Americans' debt burden, retirement readiness, and the pandemic

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This paper evaluates the extent to which Americans agree or disagree with the statement that debt and debt payments prevent them from adequately addressing other financial priorities. Using the January 2020 *TIAA Institute-GFLEC Personal Finance Index* (*P-Fin Index*) we compare results to the *P-Fin Index* fielded in January of 2021. Our research explores which population subgroups felt most debt constrained, how the pandemic impacted people's debt-constraint perceptions, and how these perceptions relate to financial literacy and retirement readiness.

Our analysis suggests five key takeaways. First, we show that, even before the pandemic hit, 31% of American adults expressed feeling constrained by their debt. Second, the percentage of debt-constrained individuals was the highest among Blacks and Hispanics, people lacking a bachelor's degree, those with children under the age of 18, the lower-income, those age 30–44, and those with low levels of financial literacy. Third, we find no significant change in people expressing stress due to debt between January 2020 and January 2021, probably due to the federal relief efforts that helped ease immediate financial distress and inability to cover debt payments. Further, the demographic subpopulations financially vulnerable before the pandemic remained vulnerable into the pandemic. Fourth, we show that being debt constrained can have long-term financial consequences, as it is negatively linked to planning and saving for retirement. Finally, the data consistently shows that financial literacy is strongly linked to both debt and retirement money management; specifically, more financially literate households are less likely to be debt constrained and more likely to plan and save for retirement.

Data and variable definitions

Our empirical analysis is based on the *TIAA Institute-GFLEC Personal Finance Index* (*P-Fin Index*), a survey designed to measure Americans' knowledge and understanding of the factors leading to sound financial decision making and effective management of personal finances.[1] This nationally representative survey, first fielded in 2017, has been collected every year since then. For the present study, we analyze and compare the 2020 and 2021 waves, both of which were collected in January of the respective years. Therefore, we compare data collected immediately prior to the COVID-19 pandemic, with data collected almost a year into the crisis.

The *P-Fin Index* provides the most comprehensive measure of financial literacy to date as it is based on responses to 28 questions across eight areas of personal finance in which individuals must routinely function. This comprehensive measure of financial literacy is unique in its breadth and is complemented by questions related to financial well-being, including debt management and retirement savings behavior. Specifically, our main empirical analysis focuses on a question measuring how people reported that debt constrained their personal finances, which is as follows: *Debt and debt payments prevent me (and my spouse/partner) from adequately addressing other financial priorities.* Possible answers ranged from 1 to 5, where 1 = "Strongly agree," 3 = "Neither agree nor disagree," and 5 = "Strongly disagree;" additional options included 98 = "Don't know," and 99 = "Refuse to answer." Those responding 1 and 2 were classified as being debt constrained, and those responding 4 and 5 as not debt constrained. Respondents who chose "don't know" or "refuse to answer" have been excluded. In the second part of our study, we investigate the long-term consequences of debt by examining two indicators of retirement readiness: retirement planning and saving for retirement. The exact question wording of those questions is as follows: (1) *Have you (and your spouse/partner) ever tried to figure out how much you need to save for retirement?* and (2) *Do you (and/or your spouse/partner) save for retirement on a regular basis?* The possible answer options in both cases are: "Yes," "No," "Don't know," and "Refuse to answer." Both questions were analyzed and together serve as indicators for measuring retirement readiness.

Empirical findings

Next, we analyze the self-reported debt-constraint measure, including its correlation with financial literacy and retirement readiness.

Who are the debt constrained?

Table 1 shows that, in 2021, about 30% of Americans reported feeling constrained by their debt; some (20%) felt neutral; and the remaining 50% did not feel that debt and debt payments prevented them from adequately addressing other financial priorities. Moreover, some demographic subgroups—Blacks and Hispanics, those lacking a bachelor's degree, those with children under the age of 18, the lower-income, those age 30–44, and those with low levels of financial literacy—reported feeling particularly constrained by debt. Importantly, these particularly vulnerable individuals remained among the most financially vulnerable even after controlling on a range of socio-demographic characteristics in a regression analysis.[2]

