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Abstract

Both theoretical frameworks and empirical evidence show that asset-based, means-tested welfare programs have negative effects on savings behaviors of welfare recipients. In this study, we examine how welfare recipiency is associated with savings outcomes in Individual Development Accounts. The results suggest that when other factors are controlled, receipt of welfare either before or at enrollment of IDAs is not correlated with savings outcomes. Policy implications under current welfare reform are discussed.

Key words: Savings, welfare recipients, IDAs, welfare reform

Background

Compared with nonpoor households, many poor households accumulate little wealth over their lifetime. For example, in 1994, over 90% of welfare recipients have less than $500 of accumulated financial liquid assets (Hurst & Ziliak, 2001). The poor may have low wealth because they have low abilities to accumulate assets. For example, the poor face a lifetime of lower incomes and other resources. The low accumulation of assets of the poor might also be due in part to their responses to disincentives to accumulate assets created by means-tested transfer programs, such as AFDC/TANF, SSI, Medicaid and Food Stamps. In order to be eligible for benefits, a household's income and assets holdings must be sufficiently low. And even if it is eligible, benefits are reduced as recipients' private resources increase. A variety of theoretical frameworks predict that asset limits negatively influence savings.

Theory

Theory suggests both direct and indirect effects of asset-based, means-tested welfare programs on the savings behaviors of welfare recipients. The major direct effect is that, in order to receive many forms of government assistance, households may not accumulate assets above the federal or state mandated limit (Hubbard, Skinner, & Zeldes, 1994; 1995). Thus, assets-based means testing is a strong financial disincentive to save. The "limited-savings-on-welfare" rule poses a threat to the long-run wealth accumulation of welfare-dependent individuals and their communities (Sherraden, 1991).

Using a simulation model parameterized to the Panel Study of Income Dynamics (PSID), Hubbard, Skinner, & Zeldes (1994; 1995) suggest that welfare programs also have two indirect negative effects on savings. First, the provision of public assistance decreases precautionary saving because it reduces the uncertainty facing households in the bad states. This effect is more relevant to low-income people because welfare payments are high relative to their resources. Second, the restriction on asset holdings of welfare programs implies an implicit tax of 100 percent on wealth in the event that an earnings downturn or large medical expense causes the household to seek welfare support. This effect is much stronger for the group with lower lifetime income, in part because the uninsured risks of medical spending are a larger fraction of their normal consumption levels. In sum, means-tested welfare programs have the greatest negative effects on saving for low-income groups because the guaranteed consumption floor represents a larger fraction of their lifetime income. The threat of the loss of this income due to breaking asset limits discourages saving.

While different theoretical perspectives are consistent regarding negative effects of asset tests on savings, the effects of increasing asset limits are more ambiguous. Sherraden (1991) and Beverly & Sherraden (1999) assume that individuals manifest a fair amount of rationality and predict that individuals will respond positively if the constraints of blocking assets accumulation are eliminated and attractive saving incentives exist. Therefore, the poor will save more if assets limits that determine welfare program eligibility are relaxed or eliminated. Others argue that the effect of increasing the asset limit on savings depends on whether or not and how the poor responds to the change (Hubbard et al., 1995; Powers, 1998). For example, the response to the elimination of asset limits of the poor could be weak because they have very low permanent

incomes. When people have fewer resources to save, they must make a greater effort if they want to save more. Also, although the households with low permanent incomes may respond to the asset test, those households with assets sufficiently above the original assets limits but not much above the new limits might reduce wealth in order to qualify. Under these circumstances, raising limits could reduce wealth accumulation and also increase welfare caseloads.

