, Fiscal Year 2004, Analytical Perspectives. 2003. Table 6-3.

These Section 529 accounts are unrestricted; anyone can open an account for a designated beneficiary and, since 2002, after-tax contributions can be withdrawn tax free for educational purposes until the account reaches $267,580.[47] The program's costs are modest in the initial years, but once account balances accrue the tax savings for account holders will be substantial, surpassing any other educational tax expenditure. The advent of the 529 plans reflects the general trend to employ an account-based approach to encouraging savings. While some states have sought to create incentives to encourage the participation of lower-income households, the structure of the federal program will confer most benefits on middle- and upper-income families.

A similar experience was observed in the retirement arena. Traditional long-term options to save for retirement, such as the IRA and 401 (k), were augmented in the 1990s by a series of new savings vehicles. Most notably, the Roth IRA, created in 1997, allowed for after-tax contributions to accumulate

46 Both credits begin phasing out for taxpayers with adjusted gross income above $41,000 for singles and $82,000 for joint filers.

47 States administer the program and typically investment options are limited to a series of mutual funds with a range of risk and return characteristics.

tax-free. Named after its primary advocate, the late Senator Roth (R-DE), the Roth IRA has the same contribution limits as regular IRAs, but is governed by different distribution rules that make it more attractive for some investors. Contribution and income eligibility limits initially applied to the Roth IRA have been relaxed, and there is some political pressure to eliminate the income limits altogether.[48] The advantage of the Roth IRA as it is currently structured is its simplicity and flexibility. The growth of the account is tax free and since taxes have been paid up front, there are no minimum distribution requirements as with the Traditional IRA. Withdrawals are, therefore, not reported as income and do not affect a household's adjusted gross income during retirement. One drawback for some investors is that their tax rate will be lower when they are retired and without income, so the Roth IRA loses one of its advantages over the traditional IRA. The incentive of the Roth IRA is the promise of tax savings down the road, and is thus a more powerful incentive for wealthier households that can invest more money in their accounts.

President Clinton proposed overcoming the lack of savings incentives for lower-income families by proposing to create Universal Savings Accounts (USAs). Introduced in his 1999 State of the Union, the federal government would make an automatic contribution into these accounts every year for eligible accountholders and would match, dollar for dollar, voluntary contributions to the accounts by low- and moderate-income workers.[49]

Eligible workers with higher incomes would have a match rate of at least 50 percent. Several aspects of the USA proposal were notable. First, it sought to frame the debate around Social Security reform in the context of the need to strengthen private savings and asset building. Second, it built upon an account-based approach for building assets and retirement savings. Third, the structure of incentives was designed to address the inequities in the current tax system. The roll out material prepared by the White House highlighted that 66 percent of the prevailing tax benefits for pensions and retirement savings accrue to taxpayers with incomes above $100,000. In contrast, the USA proposal would provide 80 percent of its benefits to families with incomes below $100,000. For a variety of reasons, the Clinton Administration was unable to move this through Congress.

The Bush Administration has picked up on the account-based approach with a set of far-reaching savings proposals. In its fiscal year 2004 budget, the Bush Administration first proposed creating three new tax-preferred accounts, to be called Lifetime Savings Accounts (LSAs), Retirement Savings Accounts (RSAs), and Employer Savings Accounts (ERSAs).[50] These accounts are designed to substantially expand opportunities for tax-sheltered savings and consolidate rules for tax- advantaged saving. Every individual could set up a LSA and a RSA; contributions to each account would not be tax-deductible and would be capped. Initially, this cap was set at $7,500 per account per year, but it was lowered to $5,000 when the proposals were reintroduced in the Bush Administration's 2005 Budget.[51] There would be no maximum income or age limit on contributions and there is no requirement that account funds must withdrawn while the account holder is alive. LSAs are designed to provide tax-free saving, so withdrawals from a LSA account may be for any purpose at any time, while RSAs funds can only be withdrawn after age 58 to avoid a penalty. Because these accounts would have no limits on

48 Eligibility rules for Roth IRAs have an Adjusted Gross Income of under $160,000 for married filing jointly households or $110,000 for single households; phaseouts begin at $150,000 and $95,000 respectively. Contributions are currently limited to $3,000 for those under 50.

49 Eligibility for USAs was restricted. It was proposed that each spouse in a married couple with family earnings over $5,000 and adjusted gross income of less than $100,000 who is between the ages of 18 and 70 would be eligible for a USA tax credit (single taxpayers must have adjusted gross income below $50,000; head of household filers must have income below $75,000). In addition, workers with higher incomes who do not have pension coverage would be eligible for an account.

50 See Burman, Gale, and Orszag (2003) for an in-depth analysis of the Bush Administrations proposal to create LSAs, RSAs, and ERSAs.

51 Details on these proposals are included in Bush Administration's Budget proposal for fiscal year 2005. Office of Management and Budget (2003).

household income and substantially higher contribution limits than current Individual Retirement Accounts (IRAs), the Bush proposal would provide a disproportionate share of benefits for higher income households, particularly those with incomes above existing limits on IRAs.

The proposed accounts are intended to replace the existing array of tax-preferred accounts in the long run. To encourage consolidation, individuals could roll over balances from these accounts (Coverdell Education Savings Accounts, Archer Medical Savings Accounts, Section 529 accounts) into an LSA. Roth IRAs would be renamed RSAs and ERSA would replace the seven different types of defined contribution plans. These rollovers would actually create revenue in the short term as accounts are rolled over into the new vehicles, but the proposal would create growing revenue losses over time, with the annual revenue loss exceeding 0.3 percent of GDP within a decade.[52] Noting the substantial tax sheltering opportunities created by the new accounts, some analysts have questioned whether the proposals would even raise the private saving rate because the transfer of existing taxable assets into LSAs would reduce taxes but not increase private saving.[53] The opportunity to shelter income is a less valuable incentive to lower income households even though they still would benefit from savings incentives.

Congress has not acted upon these proposals of the Bush Administration even though they have been included in each budget proposal since 2003. One of the most notable features of the Bush proposal is the attempt to unify many of the diverse tax-preferred accounts into a more simplified account-based system. This idea was also proposed by the President's Advisory Panel on Tax reform and is one which any proposal for child savings accounts should consider.

3. Private Sector Initiatives

While the public sector has explored the possibilities of child savings accounts through legislative proposals and enacted account-based savings vehicles, the private sector has taken the lead in pioneering some of the concepts central to the Children's Savings Accounts approach. Two initiatives are worth highlighting.

The first is a privately-funded demonstration project of child accounts, called the Saving for Education, Entrepreneurship, and Downpayment (SEED) Initiative, which is a six-year effort to develop, administer, and test matched savings accounts and financial education for children and youth.[54] SEED accounts are long-term savings and investment accounts established at birth and allowed to grow over the course of a lifetime. Seeded with an initial deposit of $200 to $1,000 and built by deposits from family, friends, and accountholders themselves, as well as augmented by other public and private sources, SEED savings are restricted for the primary purposes of financing education and training, starting a small business, buying a home, or financing retirement. Participation in the program will include financial education. Launched in 2003 in partnership with community organizations at 10 sites across the country, each community partner will work with different age cohorts, and offer a range of savings incentives and financial education approaches. It is expected that 1,100 accounts will be created across the country.

This effort is designed to set the stage for universal, progressive policy for asset building among children, youth, and families. A long-term evaluation strategy has been developed which will assess

52 Burman, Gale, and Orszag (2003).

53 Burman, Gale, and Orszag (2003).

54 The SEED Policy & Practice Initiative is a partnership between funders, CFED, Center for Social Development (CSD), University of Kansas (KU) School of Social Welfare, New America Foundation, and the community and experimental partners. See http://seed.cfed.org/.

each community partnership through on-going monitoring and periodic outcomes surveys. Analysis is intended to help answer a range of questions regarding the psychological, social, behavioral, and economic effects of holding an account, effective means of engaging participation, potential roles of the public, private, and nonprofit sectors, and the delivery systems capable of being scaled up in a national accounts system.

The second initiative is the work of the "I Have a Dream Foundation," (IHAD) which runs a series of tuition guarantee programs for students in low-income communities across the country. Initially inspired by philanthropist Eugene Lang, IHAD provides long-term educational support programs that work with entire grades in specific elementary schools or entire same-age cohorts in public housing developments. The objective of the program is to ensure that every participant graduates from high school and has the option of attending college or obtaining rewarding employment. Once participants graduate from high school, the Foundation provides tuition assistance to assure that they have the opportunity to receive post-secondary education. Begun in 1981 in East Harlem, New York, there are now 180 projects nationwide with 13,500 participants since inception, 6,000 are in active projects. The program combines personal financial commitment with individual support services.

Evaluations of the initiative have shown positive results when outcomes are compared to control groups in particular project cities.[55] Measureable effects include high rates of graduation, college attendance, academic performance, and school attendance. Studies commissioned by the IHAD Foundation as well as other private funders, such as the MacArthur Foundation, have also examined the attidudinal and behavioral effects of program participation and found that participation in the program has produced tangible benefits. IHAD programs vary by project site and the interaction with project coordinators and other support services has moved the progrgram beyond tuition assistance, yet the high expectations and tuition rewards appear to have an enduring impact on program participants.

