

# Educational Saving Incentives for Low-Income Families

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# Background

- Low-income families save very little, especially for education
- Public policies to increase saving for these families
- Traditional tax subsidies allow tax-deductible contributions and accrual at the pre-tax rate of return
  - Limited incentives to save for families with low marginal tax rates.
- Unfamiliarity with financial institutions

# Background

- Recent initiatives either
  - provide matching contributions (Retirement Saver's Credit) or
  - matching contributions, account access, and case management, Individual Development Accounts (IDA)

# Background

- Empirical findings on impacts have been mixed
  - **Duflo, et al. (2006)** - matching had sizeable impact on IRA contributions in experiment in St. Louis, MO
  - **Mills, et al. (2008)** – IDA raised homeownership substantially after 4 years in experiment in Tulsa, OK
  - **Grinstein-Weiss et al. (2011)** – Tulsa, OK effects dissipated almost fully after 10 years

# Our Contribution

- Evidence from first randomized experiment on the effects of IDAs on saving for children's education among low-income families
  - Michigan SEED Program
  - Saving for college education in Head Start families
  - Families on the college-attendance margin

# Preview of the Results

- 67% of treatment-group children had a 529 plan
- 22% contributed their own funds
- Saving through 529 plans resulted in 55% crowd-out of other college saving

# The Michigan SEED Program

- Saving for Education, Entrepreneurship and Downpayment (SEED)
  - Funded by Ford Foundation and others
  - National initiative conducted at 12 sites each with a community partner
  - Similar basic structure – account with initial deposit and matched contributions
  - Test approaches for building assets for low-income families' children

# The Michigan SEED Program

- This study focuses on the SEED program in Pontiac, MI
  - Only program of twelve with **random assignment design**
  - Random assignment allows us to identify the causal impact of SEED on savings
  - Program targeted families with children enrolled in Head Start

# The Michigan SEED Program

- Enrollment began in Summer, 2004
- Letters, open houses, parent orientation sessions
- All families at the Head Start centers were eligible
- “Focal” child
  - had to have been enrolled in Head Start
  - youngest

# The Michigan SEED Program

- Baseline interview in Fall, 2004
- Random assignment by Head Start center after completion of baseline interviews
- 7 treatment and 7 control Head Start centers
- A follow-up survey of all families in Fall, 2008
- 86% completed the follow-up survey
- **Sample of 600 families**, 302 treatment and 298 control

# Baseline Characteristics

- Young, single mothers
- 40% had some college education
- 46% were White and 43% were Black
- Average family income was \$20,870
- 58% got Food Stamps

# 529 Plans

- The saving vehicle in the SEED experiment was a 529 plan
- 529 plans are state-sponsored college savings plans enabled by federal legislation
- Available in all but 2 states
- Well-established, reputable saving vehicle, specifically targeted toward educational saving

# 529 Plans

- **Beneficiary** is a child who will use the funds
- **Owner** is an adult who makes a contribution to the plan
- Owner can change beneficiary or withdraw funds at any time

# 529 Plans

- Contributions not tax-deductible for owner's federal income
- In MI contributions are for determining state income tax
- **Earnings on all deposits are tax-free**
- Qualified uses include tuition, books, supplies, required fees, and some room and board costs
- 4 investment options for plan assets: 100% equity, 100% fixed income (bond), balanced, and guaranteed

# 529 Plans – Treatment Group

- Treatment group 529 plan components
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  2. **\$200 state match in custodial 529 plan**
    - a) For qualified families, the first \$600 of their own contributions were eligible for the **33% state match**, up to the **\$200 match cap** in the first year in which the beneficiary is enrolled in the plan.
    - b) SEED is the owner of the custodial 529 plan

# 529 Plans – Treatment Group

- Treatment group 529 plan components
  1. \$800 initial deposit into parent-owned 529 plan
  2. \$200 state match in custodial 529 plan
  3. **Parent's own contribution matched 1:1**
    - a) Parent's contributions placed in parent-owned 529 plan
    - b) SEED matching contributions placed in custodial 529
    - c) First \$1,200 of own contributions matched 100% by SEED

# 529 Plans – Treatment Group

- Treatment group 529 plan components
  1. \$800 initial deposit into parent-owned 529 plan
  2. \$200 state match in custodial 529 plan
  3. Parent's own contribution matched 1:1
  4. “High touch” approach
    - a) Financial education
    - b) Case management

