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Building Opportunity and Financial Capability with Child Opportunity Accounts

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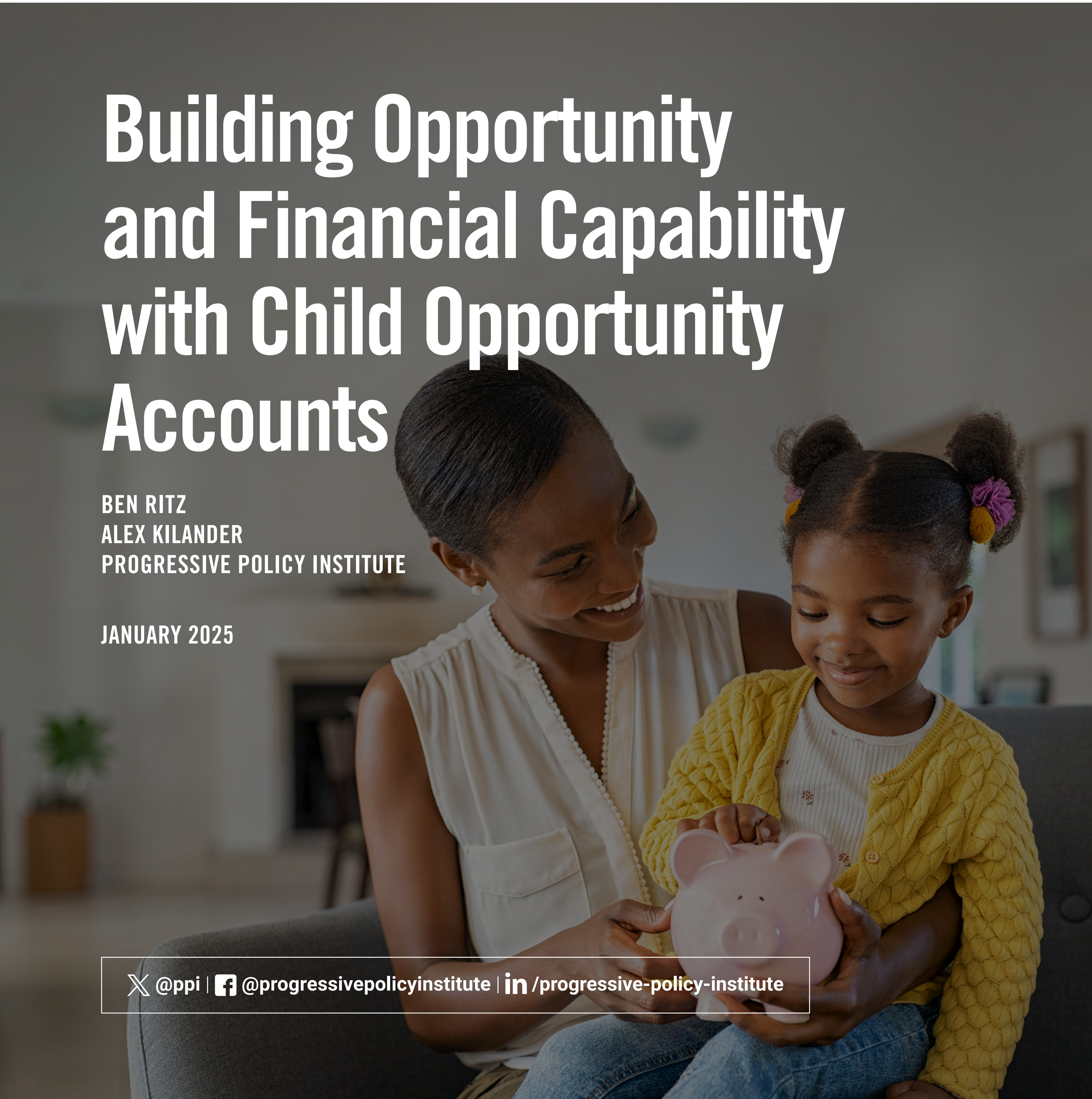

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INTRODUCTION

America has long had a reputation as the land of upward mobility and equal opportunity. In recent decades, however, the United States has scored lower on measures of social mobility than many other economically advanced countries.[1] This decline in upward mobility is driven by a stark inequality of opportunity early in Americans' lives.[2]

Regardless of their merit, many Americans often don't have access to the opportunities they need to succeed, or must pay a heavy price for the same opportunities that their wealthy peers often get at no cost.[3] Young adults from disadvantaged backgrounds might lack assistance paying for education without relying on burdensome debt or generous scholarships, struggle to secure well-paying job opportunities and professional connections, or be unable to rely on family help to cover emergency costs.

