The Journal of Extension

Volume 39 | Number 1 Article 7

2-1-2001

Individual Development Accounts: The Path to a Dream

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February 2001 // Volume 39 // Number 1 // Feature Articles // 1FEA4

Individual Development Accounts: The Path to a Dream

Abstract
Low-income workers can increase their financial security by increasing their asset base. Individual Development Accounts (IDAs) match participant savings for preagreed upon goals such as home ownership, education, and small businesses. IDA program evaluation found that half of the participants saved at least 80% of the maximum amount allowed. Extension educators have an opportunity to incorporate IDAs into poverty-reduction strategies in their counties. They can also provide financial education as a means to help families set and sustain long-term financial goals and plans.

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Increasing Economic Security of Low-Income Families

What if you could find a way to help low-income families save? Even better, what if you knew that almost half of the families you worked with would learn to set aside some of their income to reach a future goal? Would you want to be involved? There is a national effort sweeping the country, and preliminary evaluation data indicates that poor folks who participate can save and will save.

When the United States initiated a major shift in welfare policy in 1996, Extension educators across the country joined forces with county departments of social services and nonprofit organizations to offer life skills education to welfare recipients to prepare them for work-based support of their families. Setting the stage for significant policy change, a social work theorist, Michael Sherraden, at the Center for Social Development at Washington University, promoted the idea that assets could help low-income families achieve economic stability and security.

From the inception of tax policy, individuals have been rewarded for certain financial decisions. Individuals and families with higher incomes have been able to deduct mortgage interest on their homes (and vacation homes) and have been able to make tax-advantaged contributions to retirement accounts.

However, lower-income households have not had adequate income and cash flow to take advantage of tax benefits or accumulate assets. Although asset ownership is a critical component of financial security, almost half of America is asset poor, with less than $1,000 in assets (Boshara, 1999). More than one-third of the United States population have no investable assets (Duran, 1998).

Assets accumulate as families are able to defer current spending to savings to reach financial goals. Sherraden is credited with creating the concept of Individual Development Accounts (IDAs) to help low-income families accumulate assets to reach long-term goals. Without assets, it is difficult to own a home, help children acquire post-secondary education, or retire with adequate income.

Sherraden has written convincingly that low-income families deserve the same opportunity to amass assets as middle- and upper-income families. He believes that assets are as important to low-income families as to families with many resources. Sherraden (1991) outlines the positive effects of asset-building:

1. Improved household stability;
2. New hope for the future;
3. A foundation for increased risk-taking;
4. Increased personal efficacy;
5. Increased social influence;
6. Increased political participation; and
7. Enhanced welfare of children.

Sherraden states that the pathway out of poverty comes from saving and asset accumulation. In addition, he suggests that as low-income families switch from short-term to long-term planning, their behavior changes to achieve long-term goals.

Assets benefit society as well as families. Education increases lifetime earnings of bachelor's degree over those with high school diplomas more than $600,000. A 10% increase in the average level of education raises productivity by 8.6%. Homeownership benefits children, who have lower dropout and pregnancy rates than children of renters with identical socioeconomic characteristics (Duran, 1998).

Individual Development Accounts: New Tools for the Working Poor

An IDA is a savings account established by a low-income individual who meets established guidelines. As the participants save, their savings are matched by an established ratio of 1:1 up to a ratio of 1:9. Matching funds may come from Temporary Assistance for Needy Families (TANF) funds, federal and state funds, and banks through the Community Reinvestment Act.

IDA savings plans are managed by community organizations, and accounts are held at local financial institutions. At the end of a pre-agreed upon time period, often 2 to 3 years, the savings plans are available to participants for personal goals. The most common goals are education (for adults and/or their children), starting a new business, or buying a home. Depending upon each program's guidelines, additional goals may be funded, such as retirement accounts, automobile purchase and repair, and major home repairs.

All programs have something in common, but each defines its own specifics. They all define:

1. Who is eligible,
2. What the savings accounts can be used for,
3. Agencies eligible to supervise the IDAs,
4. Institutions that will bank the funds,
5. Level of matching funds for each dollar saved by the participant,
6. Maximum amount saved for a match,
7. Length of time someone can participate in the IDA program, and
8. Required financial education programs.

Several states have allocated state funds for IDAs. They include Illinois, Indiana, Minnesota, North Carolina, Oklahoma, Pennsylvania, Vermont, and Virginia.