The proposals, initiatives, and enacted policy described in this section reflect the policy context within which any Children's Savings Account proposal should be considered. Collectively, they demonstrate a historic interest in stakeholding policies which, up until now, have neither been universal in scope nor focused on children. The profusion of these proposals also reflects a widespread and growing interest in account-based solutions to achieving national policy objectives. The savings incentives that accompany these accounts are increasingly offered through the tax code, which limits their value for lower-income families. People in lower-income households have, in fact, been shown to respond to other savings and achievement incentives, such as matched savings accounts and tuition-guarantees, creating an opportunity to craft more effective policies. What is needed is a unifying proposal capable of promoting stakeholding, opportunity, and ownership through an accounts-based asset building system open to all.

PART II: POLICY DESIGN

This section identifies the key policy issues which must be settled before a nationwide system of children's savings accounts can be introduced. From a design and implementation perspective three fundamental questions must be addressed when considering how to construct a national system of children savings accounts: (1) how are the accounts administered? (2) what rules govern distributions? and (3) how are the accounts funded?[56] While many of the concerns embedded in these questions overlap, there is a benefit of trying to untangle them by distinguishing between issues of policy design,

55 Coons and Petrick (1992) and Higgins et al (1991).

56 These questions were first raised and considered by Fred Goldberg, former IRS Commissioner, in an article that provides a valuable discussion of implementing a child savings account using a tax credit approach. Goldberg and Cohen (2001).

program implementation and fiscal matters. Each issue represents a series of decision points, usually with multiple options of how to proceed. For the purposes of this presentation, a range of options will be presented and discussed, and the preferred path described in the prototype proposal will be defended to varying degrees.

D. Primary Policy Design Issues

Large-scale initiatives intended to address broad policy objectives are often critiqued in terms of how they handle the tradeoff between equity and efficiency. Economists assert quite confidently that equity and efficiency cannot be achieved in consort. The classic formulation of this tradeoff by Arthur Okun asserts that any dollar transferred from a wealthier individual to a poorer one results in less than a dollar increase in income for the recipient.[57] Okun offers several basic explanations for this "leaky bucket" phenomenon. There are costs to administer the transfer as well as changes in effort, savings, investment, and attitude induced by the transfer. Furthermore, the imposition of equity cannot be achieved with perfect precision. Programs that redistribute public resources to people in-need are likely to benefit some without need. Consequently, government efforts to achieve greater equity necessarily create a smaller level of total income and a less efficient use of resources. The prevailing policy question then becomes one of how much leakage a society is willing to accept in order to achieve a desirable level of equity.[58]

While there are plenty of examples that support the thesis that government transfers designed to create greater equity produce inefficiencies, in some cases the effect created is quite small. Economist Rebecca Blank suggests that there are three policy situations in which equity-increasing transfers can occur without seriously reducing efficiency: when public assistance is directed to particular populations that cannot change their behavior; when public assistance is provided through programs that include behavioral mandates; and when public assistance functions as a long-term investment that may accrue benefits down the road.[59]

The leaky bucket thesis is undoubtedly more applicable to the classic welfare formulation where a wealth transfer reduces labor supply through cash supports to the poor, but may be less relevant to populations that do not exert individual agency, such as children and the elderly.[60] While the equity and efficiency tradeoff has been used as a cautionary tale to dissuade policymakers from crafting redistributive interventions, for several reasons this tale is less applicable to the Children's Savings Account approach. First, the beneficiaries of the accounts are initially children, who have no behavioral response to participation. Second, as children mature there is a link between program benefits and behavior incentives; participants can access additional contributions if they continue their education through high school. Third, the overall effect of the transfer subsidizes future investments that will create opportunities for participants to increase their welfare in subsequent years. This may be particularly true when benefits are restricted to asset investments, such as human capital expenditures, rather than cash accruals which can be used to support less restricted consumption. Yet the most effective response to concerns with the equity and efficiency tradeoff is to establish a set of rules for participation that will provide universal eligibility, guaranteeing all participants equal access to program benefits under identical conditions.

57 Okun (1975).

58 Okun (1975).

59 Blank (2002), page 25.

60 Blank writes that "It is possible that the general distaste for redistributive transfers that characterize the opinion of many economists may be the result of a highly selective set of research studies, which have focused on populations where the costs if redistributive transfers are likely to be highest." Blank (2002), page 25.

1. Participation and Eligibility

The manner in which the twin issues of participation and eligibility are addressed will impact the equity and efficiency tradeoff and determine the ultimate scale and scope of the initiative. Restricting program eligibility will increase the potential that program benefits will flow inefficiently because it is difficult to create a set of thresholds that perfectly define a population in need. Conversely, if participation is universal and benefits are not means-tested, greater efficiency can be achieved because no one will fall through the cracks. Such an approach imposes a high degree of equity because everyone is subject to the same rules—no one is treated differently.

Universal eligibility minimizes the equity/efficiency tradeoff and gives every family an interest in how the program operates. The account offers each child a stake in the society as a whole and becomes a feature of citizenship, eventually giving everyone the right to share in the nation's wealth by virtue of being a member of the national community. To achieve the full benefits of universal eligibility, it is likely that program participation will have to be made mandatory. This approach mirrors that of the Social Security program, which offers a successful model of how to compel participation.[61] Universal eligibility ensures a level playing field and mandatory participation ensures that everyone gets in the game. Denying the option to opt out of the program affords each participant a degree of protection from decisions made by their guardians which are beyond their control.

Table: Policy Design Options: Eligibility and Participation

Eligibility	Participation
Universal	Mandatory
Targeted	Voluntary

There are alternatives to a universal eligibility and mandatory participation approach. One alternative is to restrict eligibility to families that would achieve greater benefit from the program and prevent subsidizing families that already have sufficient means. This targeting approach could be achieved by creating a means-test designed to create a threshold that distinguishes worthy beneficiaries or crafts a phase-out that offers fewer benefits to children in wealthier families. Advocates of a means-test with phase-outs argue that families with higher incomes can fund savings accounts for their children on their own and thus, should not be subsidized by the federal government. Conversely, some families with means will not necessarily use them to establish savings accounts for their children and family income is subject to fluctuation; it may be high during the initial funding period but decline at another point in a child's life.

There are two primary challenges to a means-test. The first is the difficulty in crafting such a test without unwittingly denying some that could benefit or including some with comparatively less need. The second is the additional costs incurred by administering a targeted and restricted system. These costs are associated with workload issues involved in processing applications, providing case management and technical assistance, and verifying income as well as monitoring fraud. A means-tested

61 The Social Security program should be considered as a universal system but it only applies to covered workers.

program is susceptible to fraud and non-compliance because it conveys benefits to those that claim eligibility even if they are not entitled.[62] The Earned Income Tax Credit (EITC) offers benefits through a means-tested criterion and even though it is widely regarded as an effective work incentive that lifts many families out of poverty, it has been criticized for providing benefits to ineligible recipients. Congress has responded by subjecting the EITC program to compliance testing beyond what the rest of the tax system receives.[63] Restricting eligibility to Children's Savings Accounts adds complexity and administrative costs that a universal system avoids. Regardless of cost and complexity, a restricted program curtails the impact of the effort, denying some the potential to build assets and leaving key policy objectives unmet.

Another alternative is to create a program where participation is voluntary. This would allow families uninterested in receiving public support the option of refusing benefits. Since a universal program is unlikely to have a social stigma attached to participation, the voluntary approach would more likely be used to require families to opt-in. Moving away from a mandatory, universal system increases the likelihood that children eligible to participate in the program will fail to do so, lowering the take-up rate. This assertion is based on the historic take-up rates of public assistance programs, defined as the portion of population eligible for assistance that participates in the program. For example, it has been estimated that only one-third of elderly persons eligible for food stamps participates in the program, while the take-up rate is only approximately two-thirds for families with children.[64] A variety of reasons have been used to explain low take-up rates. Families may not be interested in receiving public support because of the stigma associated with welfare programs or they may not believe they have a need that the program will meet. More troubling would be cases where families do not participate because they have incomplete or inaccurate information about program requirements. Research has revealed that many eligible participants in the Food Stamp program do not believe they meet the requirements to receive benefits.[65]

More likely, offering child accounts on a voluntary basis would be pursued in order to minimize the direct federal contribution while allowing families to contribute to a tax-preferred savings vehicle for children. In this conception of the child savings account, it becomes more akin to the current Section 529 plan for post-secondary educational expenses, but with a wider set of uses. Because of the presence of the Section 529 plans, there is less need for this approach; however, there would be opportunities to expand the incentives offered to induce contributions to these accounts, especially ones aimed at lower-income households.

While it may be assumed that targeting eligibility and relaxing participation rules will reduce the overall cost of the effort, since fewer families would be enrolled, this approach introduces a number of administration issues that create complexities and add to the program costs. For an initiative that focuses on children, there is a virtue in crafting a universal program that is open to all, regardless of income. The universal eligibility and mandatory participation approach may work best to establish the basic foundation of a children's accounts system, and it does not necessarily preclude the introduction of more progressive features tied to the crafting of means-tested savings incentives.