Evidence

Several studies have documented the negative effect of assets limits on a variety of government-public assistance and social-insurance programs on wealth accumulation among low-income households (Carney & Gale, 1999; Engen & Gruber, 1995; Feldstein, 1992; Gruber & Yelowitz, 1997; Hubbard et al., 1994; 1995; Hurst and Ziliak, 2001; Neumark & Powers, 1998; Powers, 1998; Silverman, 1997; Ziliak, 1999). Relevant to the discussion of this study, for example, Silverman (1997) found that 49 percent of public assistance recipients indicated that they would save more if the government did not cut their benefits because of their savings. Carney and Gale (1999) found that receipt of public assistance was negatively related to wealth accumulation after controlling for a series of other variables including income and educational status. Some of these studies also examine how relaxing asset limits is related to the savings of both current and potential welfare recipients. For example, Powers (1998) found that a dollar increase in the AFDC asset limit was associated with about 25 cents additional savings of potential AFDC recipients (female-headed households). Using state-level variations in AFDC, Food Stamps, SSI, and Unemployment Insurance, Ziliak (1999) suggests that means-tested welfare programs as a saving disincentive contributes 25 percent (at most) of the rich-poor wealth gap, and that these programs discourage accumulation of liquid assets but not net wealth. The recent study by Hurst and Ziliak (2001) found that a $170 increase in liquid assets savings per $1,000 increase in the assets limits for households at high risk of entering welfare. They also found evidence that the modest-risk households of entering welfare dissaved in response to higher asset limits. This finding is consistent with the discussion by Hubbard et al. (1995) of possible negative effects of raising asset limits on the savings of the "near-poor". To our knowledge, Hurst and Ziliak (2001) and Powers (1998) are the only two formal empirical tests of how assets limits affect the savings of low-income households.

In this paper, we examine savings behaviors of welfare recipients in a matched savings program for the poor—American Dream Demonstration (ADD), which is a national demonstration of Individual Development Accounts for low-wealth households. Individual Development Accounts (IDAs) are special savings accounts that are designed to help people build assets for household development and long-term economic security (Sherraden, 1988; 1991). Account holders receive matching funds as they save for purposes such as buying a first home, job training, going to a college, or starting a small business. Because savings in ADD do not count toward asset limits for welfare program eligibility, and the savings are matched, it is expected that ADD will increase savings of welfare recipients. This study is the first quantitative assessment of the savings patterns of welfare-recipients in a structured savings program, and how their savings patterns are different from non- and former welfare recipients.

Motivation

Studies that examine the relationship between welfare recipiency and savings outcomes have important policy implications under current welfare reform policy. Until recently the welfare program was cash-based, and recipients could not exceed assets limits while on public assistance. For example, by 1983, all but a couple of states imposed a $1,000 limit on most non-home, non-vehicle property, and a $1,500 vehicle equity exclusion (Powers, 1998). The Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996 represents a fundamental change in the delivery of cash welfare to program participants. Following enactment of PRWORA, states replaced Aid to Families with Dependent Children (AFDC) with a work-based program Temporary Assistance to Needy Families (TANF). Major changes under PRWORA included the end of an entitlement to policy, time limits, and a greater control of program rules by states. Individual Development Accounts (IDAs), a matched savings program for the poor, were included as a state option in the PRWORA, allowing states to establish IDA programs using TANF funds and to exclude counting IDAs as assets for the purpose of qualifying for benefits.

In response to PRWORA, many states are attempting to stimulate savings of the poor by loosening limits on liquid-asset and vehicle wealth holdings and adopting IDAs. By federal fiscal year 1998, 37 states had increased the liquid-asset limit above $1,000 and 47 states had increased the vehicle exemption limit above $1,500 (Hurst & Ziliak, 2001). Also, at least 29 states have passed IDAs or related legislation allowing TANF recipients and/or low-income residents in their states to participate savings (Center for Social Development, 2000). Therefore, it is important to know how welfare recipients save in IDAs.

Data and Methods

Subjects

The data for this study came from the 14 IDA programs across the United States that are part of the American Dream Demonstration (ADD). The project is funded by a consortium of foundations and is the first systematic test of IDAs. The primary purpose of ADD is to find out whether IDAs are successful, in what ways, and for whom. In terms of scope and resources, ADD may be the largest policy demonstration in the country at the present time. ADD is scheduled to run for four years (1997-2001), with research extending several additional years. Enrollment began in July 1997, and as of June 30, 2000, ADD had 2,378 participants. “Participants” in this analysis include all enrollees, including those who have dropped out of the program without a matched withdrawal. Program staff collect demographic and savings information for the evaluation of ADD with the Management Information System for Individual Development Accounts (Johnson, Hinterlong, & Sherraden, 2001). Savings data come from monthly passbook savings account records from depository institutions. Welfare status of participants is reported at their enrollment in the IDA program.