Compounding the problem is a low level of financial capability, also known as financial literacy. According to a survey by the Global Financial Literacy Excellence Center, respondents could give correct answers to a set of basic financial questions about saving and investing only 48% of the time.[4] Financial literacy is especially low among the young, who have little experience with financial decision-making. This makes them particularly prone to making poor financial decisions early in life, which can set them back for years. Put together, unequal access to opportunity combined with low levels of financial literacy limit social mobility for children in low-income families.

As a result, many Americans remain stuck on the lower rungs of the economic ladder through no fault of their own. Remedying this inequality is not merely a moral problem, but an economic one. Talent is more evenly distributed than opportunity. Amongst the millions of Americans who lack promising opportunities or financial stability could be the founder of the next great American company or a scientist behind the next medical breakthrough. All young Americans should have the opportunity and habits to build a successful and financially stable future for themselves.

Child Development Accounts (CDAs) are one potential tool to address these problems. CDAs are accounts designed to help children and their families, especially low- and middle-income ones, build wealth for the future. Countries around the world, such as Singapore and Israel, have long had formal CDA policies. Several U.S. states, including Oklahoma, Maine, and Rhode Island, have also pioneered their own programs and found some success in improving opportunity and financial literacy for participants.[5, 6] There are also many proposals to establish CDA-like accounts at the federal level, the most prominent of which is a "baby bonds" proposal sponsored by Senator Cory Booker and Congresswoman Ayanna Pressley.[7, 8] However, as detailed more throughout this report, this plan is expensive, relies on accounting gimmicks to create the false appearance of wealth creation, and does little to help children build financial capability to grow wealth on their own.[9]

PPI proposes instead to create "Child Opportunity Accounts" (COAs) that would better promote equal opportunity, self-sufficiency, and financial capability for all children. As the first section of the paper explains, these accounts would be universal: every child would receive an account at birth with a $700 balance, automatically invested in a diversified investment vehicle. Then, every year on the child's birthday up to their 16th birthday, the government would make additional contributions of up to $700, depending on a household's income. The universal provision of accounts provides all children a shared educational experience building wealth at relatively low cost to taxpayers, while the means-tested annual contributions ensure the most financial assistance goes to children whose parents would otherwise struggle to give them the same "starting capital" in life as their wealthier peers.

The next section focuses on how the accounts would help children and parents acquire the financial understanding and habits to effectively manage their assets. To help young Americans build financial capability, information about important topics would be embedded into the access portals for the accounts, and account holders would be required to pass a financial literacy assessment before accessing their funds at adulthood. This financial education can occur both in formal classroom settings and via informal family socialization.

This report then examines how account holders can use their COA savings to pursue opportunities, laying out allowable uses for withdrawals and guardrails to ensure they do not exhaust the account balance too quickly. Young adults would be permitted to withdraw up to 25% of the balance per year between ages 18 and 25 to use for a number of "qualified uses," including education, health care, starting a business, a down payment for a house or car, select moving expenses, and/or saving for retirement. Once they have reached age 25, account owners would be able to withdraw the remainder of the funds without adhering to the 25% limit. The report also explains how COAs can help establish a civic compact for America's youth that reinforces their responsibility to positively give back to the nation, rather than merely acting as a new entitlement.

Finally, PPI offers several fiscally responsible options to pay for these accounts, so that the wealth they build for young Americans won't be canceled out by a higher public debt burden that they will be forced to service. One particularly fitting pay-for, which PPI detailed in another major report last month, is reforming the taxation of inheritances. This pair of policies would work in tandem to equalize opportunity by taxing the birthrights of people born in the richest 1% of households to give every American child a birthright of their own. And unlike other welfare schemes, this combination of policies would neither give handouts to adults who could otherwise have earned the money themselves nor confiscate a single penny that someone earns through their own hard work to pay for it.

HELPING CHILDREN BUILD ASSETS

Young Americans from high-income families often can rely on their parents for help in getting ahead. They help with paying for college, making a down payment on a house, moving to job opportunities, and making professional connections. They also provide a familial safety net to fall back on when times are tough. The same cannot be said for Americans who grow up in low-income families. They often live in neighborhoods with low-quality schools and high levels of crime, where jobs are scarce, and parents can't provide much of a financial cushion. This feeds self-fulfilling doubts and low expectations about what they can accomplish in life.

