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Executive Summary

Savings Plans for Youth from Low Income Families

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About the Milken Institute Fellows Program

The Milken Institute Fellows Program accelerates Israel's economic growth through innovative, market-based solutions for long-term economic, social, and environmental challenges. Our goal is to accelerate Israel's transition from a Start-up Nation to a Global Nation with solutions that others can replicate.

Directed by the Milken Institute Israel Center, the Milken Institute Fellows Program awards annual fellowships to outstanding Israeli university graduate students. Through the Milken Institute Fellows program, we train some of Israel's best and brightest young professionals in creating pragmatic financing and economic policy solutions, and they deploy them as resources to government ministries, nonprofits and other key organizations. Our applied research and Financial Innovations Labs® are a launching pad for transformative change, using innovative financing mechanisms, programs and policies to bridge social, regional, economic and productivity gaps within Israel and between Israel and the world.

In addition, Fellows craft their own policy studies during their internship aimed at identifying barriers to job creation and capital formation in Israel. The Fellows' research, carried out under the guidance of an experienced academic and professional staff, support policy makers who shape economic reality in Israel. The program offers the ultimate training opportunity, combining real-life work experience with applied research.

Throughout the year, Fellows receive intensive training in economic and financial analysis, public policy processes, and research methods. They acquire tools for communication and presentation, policy analysis, leadership and project management. The fellows participate in a weekly research workshop where they meet senior economic and government professionals, business leaders, and top academic and financial practitioners from Israel and abroad. They also participate in an accredited MBA course. The course, which focuses on financial and economic innovations, is taught at the Hebrew University School of Business Administration by Prof. Glenn Yago (Senior Director/Senior Fellow at the Milken Institute).

Fellows Program alumni can be found in senior positions in the public and private sectors. Some serve in key positions in government ministries while others work at private-sector companies or go on to advanced graduates studies at leading universities in Israel, the United States and Great Britain. Within the program's framework, more than 80 research papers have been published, catalyzing reforms, reducing barriers, accelerating economic growth, and improving the quality of life for Israel's citizens.

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The Economic behavior of households is shaped by cycles of income and expenses, but is also affected by the use of savings and assets that were accumulated in previous periods or by previous generations. Savings and assets are used by households for investment purposes and in order to cope with economic shocks ("consumption-smoothing").

Economic and demographic processes that have occurred in recent decades in developed countries, including Israel, have led to the creation of new economic needs. These needs put a burden on households over long periods of time, and require that the volume of assets and savings they hold will be increased. The processes that create these needs are primarily the lengthening life expectancy, the increasing return on human capital and the dynamization of the labor market.

The lengthening of life expectancy has increased the number of years that households are required to finance after retirement, and involves the high cost of living in advanced ages, especially due to medical needs. The increasing return on human capital results in a greater number of individuals entering the higher education system, and of many others that now pursue higher degrees. In this reality, many more households are required to finance tuition, and additional costs arise due to the delayed entry into the labor market. Finally, the dynamization of the labor market increases the number of transitions between jobs and therefore also the volatility in income. Additional funding is needed for these transition periods and for training and education through the career, so as to enable smoother and quicker transition between jobs and occupations.

In this situation, there is a need for realignment of health and welfare systems of the developed countries. While this process has indeed already begun in recent years, it is clear that the changes will not be sufficient. More, the fiscal costs that will result from these processes in the coming decades could reach up to 4% of GDP or even more. Even thorough and generous reforms, in other words, will leave a financial burden of a considerable scale that will be felt by most households.

The new needs for savings and assets will be more strongly felt by households belonging to the lower income deciles. That is because these households have always had to face various limitations and constrains in financing, such as low accessibility to financial services, credit, and relevant saving instruments. In addition, their ability to lean upon non-institutional financing, e.g., the help of their family or community, is generally lower than families of higher socio-economic status. The erosion of assets and savings of older generations (that for the middle class serve as an important source of income) makes it more difficult for many households to break the intergenerational cycle of poverty. From the point of view of a single generation, this means longer periods of living in poverty, since assets are a means by which these periods can be shortened (two thirds of the poor households in Israel experience persistent poverty).