2. Funding Mechanism

62 There is an important distinction between fraud and non-compliance. A non-complaint applicant may unwittingly claim benefits to which they are not entitled if they do not understand program requirements.

63 Congress has appropriated funds to increase EITC compliance after receiving reports that the non-compliance rate was between 27-32%.

64 Haider et al (2003).

65 Brauner and Zedlewski, 1999.

Answering the question of how child accounts will be funded is one of the most fundamental issues to confront in designing a Children's Savings Account system. The choice of funding mechanism, whether accounts are funded through direct government expenditures or through some form of tax expenditure, creates the basis for the support structures required to administer the program.

The prototype proposal calls for a system of direct government deposits into each child's account. This approach is preferable because it has the virtue of simplicity, where every transaction is transparent to the recipient and the budgetary process. Contributions to accounts can be made from transfers from the U.S. Treasury in a manner similar to the issuing of tax refunds. The Financial Management Service (FMS), a Bureau of the U.S. Treasury, is already engaged in the activities of issuing checks and transferring cash, and has the demonstrated capacity to disburse payments to a large number of beneficiaries; all that is needed is an address or bank account routing number.[66] This is one of the core competencies of the government.

Funding these accounts through a direct expenditure on the discretionary side of the budget would subject the effort to the annual appropriations process. Alternatively, as a universal program, Congress could classify it as mandatory spending, which refers to expenditures controlled by laws other than appropriations acts. This is a designation given to spending for entitlement programs, such as Social Security and the Food Stamp program. Regardless of whether the accounts-at-birth program was placed on the discretionary or mandatory side of the budget, the magnitude of the commitment would be relatively easy to track compared to the accounting of tax expenditure programs. For some, this would pose a problem because both of these budgeting scenarios would create a level of political scrutiny that might hinder its long-term political viability.[67]

The alternative is to structure the program through the tax system, administered with the assistance of the Internal Revenue Service. This can be done, but designing and implementing a tax credit creates a plethora of administrative issues, including the consideration of tax rules, tax enforcement strategies, and tax filing requirements.[68]

If this path is pursued and a tax credit mechanism is used, the first question is whether it should be a refundable credit or available only to off-set income or payroll tax liability. The refundable credit would provide a means to benefit children regardless of their family's tax liability. Goldberg has proposed funding child saving accounts with such a refundable tax credit system. Currently, there are only two refundable tax credits that provide benefits this way, the EITC and, to some extent, the Child Tax Credit. The vast majority of tax credits are non-refundable, providing deductions to the calculation of income or tax liability. Non-refundable credits only provide benefits to the extent that there is a tax liability, structuring a children's account system in this manner would limit the program's ability to benefit children in lower-income households because the amount of any credit would be limited to the lesser of the value of the credit or the taxpayers' tax liability. For example, given current tax rates and tax rules, a non-refundable $1,000 credit would exclude almost 50% of children.[69]

Goldberg's other reason for supporting a refundable tax credit system is its ability to facilitate a means-tested approach. Tax benefits can be phased out for taxpayers that report higher incomes. This approach has some value, especially in capping the overall price tag of the effort, but it creates the need for

66 FMS annually disburses more than $1.7 trillion to over 100 million individuals via social security and veterans' benefits, income tax refunds and other federal payments.

67 Goldberg and Cohen (2000).

68 These issues were addressed by Goldberg and Cohen (2000) in some detail.

69 Goldberg (2000), page 23.

additional rules. If taxpayers with incomes over a certain threshold begin to lose some tax benefits, there would need to be rulings on whether they would be permitted to fund these accounts on an after-tax basis and how the credit would be apportioned if the taxpayer had more than one eligible child.

A mixed system is also plausible, where direct deposits are made initially but additional deposits are encouraged through tax incentives. Another approach is a dual system for contributions which can be funded directly or through reimbursement credits after taxpayers report contributions on their tax returns.

In the spirit of simplicity and transparency, the United Kingdom has opted to use the direct approach rather than create a new tax credit to support their Child Trust Fund effort. The funding mechanism of this effort is a version of the direct deposit approach, but employs a voucher system. Issued to the parents or guardians of each eligible child, these vouchers can be used to open a CTF account at a financial institution participating in the program. The voucher can only be used to open an account for the child named on the voucher but the parents or guardian will choose the account and account provider. If the voucher is not redeemed within 12 months, the government's administering agency will open a CTF for the child and choose the account and account provider. This general approach is direct but is specifically designed to work in an accounts system with a range of financial providers and account managers. Vouchers function as a special kind of check, which can only be redeemed by account providers participating in the program. It is an approach that could work in the United States if a similar system of accounts management was employed.

Table: Policy Design Options: Funding Mechanism

Primary Choice	Secondary Decision
Direct Expenditure	Mandatory or Discretionary
Tax Credit Expenditure	Refundable or Non-Refundable
Dual (or Mixed) System	Blend of Direct and Tax Credit

3. Contributions and Incentives

Children's Savings Accounts are designed to help build a modest asset pool that can help each individual invest in their future, but these accounts are also intended to provide a signal that the broader community has invested in them. In this spirit, the depositing of public sector funds directly into the account of every child sends a powerful message, and the timing of these deposits has the potential to provide positive reinforcements. These deposits can be triggered by the opening of the account, and subsequent savings deposits. Beyond the government contributions, the accounts will build more resources the more they are stocked with savings. Voluntary contributions by family and friends, as well as the child should be encouraged through financial education and other incentives. The tax treatment of the account and contributions to the account offers an opportunity to incorporate incentives into the policy design.

Contribution Triggers

There is a strong case to be made for linking the initial deposit soon after birth once eligibility and a Social Security number have been established. Linking the account to the Social Security system ensures that everyone is included in the system and endowing the account as close to the birth of the child as possible will enable to child's fund to begin to grow as soon as possible.

The contribution rules also afford an opportunity to create a more progressive scheme. Families with incomes at or below the national median could receive a pro-rated bonus and be eligible to have their private contributions matched up to a certain amount on an annual basis. For example, the first $500 that is contributed to an account each year could be matched by the government on a dollar-for-dollar basis if the account holder's family has a qualified income. The matching incentives create the ability to channel program benefits to those families with less income and fewer opportunities to save. For example, the ASPIRE Act proposal which includes this matching incentive, provides over two-thirds of its benefits in the first year to families earning under $42,230 and thirty-nine percent of its benefits to families earning below $21,100. Further, only 11% of the account benefits go to families earning over 200% of the national median income (roughly $84,000). As more cohorts become eligible for the means-tested matched savings, the percentage of benefits to lower-income families increases.[70]

Table: Distribution of ASPIRE Act Benefits

Household Income	Percent of ASPIRE Act Benefits Distributed over Time		
	First Year	First 10 Years	First 18 Years
$0 - $21,100 (0% to 50% of national median) 25% of all households	39%	43%	43%
$21,101- $42,230 (50% to 100% of national median) 25% of all households	31%	39%	43%
$42,231 - $63,340 (100% to 150% of national median) 18% of all households	11%	7%	6%
$63,341 - $84,450 (150% to 200% of national median) 14% of all households	8%	4%	3%
$84,451 and above (0ver 200% of national median) 18% of all households	11%	6%	5%

Source: Author Calculations

70 These estimates are sensitive to the assumed contributions made by participants. Although the assumptions were intended to be reasonable, they remain estimates of future contributions.

While there is a tradeoff between simplicity and progressivity, tax returns provide a source of verification and the possibility for information sharing between the Internal Revenue Service and the federal administrative entity in charge of the system could keep administrative costs down.

Voluntary Contributions and Tax Incentives

To achieve the goal of asset building through a national system of accounts, additional voluntary contributions to each account will be allowed and encouraged. Parent, family members, and friends, as well as the account holder once they are old enough, would be allowed to contribute to the child's account; there will be no restrictions on who invests in the account. To facilitate contributions, a system would have to be created to allow irregular and smaller value cash sum payments. Allowing such contributions, along the lines of which investors purchase shares of mutual funds, would help build a child's account balances.

The question then becomes whether or not there should be incentives to promote these voluntary contributions. The choice of whether or not to provide incentives, and who to provide them to, will then affect whether or not there is a limit on these types of contributions.

In accordance with the simplicity principle, the ASPIRE Act prototype proposes that contributions are made on an after-tax-basis and all gains are exempt from taxes as long as they are withdrawn according to the prevailing rules that govern distributions. For some, this tax-exemption is an effective incentive. However, the initiative may be expanded to include additional incentives that are more powerful and attractive to diverse types of households.

Two types of incentives should be considered. The first type of incentive is designed to encourage contributions by lower-income persons, and could take the form of an expansion of a refundable credit. For example, lower-income taxpayers could receive a larger EITC and/or Child Tax Credit, perhaps limited to $500 per person per year, provided that the additional amount is saved directly in their CSA. This could be achieved by allowing tax refunds to be saved into a CSA directly on a federal tax return. Another approach is to use progressive matches for resource-deficient households. The second type of incentive is a tax benefit that would accrue to taxpayers who contributed to their children's accounts.

These incentives could also be made stronger for lower-income taxpayers if it was in the form of a refundable credit. In both of these cases, the incentives are directed at the parents of the accountholder, who will qualify for the incentive based on the information provided on their tax return. The benefits of this approach are that it has the potential to create some additional sources of incentives. Alternatively, tying incentives to the tax filing process complicates the administration, creating additional oversight responsibilities to guard against fraud and abuse.

