FINANCIAL INSTABILITY AMONG YOUNG ADULTS, 1981-1986

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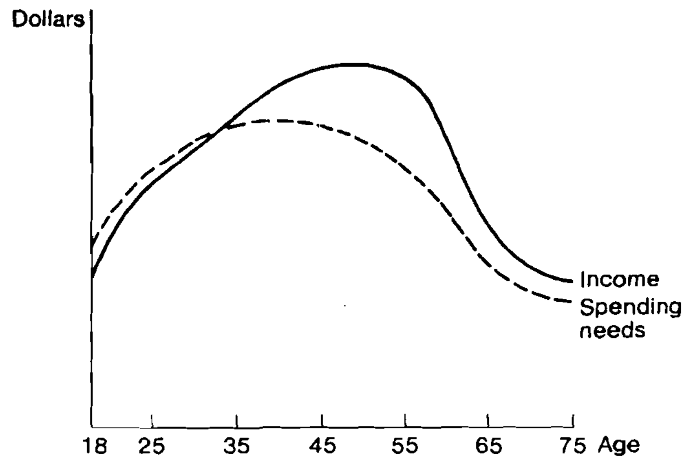
Students in personal finance classes sometimes have an unrealistically rosy idea of what their financial futures will be after they complete their studies and begin their careers. As a result, they may not be as concerned about risk management strategies, such as savings and insurance, as they might be. The discussion of earnings across the life cycle which is often found in personal finance texts (see, for example, 2, 3, 5) sometimes includes a figure similar to Figure 1, showing income which steadily increases over time until the late fifties or early sixties. Such information may be misleading in two ways.

Life-Cycle Spending and Earnings Patterns



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First, the income curve in Figure 1 may more accurately describe the income trajectory of white men in white-collar jobs than it does the curves for blue-collar workers, women, and minority workers [6]. Second, it may give students the impression that their incomes, and thus their financial well-being, will rise steadily throughout their lives, at least until they reach their mid-50's. However, findings from longitudinal studies such as the Panel Study of Income Dynamics (PSID) suggest that steadily increasing financial well-being is not the norm for households in the United States; rather, households experience considerable movement up and down the income "ladder" [1]. The same pattern holds true when looking at the ratio of household income to needs (where needs are measured by the federal poverty guidelines).

The purpose of this study was to discover the extent and direction of economic mobility for households headed by young adults aged 20 to 29. If the results show that younger households experience downward mobility as well as upward mobility, this would lend additional credibility to the advice typically given in personal finance classes to build emergency reserve funds, buy an adequate insurance portfolio, and investigate other forms of risk management.

Data Collection and Methodology

Data for this study came from the 1981 and 1986 panels of the Nebraska Annual Social Indicators Survey (NASIS). This statewide telephone survey of adults aged 18 and older used random digit dialing techniques. Over 70 percent (n=997) of the respondents who participated in the 1981 wave also participated in the 1986 wave [4]. The 158 respondents who were between the ages of 20 and 29 in 1981 and were *either* the principal income earner *or* the principal income earner's spouse comprised the "households headed by young adults" subset of the sample. (Young adults living with their parents were *not* members of the subset.) Income was measured in ten categories in 1981, ranging from less than $5,000 to over $60,000. Consistent with previous investigations into financial well-being (see for example, 1 and 5), the household's economic position was measured by calculating an income-needs ratio. The midpoint of the household's income category was the numerator of this ratio; the denominator was the Social Security Administration's poverty income guidelines appropriate for the household's size.[1]

[1]In 1986, the five respondents in the top income category (over $60,000) were eliminated from the analysis since no midpoint could be calculated for them. The poverty income guidelines, which vary by family size, are a simplified version of the federal poverty thresholds and are used to determine eligibility for a number of federal assistance programs.

Characteristics of the Young Adult Subset

The majority (70 percent) of the respondents were married in 1981; 69 percent of the couples had children living with them. Another five percent were single-parent households; thus, nearly three-fourths (74 percent) of the respondents had financial responsibility for dependent children. Another 15 percent of the subset lived as single-person households; the balance were living with non-relatives or with relatives other than parents.