Indiana, for example, passed a $6.48 million demonstration project in 1997. The legislation authorized a $3 match for every $1 the participant saves. The Indiana guidelines allow participants who have an annual income of 150% of the federal poverty level or 60% of the median income of the county where they live. Individual contributors receive a 50% tax credit. TANF recipients may participate if they have earned income. The Indiana IDA program is administered by the state

Department of Commerce and the Community Development Corporation Association. The Indiana IDA program received $930,000 in federal funding for FY2000 for IDA match dollars.

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 included provisions for states to use TANF funds to establish IDAs for low-income individuals. As of January 2000, 25 states had included IDAs in welfare reform plans, and 27 states had passed IDA legislation for TANF recipients and/or low-income families. Even more important, money in an IDA is exempt from asset limits in all federal means-tested programs.

Many states, including Colorado, passed legislation allowing TANF funds to be used for IDAs. In fact, Colorado mandated that TANF recipients be allowed to establish IDAs, but the obstacles of establishing the new TANF program and developing an IDA program have been great. There is no state fund appropriation for IDA matches or administration, and no counties had made IDAs available to TANF recipients in early 2000. Too often, welfare program administrators have decided that TANF recipients have too few funds to save. On the other hand, TANF recipients and other low-income families who are working perceive that they could save. The Community Action Project of Tulsa County, Oklahoma used focus groups with existing clients. Eighty-nine percent of 300 respondents thought they could save $25-30 each month.

As of February 2000, there were approximately 200 IDA programs across the country, and another 100 were being developed. Because IDAs are a form of investment in the community--homeownership, business development, and workforce education--the program should be considered an investment in human capital rather than another give-away effort.

Do IDAs Matter?

Ten foundations were convinced that IDAs offered an incentive to reward initiative of the working poor. Because this effort is based on empowerment instead of entitlement, the foundations provided $15 million to measure the potential value of IDAs. A demonstration project, the American Dream Demonstration (ADD), selected 13 sites around the country for the initial demonstration. Demonstrations are located in Austin, Texas; Barre, Vermont; Berea, Kentucky; Chicago, Illinois; Fond du Lac, Wisconsin; Indianapolis, Indiana; Ithaca, New York; Kansas City, Missouri; Portland, Oregon; San Francisco, California; Tulsa, Oklahoma; and Washington, DC. Of the original sites, only three had previous IDA experience. Nine of the thirteen are located in urban areas, but four serve small cities and rural areas.

A national evaluation study is in its initial phase (Sherraden, Page-Adams, & Johnson, 1999) to evaluate the American Dream Demonstration. The evaluation will cover 1997-2003 and will provide data about the costs and benefits of IDAs. There are several components of this large project, including interviews with participants and additional data collection through a monitoring instrument known as "MIS IDA." This computer program collects information about numbers of accounts, patterns of savings, use of savings, etc. It reports both program level and individual level data.

An experimental design survey is being done in Tulsa, Oklahoma using in-depth interviews. A snap shot survey of cross-sectional participants in programs other than Tulsa will provide information on an interim basis. Successful and non-successful participants will be interviewed and written up as case studies to bring to life the quantitative data.

One of the original American Dream Demonstration sites, ADVOCAP, Inc. in Fond du Lac, Wisconsin has been evaluated over a 2-year period. The maximum savings allowed was $1,000 per participant, which could be matched by $2 for every $1 saved. A participant could accumulate a total $3,000 in savings. Forty-four percent of the participants saved the maximum; 50% saved $400 or more; and 64% saved at least $200. Nine participants used their IDA savings to purchase homes. Ten participants funded a business. Most interesting, most of the savers funded their IDAs with a lump sum rather than in smaller amounts on a more frequent basis. (Lazear, 1999).

As of June 30, 1999, 1,488 low-income families throughout the United States had saved $259,593, and those IDA accounts garnered an additional $761,712 in matching funds (Corporation for Enterprise Development, 1999).

Initial findings indicate that programs need to do a better job with their financial education programs. The programs that offered financial education classes at the same time that participants were saving were more successful in getting people to save than those who gave workshops before savings accounts were opened.

Research on programs offering IDAs show that educational programs designed to help participants achieve financial goals and learn how to manage money and credit are excellent supports for participants in the IDA program. Through money management education, IDA participants learn to avoid credit crises (Riley, 1999).

Asset accumulation and financial education have many benefits for the participants. Participants report positive effects on life satisfaction and self-empowerment, and an overall improvement in psychological well-being. There are positive effects on planning for future economic security (Friedman, 1999). Following are comments from some of the participants.