1 It is a joint project between the TIAA Institute and the Global Financial Literacy Excellence Center.

2 More information on the regression findings can be found in the full paper.

Table 1. Demographics of the debt constrained in 2021

	Debt Constrained (1 & 2)	Neutral (3)	Not debt constrained (4 & 5)
Total sample	31%	19%	50%
	AGE		
18–29	33	21	47
30–44	39	19	43
45–59	34	20	46
60+	20	17	63
	RACE/ETHNICITY		
White, non-Hispanic	26	17	57
Black, non-Hispanic	38	23	39
Hispanic	46	21	33
Other, non-Hispanic	30	22	49
	HIGHEST DEGREE OBTAINED		
Less than high school	47	25	27
High school	32	25	43
Some college	33	19	48
Bachelor's degree or higher	23	11	66
	CHILDREN UNDER THE AGE OF 18		
No	27	19	54
Yes	40	19	41
	HOUSEHOLD INCOME		
Less than $25K	43	30	27
$25–49K	40	20	41
$50–74K	36	21	43
$75–99K	30	19	52
$100K+	21	14	65
	FINANCIAL LITERACY		
Not financially literate	35	22	43
Financially literate (Big 3 correct)	21	9	70
Total Observations	898	561	1571

Source: Authors' calculations using the 2021 *TIAA Institute-GFLEC P-Fin Index*.
Note: "Don't know" and "refuse to answer" responses to the debt-constrained question are excluded. The variable household income includes the total amount of a household's annual income, including wages, tips, investment income, public assistance, and income from retirement plans. The education variable highest degree obtained includes the categories High school or less, indicating that the highest degree received is a high school diploma; some college, indicating that respondents have attended a post-secondary institution and earned, at most, a two-year degree (i.e., an associate's degree); bachelor's degree, indicating that respondents have earned a four-year degree, post-graduate degree, indicating that respondents have a degree beyond a bachelor's degree. The proportion of financially literate represents respondents who correctly answered the three basic financial literacy questions (Big 3), which assess understanding of interest rate, inflation, and risk diversification. All statistics are weighted.

Interestingly, the debt-constraint measure remained stable between January 2020 and 2021, which is somewhat surprising since Blacks and Hispanics and the least educated were among the groups most negatively economically impacted by the pandemic. One explanation could be that the fiscal stimulus measures implemented in response to the pandemic helped U.S. adults make ends meet and service their immediate debt obligations. Nevertheless, as loans and mortgages are multiyear financial contracts, we anticipate that they will continue to exert financial pressure on households after the stimulus funding winds down.