Child Opportunity Accounts are designed to help them get off to a fairer start. In PPI's proposal, an account with a $700 balance would automatically be opened at birth for every child, managed by a private financial institution contracted by the federal government. The universal nature of the accounts bypasses the administrative burdens that come with having to determine a child's eligibility before opening an account. A program from which every family can benefit is also more likely to be politically durable than one with which most of the population has little interaction.

Every year on a child's birthday up to their 16th birthday, the government would provide progressive supplemental deposits of up to $700 into their accounts. Children living in households earning up to 150% of the federal poverty line ($48,200 a year for a family of four) would receive the full $700 credit and it would gradually phase out up to 400% of FPL ($128,600 for a family of four). This means-tested benefit represents the lion's share of the proposal's cost, with the initial contributions for children in affluent households being a relatively negligible expense.

PPI believes this approach is more equitable than similar proposals that provide a single lump sum at birth because it better reflects the actual socioeconomic situation in which children grow up. For example, a child who is born into a well-off family that shortly thereafter falls into poverty would have a bigger account when reaching adulthood than a child who was born into a low-income family that moved rapidly up the income ladder.

In addition to governmental contributions, parents and any other interested party could contribute to their child's COA with after-tax dollars. This option would enable parents and relatives to actively participate in their child's future while also giving the child an opportunity to start saving for themselves if they can. Other CDA proposals typically incentivize families to put dollars into their child's account, up to a certain limit. But families that must spend every dollar of their income on basic needs would be unable to save towards the account and thus lose out on the federal match, meaning those most in need would be least likely to benefit. However, states, philanthropic organizations, and other organizations could create their own matching systems to accompany COAs. For example, a state or foundation might create a 1:1 match on COA contributions for families that are enrolled on Medicaid.

Some baby bond proposals, such as the one introduced by Sen. Booker and Rep. Pressley, require that children's accounts be invested in U.S. Treasury bonds. While Treasuries are considered "safe" investments, their yields are often significantly lower than other investments and can even lag behind the rate of inflation. Tying these accounts to Treasuries thus leaves a lot of potential growth on the table. Moreover, investing exclusively in Treasuries is functionally an accounting gimmick. If the government is both providing the initial balance in year 1 and paying all of the interest accrued on that balance over 18 years, it is no different than if they had simply given the account holder a lump sum at age 18 — they have not actually created any new wealth.

PPI's proposal would instead invest COAs in equities to generate a higher real return for beneficiaries. Until the child turns 16, their account would automatically be invested into a diversified target-date fund, similar to the federal government's Thrift Savings Plan. These target date funds are designed to build and preserve wealth over time, making safer investments as the child nears the age of withdrawal.[10] This model would help prevent account holders from facing substantial volatility year over year, while still having access to the higher returns that equities offer over time.[11] Beginning at age 16, the child may also choose to redirect their investment into another pre-approved investment vehicle with a different asset breakdown, giving them an opportunity to take an active stake in their future and learn safely about the principles of investing.

Below are three hypothetical children from four-person families and their projected balances at different ages:

TABLE 1: PROJECTED BALANCES

	AGE 18	AGE 25	AGE 60
CHILD FROM LOW-INCOME FAMILY (<$48K)	$23,600	$35,300	$261,000
CHILD FROM MIDDLE-INCOME FAMILY ($98K)	$9,500	$15,500	$114,300
CHILD FROM HIGH-INCOME FAMILY (>$128K)	$1,900	$3,200	$23,300

Note: All figures shown are in 2024 dollars rounded to the nearest $100 and assume no voluntary contributions, no prior withdrawals, and an 8% average nominal rate of return (similar to that of the Federal Government's Thrift Savings Plan).

Children born before the adoption of this proposal but who are eligible for the subsidy would also receive accounts. Contributions would be made every year for those who are eligible, but nobody would receive retroactive contributions. In addition, both government and family contributions to a child's account would not count against any asset limits for safety net programs such as SSI or SNAP. This exclusion ensures that a family would not lose out on their safety net benefits simply because they are choosing to invest in their child's future. Finally, both the birth and supplemental contributions would be indexed to grow with inflation to ensure they do not lose value over time.

TEACHING YOUNG ADULTS TO MANAGE ASSETS

Money alone won't close America's opportunity gap. Policymakers must also make sure that young adults have the financial knowledge and habits they need to manage and grow those investments. Without the right financial education, American households with the fewest resources will struggle to navigate important decisions, cover sudden emergencies, or plan for the future. Previous baby bond proposals have kept programs to build financial capability mostly separate from their proposed accounts.[12] PPI's proposal integrates financial education into the account's design, recognizing that disparities in financial literacy are a serious obstacle to equalizing opportunity in America.