Measurements

Savings and asset accumulation in IDAs are built up from several elements that affect savings and assets accumulation. These elements include deposits, withdrawals (matched or unmatched), interests, fees, match rates and incomes (Schreiner et al., 2001). No single number could capture every element. Therefore, we included five dependent variables which measure the combined effects of different elements on savings outcomes. These measures include Average Monthly Net Deposit (AMND), the savings rate, deposit frequency, net deposits as a percentage of the pro-rated match cap, and the presence of unmatched withdrawals. AMND is defined as deposits plus interests minus unmatched withdrawals, divided by the number of months of participation. AMND measures net deposits but also controls for the length of time that a participant has saved.

The second measure, the savings rate, is defined as the ratio of AMND to gross monthly household income. It measures the rate at which inflows of resources are converted into IDA deposits. This measure is important because it shows how much participants save relative to their current income. Deposit frequency, on the other hand, shows how steadily a participant saves through time, and it is defined as the number of months with a deposit (excluding interest) divided by the number of months of participation. The fourth measure, net deposit as a percentage of the pro-rated match cap, is defined as the ratio of the AMND to monthly savings target. It indicates the closeness of actual saving behavior to that which would take full advantage of match incentives. The last measurement, the presence of unmatched withdrawals, is a dichotomous measure that indicates if a participant made unmatched withdrawals or not. Because IDAs are matched savings program designed for certain purposes including homeownership, education, training and business capitalization, the presence of unmatched withdrawals indicates that participants, by circumstances or preferences, succumb to shorter-term consumption needs.

Mean values of these dependent variables are presented in Table 1 for participants with different welfare status and for all ADD participants. As indicated in Table 1, on average ADD participants had $25.42 AMND, and this represented 2.2 percent of their average monthly income. They saved on average 67 percent of their savings target and the mean value of deposit frequency was 58 percent (about 7 months out of 12). The average probability of dropping out was 16 percent, and the average probability of unmatched withdrawals was 37 percent. When other factors are not controlled, compared with participants who never received welfare, participants who received welfare before or at enrollment had lower values of AMND, savings rate, deposit frequency and net deposit as a percentage of the pro-matched savings cap. Participants who never received welfare also had higher probability of dropping out of the program than those who received welfare before enrollment, and higher probability to make unmatched withdrawals compared with the participants who received welfare before or at enrollment (Table 1).

Table 1: Mean Values of Savings Outcomes by Welfare Status of Participants

Savings outcomes	TANF or AFDC never	TANF or AFDC formerly	TANF currently	All ADD
AMND ($)	26.9	22.9	16.1	25.4
Savings rate (%)	2.6	2.2	2.1	2.2
Deposit frequency (%)	58	57	48	58
Net deposit as a percentage of the pro-matched savings cap (%)	71	61	53	67
Probability of exits (%)	17	14	24	16
Probability of unmatched withdrawals (%)	38	35	36	37

The independent variables are welfare recipiency status of participants: those who never received AFDC/TANF, those who formerly received AFDC/TANF (before the enrollment of ADD), and those currently receives TANF (at enrollment of ADD). In regression analyses, "never received TANF/AFDC" serves as a reference group. Thirty-seven percent of participants received AFDC/TANF before enrollment, and 10 percent received TANF at enrollment. Altogether, 38 percent of participants (with non-missing data) had received either AFDC or TANF at some point. In other words, 62 percent of participants had never received welfare. (Many, but not all IDA programs in ADD have targeted the "working poor".)

Control variables include a variety of program and participants characteristics. This paper includes a large number of controls: 11 institutional characteristics and 31 participant characteristics. Institutional characteristics include program and administrative factors that may affect savings such as match rate, match cap, financial education and program inputs. A variety of participant factors were also controlled including participants' demographic and enrollment characteristics. These variables are assumed to be linked with savings outcomes or unobserved factors (Schreiner et al., 2001).

Analyses

In order to control for the bias of self-selection, a Heckman two-step was conducted (Greene, 1993; Heckman, 1979; Schreiner et al., 2001). The first step is a probit regression on dropout status for all participants. The second step is least-square regressions on savings outcomes for those participants with non-dropouts, controlling for a wide range of program and participants characteristics that might affect savings outcomes. Dropouts are defined as participants who leave a program without having taken a matched withdrawal. For dropouts, net deposits are zero by definition. In ADD, as of June 30, 2000, 16 percent of enrollees had dropped out. Because the presence of unmatched withdrawals is a dichotomous variable, a probit regression is run on this variable. For probit models, because the estimates do not have a direct interpretation, they are

converted to units of percentage points of change in the predicted risk of non-dropouts given a unit change of independent variable (Schreiner et al., 2001). For the OLS regression models, the estimates are presented.

