

How to Strengthen Household Financial Resilience

August 2021

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This research was
supported by a grant
from the [FINRA Investor
Education Foundation](#).

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The COVID-19 pandemic and its economic consequences have laid bare the deeply rooted financial insecurity many Americans face daily. Many households are highly dependent upon earned income and have little to buffer an income loss due to business shutdowns or sickness. Though correlated with income and wealth, financial resilience uniquely defines anyone's ability to sustain an economic shock, such as a health event, job loss, or an economic downturn (O'Neill & Xiao, 2011). In this project, we take a close look at the concept of financial resilience, its drivers, and its characteristics. We use three survey questions to assess the level of financial resilience:

- (1) Could you come up with \$2,000 within a month if an expected need arose?
- (2) Do you agree that you have too much debt right now?
- (3) Have you set aside funds that would cover your expenses for three months?

Responses to these questions show that between 2010 and 2020 (pre-pandemic), about 30 percent of American families wouldn't have been able to cope with a \$2,000 financial shock within a month, around 40 percent felt they had too much debt, and more than 50 percent did not have a rainy day fund to cover three months of expenses. These findings suggest that many American households were ill-prepared to face the economic consequences of the COVID-19 pandemic, but the numbers are more striking for women, Black and Hispanic individuals, individuals without a Bachelor's degree, and individuals ages 30–44, indicating that these most financially vulnerable subgroups were hit the hardest during the pandemic.

Our full paper on this topic shows that financial resilience is highly correlated with four financial behaviors and characteristics: income and cash flow management, debt management, risk protection, and financial literacy, and subgroups identified as the most vulnerable exhibit significant disadvantages in each. In this brief, we discuss the relationships of these four contributing factors to financial resilience and suggest policy options that have the potential to improve individual and household financial resilience.

Improving earnings

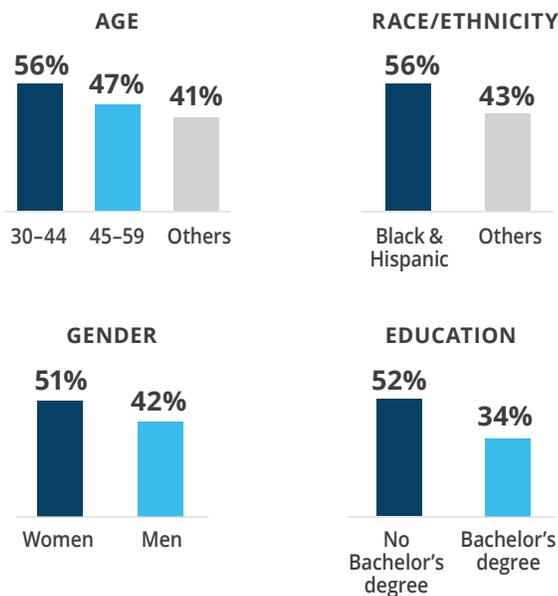
A steady job with stable income is a key component of household budgets, and financial resilience is not achievable without it. However, according to data (adjusted for family size) from the 2019 Survey of Consumer Finances (SCF), 11 percent of families live below the federal poverty line (U.S. Department of Health and Human Services, 2020) and 31 percent are below 200 percent of that line. For a family of



four living under the poverty line of \$26,200, it would be challenging to have anything left to save each month. It is therefore not surprising that close to 20 percent of families in the 2018 FINRA Foundation’s National Financial Capability Study (NFCS) reported having trouble making ends meet, and 47 percent reported having difficulty covering all expenses and paying all bills in a typical month. As can be seen in Figure 1, the most financially vulnerable segments of the population—women, Black and Hispanic individuals, individuals without a Bachelor’s degree, and individuals ages 30–44—have much greater difficulty covering financial obligations in a typical month.

Figure 1: Percentage of people who have difficulty covering all expenses and paying all bills in a typical month

Source: 2018 NFCS. Weights are used.