# 529 Plans – Control Group

- The Michigan 529 plan was open to the general public
- For qualified families, the first \$600 of their own contributions were eligible for the **33% state match**, up to the **\$200 match cap**

# 529 Plans – Difference Between Treatment and Control Groups

- \$800 initial deposit into parent-owned 529 plan
- Parent's own contribution matched 1:1
- “High touch” approach

# What Can You Accumulate?

	Treatment Group	Control Group	Difference
<b>A. Family makes Own Contribution of \$0</b>			
SEED program initial deposit	800	n/a	
Own contribution	0	0	
State match (33%, up to \$200 cap)	200	0	
SEED match on own contribution (100%)	0	n/a	
Total	1,000	0	1,000
<b>B. Family makes Own Contribution of \$1200</b>			
SEED program initial deposit	800	n/a	
Own contribution	1,200	1,200	
State match (33%, up to \$200 cap)	200	200	
SEED match on own contribution (100%)	1200	n/a	
Total	3,400	1,400	2,000

# What Does That Buy You?

- \$5,100 = projected tuition cost of 2 years at junior college
- With no own contributions, total savings would be \$1,500
- 30% of the tuition cost of an associate's degree
- With maximum matched contributions, **total savings would cover 2/3 of an associate's degree**

# How Might This Affect Saving?

1. Take-up
2. Accumulation in 529 plans
3. Total college savings

# Take-up

- Take-up should have been 100% for treatment group if participants were
  - Fully informed
  - Rational
  - Understood all of the program rules
  - Not subject to social norms
- 67% of treatment-group children had any 529 plan

# What Explains Low Take-up?

- 67% of treatment-group children had any 529 plan
  - 36% not enough money/income to save
  - 25% misunderstood program rules
  - 9% procrastination
  - Interesting, given “high touch” approach

# What Explains Low Take-up?

- Potential for high implicit tax rates on 529 plan assets from public transfer programs
  - Families in experiment granted exemption of 529 plan assets from eligibility determination for Medicaid, TANF, SSI, and Food Stamps
  - SEED program structured to avoid these high implicit tax rates

# What Explains Low Take-up?

- Potential for high implicit tax rates on 529 plan assets from college financial aid programs
  - In Michigan, value of 529 plan excluded from financial aid calculations at in-state institutions
  - Again, SEED program structured to avoid these high implicit taxes
- Expected Family Contribution used to determine eligibility for federal financial aid
- 91% of families in sample projected to have net worth less than the asset allowance

# Take-up

- One of the most interesting features of this study is the low take-up rate among treatment families
- At follow-up, 8.4% of control-group children and 67% of treatment-group children had a 529 plan
- The treatment effect is 58.5%
- The treatment effect adjusted for difference in baseline characteristics is 59.1%

# Accumulation in 529 Plans

- Accumulation is made up of
  - SEED funds
  - Own contributions
- The **average impact of the treatment on own savings contributions is ambiguous**
  - \$800 initial deposit (plus \$200 state match) - pure income effect
  - Dollar-for-dollar SEED match - substitution and income effects

# Accumulation in 529 Plans

- At follow-up, the average 529 plan balance was \$912 for treatment-group children and \$288 for control-group children.
- The treatment effect is \$624
- The treatment effect adjusted for difference in baseline characteristics is \$617

# Accumulation in 529 Plans

- Most of the treatment effect on 529 plan accumulation was SEED funds
- Only 22% of treatment-group families contributed to a 529 plan
- Of those who saved, the average contribution was \$9/month

# Total College Savings

- The treatment effect on total saving in all forms for education for the focal child is \$293
- The treatment effect on 529 plan savings is \$617
- The treatment estimate of the offset of 529 savings on total college savings for the focal child is  $\$293/\$617 \approx 0.45$
- IV treatment estimate - **55% crowd-out**

# What About Non-focal Children?

- Estimated on 470 families with siblings
- IV estimate - 9% crowd-out on saving for other children
- Relatively large standard error

# Unanswered Questions

- Long-run educational outcomes
- Specific reasons for low/no saving
- Separate impacts of program components
- External validity

# Policy Challenges

- Both low- and middle-income families are challenged by the broad gulf between savings and financial aid policies
- Savings and financial aid programs are
  - State specific
  - And use different languages at the federal level
- Savings outcomes could be improved if these programs were streamlined