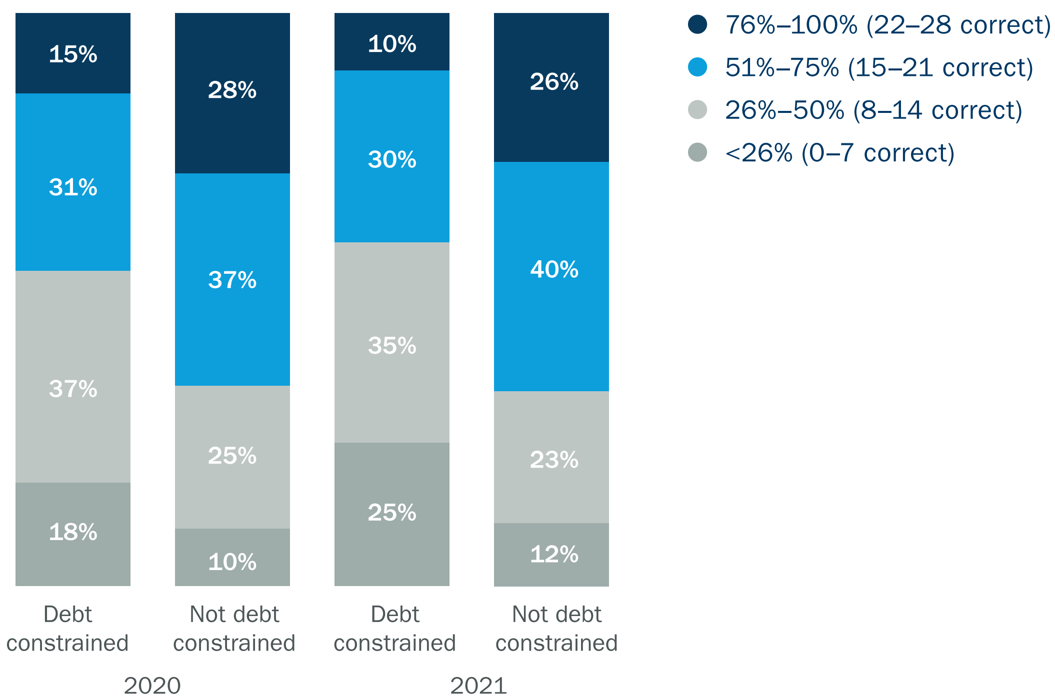
Debt constraints and financial literacy

Another important conclusion is that financial literacy seems to be protective against the corrosive impacts of debt, in that more financially savvy respondents were less likely to report being debt constrained. Specifically, in 2021, people who correctly answered only 45% of the 28 *P-Fin Index* questions were more likely to say they were debt constrained, whereas their less debt constrained counterparts averaged 59% correct answers. This highly significant difference of four questions out of 28 also held steady between 2020 and 2021.

Looking at the full distribution of the 28 *P-Fin Index* questions in 2021 in Figure 1, we find that among those who reported being debt constrained, a significantly larger share (25%) could correctly answer only up to seven *P-Fin Index* questions, evidencing very low levels of financial literacy. A significantly smaller share (10%) did very well, correctly answering between 22 and 28 questions. Overall, this pattern confirms that those feeling the most debt constrained were most likely to have low financial literacy levels.

Figure 1. Distribution of *P-Fin Index* questions answered correctly and being debt constrained

Distribution of correct *P-Fin Index* questions

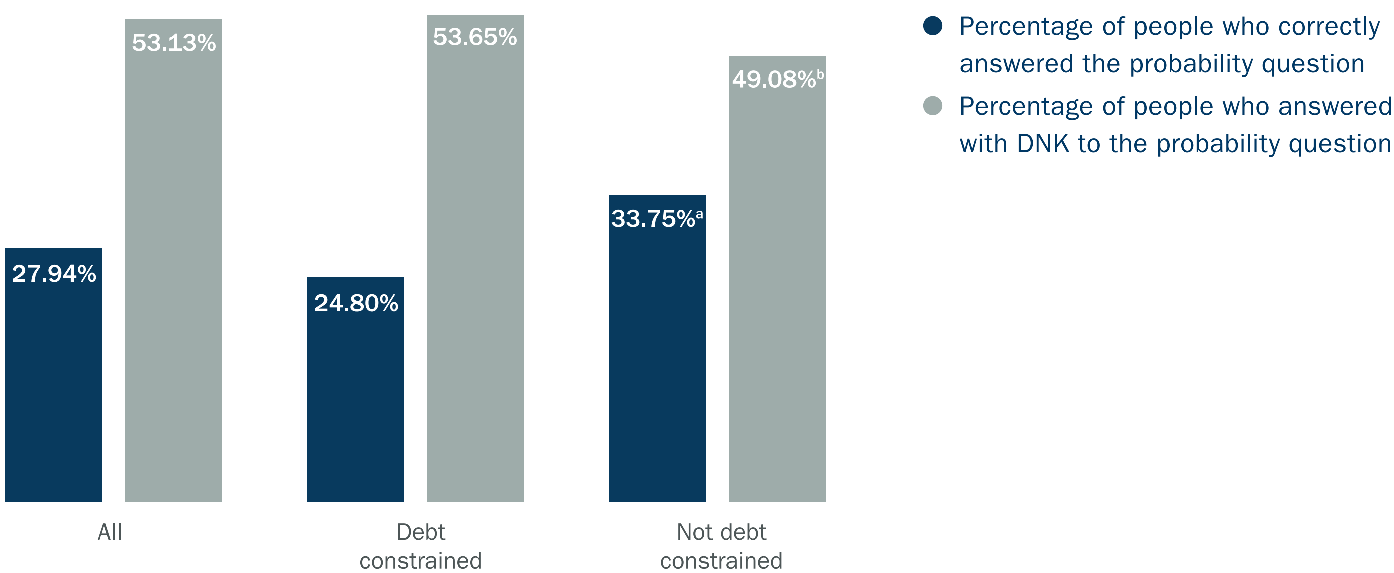


Source: Authors' calculations using the 2020 and 2021 *TIAA Institute-GFLEC P-Fin Index*.
Note: "Don't know" and "refuse to answer" responses to the debt-constrained question are excluded. All statistics are weighted.