It stands to reason that families living paycheck-to-paycheck struggle to save for emergencies. The root cause of many families’ inability to do so is that Americans’ income growth has not kept up with the rising cost of living in recent decades. According to the FRED economic data from the Federal Reserve Bank of St. Louis, nominal household income in the United States grew at an average of 3.2 percent from 1985 to 2019. However,

factoring in inflation, the median real income of all households grew only about 0.7 percent annually over the same period (Streeter, 2021). Additionally, income growth was zero or negative among cohorts without a Bachelor’s degree. According to Federal Reserve data, a high school graduate in 2019 earned the same real income as a high school graduate in 1989. The real earning power of those with some college education but no Bachelor’s degree actually fell over the three decades.

Many people have advocated raising the minimum wage as a way to ensure a living wage. However, economists are divided on the effect of a minimum wage increase on employment and income. Proponents have provided evidence that minimum wage increases lead to increases in pay with no loss in jobs (Card & Krueger, 2016). Opponents have argued that a mandated minimum wage increase adversely affects low-skilled workers (Neumark & Wascher, 2006) because, while we may not observe job losses, hiring is cut back when employers need to pay higher wages (Clemens, 2019).

Besides minimum wage, there are underlying reasons for the lack of income growth among low-skilled individuals. Many blue-collar jobs in manufacturing, construction, and retail sales are diminishing due to globalization, automation, robotics, and artificial intelligence. Some of those jobs may never return, so policymakers need to enable appropriate occupational training and new job opportunities for high school graduates. At the same time, the rise of the gig economy has provided opportunities for workers to supplement their income with temporary and/or flexible work. According to a recent survey by the Stanford Center on Longevity, 32.7 percent of respondents said they had received some income from a gig job, and 50 percent of part-time employees and 60 percent of the self-employed do gig work. While the gig economy is growing and provides valuable work opportunities, policymakers need to pay attention to worker well-being and benefits, occupational hazards, disability insurance, and access to retirement plans (Streeter & Christensen, 2021).



Beyond income, the problem of insufficient precautionary savings needs a solution. One possibility could be to institutionalize short-term saving tools in much the same way that programs for building long-term financial assets have been established, with—for example—automatic enrollment in retirement plans and tax rules that incentivize investment in retirement and housing. Solutions could come in the form of tax incentives for those who put away funds for the short term or interest rates that incentivize short-term saving habits.

Reducing debt burdens

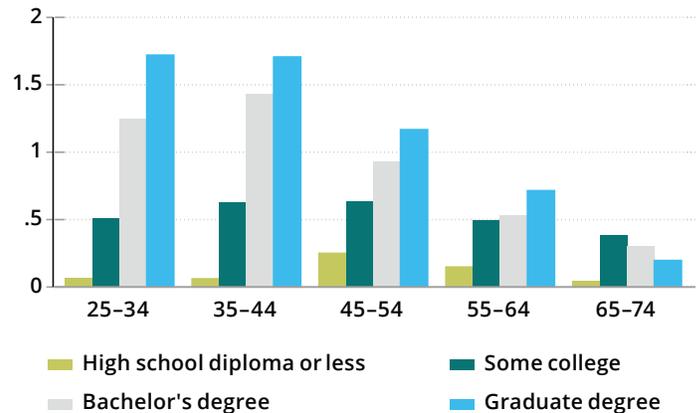
Another critical component of a household budget and a significant contributor to financial resilience is debt. In 2018, NFCS data show that 37 percent of households agreed that they “have too much debt right now.”

In 2019, median household debt was \$65,000, and over three-quarters of families had some debt (Survey of Consumer Finances, 2019). Over the last three decades, households headed by individuals in their thirties and forties have consistently had the highest level of debt. The median debt level for individuals ages 35–44 was \$128,000 in 2019, twice the level of the 55–64 age group, and three times the level of the under 35 age group. This high debt burden for those in their thirties and forties can likely be attributed to student loans, child care costs, and home mortgages, which typically are large expenses on a household’s balance sheet during that life stage.

To enable comparison across households, level of debt should be assessed relative to income or wealth. Our results show that debt-to-income ratio decreases with age and increases with educational attainment (Figure 2). In particular, families headed by a graduate degree holder between the ages of 35 and 44 had a median debt-to-income ratio of 1.7, much higher than any other age and education group.

