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To Have and to Hold: An Analysis of Young Adult Debt

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Today's young adults often have been characterized as a generation of borrowers. But are they any different from past generations, or the current generation of adults, in the amount of debt they carry?

Ngina Chiteji in her chapter in *The Price of Independence* takes a careful look at debt in young adulthood, finding that, contrary to popular perception, most of today's young adults are not carrying an unusual or excessive amount of debt, at least not by historical standards or given their time in life, just starting out.[1] The fraction of indebted young adult households age 25 to 34 has barely changed in 40 years, and while, in general, young households carry more debt than the population at large, this is consistent with the predictions of economic theory and most young adults appear to have manageable debt loads.

Yes, most young adults are indebted…

In 2001, 85% of young adults carried at least some debt, compared with 75.1% of all households. The average level of debt (the statistical mean) among American young adult households headed by an individual aged 25 to 34 is $55,616. The comparable figure for all adult households in the United States is $54,514.[2] The bulk (about 75%) of this debt is housing debt. On average, therefore, young adults carry quite a bit of debt, but no more so than the average American.

Roughly eight in ten young adults carry debt, the bulk of it mortgage debt.

Averages can be misleading, however, because they tilt toward the big borrowers. A more accurate measure of how the typical household fares is given by the statistical median. The median young adult household owes about $25,000, or about one-half that indicated by the average. However, this amount is well above the median of $14,300 for all households, although this is not unexpected. Because the median U.S. household is older than the typical young adult household, they would have had time to retire some of their debt, particularly debt accumulated early in life (such as education loans).

On first glance, then, the findings that about eight in ten young adults carry some debt and that the amount carried is greater than the typical U.S. household might seem worrisome. However, it is important to remember that young adults are at a stage in their life where big purchases, such as an education or a car, might be necessary to get started. Economists, in fact, argue that some debt is necessary at this stage in life, and that borrowing now on the assumption that earnings will rise later in life as one gains work experience is just what credit markets are designed to facilitate. (The justification for borrowing against future earnings is particularly powerful when debt is undertaken to build human capital through, for example, education, given that more education typically leads to higher earnings.) Moreover, analysis of young adult borrowing over time suggests that taking on debt has always been something that young adults do. The proportion of today's young adults (age 25 to 34) holding debt is similar to that found for the young adults of the 1960s and 1980s.[3]

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1 Sheldon Danziger and Cecilia Rouse, editors, The Price of Independence: The Economics of Early Adulthood (New York: Russell Sage Foundation Press, under review). Danziger and Rouse are members of the MacArthur Research Network on Transitions to Adulthood. For additional Network books on the transition to adulthood, see www.transad.pop.upenn.edu.
2 Data from the 2001 Survey of Consumer Finances.
3 Data from the Federal Reserve Board's1983 Survey of Consumer Finances and its 1963 Survey of Financial Characteristics of Consumers.

(over)

…But It's Not Just Plastic

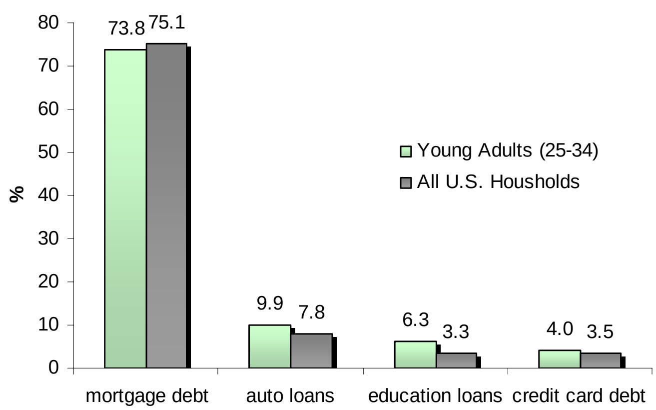
Mortgages

Almost three-quarters of all young adult debt is mortgage or home-related debt. Mortgage debt is generally considered "good" debt, because for many U.S. families home equity represents an important component of household wealth. According to the Survey of Consumer Finances (SCF), the average young adult household (again aged 25–34) had nearly $41,000 in housing debt in 2001, or roughly twice the average debt carried in 1983 ($22,233), after adjusting for inflation. Restricting the analysis to young adults aged 25–34 who hold housing debt (compared with debt averaged across all young adult households), and examining the typical young adult in that category, the median amount of housing debt held is $80,000. In 1983, the comparable figure was $48,578 (all in inflation adjusted dollars).