If withdrawals are tax exempt and a range of incentives are offered, a cap on account contributions can be imposed in order to prevent the excessive sheltering of income. Initially, the amount that can be saved each year should have a maximum limit.[71] While it makes sense to allow this limit to rise with inflation over time, it is probably more important that it is set in tandem with contribution limits with other tax-preferred accounts such as the Roth IRA in order to avoid the use of these accounts as tax shelters. However if contributions and withdrawals are not tax advantaged, there is less justification for limiting contributions. Regardless of the tax treatment of contributions, such contributions to CSAs should be exempt from any tax rule on gifts. Individual states may offer additional tax benefits to encourage contributions, as some currently do to encourage investment in Section 529 plans. As with

71 The ASPIRE Act specifies an annual contribution limit of $1,000.

these 529 accounts, account balance (gains on investments and the investments themselves) will be exempt from both income tax and capital gains tax when withdrawals are made following the prevailing rules.

As with any investment strategy, there are many factors that affect returns; however, the degree to which contributions are made to an account creates large differences in asset accumulation over the life of an account. Modeled on the provisions of the ASPIRE Act, the accompanying table illustrates how different contribution schemes, investment strategies, and rates of return influence the asset pool these accounts can generate. Although there are many alternative ways to structure incentives to trigger additional deposits, the examples displayed in the table reinforce the impact of contributions beyond the initial seed deposit.

Table: Potential Account Accumulation for Varying Contribution Amounts

		Age 18	Age 25	Age 35	Age 65
Contribution at Birth	$500				
Supplemental Contribution	$500				
Annual Private Contribute	$250				
Annual Match Contribution	$250				
Accrued Balance 7%		**21,480**	34,492	67,851	516,496
Accrued Balance 5%		17,409	24,496	39,901	172,452

		Age 18	Age 25	Age 35	Age 65
Contribution at Birth	$500				
Supplemental Contribution	$0				
Annual Private Contribute	$600				
Annual Match Contribution	$0				
Accrued Balance 7%		**23,410**	37,591	73,947	562,905
Accrued Balance 5%		19,206	27,025	44,021	190,254

Minimum Private Contribution Scenario

		Age 18	Age 25	Age 35	Age 65
Contribution at Birth	$500				
Supplemental Contribution	$0				
Annual Private Contribute	$0				
Annual Match Contribution	$0				
Accrued Balance 7%		**1,690**	2,714	5,338	40,636
Accrued Balance 5%		1,203	1,693	2,758	11,920

KIDS Account Provisions

- Every child receives an automatic $500 contribution at birth.
- Children in households that earn under $21,000 receive a one-time supplemental contribution of $500.
- Children in households that earn up to $42,000 receive a $1 to $1 match on annual contributions up to $500.

Accrued Balances are calculated as a net rate of return (earnings minus fees), no withdrawals.

4. Withdrawals and Use Restrictions

Another fundamental issue for the policy design of a children's account system is how account funds are distributed to beneficiaries. This raises the related questions of what restrictions should be placed on the use of account funds, how long these accounts can be held, and at what age participants can gain access to their funds. In many ways, the rules surrounding this issue will have the greatest influence on the public's perception of the effort because it will specify most clearly the overall purpose of the policy.

The assets which accumulate in each account are designed to facilitate opportunities for each child to invest in their future. There are a broad range of assets that can make a difference in a person's life, including investing in their own human capital, buying a home, and developing some financial security. The nature of these investments will necessarily depend on the unique circumstances of each individual, so the policy design should allow for flexibility, but at issue is how much. A policy that restricts fund uses to a set of popular choices, aligned with asset building strategies, may have a better chance of achieving stated policy goals. Alternatively, the prescribed uses may not be appropriate for every participant, whom might be able to make a better investment for themselves if given the chance. The rules which govern the distribution and use restrictions of account funds will make the difference in determining whether the CSAs are linked specifically to asset building activities or can be vehicles to promote long-term savings.

The prototype proposal enables participants to have restricted access to their account when they reach the age of 18. At this age, they can use account resources to pay for qualified uses, such homeownership, retirement savings, and business investment in additional to educational expenses. Indeed, many IDA programs throughout the country focus only on these asset building activities. Beyond the implementation issues that must be addressed to ensure that funds are only used for these purposes, the philosophical issues should be considered first.

Given the primary role education plays in the ability of each individual to achieve self-sufficiency and security, it appears logical to connect resources accrued in CSAs to post-secondary education. A quality education is often a precondition for other forms of wealth and asset building. The economic benefits of a college education have been reinforced repeatedly in the research literature, and the difference in earnings among workers with different levels of educational attainment has grown in recent decades. Over the course of a working life, individuals with bachelor's degrees earn on average nearly twice that of individuals with only high school degrees.[72] Furthermore, the costs of obtaining a degree continue to rise. According to the College Board, the costs of tuition and fees rose in 2003 14.1 percent at four-year public institutions and 6 percent at four-year private institutions, and it appears this trend has contrinued.[73]

An array of other public benefit programs exist that are focused specifically on post-secondary education, most notably Pell Grants, Section 529 Plans, and Coverdell Education Accounts, but if any child's ability to pay for college falls short, they should be able to access the resources that have been set aside for them in their CSA. In this spirit, it will be important for these funds to be made available when participants are considering the pursuit of post-secondary education.

Beyond education, there is an array of potential investments for young adults that can make a material difference in their lives. Unfortunately, there is no standard template or standard age. Excellent choices for some may be poor choices for others. For many, the choice to become a homeowner creates an opportunity to achieve a level of security, and has documented social and economic benefits.[74] Yet even the decision to become a homeowner is not advisable for all, and there is certainly no predictable age when the next generation will decide to take an interest in buying a home. But because homeownership has worked for so many Americans, there have been proposals to tie child savings accounts to homeownership as a designated eligible use. Others have focused on small business capitalization because starting and growing these enterprises has been a successful strategy for many households to

72 Day and Newburger (2002).

73 According to the College Board (2003) tuition and fees at a four-year public institution average $579 more than last year ($4,694 vs. $4,115, a 14.1 percent increase). At four-year private institutions, tuition and fees average $1,114 more than last year ($19,710 vs. $18,596, a 6.0 percent increase).

74 Scanlon and Page-Adams (2001).

achieve security and success. Retirement savings is another common objective that has been linked to increased security and peace of mind. In twenty years time, there may be other types of investment that will be available to children being born today that will greatly enhance their opportunity to thrive; we just don't know what they are at this time.

Because of the broad investment choices that may be beneficial to individuals, the system of children savings accounts being introduced in the United Kingdom will impose no use restrictions on accumulated funds once accountholders reach the age of 18. This approach was decided upon after a series of public consultations. While recognizing that there is benefit in trying to ensure some funds are not "wasted" on undesirable spending, the policymakers felt restricting uses would create additional implementation costs and run counter to the policy objectives "to help make young adults more aware of the financial opportunities and responsibilities that they will face."[75] This choice was also made with the expectation that the Child Trust Funds initiative will be augmented by a national campaign to increase financial literacy. The main concern of the architects of the UK effort was the policing of restrictions, and although the experience of restricted Individual Development Accounts programs in the U.S. was cited, it was noted that these programs were small-scale and locally delivered. While the broad issue of enforcing use restrictions is perhaps best considered in the context of the overall implementation scheme, a topic reviewed in the following section of this paper, it is worth noting that the unrestricted model is being employed in the most comprehensive system of child accounts initiated to date.

Table: Policy Design Options: Age Limits and Permitted Uses

Unrestricted Access when accountholder reach a specified age, i.e. 18 or 21 or 25.

Restricted Access when accountholder reaches at age of 18 for specified asset building uses (higher education, homeownership, retirement, small business capitalization).

Restricted Access for post-secondary education at any age, and *Unrestricted Access* at 21.

Restricted Access for post-secondary education when accountholder reaches at age of 18, and *Restricted Access* at 21 for other asset building uses (homeownership, retirement, small business capitalization).

Restricted Access when accountholder reaches at age of 18 for specified asset building uses, with *Borrowing* from the account for unrestricted uses permitted.

Establishing an age threshold when accountholders may access their accounts does not imply that there should be a requirement to spend down account resources. It could be that the account functions as a lifetime savings account, where the account can be kept open and funds used when needed. The key would be to have account rules that governed distributions in a manner that combines some flexibility with maintaining asset building use restrictions.

One alternative structure for handling distributions in this manner is to automatically roll over each account into a Roth IRA when the account holder reaches the age of 18. Distribution rules of this existing account structure allow for uses for first-time homeownership, post-secondary education and

75 HM Treasury (2001), page 16: "To restrict use of assets at maturity would undermine the sense of being a responsible stakeholder that the Child Trust Fund and its associated education would be intended to provide to young adults."

retirement, and could possibly be amended to apply to small business capitalization as well. Using the Roth IRA structure for CSA accounts not only satisfies the use restriction intents of the proposal but has the added benefit of being well understood by policy makers. Thus, CSAs would not have to justify creating new compliance and distribution rules, they simply would use the rules and systems already in place for the Roth IRA.

