The Potential for Savings Accounts to Protect Young Adult Households from Unsecured Debt in Periods of Macroeconomic Stability and Decline

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The effects of different types of debt can vary widely: some debt is considered productive by advancing young adult households' financial health while other debt can be unproductive, pushing their financial health out of reach. A savings account may help young adult households reduce their reliance on unproductive debt and increase their access to productive debt that can facilitate wealth building and economic mobility. This study tests the association between a savings account and debt in the lives American young adults during periods of macroeconomic stability and decline. Owning a savings account in 1996 is associated with a 14% decrease ($844) in young adult households' accumulated unsecured debt, while closing an account in 2008 is associated with a 12% increase ($1,320) in this type of debt. Overall, a savings account may help young adults "invest in their debt" by entering better, healthier credit markets and protecting them from riskier ones—especially during bad economic times. Policy interventions are needed that increase access to savings accounts and help young adult households to use debt productively.

Following the Great Recession of 2007 to 2009, public discussion has focused on the effect that young adults' increasing indebtedness might have on their financial health and life transitions. However, not all debt is a drain on the balance sheet, and, for this reason, debt can be a double-edged sword.

- Young adult households' average overall debt—including mortgage, vehicle, credit card, and student loan debt—was approximately $60,000 in 2010. Mounting debt can push young adults' financial health out of reach and limit their chances for economic mobility over the life course. There is concern that the current generation

of young adults may be delaying life transitions such as marriage, parenthood, and homeownership in part due to their accumulated debt.[1]

- In some cases, debt can be used in productive ways that might promote financial health by building one's credit and improving one's financial standing: mortgage debt undertaken on a home that generates equity is one example of this. A borrower who makes regular mortgage payments has the benefits of improving their credit score and investing in a type of debt that may eventually increase wealth via home equity.
- In other cases, however, debt can act as a drain on resources rather than an investment in future gain, and it is therefore unproductive. For instance, paying down high interest on credit through long repayment plans is an example of this type of debt.[2] A borrower who falls behind on their credit card payments pays high interest on the outstanding debt.

Young adults' reliance on and use of debt is intricately tied to the asset side of their balance sheets. A simple financial product like a savings account may help young adults to accumulate more savings and liquid assets, diversify their asset portfolios, access secured debt, and avoid overreliance on unsecured debt.

- Owning or opening a savings account is associated with young adults' healthier balance sheets, like having more diverse financial portfolios and accumulating more savings and liquid assets.[3] When a young adult opens a savings account, this account is associated with adding $50 to their accumulated savings and liquid assets. In addition, the account is associated with opening checking accounts, retirement accounts, and stocks that, when their values are combined, contribute over $5,000 to their accumulated liquid assets.
- Young adults who have savings and liquid assets may have the financial resources to better weather unexpected changes in income or expenses and to further invest in their futures.[4] Finding strategies that facilitate asset acquisition and accumulation may help steer young adults toward healthier balance sheets and may increase their chances for economic mobility.
- Given that a savings account appears to help young adults develop healthier balance sheets by accumulating savings and liquid assets, a savings account may also help them to use productive debt and protect them from relying too heavily on unproductive debt.

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[1] Hodson, R., & Dwyer, R. (2014). *Millennials and money: The impact of debt on young adults' financial life transitions*. Denver, CO: National Endowment of Financial Education.
Houle, J., & Berger, L. (2015). Is student loan debt discouraging homeownership among young adults? *Social Service Review, 89*(4), 1-33.
[2] Houle, J. (2014). A generation indebted: Young adult debt across three cohorts. *Social Problems, 61*(3), 448-465.
[3] Friedline, T., Johnson, P., & Hughes, R. (2014). Toward healthy balance sheets: Are savings accounts a gateway to young adults' asset diversification and accumulation? *Federal Reserve Bank of St. Louis Review, 96*(4), 359-389.
[4] Bell, D., & Blanchflower, D. (2011). Young people and the Great Recession. *Oxford Review of Economic Policy, 27*(2), 241-267.

