Study shows importance of starting savings early, as few young adults open accounts

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Savings accounts are not just a good way to have money to fall back on in case of emergency, they are, in fact, a gateway to financial health and a diversified balance sheet for young adults, new research from the University of Kansas shows. Acquiring a savings account early is key as well, as data shows that young adults who do not have an account by age 18 are not likely to get one.

Terri Friedline, assistant professor at the School of Social Welfare and faculty director for the Financial Inclusion Project at the Assets and Education Initiative, co-authored a study in which she and her colleagues analyzed data from the U.S. Census Bureau's 1996 Survey of Income and Program Participation. They uncovered three key findings: the acquisition or "take-up" of a savings account that occurs early in life may set the stage for continued account ownership; the acquisition of a savings account may be a gateway to a diverse asset portfolio; and a diverse asset portfolio may contribute to the health of young adults' balance sheets by helping them accumulate liquid assets.

About 43 percent of young adults age 18 to 40 had a savings account, and only 3 percent acquired one during the course of the panel; however, those with an account were also much more likely to have a diverse asset portfolio, including checking accounts, certificates of deposit, money markets, savings bonds, stocks and retirement accounts.

The Survey of Income and Program Participation gathered data monthly over a four-year period from thousands of Americans. The design of the data set allowed researchers to pinpoint when participants acquired certain accounts and financial services and to control for a number of factors, including gender, age, race, area of residence, employment, income and more. The study is among the first that was able to identify young adults who started the survey with a savings account or when they opened one, from those who did not. The data clearly showed the gateway effect of a savings account.

"It is particularly important for young adults to have savings because they are in the beginning of their financial lives," Friedline said. "We found savings account ownership is pretty sticky. Not many people—only about three percent—acquired an account while they were in the survey. By young adulthood, people were just not very likely to open an account if they didn't already have one."

Friedline presented the research in May at "The Balance Sheets of Younger Americans: Is the American Dream at Risk?," a conference hosted by the Federal Reserve Bank of St. Louis. The study, co-authored with Paul Johnson of KU's Center for Research Methods and Data Analysis and Robert Hughes of KU's Department of Sociology, will be published in December in the Federal Reserve Bank of St. Louis Review.

Forty-four percent of young adults who had a savings account also owned a checking account, and the majority had the savings account first. Of those who had savings, 42 percent also had a retirement account, and again the vast majority had savings first. As they grew older, young adults tended to acquire other assets in combination with their savings accounts.

"We found that having a savings account was strongly related to having so many other financial assets," Friedline said. "Even still, young adults' portfolios aren't greatly diverse. The diversity was largely distributed amongst savings, stocks and retirement accounts, but their portfolios were consistently more diverse than those who did not have a savings account."

The researchers also examined how a savings account and a diverse portfolio contributed to young adults' liquid asset accumulation. Not surprisingly, those with savings and other holdings such as stock and retirement accounts had the most liquid assets. The combination of stock and retirement accounts contributed the most—$5,283. Those without a savings account or diverse portfolio were often far behind their peers.

"In sum, the financial products from a diverse portfolio were significantly related to young adults' accumulated liquid assets," the authors wrote. "Significant, negative interactions with age suggested that the effects of these financial products on liquid asset accumulation diminished as young adults grew older; conversely, as young adults earned more income, the effects of these financial products on liquid asset accumulation increased. Likewise, as young adults grew older and earned more income, the effects increased."

Findings demonstrate the importance of having a savings account in early young adulthood, when they can benefit from the positive returns of their increasing income and before they experience the diminishing returns of age.

The findings illustrate the importance of establishing savings early in life for young people of all races, ages and socioeconomic backgrounds. Controlling for factors such as race showed that not only did more non-whites not have a saving account when entering young adulthood, even fewer acquired an account during the period than their white peers, suggesting they may experience exclusion from the financial mainstream, as previous research has suggested. The data continues to build the case for the importance of savings, Friedline said, something she has explored in her previous research. She explores how young people acquire savings, how savings can grant access to the financial mainstream, and how savings can facilitate asset accumulation and perhaps even economic mobility.

Having savings by young adulthood is vital, because without it, people can often be delayed years before they start saving, if they are ever able to do so. The growing evidence builds support for establishing savings accounts at birth for all American children, or enacting legislation and programs that make savings more accessible for all, Friedline said.

She likened having savings early in life to starting a marathon race at the front of the pack.

"If you're an elite runner as a young adult—you own a savings account, have a diverse portfolio, and accumulate liquid asset—you get to start the race ahead of everyone else."

Provided by University of Kansas

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