

Research Digest

The Region often includes one or two articles about economists at the Minneapolis Fed and their current work. Research Digest is a new *Region* feature that provides shorter summaries of recent economic research papers.

In this issue, the Digest discusses research by Greg Kaplan on economic motivations behind decisions by young adults to live with their parents or apart.

Crashing for Insurance

Greg Kaplan's research explores the economics of "Boomerang Kids."

In some countries, it's common for young adults to live with their parents, even after they get married, but if one believes media accounts, this is a fairly new phenomenon in the United States. Numerous news reports and books have focused on "Boomerang Kids"—Gen Xers and Millennials who, perhaps due to changing social norms, live in their childhood bedrooms or Mom and Dad's basement into their late 20s or 30s.

A new paper by Greg Kaplan, assistant professor at the University of Pennsylvania and a former Minneapolis Fed staff economist, suggests an economic explanation for the phenomenon. "[T]he option to move in and out of home is a valuable form of insurance against shocks in the labor market, particularly for youths from low-income households," Kaplan writes in "Moving Back Home: Insurance against Labor



Market Risk" (Minneapolis Fed Staff Report 449, online at minneapolisfed.org).

Kaplan uses data from the 1997 National Longitudinal Study of Youth, a survey that follows a large number of young adults of varied backgrounds born between 1980 and 1984, catching up with them annually afterward. Among many other variables, the survey tracks work history

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and place of residence, so it provides ideal data for research on how labor markets affect the decision to move back home.

This research doesn't illuminate how new the boomerang phenomenon might or might not be, which would require tracking the total fraction living at home over many years. Rather, it looks at a large group of people of roughly the same age and teases out what motivates them to leave or return home.

Kaplan starts by restricting attention to those survey takers whose parents are still alive and who haven't served in the military or gone to college. Because the survey stopped asking about living at home in 2002, when many of its subjects would have been just finishing or still in college, it isn't very informative about the residential decisions of the college educated. Further, the analysis only considers men because women, particularly those with children, are much more likely to receive government benefits, which interferes with the decision to move home or live apart. What's left is a large set of monthly observations

of young men who started working after leaving high school.

The next step is setting up a model of the interactions between parents and their children regarding decisions about work, savings and residence. Parenthood, as every mother knows, is a thankless job, so Kaplan assumes that children are concerned only about their own well-being. Parents, by contrast, care about their children's welfare as well as their own (though this altruism is limited) and can support their children through direct financial payments or through offering them shelter.

In addition to living rent-free, children moving home receive other perks; think cable TV or a fridge full of snacks. While leaving home eliminates those benefits, it satisfies a preference for independence, which increases over time but is subject to occasional shocks—bouts of homesickness—that make moving back home more desirable.

The labor market is the model's final ingredient. Workers are assumed to have some chance of getting fired in every period.

When unemployed, their chances of finding a job paying a given wage diminish as that wage increases. The decision to accept a job offer depends on the wage, the chance of finding a higher-paying job by waiting and the consequences of remaining unemployed.

It has long been known that income fluctuates more than consumption. When people are out of work, they use savings, credit or unemployment insurance to maintain the lifestyle to which they've become accustomed. When working, they pay debts incurred in bad times and save money for rainy days in the future.

Kaplan's argument is that for young workers, moving back home is another *consumption-smoothing* device. "By reducing the consumption response to labor market shocks, the option to live at home can help explain why young households appear to have access to insurance possibilities over and above that implied by self-insurance through savings," he writes.

To determine just how important this insurance is, Kaplan runs the data from the survey through his

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model. Then, as an experiment, he examines the model's results after removing financial transfers from parents and after removing the option to move back home. The comparison gives a measure of the importance of these sources of insurance.

Not surprisingly, Kaplan's results show that financial transfers are a more important form of insurance for young men with wealthier parents, about three times as important for the richest 25 percent of children as for the poorest. Correspondingly, the option to move home is more valuable to poorer children (about five times more valuable for the poorest 25 percent compared with the richest). This is so even after accounting for the fact that lower-income homes offer less of the "public" consumption good (cable and snacks) than higher-income homes.

One lesson of this model for parents is a version of the Samaritan's dilemma—by helping someone currently in need, the good Samaritan also encourages behavior that is ultimately counterproductive. In this case, children who can get money or shelter from their parents end up saving less of their wages than they would otherwise. This is a new explanation for why savings rates among young people are often observed to be lower than economic theory predicts.

More broadly, Kaplan notes that macroeconomic theories usually divide the life cycle neatly between childhood and adulthood.

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Kaplan also draws attention to a related policy issue. If workers can smooth their incomes with money and shelter from their parents, then the consumption-smoothing benefits from unemployment insurance may be smaller than previously thought. Unemployment insurance could also "crowd out" this private insurance, rendering it less important than it would be otherwise.

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—Joe Mahon