An examination of these rules already spelled out in the tax code, especially those governing distributions and early withdrawals, reflect the promise of this approach. Any qualified distribution from a Roth IRA is not included in an individual's gross income for tax purposes. Contributions are made on an after-tax basis but there is no tax due on earnings or on the principle when it is withdrawn. To be a qualified distribution, the distribution must be held in the account for five years and then must be:

- Made on or after the account holder reaches the age of 59 ½; or
- Made to a beneficiary or an estate after death; or
- Made after account holder becomes disabled; or
- Used to pay for a qualified first-time home purchase.

The five year holding period and the qualified distribution rules both must be met for the distribution to be tax-free and to avoid penalties. Early withdrawal penalties, when triggered, are steep at 10% on the amount of the distribution. Still the Roth IRA is a more flexible account than the traditional IRA because not only does it have more specified uses but it allows account holders to remove their contributions at any time without tax or penalty. A non-qualified distribution also imposes an ordinary income tax on the distribution in addition to the 10% penalty.

Still there are exceptions to the early withdrawal penalties which also make the Roth IRA rules potentially applicable to CSA purposes. Most relevant, the early withdrawal penalty does not apply to distributions for higher education costs. There are also exceptions for disability, back taxes, medical insurance, and medical expenses. Each of which could be seen as helping an account holder avoid debilitating hardship.

The drawback is the Roth IRA tax-free withdrawal benefits may be costly once the CSA accounts mature and the tax benefits are most helpful to higher income taxpayers who do not need the savings incentives. A potential response is to set the annual contribution cap at such a level which prevents excessive tax sheltering. The ASPIRE Act sets a cap of $1,000, but an even lower figure could be used, especially if it tracks the cap on matching contribution limits.

Another option is to move away from the Roth IRA structure and to tax withdrawals or earning. This eliminates the long-term budget impact but does require keeping track of the account basis which may be defined as account contributions and also keeping track of earning. Partial withdrawals require pro-rating the taxable and non-taxable distributions, and a full distribution requires the reporting and taxing of earnings. This adds complexity for the accountholder and the administrator but might be worth it to achieve better targeting of benefits.

E. Program Implementation

Structuring an administrative system to implement children's accounts will depend in large part on the choices made in determining a policy design. This section will explore the implementation issues for the CSA proposal and review some alternatives.

1. Account Management

The universal provision of children savings accounts will require that a centrally-administered account management system is created. The most logical manager of such a system is the federal government. Yet there are many roles to play in account management, including the institutional manager, fund processor, customer service provider, and fiduciary investor; some of these functions can be contracted out to other private sector entities or assigned to the states.

The prototype proposal calls for the creation of an administrative entity similar to the one that currently operates the retirement savings plan which the federal government provides to its employees. The Thrift Savings Plan (TSP) is a government-sponsored retirement savings and investment plan, which offers the same type of savings and tax benefits that many private corporations offer their employees. The TSP was established by Congress in 1986 to provide retirement income; it is a defined contribution plan that accrues assets based on participant contributions and the financial performance of invested contributions.

TSP regulations are published in Federal Code and it is overseen by a five-member board, the Federal Retirement Thrift Investment Board (FRTIB), which is an independent government agency required by law to manage the TSP prudently and solely in the interest of the participants and their beneficiaries. [76] The TSP financial statements are audited annually and financial statements are available to the public. It contracts out record keeping to another federal agency but directly runs the Service Centers that process contributions, fund transfers, and withdrawals. TSP participants are offered a range of other services, including account statements, investment options, telephone service, and web-access to account and fund information.

One of the central features of the TSP that should be replicated in a CSA system is a choice of investments. Participants may choose between five index funds designed to track the performance of different market segments, such as government securities, international markets, small cap firms, and the broad U.S. stock market. Index funds provide a relatively prudent way to invest and participants are allowed to distribute their assets among these funds, so they may increase their diversification and manage their own risk. The FRTIB currently has contracts with Barclays Global Investors, a publicly listed financial services company based in London, to manage its fund assets which are invested in index funds open only to tax-deferred employee benefit plans.

The experience of the TSP is an appropriate reference model because it currently manages accounts for over 3 million active and retired federal employees and has a similar set of services as would be required by a CSA system, which would serve the four million children born each year.[77] The economies of scale that the TSP has achieved help it keep its administrative costs low.[78] Additional factors in minimizing administrative costs include providing relatively restricted access to the account and account information, limiting investment options, and restricting the ability to change investment choices compared to private sector mutual fund companies. The size of the overall investment pool has enabled the TSP to negotiate a low investment management fee with its private sector investment manager compared to other types of accounts.[79]

76 See http://www.tsp.gov/.

77 In 2002, the TSP had $101 billion in assets under management, paid out 2.5 billion in benefits, and cost $70.6 million to operate.

78 According to the Thrift Savings Plan (2003) Financial Statement, administrative overhead costs per participant were $23.

79 TSP has an expenses management ratio that ranges between .06% to .07%, or $0.06 to $.07 for every $1,000 invested.

The two central distinctions between the TSP and the CSA proposal is funding and the use of funds. As a traditional, employer-sponsored retirement plan, contributions to the TSP are administered by the employer and the distribution rules are designed to meet the needs of retirement. The CSA system would not be employer-based and there could be more complex distribution rules if uses are restricted. Still the experience of the TSP identifies the necessary components of an implementation system; they include an oversight board, an account manager, an investment manager, and account servicing.

As with the TSP, CSAs will require federal oversight but other functions may be performed by government or non-government entities. From an investment and management standpoint, the TSP provides a good model because a private-sector fund manager can oversee investments and offer a limited set of investment options, enough to provide for a range of risk aversion and market opportunity. Account servicing can, likewise, be contracted out.

However, it may be practical to have other functions administered directly by the federal government. Having a federal entity fund the CSA system and hold the accounts may help solve one of the more cumbersome implementation issues: how to identify and provide account benefits to children in families that have no experience with the financial sector. This will be particularly true if the program is one of universal eligibility and mandatory participation. Since many households have no connection to the financial services sector and more than 30% of all families have no financial assets, creating a federal system is an effective way to introduce many to the "world of assets."[80]

Even children born into families without bank accounts are issued social security numbers by the Social Security Administration (SSA). This government identification scheme can be used to establish child accounts if SSA is instructed by Congress to notify the administrative entity implementing the CSA system when numbers are issued for newborn children. The administrative entity could then notify Treasury's Financial Management Service (FMS) to transfer the initial endowment into the child's account. It would be less problematic to oblige cooperation and coordination between two government entities sharing personal information than it would if one were from the private sector.

Whether the responsibilities of administering the CSAs system is added to TSP's current mandate or a TSP-like entity is created, the combination of public sector account oversight with private sector investment management is attractive. Work by the Pension Rights Center has indicated that the TSP Board should have the capacity to oversee the CSA system, especially if it had the option to contract out some management features, but other experts have expressed doubt that the TSP could replicate the low administrative fee structure it currently provides to its pension clients. This is because the TSP relies on sharing costs with government agency employers that promote the plan, provide education, enrollment, counseling and account services. Furthermore, there is a potential conflict between an expanded mandate with the prevailing statutory responsibility of the TSP to act solely in the interests of TSP participants and beneficiaries.[81]

An alternative model of implementation is being pursued for the UK's Child Trust Fund effort, where parents can take their child's voucher to a broad range of private-sector providers that have committed to offering these types of accounts. Each provider may offer a range of CTF accounts to suit different needs, but will be required to offer one "stakeholder CTF account" that is "simple, low-cost, accessible, and risk-controlled."[82] Since these initial investments will be long-term, there is an expectation that equity investments will be made but risk and return tradeoffs will be balanced with regard to the

80 Barr (2003).

81 Cavanugh (2002).

82 HM Treasury (2003), page 11.

expected maturity of the investment.[83] Other investment options can be designed by the financial providers that recognize the diversity of attitudes and preferences among the population, including social, religious, and ethical beliefs. The rules governing the UK program allow for portability and transfer, where parents and guardians can move their child's account to another CTF provider free of charge. The UK government has negotiated with the financial service industry and agreed on a maximum cap charge of 2% for primary CTF products.

Each family in the UK will therefore be required to make two decisions when they open their CTF, which provider to invest with and which of the financial products to invest in. The TSP model for administering a CSA system takes away one of these choices, and limits the other.

Another option would have a government entity set up all of the accounts, but allow participants to transfer the accounts to designated financial institutions in the private sector after they reach a certain age. Financial institutions should appreciate being able to attract and compete for these accounts, especially after they mature and accumulate resources. However, their political reaction is uncertain since they would have to wait so long to market alternatives. Facilitating their involvement at an earlier date could be explored further.

Taxpayers participating in existing tax-preferred savings vehicles, such as IRAs, are generally free to select the private financial institutions that manage their investments. The distinction here is that the federal government would take the first step in establishing and endowing the account before receiving instructions on where to transfer account funds. If parents or guardians do not provide instructions after a specified period of time, perhaps one year, the government could transfer the account to a selected provider. This approach requires a set of rules for the provision of these accounts in the private sector similar to what are being negotiated in the UK.