Car Loans and Education Debt

Figure 1. Type of Debt as Proportion of Total Debt, 2001

Note: This is not an exhaustive list of all available types of debt, just the types that are salient to most households.



Two-thirds of young adult households carry some sort of installment debt, compared with 45% of all households, and it represents a substantially higher proportion of their total debt load than the average U.S. household (see Figure 1).[4] The amount of installment debt, primarily educational and auto loans, held by the typical, or median, young household has risen dramatically in the last 40 years, doubling between 1963 and 1983, and then more than quintupling between 1983 and 2001. Again, however, the higher installment debt relative to the U.S. population as a whole might reflect young adults' stage in life. Consider, for example, a situation in which a young family buys a home and uses installment credit to pay for appliances. A family that went through this phase in 1981 would likely have retired that debt by 2001, while a young family in 2001 would still be paying off that debt. The high level of installment debt shouldered by today's young adults also might suggest that getting started costs more these days, or that expectations for the "must have's" have changed.

Nearly one-half (49%) of young adults are paying on auto loans compared with 36% of all households. Auto loans account for 9.9% of the debt load among young adults, somewhat more than the 7.8% share for all households (see Figure 1). Not surprisingly, young adults are twice as likely to be carrying educational loans as the U.S. population as a whole (29% vs. 14.6%). Education debt represents 6.3% of the total young adult debt load, twice that for all U.S. households, and the amount held has increased since 1983 (on average).

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[4] In the SCF, the installment debt category represents consumer loans with fixed terms and fixed payment periods, such as vehicle loans, student loans, and loans for furniture or other household durable goods.

Credit Cards

Credit card debt represents on average only 4% of the total debt load of young adults, not dissimilar to the 3.5% share for all U.S. families (see Figure 1). Although young adults are more likely than older households to be carrying credit card balances (51% vs. 44%), almost one-half either pay off their balances in full every month or do not use credit cards at all.

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While the average amount of credit card debt held among those who hold credit card debt is $4,000, this figure obscures the fact that many young adults (49%) carry no balance at all. Because many young adults do not have credit card debt, the average for the entire young adult group is only $2,246. Moreover, the amounts of credit card debt held vary greatly across young adults: The median balance carried among the 51% of young adults who hold credit card debt is $2,400, which is much lower than the $4,000 mean. This indicates that the *typical* young adult household that holds credit card debt only has a little over half the debt load that would be suggested by looking at the average. In addition, the median for the entire young adult group is only about $70, so the *typical* young adult household from the young adult population at large holds under $100 in credit card debt. (Overall, the SCF data indicate that fewer than one in five young adult households have credit card debt totaling $4,000 or more.) These figures highlight the unevenness of the distribution of credit card debt and the consequent need to interpret data carefully when assessing the situation facing young people.

Mired in Debt? Some Are, Most Aren't

Some young adults certainly have very high debt levels. Chiteji finds that about 1% of young adults have a total debt load that is more than 7 times their annual income, while 10% have a debt-to-income ratio of 2.5 or more; that is, their debt is twice their income. However, the median young adult household in 2001 has a rather modest debt-to-income ratio of about 0.6, or about a $30,000 mortgage with a $50,000 income.

> • Young adults use only 19% of their monthly income to service their debt. Debt is considered burdensome when it consumes 40% or more of monthly income.
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> • About 9% of young households are in financial distress, slightly lower than the 11% for U.S. households overall.
>
> • Therefore, as a group, today's young adults do not appear to have an unusually fragile or problematic financial situation

Because viewing debt levels or borrowing behavior in isolation may provide an inaccurate picture of the extent of the problem, Chiteji also asks not whether debt *per se* is a problem but whether there are young adults whose overall financial position is weak. About 17.5% of young adults could not meet three months' worth of their existing debt repayment obligations with their current savings (if financial assets are used to gauge a household's savings). The comparable figure is about 16.5% if using net worth to measure household savings. Approximately 8.5% of young adults have no financial assets. Moreover, this group with no savings (or zero or negative net worth) owes almost $24,800 (on average), with an average monthly payment of $381. The median values are a bit lower—$14,650 and $300, respectively. However, these levels could still be considered troublesome given that these are households with no savings to cushion them should they lose a job or other sources of income.