After examining the use of secured and unsecured debt among 114,883 households headed by young adults in 1996 and 2008, a new study finds that owning a savings account may help young adults "invest in their debt" by entering better, healthier credit markets and protecting them from riskier ones.[5]

- Young adult households in 2008 accumulate significantly more debt of all types compared to their counterparts in 1996. Households in 2008 accumulate of 23% more total debt, 16% more secured debt, and 48% more unsecured debt. This pattern confirms the lending and borrowing histories represented by these distinct macroeconomic periods, particularly that young adult households' increased debt coincides with the start of the Great Recession.
- A savings account is associated with households' acquisition and accumulation of secured, productive debt—a relationship that exists in both periods of macroeconomic stability and decline. This suggests that a savings account may provide households with a gateway to productive debt.
    - A savings account has the strongest relationships with secured, productive in 2008 during the Great Recession when households may have struggled to take on new debt as credit markets contracted.
    - In contexts like the Great Recession when borrowing becomes more difficult, a savings account may facilitate borrowers' connection to lending markets and help them to demonstrate creditworthiness.
- Owning a savings account is associated with protecting households from accumulating unsecured debt, which may be more costly to—and thus riskier for—the health of their balance sheets. In comparison, closing a savings account may expose households to risk.
    - Owning a savings account in 1996 is associated with a 14% decrease in the value of households' accumulated unsecured debt, or about $844. This amount is almost twice the average payday or cash advance loan of $500 and, while this amount might seem small, the money that young adult households save by decreasing their unsecured debt could add up quickly.[6]
    - Closing a savings account and potentially losing one's connection to the financial mainstream in 2008 is associated with accumulating 12% more unsecured, unproductive debt, or $1,320, during the Great Recession of late 2000s.

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[5] This study examined cross-sectional data from 114,883 young adult households ages 18 to 40 that participated in the 1996 and 2008 waves of the Survey of Income and Program Participation (SIPP). In order to measure a savings account in a way that captured whether or not, and when, young adult heads of households owned, opened, or closed an account, quarterly histories were used that tracked a savings account retrospectively over one previous calendar year. The analyses controlled for such things as young adults' race, gender, education level, quarterly earned income, and home ownership. Double hurdle models separately examined the probability that young adult households acquired and accumulated secured and unsecured debt.

[6] Consumer Financial Protection Bureau. (2014). *CFPB data point: Payday lending*. Washington, DC: The CFPB Office of Research.

- In addition to a savings account, young adult households' socioeconomic position in the economy still makes a difference when it comes to their use of debt. Households may have greater access to and accumulate debt of all types when their heads are more highly educated, are employed, and earn higher incomes.

Local, state, and national programs and policies that automatically open safe and affordable savings accounts may assist young adult households in using debt productively.

- Programs and policies like Children's Savings Accounts (CSAs; also referred to as Child Development Accounts [CDAs]) and Individual Development Accounts (IDAs) that automatically open safe, affordable, and progressively incentivized savings accounts for those who qualify may help to facilitate young adults' savings account ownership.[7]
- Cities and states around the US are supporting initiatives like Bank On, SaveUSA, and Refund to Savings, which may be important for reducing barriers to savings account ownership and leverage annual tax filings to promote saving.[8]
- Minimizing unsecured, unproductive debt and burdensome student loan debt is an obvious policy intervention which would benefit young adults' balance sheets and allow them to begin building toward a strong financial future. Like the historic wealth transfers made available by the Homestead Act of 1862, perhaps the equivalent policy intervention for the 21st century is one that invests in young adults' debt to stabilize their financial health and catalyze them toward economic mobility.

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[7] Friedline, T. (2014). Extending savings accounts to young people: Lessons from two decades of theory and research and implications for policy. In R. Cramer & T. Williams Shanks (Eds.), *The assets perspective: The rise of asset building and its impacts on social policy* (pp. 203-223). New York, NY: Palgrave MacMillan.
Sherraden, M. (1991). *Assets and the poor: A new American welfare policy*. Armonk, NY: M.E. Sharpe.
[8] Grinstein-Weiss, M., Perantie, D., Russell, B., et al. (2015). *Refund to savings 2013: Comprehensive report on a large-scale tax-time savings program*. Washington, DC: Brookings Institution.