Beyond the additional rulemaking required, this approach of using a government entity as only a temporary investment vehicle has several potential benefits. First, it facilitates the creation of accounts for unbanked households; second, it would minimize the administrative costs of managing the funds held by the public sector; third, it creates a basis for participants to develop a relationship with mainstream financial institutions; and fourth, it prevents excessive government monitoring of private behavior.[84] To work effectively, this system would need to implement rules that minimized the barrier to transferring funds to the private sector providers. Conversely, mandating an account transfer to the private sector may pose potential problems for account holders. The ability to keep the accounts within a government entity should be maintained as an option; this would facilitate the use of this account as a life-long asset account.

Table: Distribution of Function in Select Savings Account Systems

Function	**Thrift Saving Plan**	**UK CTF**	**ASPIRE Act Prototype**
Oversight and Policy Board	FRTIB	HM Treasury	KIDS Account Board
Rule Maker	Federal Government	HM Treasury	Federal Government
Account Manager (holder)	TSP Service Center	Private Sector Provider	KIDS Account Fund
Investment Manager	Contract with Barclays	Private Sector Provider	Contract with Private Sector
Record Keeping	Contract with USDA	Private Sector Provider	Contract with Public Sector
Distributor	TSP Service Center	Private Sector Provider	KIDS Account Fund

83 In other words, "A lifestyling appoach should be taken, where the proportion of less risky investments should increase as the stakeholder CTF account reaches maturity." HM Treasury (2003), page 11.

84 For these reasons, this approach is supported by Goldberg and Cohen (2003). They refer to these as "Government Sponsored Funds (GSF) and argue that they "should not interfere or compete in any material way with private sector financial institutions. The best way to achieve this result is to view" them as "a temporary investment vehicle."

An additional implementation model to consider for CSAs would replicate the structure of the Section 529 Plans for college savings that has taken shape in the unique context of American federalism. While the federal government has established a broad set of rules to govern these savings accounts, it has allowed each of the fifty states to craft its own system. Section 529 Plan rules require each state to run a centralized program, so all participants are in the same system, but this franchise can be awarded to a single provider in the private sector. Offering the provider to chance to develop economies of scale, each state is in a strong position to negotiate among competing providers for a competitive fee structure. Federal policies ensure full portability so Section 529 Plan investors can keep an account in one state even if they move to another, but individual states can take the initiative and introduce additional incentives to promote progressivity and savings. Rhode Island and Maine, for example, use fees generated from their 529 accountholders to fund a savings match for low- to moderate-income state-resident families, and Michigan and Louisiana provide a savings match through state appropriations.[85] Although it varies by state, a common feature of the Section 529 Plan is the limit on investment choices, typically restricted to a few index funds with a range of risk and reward characteristics; this contrasts to the unrestricted options available to IRA investors. Restricting options creates the potential for lower investment management costs, which have been realized in some, but not all, of the Section 529 state plans.

2. Compliance

The development of appropriate oversight measures to ensure that account holders are complying with program rules will depend on the program's ultimate policy design and implementation structure. Whatever system is created, there will be an interest in minimizing and deterring fraud. The imposition of use restrictions will require a more extensive strategy to oversee the distribution of funds than if funds can be withdrawn without restrictions. Likewise, additional mechanisms to monitor accounts may be needed if these accounts are held by a range of financial institutions rather than the public sector. Regardless of what approach is pursued, it is envisioned that each account will have a unique reference number tied to a child's social security number. This will make it possible for the compliance agent to certify that only one account has been opened for each eligible child.

The system most amenable to monitoring compliance is one with universal eligibility, unrestricted use of funds, and central administration. This mirrors the path taken by the UK in the CTF initiative although a range of financial institutions will provide accounts.

For a system with use restrictions, there are several ways to construct a compliance monitoring mechanism. The first is to develop and publicize program rules, and hold the accountholders and their parents or guardians responsible for withdrawing funds from their funds in accordance with the prevailing rules. The actions of the accountholder will be subject to auditing and they can be held liable for actions that have broken the law. This is similar to how the current tax system is enforced, and may be called voluntary compliance. For example, taxpayers can draw down funds from existing retirement accounts without a penalty after they reach a certain age or under certain conditions. The IRS has procedures in place that govern the monitoring of these withdrawals and could employ the same approach with CSAs.[86] This approach would work if the accounts are held by either a public-sector or private sector entity, and would build on existing tax compliance procedures. If a government-sponsored

85 Clancy (2003).

86 For example, Goldberg and Cohen note that the private sponsors of the whole range of IRAs are required to file a Form 1099-R showing annual distributions, conversions, and rollovers from such accounts. This includes indicating whether the distribution was subject to taxes or not.

entity, such as the ASPIRE Act's proposed KIDS Account Fund, were to hold the accounts, it would still be possible to contract out the monitoring of distributions along with other aspects of account management.[87]

The second main approach to compliance is to create mechanisms that ensure distributions can only be made through a certification process. For example, if homeownership is one of the primary uses of these accounts, then an accountholder seeking to use their funds for such a purpose would provide documentation to the administrative entity so that a check could be issued to the home seller or mortgagee. The same structure would apply to other asset building investments, such as post-secondary educational expenses.

These types of compliance systems have been used by administrators of Individual Development Account (IDA) programs, especially when these matched savings program are linked explicitly to asset building rather than savings objectives. Although both are laudable, the distinction is meaningful. Money in a savings account is certainly a valuable asset for many low-income people, but the ability to use those resources to make a useful and productive investment can have a bigger impact on their lives in the long term. However, these IDA programs operate on a smaller scale, with staff support to monitor account withdrawals. Any system that requires the account manager, whether it is a private-sector or public sector agency, to oversee distribution will impose burdens on a compliance system that are likely to increase administrative costs.

If account holders are permitted to use their accumulated resources for any purpose they choose, then many administrative compliance issues are minimized. This was part of the reasoning behind the UK's decision to allow unrestricted access to the Child Trust Fund account once a child reaches the age of 18. But if account holders are allowed to withdraw funds only for a restricted set of uses, then a series of implementation mechanisms will be required to ensure that funds are used properly. Creating a system capable of directing checks to a range of designated beneficiaries is possible but it may be more practical to opt for the voluntary compliance subject to enforcement approach described above.

3. Account Rules

As with any new account, especially one with tax and benefit implications, there will be a need to develop a set of account rules. Some of these rules will be related to eligibility and account access, while other rules will be asked to clarify the treatment of these accounts in the context of the larger tax code. As a general rule, a primary principle of the prototype proposal is to make these rules as simple as possible and employ existing procedures and guidelines; given the complexity of the U.S. tax code, this may be difficult to achieve.

Among the reasons to embrace a universal eligibility criterion for this proposal is the simplicity of the concept and the chance to avoid having to craft a well-defined means-test. Yet even the basic concept of universality will have to be clarified with a set of rules regarding residency, custody, and cut-offs. A second set of account rules will be required to govern account ownership. Parents and guardians will make investment decisions for their children and may have access to the potential tax benefits associated with contributing to such an account, but the child's account will be in their name, not their parent's or guardian's. A third set of account rules will govern whom exerts control over the account and under what conditions this control will be lost. All of these rules will have to take into consideration diverse and dynamic family structures. For instance, who makes account decisions when there is a custody dispute or the parents are not yet of legal age themselves.

87 Goldberg and Cohen (2000), page 59.

Once control is clarified, rules will have to be created to govern access to the account and access to account contributions. Some may argue that the public endowments should not be available until the child matures but parents should be able to access their contributions if they deem it necessary. In order to simplify administration and generate maximum returns, it is proposed that there is limited access to contributions until eligible withdrawals are made. This creates a risk that some would invest money in a CSA that would best be held in a more liquid account. Another issue is that of penalties. What should be the appropriate penalties for withdrawals that do not conform to program rules? It may be that the prevailing penalties enforced for the current retirement accounts may be appropriate, but even those rules will have to be modified to apply to CSAs.[88]

As with all of the other tax preferred savings plans created by Congress, rules that govern the tax treatment of CSAs will need to be devised. It is assumed that it will be possible to roll over CSAs into other tax-effective savings vehicles at some point in the future. Other tax-related rules will be required to clarify how a CSA is to be treated upon the beneficiary's death.[89] The options are to consider each account as the property of the original beneficiary and be handled through existing estate laws, or to have the resources in the account revert back to the government. The former may be preferable because it is consistent with the concept of ownership and an approach that encourages financial literacy, requiring that custodians of the account have made decisions about where resources are invested. Also, additional tax rules will be required to clarify the extent to which the account assets are protected from creditors of the beneficiary or under what conditions they can be seized by the Internal Revenue Service.

Deciding how to structure an implementation scheme for CSAs will depend on how policymakers assess the issues described above. The choice of investments, compliance regime, account management, and account rules will each greatly influence how the national system of accounts is understood and embraced by the public at large. It may be that the manner in which these rules are devised and the design issues settled will ultimately determine the success of the entire effort.