A 2021 survey by the Financial Industry Regulatory Authority found that individuals with annual incomes below $50,000 were only half as likely to score highly on an assessment of financial literacy as those making more than $50,000.[13] Closing this gap can have tangible benefits for low-income families: Individuals who earned between $25,000 and $50,000 while demonstrating above-average financial literacy were 15 percentage points more likely to have three months of emergency savings and 10 percentage points more likely to spend less than they earn, putting them on par with individuals making more than $100,000 but demonstrating below-average financial literacy. These findings suggest a good financial education can give many lower-income families the same financial security that some high-income households enjoy.[14]

For many children, the bulk of their formal financial education occurs in school, with 25 states requiring some amount of personal finance coursework to graduate high school.[15] Compared to just a few years ago, when only eight states did so, this expansion is a huge success in helping America's youth build stronger financial habits.[16] However, work remains to ensure that these programs are rigorous and effective across a myriad of jurisdictions. While some studies of financial education programs do show some modest improvements in financial knowledge, many find little evidence that merely teaching students the information changes their actual financial behavior once they enter adulthood.[17, 18] One major hurdle is that financial education is often completely untethered from a student's day-to-day life. How reasonable is it to get a 17-year-old to internalize the importance of compound interest, or the difference between a Roth and traditional IRA, when these topics have little material meaning to them in the present day?

COAs could be used to improve the rigor and retention of these programs by helping to connect course material with the real-life decisions that are faced by account holders. This "experiential learning" model gives students the opportunity to engage with the actual financial phenomena and decisions they will face as adults, rather than merely give them the information they need to do so.[19, 20] It is easy to imagine how COAs can fit into this model, as children could set savings goals, track the progress and growth of their balance, and discuss different options for using the funds. This hands-on approach would not only reinforce financial concepts such as saving and compound interest, but also build the strong financial habits that are essential for their long-term success.

Aside from formal financial education, many children typically develop their financial attitudes and habits from their parents.[21] For example, a child might receive an allowance from their parents to practice saving, have a bank account or credit card opened from a young age, or use their parent's own financial habits as a model. This phenomenon is well documented amongst high-income households, with children raised in wealthier or more well-educated households tending to do better on tests of financial literacy than those who are not.[22, 23] Even if these children fail to develop good financial habits through socialization, they can rely on a stronger family safety net to avoid the biggest consequences of any poor decisions.

However, children from low-income households have less opportunity to develop habits through this type of socialization. For families who themselves might be struggling to save for retirement, build up emergency savings, get out of debt, or navigate daily expenses, there is both less ability and less opportunity to pass sound financial knowledge onto their children. As a result, young adults from lower-income households typically enter adulthood without the same soft skills and knowledge that their high-income peers often absorb from parents.[24] They also lack a family safety net to fall back on, meaning that even a few poor financial decisions can trap aspiring young adults at the bottom of the economic ladder.

COAs can act as a catalyst for this type of passive socialization, encouraging parents and their children to develop better financial habits and knowledge. From the moment the account is opened, information about important financial topics such as budgeting, investing, and retirement planning would be embedded into the access portals for the accounts. When someone logs into their account, they would not only see the overall balance and its growth, but be encouraged to read through its user-friendly financial education tools such as FAQs, webinars, asset growth calculators, and more. Existing financial institutions, especially those contracted to run the accounts, can utilize their depth of knowledge and experience in financial education to help develop this platform.

As they engage with their accounts, children could have regular discussions at home about their account goals, think critically about spending versus saving, and track their progress over the years to reinforce the importance of long-term financial planning. This phenomenon has been routinely observed in prior studies, as children who have the opportunity to engage firsthand in meaningful financial decision-making develop stronger habits and knowledge as a result.[25, 26, 27]

Children’s savings can also have a positive secondary effect on parents. Research from prior CDA experiments found small but notable increases in parental savings rates for their children's future, expectations regarding their children's educational attainment, and engagement into their child’s development overall.[28, 29, 30, 31, 32] These effects were often most pronounced among families facing significant economic disadvantages, suggesting that PPI's proposal could play a crucial role in leveling the playing field. Furthermore, studies often looked at account balances that were much smaller than children would receive under PPI's proposal, meaning that policymakers could expect to see an even larger effect.