- "I saved so much more than I thought I could just in the first month."
- "I paid off my credit cards in 3 months."
- "The classes taught me about networking."
- "I am in a rural area and don't see other people except when I go to these classes."
- "I learned to set new goals and it has made a big difference in my life."
- "I learned to step up and find out about a variety of programs."
- "My IDA account gave me the confidence to approach a bank."

Key Opportunity for Educators

There is a very committed group of people across the country who believe strongly that IDAs are one solution to breaking the cycle of poverty. The economic principle, incentives matter, is just as important for low-income families as for families who have greater resources.

This effort offers a significant opportunity for Extension educators to contribute educational expertise to work jointly with local nonprofit organizations to educate and increase the asset base of the working poor. Extension is known for helping to increase the economic health of communities. IDAs provide a way for poor, near-poor, and lower income families to gain a stake in the community. IDAs also help pull community resources together. Following are some of the things that you can do to help people help themselves.

Prepare for the Next Wave of Federal Grants

Prepare for the next wave of federal grants promoting the Assets for Independence Demonstration Program. Starting in 1999, this program, funded by the U.S. Department of Health and Human Services, will continue to fund new projects for 5 years. The first award of $9.4 million funded 40 demonstration grants in 27 states. The awards ranged from $6,000 to $930,000 (www.hhs.gov). The goal nationally is to establish more than 10,000 IDA accounts. (See 12/14/99 Federal Register for Project Guidelines). The key ingredients to a competitive proposal are strong community partnerships with successful agencies serving low-income families and access to matching funding through state, local, and private funding (see www.acf.dhhs.gov/programs/ocs).

Become Familiar with and Take Advantage of Existing Resources

Become familiar with existing programs, training curricula, IDA program materials, etc. There are numerous resources including:

- Corporation for Enterprise Development < www.cfed.org >;
- Center for Social Development at Washington University < http://gwbweb.wustl.edu/Users/csd >
- IDA discussion listserve < list-request@cfed.org > (Subscribe by leaving the subject line blank and typing "subscribe idanetwork" in the body of the message.);
- IDA Internet Learning Network < www.idanetwork.org >;
- Assets Newsletter (Contact < linda@cfed.org > with your name, organization, address, phone, fax, and email address).

Check the Center for Social Development Web page to find out what your state is doing about IDAs and who the contact people are in your state < http://gwbweb.wustl.edu/Users/csd/ida>.

Check the national workforce preparation initiative Web page < www.reeusda.gov/wfp> for innovative program ideas and curricula that have been developed for low-income families.

Attend the annual spring IDA conference. (See < www.cfed.org> for details).

Hold Partnership Meetings

Hold training and partnership meetings around the state with nonprofit agencies, Community Development Credit Unions, United Way representatives, program leaders who work with TANF, and other interested people. Form community coalitions (McKenna & Carroll, 1999; Borden & Perkins, 1999; Stevens & Lodl, 1999). In the collaboration meetings, emphasize the potential to increase human and financial capital. If people are financially healthy, they are more likely to be physically healthy (Aldana & Liljenquist, 1998). Don't forget the assets that participants bring to this program.

Offer Training

Current research shows that financial education and financial health result in fewer absences from work and increases in productivity (Garman et al., 1999). Work with employers to hold financial education classes for low-income families at the work site.

Use (and adapt) existing curricula and promote financial education. Evaluation research (Sherraden, Page-Adams, & Johnson, 1999) indicates that participants are better prepared and more likely to complete participation if they receive financial education at the beginning of and during the time they are contributing to IDAs. Education is focused on existing strengths of participants and expands their knowledge of budgeting, saving, and investment basics. Further education is determined by the participant's goal.

IDAs are not just a program about managing credit, even though that is an important component. Neither are they only about where to find the best interest rate on a savings account. The purpose of this program is to transform participants from handout seekers to investors. Savings represent hope and the future (Riley, 1999).

Extension educators have an opportunity to partner with nonprofit agencies in the establishment and sustainability of important financial planning practices. Armed with an interesting, motivating, and challenging base curricula plus modules to meet various goals, educators can promote ideals of lifelong asset building to low-income families.

Some Extension educators have contracted to provide financial education to program participants. For example, the money management training for the Community Action Project of Tulsa County is provided by Cooperative Extension < www.idanetwork.org>. Other educators provide the training as part of their educational responsibilities. IDA savers can be incorporated into current educational programming on the earned income credit or other financial literacy and life skills programs.

Conclusion

Individual development accounts are designed to help low-income workers acquire assets to meet goals leading to financial security. Establishing IDA programs is a community-building and enrichment process that ultimately enhances the entire community. As Michael Sherradan says, "we want to help people save their way out of poverty."

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