The challenge here is to develop a system that is as simple and transparent as possible. This will be particularly important because any program that encourages private investment also involves risk. CSA investments will be subject to the investment caveat that accompanies the literature on any financial product: returns on investment are subject to market dynamics and profits are not guaranteed. While the historic performance of equities traded on the stock market is sound, averaging 8%, there are boom and bust cycles where market values fluctuate in the short term. Of course, many individual investments do not perform, and can lose all of their value. The realities of investing may justify an indexing approach, where some risk is mitigated through diversification, but regardless of what investment options are provided, there will be a widespread need to offer financial education that will help participants evaluate the options that best suit their individual circumstances. Children's Savings Accounts can provide a platform for delivering some of the most basic aspects of financial literacy. Even as a simple system will help minimize administrative costs, more significantly, it will allow participants to understand the potential benefits of contributing to their accounts and make informed choices.

F. Fiscal Matters

88 Withdrawals from Roth IRAs before age 59 are subject to a 10% penalty.

89 Goldberg and Cohen (2003) cite statistics from the U.S. Center of Disease Control that demonstrate the significance of this question. "Of the 4 million children born in this country each year, it is estimated that about 28,000 will not live to the age of 1, that about 35,000 will not live to the age of 5, that about 43,000 will not live to the age of 15, and that about 56,000 will not live to the age of 20."

Establishing a policy to provide every child an account will be a significant undertaking, representing a large national commitment. From a policy perspective, there are associated costs and benefits which must be untangled before policymakers should be expected to confirm this commitment. This section will consider some of the fiscal implications and budgetary impacts of this effort.

1. Cost Estimates

Developing precise budget costs is beyond the scope of this paper, but it is possible to distinguish the key cost components of the ASPIRE Act proposal and evaluate the factors which would influence any CSA proposal. There are two major costs components that will be addressed separately. The first is the program cost to support the accounts and the second is the administrative cost of managing the system.

The program costs are primarily comprised of the costs of the public contribution to the accounts. A universal system will require an account for each of the approximately four million children born each year. If every one of these children was given an account at birth endowed with $500, the size of the government's commitment would be $2 billion a year. Additional public contributions would eventually raise the cost of the effort as the initial cohort matures. Some of these costs may eventually be offset if this cohort is required to repay the value of the initial seed contribution once they enter the workforce. Given the unique nature of the policy, the overall costs (and many of the benefits) will not be realized for decades to come.

Another component of program costs would be the augmentation of the initial contribution with annual saving incentives. The cost of this feature depends on how households respond to the savings incentive and how the incentive is structured over time. Key questions to answer in order to estimate the cost of the match contributions include:

- What is the match rate? ($1:$1, $.50:$1)
- What is the annual cap of the voluntary contributions that can be matched? ($500, $1000)
- When is the incentive available? (every year, tied to specific ages)
- What are the limits placed on the incentives? (limited number of years, a lifetime cap)
- Should voluntary contributions be after-tax or eligible for a tax deduction?
- Who is eligible to receive a match? (80%, 100%, or 120% of national median income)

The number of issues that these questions raise makes it difficult to estimate the program costs of different incentive schemes. There may be a large cost difference if generous matches are available when a child is young or not accessible until a child matures. The Aspire Act calls for a dollar-for-dollar match of the first $500 contributed annually for children in families earning up to the national median income. The cost of this provision depends on the take-up rate, but $600 million a year for each cohort is a reasonable estimate.

Looking at a ten-year budget window, which captures the initial and supplemental endowments as well as the matching contributions, the estimated cost for the ASPIRE Act is $37.5 billion. The cost in the first year when accounts are opened is $3.25 billion. Annual costs will rise as each year a new cohort becomes eligible for account benefits. Over twenty years, the total estimated cost is $85.6 billion. These estimates assume that only children born after the program's commencement date will be eligible. A more costly alternative is to include in the program more children already born, avoiding the "notch" problem that many new benefit programs create.

Table: Estimates of Program Cost for Prototype American Stakeholder Accounts, Net Present Value

First Year	Ten-Year	Twenty-Year
$3.25 billion	$37.5 billion	$85.6 billion

Assumptions: 4 million children born each year; $500 endowment at birth; $500 supplemental contribution prorated for children in families earning up to the national median income; dollar-for-dollar matching contribution up to first $500 for children in families earning up to the national median income; contributions index to inflation rate of 3%; and 6% discount rate.

Another component of the cost which should be taken into account over the long term is the cost of tax-free withdrawals. Normally, the government would be in line to collect taxes on accrued savings, but if these accounts are created as tax-preferred vehicles, it shelters the earnings from future taxation. However, given that these are accounts created at birth, the impact of this cost does not appear for several decades. It will become a significant cost component of the proposal, but one that depends on predicting tax rates in the distant future.

Program costs can be lowered if the contributions and match rates are less generous. The UK Child Trust Fund proposal is being launched without matching incentives and with a more modest initial contribution (equivalent to $400 for each newborn, and $800 for each child born to a low-income family). Replicating this approach for the four million Americans born each year would have a ten year program costs of $15.7 billion, or only $2.13 billion on an annual basis. While more parsimonious, the universal provision of an account for every child has the potential to serve as a powerful savings vehicle for all citizens. The major contribution of this approach from a policy standpoint is that it establishes the infrastructure to promote subsequent savings and asset building strategies rather than committing to invest in these accounts up front.

2. Costs of Administration

Program costs would be the major cost component of any national accounts system that includes contributions. However, any national initiative will incur administrative costs as well. Administrative costs would be all of the operational expenses associated with providing program benefits, including those of program management, start-up, and compliance monitoring.

The most significant determining factor in accounting for administrative costs is the program design, and the uncertainty of program design features makes it difficult to estimate administrative costs before these details have been decided upon.

There has been some work performed calculating the administrative costs of employment-based pension plans as a model for costs under an individual accounts reform of the social security system.[90] The insights to be gained from these analyses identify several cost factors and identify means to minimize administrative costs. For example, systems with less investment choices and restricted access to account statements are less expensive to operate.[91] This conclusion is reinforced by the experience of the Thrift Savings Plan that has kept administrative costs low relative to other retirement plans by limiting

90 Employee Benefit Research Institute (2001).

91 Employee Benefit Research Institute (2001).

investment options, the number of account statements issued, and the number of inter-fund transfers. In 2003, total participant expenses in the TSP were 10 basis points, compared to 63 basis points for comparable index funds in the private sector.[92]

But for several reasons, it will be difficult to replicate TSP's administrative fee structure. First, many costs of administering the system are passed on to the employer agencies. The farming out of the "retail" functions to employers, such as payroll deductions and counseling, while retaining the "wholesale" responsibilities minimizes the expenses ratio. In this respect, the TSP has less experience in performing the face-to-face counseling and in estimating the cost of handling the communication responsibilities. Second, the TSP serves a relatively high-income, educated, and stable work force. This has many implications, but a main one is that is leads to accounts with large balances. Small accounts cost more to run, and higher administrative fees take a bigger portion of the overall balance. So while the TSP model is potentially a good one for the CSA system, it would have to be expanded upon in order to work for a national system of children's accounts.

Administrative costs will also rise if a system of individual accounts is operated by private sector firms offering 401 (k) type services and investment options. These operations require more staff to oversee investment management and have higher organizational overhead expenses. As a point of comparison, one analysis contemplating the cost differences implementing individual social security accounts estimated that a private, 401(K) system would need 100,000 new workers while an additional 10,000 workers could handle the expansion if it offered TSP-like services and investment options.[93] This does not mean that the administrative costs of a private sector approach will necessarily exceed one using a public sector entity. The theory behind the Section 529 Plans is designed to allow states to negotiate low administrative fees with private sector firms in return for a franchise which requires them to offer only a limited array of investment choices, and in some states this theory has been confirmed in practice.[94]

In order to estimate the range of administrative costs, GAO examined several studies of various potential administrative mechanisms for individualized Social Security accounts. "These studies estimated that the administrative costs for a centralized system ranged from 0.11 percent of assets to 0.79 percent, while the range for a decentralized, individually-managed system ranged from 0.32 to 1.5%.[95] While not a tight comparison, these estimates offer a sense of the range of administrative costs relative to program design. Beyond program design, some costs are imposed by program rules. For example, keeping track of where beneficiaries live and sending them frequent account statements can be expensive, but if this is not required by law. The Social Security Administration minimizes costs because it is not mandated to update individual addresses and issue account statements for all recipients on an annual basis.

Once administrative costs are determined, the next issue to settle is how they will be charged and who pays for them. If a federal entity is created, the administrative costs could be paid for by the public or reimbursed through a fee imposed on every account. Similarly, a fee imposed on account holdings could offset the administrative costs of a private sector firm providing accounts.[96] It makes most sense to allow

92 Fitzgerald (2004).

93 Employee Benefit Research Institute (2001).

94 In practice, the Section 529 Plan experience has been mixed, with the fees of some state programs being significantly higher than others. A number of states have contracted with low-cost providers, such as TIAA-CREF and Vanguard. TIAA-CREF has 529 expense ratios sometimes as low as 0.65% annually with no additional charges on the underlying investments. Typical total fees for TIAA-CREF plans range from 0.65% to 0.80%. In comparison, industry average fees for mutual funds are 1.24% for stocks, 1.13% for bonds, and 0.46% for money market funds. Ma and Foe (2002).