Without a meaningful increase of the portion of sources that are allocated to savings, many households in Israel will find it difficult to lift up their income potential and to reinforce themselves against unexpected situations. Therefore, the kinds of savings that need to be increased are not only long-term (i.e. pensions), but also short term and mid-term savings. These types of savings are needed for developing human capital and entrepreneurship in the early years of the mature life, and for absorbing economic shocks and bridging income gaps in further years. Put simply, in the current era, the shortage of mid-term saving instruments constitutes a barrier to the development potential of individuals and households.

A New Conceptual Framework

The need of households to finance more services over a longer period of time enhances the importance of assets available to them. Households that do not have enough assets that could maintain them for a period of time in which they have no current income are defined as asset poor. The term "asset poverty" allows for an evaluation of the situation of different populations that do not necessarily live in poverty in terms of current income, such as low-medium income groups and the working poor. In addition, the category of asset poverty enables us to address various aspects of the lives of poor or low income households, and particularly to analyze their ability to cope with unexpected life situations and to estimate their potential to increase their earning capacities and to diversify their income sources.

The asset poverty line is defined as a value of assets that equals the income-poverty-line multiplied by a number of months. In the United States the period of time that is used as a benchmark is three months. Hence, if the income-poverty-line of a household, dependent upon the number of persons in it, is 7,000 NIS, then the poverty line in asset terms will be 21,000 NIS. One of the assumptions underlying this definition is that three months is the time required for a recovery from a significant economic shock, for example the time required to find a new job after being fired. In this case, a minimal volume of assets is needed in order to back up the recovery period. However, one might think of various reasons (such as the dynamics of the economy, or the support given by the social security system) which would support an argument that the number of months that should be used to define the relevant asset poverty line in Israel may be higher or lower than three months.

In the United States, where there is an extensive database on the extent and type of assets held by households, the estimated proportion of the asset poor moves from 25% to 45% In the U.S., the asset poverty rate is affected by the type of assets included in the calculation; Hence, the inclusion of housing value significantly reduces the portion of assets poor. More, as in the case of income poverty, the probability of an individual to be an asset poor decreases as a function of his age, especially during the ages of 35-50, and then rises again in the years after retirement.

Israel, on the other hand, lacks such a database that would enable an adequate assessment of the asset poverty rate and an analysis of the population's characteristics. Despite this, it can be roughly estimated that 40%-50% of the Israeli households are asset poor.

In light of these circumstances, an implementation of new saving tools, and the use of new types of incentives, is a necessity. These tools should be adjusted primarily for low-income households. Further, designing of the new tools needs to be done with careful consideration of the saving instruments that are in use in Israel today, and with respect to the various incentives and constraints faced by the target population.

A New Kind of Saving Instrument

In recent years, legislators and regulators in Israel have been dealing intensively in pension instruments. This is one of the reasons why pension arrangements are generally becoming more and more widespread. However, long-term saving instruments of the sort are common mostly among high income groups. In addition, the main part of the tax benefits for savings goes to these types of instruments, and, thus, only certain parts of the general population in the country.

Developing new forms of mid-term savings instruments for a wide range of populations can happen by widening the reach of several innovative saving instruments that are in use today in different developed countries. Indeed, while only some of these instruments are relevant in the Israeli context, examination of these tools can enable a real breakthrough in the field.

Some barriers exist to the implementation of these different types of savings tools. Forcing saving, as in the case of pension arrangements, is hard to justify, at least politically, and even more so in the case of mid-term targets. Similarly, reliance on tax benefits savings is a significant consideration only for populations with medium and high income levels, and thus its effectiveness as an incentive for those who are not currently saving is quite limited.

Therefore, this research proposes that the new tools that should be developed will be based on a match basis, and that these savings will be opened at an early age and will be designed as designated savings accounts that will be used to for several defined purposes.

In the last two decades, such programs were launched in several countries. The main model according to which these programs were designed is the Individual Development Accounts (IDA), which stimulates – on a match basis – low income population to save to designated saving accounts that will be used for tuition, housing, and entrepreneurship purposes. In recent years, special saving programs for children and youth of low income families were developed in a similar manner, namely: the Child Development Accounts (CDA). The central components of this program is: (1) opening an account on the child's name, (2) depositing an initial amount of money in the account, (3) matching the money saved by the child's family every month up to an annual cap, (4) providing education, training and guidance in relevant issues (finance, educational achievements), (5) designating the use of money for certain purposes, and (6) carrying out research examining the achievements of the participants in the program and the changes they have gone through.