Marital stability was common; 62 percent of respondents remained married throughout the six years. Nearly one-third (32 percent) changed marital status at least once during the 1981-86 period; of these 49 individuals, 20 divorced or separated at least once. The rest were singles (divorced or never married) who married. None began as a widowed person or became widowed.

The majority of respondents (59 percent) had completed some post-secondary training (ranging from one to seven years); another 38 percent had finished high school, and only three percent had not completed high school. One-half of the households in the subset increased in size during the course of the study; 43 percent did not change and seven percent of the households grew smaller. The midpoint of the median income category was $21,000 (expressed in constant 1986 dollars); the lowest income category reported was under $5,000 and the highest was between $40,000 and $49,999.

Changes in Financial Well-Being

By 1986, the midpoint of the median income category for the households headed by young adults had risen from $21,000 to $27,500. However, when economic position was measured by dividing household incomes by the poverty income guidelines, financial well-being declined each year; the income-needs ratio dropped from 3.06 in 1981 to just under 2.74 in 1986, a decline of just over eight percent.

Table 1. Distribution of Households Headed by Young Adults by 1981 and 1986 Income-Needs Ratios (N=158)

Distribution of	1981 Income-Needs Ratios		1986 Income-Needs Ratios	
Income-Needs Ratios	Range	n	Range	n
Lowest Third	.32 - 2.20	50	.17 - 1.75	49
Middle Third	2.21 - 3.61	57	1.76 - 3.11	46
Highest Third	3.62 - 7.22	47	3.12 - 8.40	56

Table 1 shows the distribution of the households by the income-needs ratios in both 1981 and 1986. In 1986, the endpoints of the lowest and middle category were lower than they were in 1981, which meant that overall the lower two-thirds of the distribution had shifted downwards.

To determine the extent and direction of economic mobility among the subset of young adults, the income-needs distribution in 1981 was divided into thirds and cross-tabulated against the income-needs distribution of 1986, similarly divided (see Table 2). Of the respondents aged 20 to 29 who were in the lowest third of the income-needs distribution in 1981, 50 percent (n=25) remained there in 1986; 32 percent had moved into the middle third of the distribution, and 18 percent had moved into the top third. Of the 55 households who were in the middle third of the 1981 income-needs distribution, 27 percent dropped to the lowest third, 38 percent remained in the middle third, and 35 percent moved into the top third. Of the 42 respondents in the top third of the distribution in 1981, 62 percent maintained their position, 21 percent dropped to the middle third, and 17 percent fell into the lowest third of the income-needs distribution in 1986.

Implications for Educators

The results of this study should be interpreted cautiously due to relatively small cell sizes. However, the results suggest that young adults face downward as well as upward mobility. In teaching personal finance, it may be well to stress that economic mobility is a two-way street, and that most consumers can expect to travel in both directions during their lives. Such information could be used to supplement the occupation and income section of a personal finance course or to introduce the section on risk management. Either way, the instructor could encourage students to investigate the possible causes of downturns in household financial well-being and to consider whether those causes are subject to consumers' control. Recent headlines regarding layoffs at major corporations and statistics on average periods of unemployment in various occupations could serve as a starting point for discussion. How much control do household members have over these events? How can a household cover a substantial drop in income relative to needs? Such discussion should serve to highlight the need for an emergency reserve fund and should also reinforce the idea that high fixed expenses relative to income leave a household with very little room to maneuver in the event of a drop in income. Students could be asked to list other events that might cause a substantial drop in income relative to needs and to develop a matrix in which each event was assigned a rating with regard to the consumer's degree of control over the event, its probability, and the magnitude of financial consequences that might result from the event. This rating scheme, in turn, could be used as the basis for discussion of the appropriate risk management strategy for each event. Such an exercise could provide a framework to assist students in thinking about what their financial futures might hold.

Table 2. Distribution of 1981 Income-Needs Ratios by 1986 Income-Needs Ratios for Households With Heads 20 to 29 Years Old in 1981 (N=147)[a]

Distribution of 1981 Income-Needs Ratios	1986 Income Needs Ratios: Lowest Third n	Percent	Middle Third n	Percent	Highest Third n	Percent
Lowest Third	25	50%	16	32%	9	18%
Middle Third	15	27	21	38	19	35
Highest Third	7	17	9	21	26	62

[a]Four cases had missing data in 1981 and seven had missing data in 1986, leaving only 147 cases.

References

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