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Why older Americans are taking on more debt

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Credit: University of Pennsylvania

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Older Americans are accumulating more debt as they near retirement, according to recent research that reveals a troubling trend in personal finance among people in their 50s and early 60s.

Just when they should be reaching the peak of their retirement savings,

this group is still paying off mortgages and grappling with credit card debt, medical bills, and student loans. The burden is leaving them stressed, harassed by bill collectors, and worried about their financial future as the clock ticks down on their income-earning years.

"This is a very different world in terms of debt than our parents and grandparents lived in," said Olivia S. Mitchell, a Wharton professor of business economics and public policy who co-authored the working paper, "Understanding Debt in the Older Population," published by the *National Bureau of Economic Research*.

The survey-based study expands work that Mitchell did more than a decade ago following the Great Recession that found the median debt for baby boomers had quintupled. Now, the Generation Xers right behind them aren't faring much better. They report being saddled with debt from a variety of sources, including caring for still-dependent children under the age of 18, paying off student loans for themselves or as co-signers, and digging out from under medical bills not covered by health insurance. The skyrocketing cost of housing is adding to the stress.

"Instead of going with the old way of the mortgage-burning party, which is what people did when they paid off [their mortgage] prior to retirement, nowadays we see people buying bigger, more expensive houses with less down payment and therefore carrying bigger mortgages into retirement, which can put them in very tight straits if they're not very careful," Mitchell said during an interview with the Wharton Business Daily show on SiriusXM. (Listen to the podcast at the top of this page.)

The Most Vulnerable

One major concern with mortgage debt among older Americans is they

have less room to ride out negative income shocks. For example, if they have a variable rate mortgage and interest rates rise, they will be on the hook for more money. "That could be a big bath of cold water," said Mitchell, who is executive director of the Pension Research Council at Wharton.

Not surprisingly, Mitchell said, the study found the most vulnerable groups to be African Americans, women, and the least educated. People with lower incomes and less financial literacy tend to fall prey to what Mitchell described as "high-cost debt," such as credit cards, payday loans, auto title loans, and even pawn shops.

"All those are very expensive forms of debt, and yet they've become normalized in many people's lives," she said.

The study's authors encourage practitioners and policymakers to devote more attention to these vulnerable groups and to the debt load created by student loans and medical bills, in particular.

"Another concern from the more macro perspective is that central bankers really need to take a look at the level of debt in the population," Mitchell said. "Not just federal debt, which we know is exploding, but also household debt, because that means the bigger the debt the more susceptible people are to changes in the interest rate, and that will potentially put them in even deeper trouble."

The "Silver Lining'

Despite the report's grim findings, there is good news. Financial literacy can help boost positive behaviors such as planning for retirement and building a good credit score. In the study, participants were asked questions to assess their understanding of compounding interest, inflation, risk diversification, and other basic concepts. The authors

found that respondents who were able to answer one additional question correctly were 11% more likely to plan for retirement, 4% more likely to report a good credit score, and less likely to be hounded by bill collectors.

"The general concern with financial fragility—people's sense of impending financial doom—is something we're very worried about, especially in this continuing COVID pandemic," Mitchell said, "The one bit of silver lining is that financial literacy can play a very positive role."

Mitchell has long advocated for mandatory financial education classes in high school, when the lessons can have a lasting impact into adulthood. Research has shown that graduates from the handful of states with such programs are more financially savvy than their peers.

"They budget better, they plan for retirement, they save, they diversify their savings, and they're less likely to take out student loans that they can't repay. So, there's a real social benefit to financial education in the schools," Mitchell noted.

Early financial education could help people avoid falling for the "lump sum illusion" when they're older and facing retirement. That sometimes happens when people see a big number in their retirement account—say, $100,000—and think they are rich.

"What they don't realize is, if it's converted to an income stream, that may be worth $6,000 a year or $6,500 a year, depending on how old you are," Mitchell said.

More information: Annamaria Lusardi et al. Understanding Debt in the Older Population, *National Bureau of Economic Research* (2020). DOI: 10.3386/w28236 www.nber.org/papers/w28236

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