Figure 2: Household debt-to-income ratio is highest among the most educated under age 44.

HOUSEHOLD DEBT BALANCE TO INCOME RATIO
2019, MEDIAN RATIO



Source: Survey of Consumer Finances (2019)

This heavy debt burden imposes financial risks for many well-educated individuals and their families. These families tend to have regular income to sustain their high level of debt payment and a comfortable lifestyle. However, economic shocks can affect their ability to service their debt, potentially putting a heavy strain on their budget, especially in the absence of a rainy day fund.

One policy option for reducing debt burdens is reducing individuals’ outstanding student loan debt. In line with rising tuition, student loan debt has increased dramatically in recent decades, pushing the collective amount owed in the U.S. to a record high of about \$1.6 trillion in 2020, making it the second-largest consumer debt category after mortgage debt. However, policy measures that directly reduce outstanding loans (“student loan forgiveness”) could have an adverse signaling effect on future generations of students, potentially incentivizing them to take out even larger loans (Epstein, 2020). Further, such policies would also include equity issues between college graduates who likely have higher earnings compared to tax payers who did not attend college. A more practical policy option is to



curb the cost of higher education. Without cost control, we are addressing the “how to pay for it?” question without considering the “why is it expensive?” question. If universities and colleges do not accelerate cost control, young people will increasingly seek alternative ways to receive education and obtain the credentials needed to secure a job.

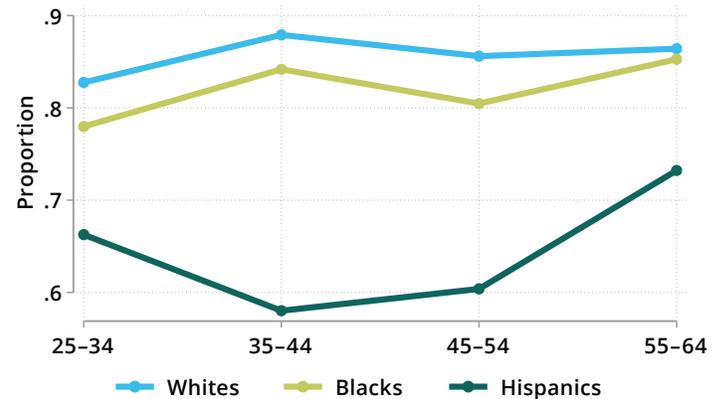
Expanding risk protections

Sufficient risk protection is another factor that is critical to financial resilience. Our results show that vulnerable groups disproportionately lack sufficient health insurance coverage. As shown in Figure (3), at any age, Blacks and Hispanics are less likely to have health insurance coverage than non-Hispanic Whites, though lack of coverage is more pronounced among 35–44 year-old individuals and less pronounced among younger and older groups, partly because young people can get coverage through parents, and older people can be covered through Medicare.

Lacking affordable health insurance coverage can have serious long-term consequences. Uninsured children and adults are more likely to skip preventative, routine health checkups, and doing so can have long-term implications on health and well-being. When underinsured and uninsured individuals do seek care, their out-of-pocket costs can be unaffordable. The Affordable Care Act significantly increased health insurance coverage in the U.S. by 7 percentage points (from 82 to 89 percent coverage). However, the drop in the number of people without health insurance means that Medicaid, the Health Insurance Marketplace, and other state-based exchanges are overloaded. Individuals purchasing plans directly from the Marketplace have encountered many issues, including high out-of-pocket expenditures, increased premiums, and a reduced number of providers accepting their plans (Streeter, 2021). These are all costs that directly or indirectly put families at a disadvantage in case of an emergency and likely exacerbate their already precarious financial state, further jeopardizing their long-term financial well-being.

