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Three Considerations for Children's Savings Accounts

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A primary goal of children's savings accounts (CSAs) is to provide children, especially in low-income families, a strong economic footing. The ability to do that, however, depends on how CSAs are designed and how much families contribute. This fact sheet estimates the impact of CSAs on families' savings and identifies key considerations for their design.

The findings are based on Butrica and coauthors (2008), using projections from the Urban Institute's DYNASIM model. Their CSA plan includes (1) an initial federal deposit of $500 for all newborns, (2) an initial supplemental grant up to $500 for households at or below the national median adjusted gross income (AGI), (3) private contributions up to $1,000 per year, and (4) a dollar-for-dollar government match on private contributions for households at or below 120 percent of the national median AGI. Government grants and interest earnings are not taxed. (The paper also considers an alternative scenario in which accrued interest is taxed.)

Butrica and coauthors (2008) estimate that such CSA accounts will average only $2,413 in 2008 dollars at maturity (i.e., age 18). Even assuming twice as many CSAs as normal would receive contributions, average account balances would still be modest—only $3,653. More importantly, however, the authors find three points relevant for any asset-building proposal or program: incentives make a difference, targeting can be difficult, and nontaxability matters for all subsidies.

Incentives Make a Difference

A government match will significantly increase both the rate and level of private contributions to CSAs. Butrica and coauthors (2008) project that for children in low-income families, a government match will increase the percentage of CSAs that ever receive a contribution from 1.7 to 10.0. A match would also raise the average contribution per year and per CSA from $39 to $346 (in 2008 dollars). For children in higher-income families, a government match would increase the average contribution rate from 6.8 to 15.5 percent and the average contribution from $596 to $741—though it is not clear whether this is new saving.

Targeting Can Be Difficult

A significant portion of CSA government benefits intended for low-income families will instead accrue to middle- and higher-income families. This is because many families will experience economic mobility over their lifetimes. For example, 38 percent of children in the lowest income group at birth are projected to move into a higher income group in just one year. And 67 percent of these children will be in a higher income group when their accounts mature. If the goal of a program is to redistribute income, then conditioning eligibility on low annual income will limit its impact. One way to address this might be to require those with higher incomes at maturity to repay their government subsidies.

Nontaxability Matters for All Subsidies

Exempting CSA savings from taxation will distribute significantly more benefits to higher-income groups than to lower-income groups. Not taxing the government grants and the interest they earn is itself a subsidy. For example, a $500 tax-free federal CSA deposit is equal to a $588 taxable deposit for a low-income person in a 15 percent tax bracket, but a $714 taxable deposit for a higher-income person in a 30 percent tax bracket. If interest accrued is also tax free, the effective government grant is even more valuable. One way to address this might be to exclude those with higher incomes from receiving nontaxable subsidies.

Reference

Butrica, Barbara A., Adam Carasso, C. Eugene Steuerle, and Desmond J. Toohey. 2008. "Children's Savings Accounts: Why Design Matters." Washington, DC: The Urban Institute. Opportunity and Ownership Project Report 4.

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