95 General Accounting Office (1999).

96 In the UK, a fee structure for the Child Trust Funds has been proposed by the government but is still under negotiation. Estimates of implementation costs to administer the system have not yet been published.

for a fee to be charged to each account that would cover investment management and other operational expenses. The one caveat for policymakers is to avoid creating a fee structure that will unduly erode the value of each account. Federal oversight may be needed to help keep fees to a minimum.

A final fiscal matter to consider is the source of funds to support the overall initiative. Budgetary support for many federal programs is paid for out of general revenue funds, while other programs have a dedicated source of funds. Given the pressures on the budget in the annual appropriations process, it often makes sense to tie new initiatives to a dedicated funding source, especially if the source is related in concept to the proposal. Conceptually, it is easier for much of the public (and many politicians) to support a gasoline tax if it is tied to building highways, a fee on airline tickets if it increases security.

A logical funding source for any CSA proposal is the estate tax, a connection first proposed by Thomas Paine. Current tax rules call for a repeal of this revenue source by 2010 and an increasing exemption of estate wealth until that time. It has been estimated that the country may lose up to $800 billion between 2011 and 2021 if the repeal is made permanent. The estate tax is currently one of the country's most progressive because only estates worth more than $1 million are affected. The overwhelming majority is paid by the fewer than 3,000 estates with assets in excess of $5 million.[97] Between now and 2052, the intergenerational transfer of wealth is projected between $41 trillion and $136 trillion; up to one-half of which will be transferred by estates worth more than $5 million.[98] Keeping the estate tax will preserve a progressive source of revenue that can fund child accounts, so that the wealth of the current generation can directly support wealth creation for the next.

There is a logical connection between using the estate tax as a revenue source and the policy objectives of endowing every child with an asset building account. More poetically, canceling the repeal of the estate tax and generation skipping transfer taxes has the potential to raise $126 billion dollars between 2004 and 2013, more than enough to afford the ten-year price tag of even ambitious CSA proposals.

G. An Accounts-Based Approach to Asset Building for Children

1. Program Benefits and Challenges

Creating a universal system of accounts for children is a powerful approach to social policy because it has the potential to contribute to both economic growth and social development. It does so by investing on an individual basis in a manner that creates widespread opportunities. While investment returns are not guaranteed, they are likely to offer each participant access to a modest stock of financial assets when they begin their adult lives. For some, this asset pool can be used to seed profitable and productive investments, for others, it may provide a sense of security many now lack. The public investment signals that society has an interest in the success of every child, and they, in turn, will be responsible to make appropriate choices throughout their lives.

Implementing Children's Savings Accounts is consistent with contemporary approaches to social policy that have moved away from guaranteed entitlements and toward more account-based support mechanisms. In contrast to traditional income supports, the level of investments in the account is no substitute for social protection. Rather they are intended to promote social and economic development at the household level, at the same time as they advance fiscal stability, savings, and investment at the macroeconomic level. This account-based approach to social policy has been emerging for decades, and is linked to the rise of policies designed specifically to promote asset holdings. The state creates the

97 Gates and Collins (2002).

98 Gates and Collins (2002).

accounts, (401 (k)s, IRAs, Section 529s, etc), defines the policies, provides the regulations, and offers the tax benefits. The collective intent is to subsidize asset building through a system of asset accounts. The proliferation of asset accounts as a main instrument of social policy is a historic development, described by Sherraden as a transition from a social welfare state to a social investment state.[99] Whether asset-based policy should replace social insurance is open for debate, but the emerging transition is grounded in the broad policy consensus that asset holdings make a material difference in people's lives and open the door to economic and social opportunity.

Yet the tools are incomplete. The reliance on tax benefits to promote asset building has until now been problematic because the poor, who do not qualify for the tax benefits, are unable to benefit. The current structure of that tax code has made asset-based tax benefits highly regressive. There is no universal, progressive asset-based policy, and the state has become an instrument of reinforcing the prevailing inequality of asset holdings among the population.

A major benefit of the CSA initiative would be its ability to reach all citizens, especially those currently excluded from receiving asset building incentives, and provide access to asset building activities that could last a lifetime. The universal extension of this opportunity will reduce social inequality and increase economic activity. Encouraging and subsidizing asset holding by all citizens can contribute to growth in the long term. American history is full of examples where small initial investments are remade into substantial fortunes, but more profoundly, small investments have been shown to make significant differences in people's lives when they are used to provide security or an investment in the future.

For several reasons it makes most sense to focus on an asset building policy on children. The very nature of asset building is long-term, investing when children are born provides the most time for assets to grow, and the dynamics of accumulation will provide their own lessons. Also, the experience of asset holding may be transformative, changing attitudes for the better. Beyond the potential economic effects, stakeholder accounts could serve as a means of providing financial education, a skill set which will be in need of augmentation if the ownership of equities and investments is to become further democratized.

The CSA approach is designed to reinforce a message that combines rights with responsibilities. For many, the public contributions into accounts will be an important incentive for savings. And there will be rules governing account withdrawals that will send vital social messages about what types of purchases are productive investments. The repayment of the initial deposit, once steady employment has been secured, will facilitate the seeding of the next generation's growth. The sharing of prosperity may have social benefits that cannot be predicted, and the ultimate impact of giving every child a stake is, of course, unknown, yet broad inclusion is itself a worthy public investment that will increase society's collective capacity to participate in the economy and society as a whole.

Still, devising any system of child accounts faces a series of challenges that policymakers will have to overcome.

Reaching out to households that currently have no connection to mainstream financial services will be a major achievement of any CSA initiative, but it also represents one of its greatest challenges. Creating a system that is truly inclusive will be no small task given that roughly 10% of the general population, and 30% of low-income households, have no connection to mainstream financial institutions.[100] Ensuring that everyone has access to an account would be a major achievement, which would, in turn, facilitate

99 Michael Sherraden (2003).

100 Aizcorbe, Kennickell, and Moore (2003). According to the Survey of Consumer Finances, of households in the bottom 20% of income, only 70.9% have transaction bank accounts. Overall, 90.9% of households have such accounts.

additional public and private investments. The tax return, which is used to facilitate other asset building objectives, is not an ideal vehicle for a universal account because many low-income families are not required to file. A refundable credit may provide an incentive to file if that is the chosen funding mechanism, but this incentive may not be available every year, creating some confusion.

It may not be possible to implement a universal, inclusive system all in one blow; there may be a period of transition where the initiative is ramped up to scale. The transition period creates its own challenges, including how to keep costs down and how to avoid the arbitrary awarding of benefits. A full phase-in of an accounts-at-birth program will eventually leave no child behind, but initially a threshold eligibility date will necessarily create arbitrary distinctions which may be troubling.

A final challenge is created by existing gaps in the research literature on the role which assets and asset holding play for children, their families, and their communities. The asset building field remains relatively new, but a series of research questions have been identified which require analysis; these include: What are the asset effects? What asset investments are most productive? At what age do the asset effects materialize? What effects will differential asset pools have on youth? What are the tradeoffs between consumption and savings? and What are the barriers for making informed investment decisions? The lack of answers to these questions may undermine support for children's accounts, but each represents an opportunity to increase our understanding of the impact widespread stakeholding would have on our society as a whole.

2. Assessment of the Current Terrain

The challenges in building a universal account-based system are significant, but they certainly can be addressed through the process of program design and implementation. Constructing a system of accounts that is workable and effective is achievable. The greater challenge is gaining political support for the proposal, sufficient to shepherd it through the legislative process. This may ultimately depend on policymakers accepting the premise that inclusive asset building policies are a means to promote social and economic development. These policy goals should be distinguished from other anti-poverty objectives because, at the core, asset-based policy is intended to enable individuals to exert greater control over their lives and expand their capacity to take advantage of the diverse opportunities offered by American society. Any large-scale asset-based policy effort should complement, rather than replace, existing policies that provide social insurance.

The central problem with the current array of asset policies is that they are regressive and, for the most part, exclude the poor. A targeted effort may address this deficiency, but it creates a new problem of how to craft an effective targeting mechanism. More significantly, it loses much of its political appeal. For better or worse, policymakers are likely to be more responsive if program benefits are distributed broadly. In order to make the effort progressive, it should be made universal. Beyond the political calculation this strategy entails, there are sound justifications for pursuing universal children's accounts. Asset building and savings are sound objectives for every citizen, and universal access to an account merely offers each citizen the opportunity to participate, regardless of the income status of their family.

The fiscal impact of a children's account system depends on the manner in which the policy is crafted. The issues laid out in this paper have identified the major cost variables of a children's account system and signaled how the budgetary cost can be minimized. A voluntary system with no public contribution replicates existing policies that exclude many of the people who would benefit from the policy the most. A universal system is able to reach those currently excluded while providing every participant the opportunity to benefit. Given the preceding analysis, the most promising approach would be a universal system, with progressive public contributions, incentives to encourage voluntary contributions, deposited in a range of no-frills investment funds. Paradoxically, the most promising approach may be the one that requires the most political leadership to enact.

Contact Information:

Reid Cramer
Research Director, Asset Building Program
New America Foundation
1630 Connecticut Avenue, NW 7th Floor
Washington, DC 20009
202-986-2700
202-986-3696 - fax
cramer@newamerica.net

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