Moreover, our study shows that a basic comprehension of risk and uncertainty is quite important in the context of debt and debt management. Unfortunately, on average, only one of the three risk questions included in the *P-Fin Index* was answered correctly in 2021, showing that risk and risk-related topics are extremely difficult concepts for people to grasp. In fact, this is the area where people scored the worst across all personal finance topics covered by the *P-Fin Index*. Looking separately at those who felt debt constrained and those who did not, debt-constrained respondents could correctly answer only 34% of the questions on average in 2021; however, non-constrained people knew the right answers to 41% of the questions. A negative correlation between risk literacy and being debt constrained underscores how important it is to understand risk when seeking to manage debt.

In 2021, we added a new question to the survey to capture peoples' understanding of risk probabilities. The novel question was framed in the context of the ongoing COVID pandemic, where the public was deluged with information on infection and deaths resulting from the virus, as well as on vaccine effectiveness, much of which used terminology involving probabilities. Even though our question used an example related to health, the goal was to test people's understanding of probabilities, also important for debt management. The question asked: *Which of the following indicates the highest probability of getting a particular disease?* Possible answer options were: *1 = "There is a one-in-twenty chance of getting the disease," 2 = "2% of the population will get the disease," 3 = "25 out of every 1,000 people will get the disease," 98 = "Don't know," and 99 = "Refuse to answer."* Our results confirm that U.S. adults struggled to understand probabilities, as only 28% of our survey respondents correctly answered this question, and 53% responded that they did not know the answer (Figure 2). Moreover, we found that those not debt constrained were significantly more likely to correctly answer the probability question, and less likely to answer "don't know" compared to the debt-constrained respondents. This indicates that there is a link between the understanding of probabilities and the feeling of being debt constrained.