Results[1]

Table 2 presents the results of the first step of Heckman two-step regression, which predicts the probability of dropping out from the IDA program. Results indicate that, compared to those who never received welfare, participants who received TANF at enrollment were 0.76 percentage points more likely to drop out, and those who received AFDC/TANF before enrollment were .09 percentage points less likely to drop out. But the relationships were not statistically significant. In other words, participants in ADD who received TANF were no more likely to drop out than others.

Table 2: Welfare Status of Participants and Dropouts: Probit Regression

	Mean	Change in % points	p-value
TANF or AFDC never	.62		
TANF or AFDC formerly	.38	.09	.86
TANF currently	.10	-.76	.27

Table 3 presents the second step of the Heckman two-step regression on savings outcomes which shows the relationship between welfare status and savings outcomes after controlling for other factors. The results indicate that receipt of AFDC/TANF, whether before or at enrollment, was not significantly related to AMND, savings rate, deposit frequency or net deposit relative to the savings target. In other words, with other observed factors in the model constant, receipt of welfare is uncorrelated with unobserved factors that reduce saving. Table 3 also shows that the receipt of welfare was not significantly associated with the probability of unmatched withdrawals.

[1] Due to the large number of control variables, we did not present the results of their relationships with savings outcomes in regression analyses. The full results are available upon request.

Table 3: Welfare Status of Participants and Savings Outcomes: OLS Regressions and Probit Regression

Dependent variables	Coefficients/ change in % points*	p-value
AMND		
(TANF or AFDC never)		
TANF or AFDC formerly	-1.6	.20
TANF currently	0.2	.93
Savings rate		
(TANF or AFDC never)		
TANF or AFDC formerly	-.22	.36
TANF currently	-.01	.88
Deposit frequency		
(TANF or AFDC never)		
TANF or AFDC formerly	-.005	.70
TANF currently	-.03	.22
Net deposit as a percentage of pro-rated match cap		
(TANF or AFDC never)		
TANF or AFDC formerly	-.05	.14
TANF currently	-.02	.75
Unmatched withdrawals		
(TANF or AFDC never)		
TANF or AFDC formerly	.05	.92
TANF currently	-.89	.22

* Units of percentage points of changes are reported for the dependent variable "unmatched withdrawals" (probit regression). For all other dependent variables (OLS regressions), coefficients are presented.

How can we explain this? Because savings in ADD do not count toward the asset limits to receive public assistance, and ADD provides other savings incentives such as matches, financial education and monthly savings goals, ADD is assumed to offer savings stimulus for participants. These results suggest that incentives such as savings target and match rates may have greater effects on savings for the very poor (Schreiner et al., 2001). At a minimum, it is safe to conclude that some welfare recipients have the willingness to save if they are provided access and incentives to accumulate assets. However, through the analysis of these data, we cannot fully reveal exactly what kind of incentives caused the increase of their savings or sort out effects of different factors.

Conclusions

Evidence shows that welfare recipients have lower wealth accumulation than non-welfare recipients, and this is partly because asset limits discourage savings. The results of this study indicate that, after controlling for other factors, welfare receipt before or at enrollment in IDAs did not significantly affect a variety of their savings outcomes. These results suggest that at least some welfare recipients have the ability and willingness to save.

We interpret the results with caution because several limitations of this study should be noted. First, participants in ADD are both self-selected (they chose to participate based on expected net benefits) and program-selected (most programs targeted the "working poor"). Therefore, ADD participants, in some aspects, are different from the general low-income population. Second, savings in IDAs may not necessarily represent a net increase of wealth. They could simply be transferring savings from other assets towards IDAs. In other words, asset shifts are possible for ADD participants (Schreiner et al., 2001). Third, using ADD data, we do not know yet how the welfare recipients can save through IDAs because we cannot compare savings behaviors of welfare recipients with or without IDAs.

In spite of these limitations, the findings of this study suggest that the response of welfare recipients to savings incentives is not different from that of people who are not on welfare, after controlling for income, assets, debts and a wide range of other characteristics. Welfare recipiency itself, in the absence of asset limits, appears not to be linked with saving performance. IDAs may be a potential way to help welfare recipients to accumulate assets and provide them with opportunities to build assets and escape poverty over the long-term. Thus, it may be desirable for public policy to encourage and support IDAs or other saving strategies for low-income families.

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