A number of countries – including Canada, UK, US, and South-Korea – have in the past decade launched CDA plans to various extents, some of which are universal plans and others aimed at specific target populations. Given the new needs and the constraints that low-income families face, developing similar plans in Israel is clearly relevant. Not surprisingly, in recent years several attempts have been made to launch an Israeli version of a CDA program, though without much success. The most notable effort in this direction was made in 2010, by the Ministry of Social Affairs and the National Insurance Institute of Israel. This attempt is used as a reference point in the discussion offered in the main research.

The Proposed Plan

A successful implementation of this kind of plan in Israel depends on overcoming some significant challenges. Its success, however, would translate into tangible benefits for the Israeli public. The challenges are primarily the relatively high cost of the program (per participant and overall), the difficulty in identifying those who belong to the target population once it has been defined, and finally, addressing political issues and questions of distributive justice. The main opportunities are increasing the level of human capital among a wide range of the population, and pushing forward the establishment and development of businesses by young men and women. These two processes then also mean expanding employment possibilities, accelerating economic activity and increasing state tax revenues.

Bridging the gap between challenges and opportunities depends on determining the characteristics of the program. For the purposes of this study, the proposed elements of the program are as follows: (1) the target population of the program will be about a third of the country's children (from new cohorts) and incentives will be identical for all participants , (2) participation in the program for those defined eligible will not be mandatory, (3) deposits would be on a small scale, and over an extended period,1 so as to minimize the need to adjust consumption level downward, (4) the goal will be to blend money from several sources – governmental alongside philanthropic and that of social organizations, on top of the deposits made by households and extended family – so as to reduce government spending, creating the commitment of multiple players, and establishing a strong and consistent source of money, (5) the program will limit the use

[1] for example a period of 18 to 25 years, and a total sun of around 40-60 NIS a month

of saving funds to a number of purposes (high education, living costs during university years, business initiation, etc.), (6) accompanying the program, mentoring and counseling will be provided for the participants in order to increase the chances that savings will be used effectively, (7) the program would ensure low management fees from the banks that manage the savings (given the attractiveness they see in opening accounts at an early age), (8) relevant administrative techniques would be used to encourage and expand participation in the program, using elements such as automatic deposits , and opt-out.

It should be noted that implementing a CDA-based plan is only one element of a broader process that needs to be promoted in order to strengthen the accessibility of low-income populations. These populations require access to relevant financial services and increasing the supply of financial instruments suitable to their needs, abilities and preferences, as a means of expanding the amount of assets they possess.

In the full research, two operational plans are presented: a general-universal plan, whose participants will include about one third of the children born in each of the first 23 years of the plan; and a limited plan, focused on boarding school graduates. The sum available to a participant that completed the general program at the age of 18 could reach 47 thousand NIS, or, at the age of 25, up to 64 thousand NIS. A participant in the targeted program – that will last between 6 to 9 years – could posses a sum of 21 and up to 28 thousand NIS.

The overall costs of the general plan will require contributions from the state and third sector partners, in the amount of 22 billion NIS over the first 23 years of the program (1 billion NIS a year), on top of households' deposit. Using conservative assumptions, which reflect income growth that will be derived from improved and higher human capital and the opening and strengthening of businesses, show that the program would have an effect on households' revenue over the last 19 years of the program (28-47 years) at a level of 137 billion NIS (18.5 billion a year), and would expand state tax revenues (while taking into account avoided fiscal costs e.g. avoided unemployment allowance) to approximately 60 billion NIS over the same period (about 3 billion NIS a year). Implementation of the limited program (that will include hundreds of students a year and several thousand over ten years) would require about 53 million NIS over 10 years.

Recommendations

The recommendations included in this report are as follows:

1. To survey and analyze the assets of individuals and households so as to reflect the status of assets in Israel.
2. To design an asset poverty index and to define measures, and to set goals for financial accessibility and financial inclusion.

3. To establish a multi-office advisory council that will be responsible for advising on how to design attractive financial instruments relevant to populations of low and middle-low income levels, so as to strengthen and expand assets among these populations.
4. To create the involvement of research institutes and leading academic figures in the process of mapping and studying the status of assets in Israel.
5. To design modular solutions in the field of saving instruments and incentives for the relevant populations, including the initiation of designated CDA and IDA programs.
6. To connect philanthropic funds and other social organizations to the goal of Asset building.
7. To create a linkage between CDA programs and the fields of social investment and microcredit that started to be developed in Israel in recent years.

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