

The Increase in the Proportion of Households with Heavy Financial Obligations

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Dynan, Johnson, and Pence (2003) described a financial obligations ratio which includes rent, auto leases, homeowners insurance and property taxes along with the traditional measures of debt service payments. They noted that “Some households may increase their ratios by borrowing more because they are appropriately optimistic about their future income prospects and their corresponding ability to repay debt. Other households may increase their ratios because they have suffered an unanticipated misfortune that necessitates borrowing to cover their extra expenses.” Johnson (2005) updated the aggregate estimates and found a substantial increase in the ratio between 1992 and 2005. The purpose of this study is to investigate changes over time in the financial obligations ratio of households, and examines whether a time trend still exists after controlling for major characteristics of the households. We calculate the financial obligations ratio using the Federal Reserve Board’s Survey of Consumer Finances datasets for 1992 to 2007. We estimate a multivariate model of the factors related to the ratio and the likelihood of households having a ratio over 40% of pretax income, controlling for household characteristics and expectations. One contribution of this paper is estimation of the financial obligations ratio using household data from 1992 to 2007, as that has not been previously done. Another contribution is examination of the effects of household characteristics on the likelihood of having a ratio over 40%, as these effects may provide insights into what types of households are most at risk if income decreases. The proportion of U.S. households with heavy financial obligations burdens (over 40% of income) increased from 18% in 1992 to 27% in 2007. The increases were interrupted only by the 2001 recession, and would have been greater if household characteristics and attitudes had not changed. Expectations of prosperity seem to increase the proportions of households with heavy financial obligations, and more educated households were more likely to have a heavy burden than otherwise similar less educated households.

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