Figure 2. Link between probability question and being debt constrained

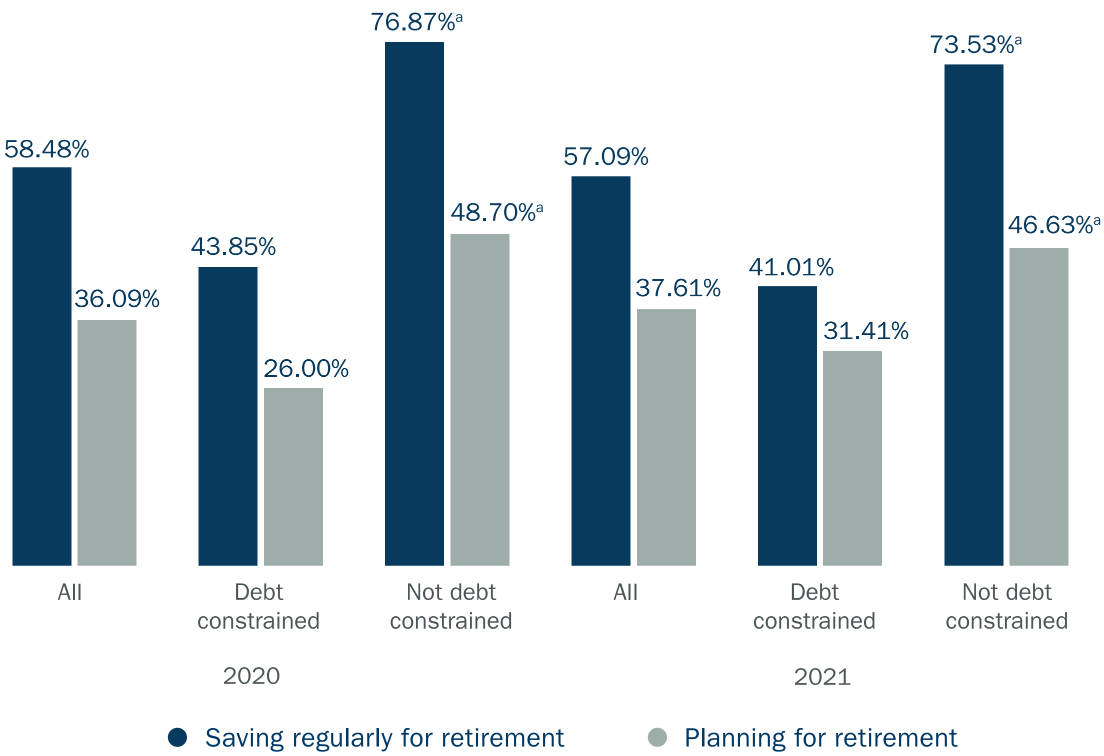


Source: Authors' calculations using the 2021 *TIAA Institute-GFLEC P-Fin Index*.
Note: "Don't know" and "refuse to answer" responses to the debt-constrained question are excluded. The exact question wording to the probability question is "Which of the following indicates the highest probability of getting a particular disease?" And the possible answer options are: (1) There is a one-in-twenty chance of getting the disease; (2) 2% of the population will get the disease; (3) 25 out of every 1,000 people will get the disease; (4) Do not know (DNK). All statistics are weighted.
[a] Difference to being debt constrained is significant at the 1% level. [b] Difference to being debt constrained is significant at the 5% level.

The empirical relationship between being debt constrained and retirement readiness

Next, we examined whether being debt constrained impacted retirement readiness. Figure 3 shows that, in January 2021, only 31% of non-retired debt-constrained respondents reported having ever tried to figure out how much they needed to save for their retirement. Of non-retired respondents who were *not* debt constrained, 47% indicated that they had been planning for retirement. An even more pronounced difference arose in the pre-pandemic 2020 period. Moreover, in 2021, 41% of non-retired debt-constrained respondents said they regularly saved for retirement, whereas 74% of non-retired respondents who said they were *not* debt constrained saved for retirement. Financial literacy also has a strong influence on both retirement planning and saving for retirement. Thus, being financially literate helps people plan and save for retirement, ultimately leading to increased retirement financial well-being. In sum, greater financial literacy positively shapes both debt management and retirement readiness.

Figure 3. Link between planning and saving for retirement and being debt constrained



Source: Authors' calculations using the 2020 and 2021 *TIAA Institute-GFLEC P-Fin Index*.
Note: "Don't know" and "refuse to answer" responses to the debt constrained as well as retirement savings and planning questions are excluded. Statistics only reflect the subsample of non-retirees. All statistics are weighted. [a] Difference to being debt constrained is significant at the 1% level.

Discussion

We have analyzed Americans' perceptions of being debt constrained, focusing on the subgroups reporting feeling most debt constrained, how this perception was impacted by the pandemic, and how it related to financial literacy and retirement readiness. Using the 2020 and 2021 *P-Fin Index*, we have shown that one in three Americans felt constrained by their debt in both periods. A potential explanation for why the debt-constraint measure remained stable might be that the relief efforts implemented by the government eased people's ability to cover debt payments. Nevertheless, long-term mortgage debt and student loans, along with other debt, are likely to continue pressuring household finances in the future.

We also found that Blacks and Hispanics, those lacking a bachelor's degree, those with children under the age of 18, the lower paid, those ages 30-44, and those with low levels of financial literacy were far more likely to report feeling they were debt constrained, compared to their counterparts. Moreover, feeling constrained by debt proved to be strongly linked to lack of retirement planning and saving, suggesting that too much debt can have long-term financial consequences. Finally, we confirmed that financial literacy matters for debt management and retirement readiness. Accordingly, enhancing peoples' financial knowledge could help build financial security in the short as well as the long term. In this context, educational programs can be seen as an important remedy to correct lack of financial literacy, as they provide a means by which to teach people key personal finance concepts as well as the workings of financial products.

About the authors

Andrea Hasler is an Assistant Research Professor in Financial Literacy at GFLEC. She leads the team of researchers working on financial literacy and capability, and develops analyses for educational and policy initiatives. Hasler has recently worked on projects focused on financial literacy levels of the young, women, entrepreneurs, investors, and historically underrepresented communities in the United States and around the world. She holds a Ph.D. in finance as well as an M.Sc. and B.A. in business and economics from the University of Basel. During her doctorate, she spent two years at the New York University Stern School of Business conducting research on household saving and financial decision making. She also has been a lecturer at the University of Basel for the past seven years. Her professional experience includes the development of an online advanced studies course in financial market theory and work as an analyst conducting global equity market research.

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