As a whole, are young adults in trouble? On average, young adults use only 19% of their monthly income to service their debt. Typically, only households that need 40% or more of their monthly income to pay debts are considered to have burdensome debt levels (and to be experiencing "financial distress"). About 9.3% of young households are in financial distress, slightly lower than the 11% for U.S. households overall. Therefore, as a group, today's young adults do not appear to have an unusually fragile or problematic financial situation. Young adult households are not remarkably different from other families in the nation. However, the research also finds that there are some young adult households whose financial situations appear troublesome. Policymakers and others certainly might want to direct their attention to these households.

Policy Directions

This analysis raises a question for policymakers and others to consider: Is there any reason for policymakers to care about trends in young adult debt?

College Debt

Much has been written the costs of college and the pressure it places on students and families to borrow. Yet, despite the increased costs, a college education still pays for itself, adding about $400,000 to a graduate's lifetime earnings.[5] So here society faces a difficult dilemma: Who should pay to educate the nation's youth? Should it be the young people themselves because they stand to benefit from the labor market premium paid to an individual with a college degree? Is society troubled when some students must borrow against future income to finance their educations while individuals from wealthier families might be able to get their schooling free (with their parents paying for it instead)? A policy tradeoffs arises here because, if policies allow students to avoid borrowing to finance education, the costs still must be borne by someone. Should it be the taxpayer who pays, in which case those who do not go to college (but straight to work instead) may end up subsidizing those who do?

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Credit Card Debt

Do the current levels of credit card debt held by today's young adults warrant any policy interventions? More specifically, should policymakers be worried about the subset of young adults with high levels of credit card debt? If credit card debt is a personal choice, and one heavily influenced by a consumerist culture, the answer is probably no. Is it possible, however, that some young adults are compelled to rack up large amounts of credit card debt to meet unexpected medical costs, for example? Why are some young adults affected by credit card debt while others are not? Do the differences in credit card indebtedness exist because some young adults have families that support them financially as they start out in life, while others do not? Or, are there differences among young adults in expectations and attitudes about what a "normal" life entails?

Much more research—and better data—is needed to answer these types of questions. Perhaps one of the reasons for the current disconnect between perceptions of young adult debt and reality is because the data on debt do not allow us to understand just what young adults are spending their money on (beyond the broad categories of student loans, mortgages, and installment debt). For example, although we know the typical amount of credit card debt held by young adults, we do not have reliable data on credit card purchases to determine what a person bought. Absent this type of data, scholars and others are left only with anecdotal evidence of whether today's young adults are frivolously spending their money.

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[5] Lisa Barrow and Cecilia Rouse, "Does College Still Pay?" *The Economists' Voice*, vol. 2 (2005), available at www.bepress.com/ev/vol2/iss4/art3/

Difficult Decisions

The growing discussions of debt and young people's struggles to gain a foothold in adulthood raise issues that ought to prompt further discussion about what society wants for its young adults, and about how we might structure society to achieve those goals. In some sense, by questioning or contemplating the merits of borrowing among young adults, we are arguing about who should pay for the goods and services that young adults acquire and require as they move through their lives. Although the nation can structure policies to lower young adult costs, and to reduce their borrowing, the costs do not disappear. They will be borne by someone. That said, it is important for a society to continually evaluate its structure and ask whether societal institutions are functioning well and fairly for its young adults. Market conditions (and human needs) can change over time, making existing government policies outdated or insufficient to meet the needs of young adults, or to require intervention in places where it was not required previously. Determining when intervention is justified is an important question before policymakers and society as a whole.

Based on Ngina Chiteji, "To Have and To Hold: An Analysis of Young Adult Debt," in The Price of Independence: The Economics of Early Adulthood, edited by Sheldon Danziger and Cecilia Rouse (New York: Russell Sage Foundation, under review).

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