WITHDRAWING ACCOUNT BALANCES IN YOUNG ADULTHOOD

With the financial habits and “starting capital” they need, account holders would be able to pursue a wide range of opportunities to build a successful future for themselves. To ensure that the money is used responsibly to access economic opportunities and build wealth, the account would also come with a few guardrails.

Under PPI's proposal, account holders would be required to demonstrate a baseline level of financial literacy. Upon reaching adulthood, the account holder must pass a simple online financial literacy assessment before they are able to make withdrawals from their balance. This assessment would cover both the uses of their account balance, as well as other important financial topics such as budgeting, saving, and investing. As mentioned in the above section, all the relevant information for this assessment would already be embedded in the account, allowing for easy access for account holders to learn.

Withdrawals from the account would initially only be permitted for certain “qualified uses.” As young adults mature, these guardrails would help steer funding toward activities that expand opportunity and build wealth. Account holders would be prohibited from borrowing against their COA balance to prevent them from using debt to circumvent these guardrails.

Below are some "qualified uses" lawmakers could include for COAs:

- Education and skills training: Account holders should be permitted to spend their balances on a wide array of higher educational pursuits, including universities, community colleges, trade schools, apprenticeships, and more. Together with other federal resources like the Pell Grant, COAs could make higher education more affordable. Lawmakers should pair this use with measures to control costs, so institutions cannot merely prey on this new source of revenue to increase their tuition.[33]

- Home ownership: Owning a home is one of the most common ways for middle-class families to build wealth over time. Account holders should be permitted to use their balance as a down payment for a starter home.

- Moving expenses: One major barrier disadvantaged Americans face is the initial cost of moving from one place to another. Account holders should be permitted to use their balances for some select moving expenses, such as a moving truck or security deposit.

- Starting a business: Small businesses are the backbone of the American economy. Young people should be allowed to tap into their COAs to finance a start-up or self-employment opportunity. However, lawmakers would have to ensure that rules are in place to prevent people from merely using a fictitious "business" to expense a wide array of unrelated personal costs.

- Paying medical bills: Health emergencies or costly treatments for certain chronic conditions can be debilitating for people trying to move up the ladder or reach financial stability. In addition, lawmakers might also choose to exempt health-care expenses from the annual withdrawal limit, so that account holders are not forced into medical debt.

- Getting to work: Access to a broader job market can depend on one's access to reliable transportation. When people can travel beyond their immediate neighborhoods, they can search for labor market opportunities that might offer higher wages, better benefits, and more career growth potential. Account holders should be permitted to use their balances as a down payment on a car.

- Saving for Retirement: Account holders should be permitted to roll their balances over into a Roth IRA, subject to annual contribution limits. Roth IRAs are a particularly advantageous plan for young adults to start with because they allow contributions using after-tax dollars, subsequently providing tax-free growth for retirement. Since young people often have lower incomes than their future selves, contributing to a Roth IRA allows them to face lower tax rates on their retirement contributions than they would if they opted for other savings options.

Account holders would only be able to withdraw up to 25% of the balance per year to spend on qualified uses between the ages of 18 and 25. This provision prevents account holders from making a poor financial decision that quickly depletes their entire balance while still allowing them to withdraw significant sums for expenses such as higher education. For example, a young person could not rashly use their entire balance to pay for one year of a pricey college before realizing they have no plan to pay for the remaining three years. But they could annually withdraw from their balance to cover tuition costs as part of a sustainable plan to cover the full cost of their education. Limited withdrawals in one's early years provides a balance between accessibility and long-term savings, helping young adults manage their finances responsibly while still allowing them to invest in their future. If they so choose, policymakers can tweak both the withdrawal percentage and the age at which it applies, but should strive to maintain this principle.

Once they reach age 25, account holders would be able to withdraw the entirety of the remaining balance, or choose to continue to let it build wealth over time. Lawmakers could also choose to remove or loosen the "qualified uses" requirement, allowing beneficiaries to spend the money freely. If the accounts were truly effective in helping children build strong financial habits, then young adults could "graduate" from the guardrails as well, to determine for themselves how best to pursue economic opportunity and success.

ESTABLISHING A CIVIC COMPACT

Policymakers could add further guardrails to ensure that, rather than merely act as a new entitlement, COAs help establish a civic compact for America's youth that reinforces their responsibility to positively give back to the nation. Lawmakers have several options when building out exactly what this compact entails. For example, they could require that account holders have a high school diploma or GED to access their funds. Graduating high school is a crucial achievement, as it often opens doors to higher education and better job opportunities. Without a diploma, people will face significant barriers to entry in many fields, limiting their earning potential and career advancement. It thus serves as a foundational stepping stone toward economic stability and upward mobility. In addition, lawmakers might also include a requirement that account holders are responsible citizens, choosing to suspend withdrawals if account holders commit any serious crimes.

