

Debt Literacy, Financial Experience, and Overindebtedness:

Just the Facts

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Financial illiteracy is widespread:

From a representative sample of the US population:

- Only 36% of respondents performed an interest rate calculation correctly.
- Only about 35% of respondents figured out that making minimum payments equal to the interest payment on outstanding credit card debt will never eliminate debt.
- Only 7% of respondents responded correctly to a question requiring an understanding of the notion of the time value of money.

Groups displaying **lowest levels of financial literacy**:

- The **elderly** (those older than 65)—they display the lowest amount of knowledge about interest compounding; also, more than 30% do not know the answer to a question about credit card debt.
- **Women**—their correct response rate is sometimes up to 20 percentage points lower than that of men.
- Those who are **divorced/widowed/separated**.
- **Minorities**—particularly African-Americans and Hispanics.
- Those with **low income** and low financial assets.

Overconfidence:

Most respondents think they know more than they do: when asked to rate their own financial knowledge on a scale of 1 to 7, the average score in the sample is 4.88 and more than 50% of respondents chose a score as high as 5 or 6.

- The **elderly** display low levels of debt literacy but rank themselves highest: their average score is 5.3.
- Those who are **divorced/separated/widowed** display low levels of debt literacy but rank themselves high: their average score is 4.79.

We identify four groups of people with common financial experiences:

- Cluster 1, the **“in control”** group (26% of the sample), is people who use traditional financial services and are in control of their money.
- Cluster 2, the **“borrower/savers”** group (12% of the sample), is people who have high levels of experience with savings and investments, but also high levels of experience with debt.
- Cluster 3, the **“overextended”** group (31% of the sample), is somewhat similar to the “borrower/savers” group, except that these people have less experience with savings and more markers of extended credit.
- Cluster 4, the **“fringe”** group (30% of the sample), are people who disproportionately use high-cost, non-traditional borrowing methods.

There is a **strong relationship between financial literacy and debt behavior:**

- The more financially knowledgeable are more likely to be in control of their finances.
- People who use high-cost borrowing methods come from vulnerable demographic groups and—even after controlling for these factors—are less debt literate.

Debt loads:

- **26.4% said they had “difficulty paying off debt”**; 60.5% said they had “no problems with debt”; 2.0% “wish they could get more debt”; **11.1% “just didn’t know.”**
- The “just didn’t know” group is disproportionately **women** (nearly 70%), **black** (18%), **unmarried** (60%), and **low-income** (59% make under \$30,000 per year).

There is a **strong relationship between financial literacy and self-assessed debt loads:**

- Those who report higher levels of literacy are more likely to report having “no problems with debt.”
- Those who are less financially literate are much more likely to report having “difficulty paying off debt.”

Financial Literacy Initiative: <http://www.dartmouth.edu/~alusardi/fli.html>

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