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A Promising Platform for College Saving

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A Promising Platform for College Savings¹

The Obama Administration, as part the President’s larger agenda to create a “save and invest” economy, has announced a thorough review of College Savings Plans (529 plans) in order to expand their use by middle- and low-income families. Given the President’s leadership, let us take a moment to examine 529 challenges and potential.

Many 529 balances have declined in the current stock market downturn, and some observers have criticized 529 plans as being too risky. In our view, 529s certainly deserve some criticism—there is plenty of room for improvement. But we should not have an unbalanced view of the risk.

All state 529 plans offer a range of investment options, typically including an equity fund, a bond fund, and a money market fund or other guaranteed option. A majority of states offered conservative investment options well in advance of the recent stock market decline. Newly added conservative options have been primarily bank products, offering FDIC insurance, and these are becoming more popular. Thus, participants can choose the level of risk that they are comfortable with.

We have just traversed a stock market decline and the dark side of investment risk. But risk has two sides, and the other one is sunny. In this regard, very likely now is a good time to invest in equities for the long term—in a 529, 401(k), IRA, or other instrument. Most Americans would agree that it’s better to have investment opportunities than not.

Looking at the larger picture, savings inevitably have an important role to play in college financing. Policy makers and universities are expecting families to save more towards their children’s education. In these circumstances, saving should be viewed as one part of a balanced plan for paying for college—in addition to awards and scholarships, loans, and work study for some students. The best approach is not to eschew savings, but to make sure responsible saving options reach those who need them most.

As researchers in this area, we also see a pattern of evidence suggesting that saving for college is about more than the money. Controlling for many other variables, we find associations of household savings with educational aspirations and achievement. To put this simply, when young people have savings, they may hope more and work harder.

Like other saving policies in the United States—401(k)s, IRAs, Health Savings Accounts, home ownership—the bulk of the public money (via tax benefits) goes to the people who need it least.

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The goal should be to extend benefits and subsidies for college saving to all families. In this regard, there is considerable practical potential in 529 plans to become a more inclusive savings platform.

Every state has a 529 plan, with a centralized provider, state oversight, and efficient accounting. Many states have introduced 529 innovations to reach more low- to moderate-income families. These innovations include offering 529s in workplaces, and providing public information about saving for college. Many states have very low minimum deposit amounts, and offer low-cost investment options. At least 11 states now give an initial deposit or matching deposit to low- to moderate-income families. In Maine, a private philanthropist has bequeathed money to open a 529 account for every newborn in the state.

These innovations in 529s are only a beginning, but together they comprise an important start toward more inclusive college savings, and more is possible. The 529 *infrastructure* is an enormous but underutilized “public good”—like interstate highways or the internet—waiting to be designed to serve all families in America.

The United Kingdom already has an account for all children beginning at birth. Called the Child Trust Fund, the UK policy began in 2005. Is it time for the United States to do the same?

By all means, let us criticize, scrutinize, and study 529 plans—to find out what is effective and ineffective. Let us figure out how to design College Savings Plans to reach ever larger numbers of low- to moderate-income families.