Lawmakers could also tie the account to community or national service in several ways. Community and national service help young adults develop a strong sense of responsibility, empathy, and leadership by engaging them in meaningful work that benefits society. These experiences also provide valuable skills, broaden perspectives, and foster connections that can enhance personal growth and future career opportunities. Furthermore, there is already an infrastructure in place for this provision, given that many states and localities — including states as different as Maryland and Arkansas — require service to graduate high school.[34] If policymakers want to take a lighter-touch approach, they could reward young adults who have completed a certain number of service hours with more flexibility to use their accounts, rather than force them to complete hours to access funds.

Another important component of the civic compact is our progressive tax system: as people use their accounts to access financial success, they will pay more back into supporting the society that enabled it. When account holders withdraw funds, those with annual incomes high enough to owe capital gains tax on other investments (currently $48k for single-earners) will pay the same tax rate that they would face on any other capital gain. Since most account holders, especially those with the largest balances, would be unlikely to make much in income when they first withdraw funds, they would not be burdened with any large tax liabilities.

This tax treatment has the added benefit of ensuring that benefits flow primarily to those that need it most, distinguishing COAs from other policies to help people save, such as 529 plans. These are tax-advantaged savings accounts designed to help families save for future higher education expenses. 529s have generous limits on contributions, while future withdrawals for qualified education expenses are tax-free. However, benefiting from 529s requires having money to actually save in the first place, and the mental bandwidth to open one. As a result, high-income families with the most resources to save are the ones that receive the bulk of the overall tax benefit.[35] Since COAs are not tax-advantaged, their structure ensures that the benefit would primarily accrue to lower- and middle-income children as they withdraw funds. Wealthy parents would not be able to contribute massive sums of money to their children's accounts tax-free.

COSTS AND OFFSETS

PPI estimates that Child Opportunity Accounts would cost $290 billion over ten years. That's only a fraction of what other proposals in this space cost, such as the Booker-Presley baby bonds bill that was estimated in 2019 to cost at least $650 billion over ten years.[36, 37] It is also substantially cheaper than many other features of our social welfare system. For comparison, it would cost roughly $1.9 trillion today to make the 2021 Child Tax Credit expansion permanent.[38]

COAs could also significantly reduce young adults' reliance on traditional social welfare programs. By equipping people with a way to build wealth from a young age, COAs could help alter the life trajectories of people who might otherwise have ended up on safety net programs. For example, someone born in a low-opportunity area who uses their COA balance to pursue higher education could get a better-paying job. Without the resources from their COA, this person might have remained stuck in a low-opportunity environment and turned to safety net programs to survive.

But these incidental savings are unlikely to fully cover the cost of the proposal. However they choose to go about doing so, it is essential that policymakers fully offset the cost of creating COAs. Young Americans will benefit far less from wealth-building tools if all that new wealth must be used to service an even larger national debt.

Fortunately, PPI offered a comprehensive blueprint last year that would both fund COAs and put the federal budget on a path to balance within two decades, which demonstrates that our proposed program can easily be afforded.[39] Several of the policies in that blueprint, such as capping health-care costs, cutting special-interest tax breaks, and modernizing benefit programs, could individually be used as an offset for COAs.

One particularly fitting offset from this menu of options for lawmakers to consider is reforming the way the government taxes estates and gifts, which primarily affects the wealthiest Americans. A recent PPI report detailed a comprehensive overhaul of this system that would convert the estate tax to an inheritance tax, close loopholes, and expand the tax base in a fair and progressive manner.[40] In addition to raising more revenue than COAs cost, taxing the birthrights of the richest 1% of households to give every American child a birthright of their own would equalize opportunity between them. This pairing of policies would help create a more inclusive society where every child, regardless of their background, has access to the resources necessary for success.

CONCLUSION

While the promise of upward mobility and equal opportunity is central to America's identity, many young adults — especially those from disadvantaged backgrounds — find themselves constrained by a lack of financial resources or the capability to manage them wisely. PPI's proposal for Child Opportunity Accounts addresses both of these gaps, empowering young Americans with not only the "starting capital" they need, but the skills they need to grow it over time. While it is no substitute for anti-poverty spending that supports people in need today, COAs would focus on the future by helping children access greater opportunities, build long-term wealth, and pursue the American dream.

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