Figure 3: Health insurance coverage varies significantly across age and race/ethnicity

WHETHER ALL FAMILY MEMBERS ARE COVERED BY HEALTH INSURANCE



Source: Survey of Consumer Finances (2019)

However, even people with seemingly good employer-provided health insurance policies aren’t insulated from health-related financial risks for at least two reasons. First, a job loss often leads to loss of health insurance, and with about 50 percent of the health insurance coverage in the U.S. provided by employers (KFF, 2020), this is a risk that affects many people. Second, high deductibles, out-of-pocket maximums, and out-of-network provider charges all leave policyholders with substantial out-of-pocket expenditures (Glied & Zhu, 2020). This primarily affects individuals with incomes above 600 percent of the federal poverty level (Sawyer & Claxton, 2019).

One policy option to improve protection against the costs of adverse health events is to boost insurance enrollment. For example, Americans who lost their employer-sponsored health insurance during the COVID-19 pandemic may be eligible for subsidized insurance coverage (TIME, 2020), but not everyone is aware of this. Also, some uninsured may choose not to enroll as they wrongfully believe they cannot afford health insurance (Young et al., 2020). Other policy options include increasing the transparency of health insurance policies by helping policyholders understand



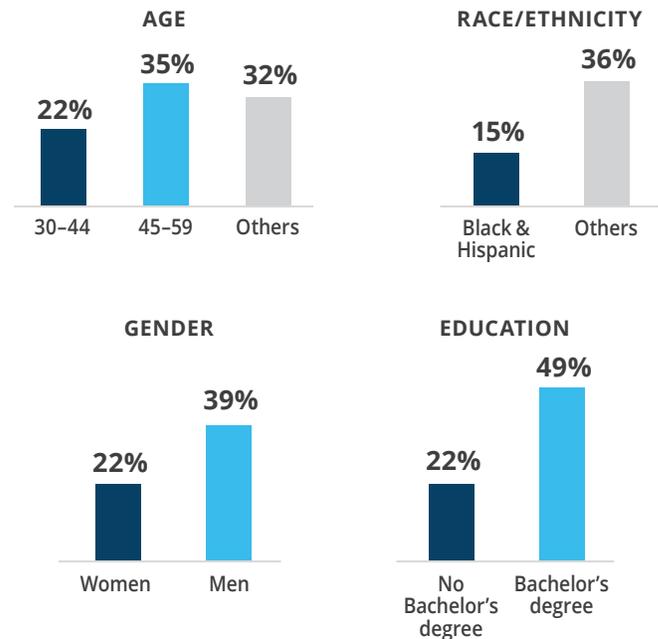
the implications of their deductible and out-of-pocket maximum elections. This would help individuals decide how to best hedge against the financial impact of a health issue, which is a highly complex decision due to the many unknowns involved.

Increasing financial literacy

The capacity to manage personal finances and make sound financial decisions is highly linked to financial resilience. Yet, financial literacy rates are low among American adults, dangerously so for families in the most financially vulnerable segments of the population. In 2018, only 30 percent of Americans were financially literate, that is, able to answer three questions that measure numeracy and understanding of inflation and risk diversification. As Figure (4) shows, this figure drops to about 20 percent among the most vulnerable segments of the population.

The knowledge and skills to manage financial resources and evaluate risks are critical to minimizing adverse impacts of financial shocks. Our research shows that those who are financially literate are significantly more likely to be financially resilient, and this relationship holds even when accounting for income and education. For example, in 2018, among those who were financially literate, only 15 percent would not have been able to cover a \$2,000 expense in 30 days compared to 37 percent of those who were not financially literate. This strong positive relationship between financial literacy and resilience holds for all financial resilience proxies and across time and demographic groups.

Figure 4: The percentage of financially literate people is significantly lower for the most financially vulnerable segments of the population



Source: 2018 NFCS. Weights are used.

To improve financial literacy, we recommend a holistic approach that includes financial education beginning no later than the high school years and continuing through an individual's life. Financial education has many benefits, from improving people's financial knowledge and behavior to increasing their awareness and confidence. The young have the most to gain from financial education, as the financial knowledge they attain can be applied to the many consequential decisions they face as young adults, including whether to pursue and how to finance a college degree. High school financial education mandates can play a crucial role. As of 2020, 21 states require high school students to take a personal finance course. This is a significantly higher number than it was in 1998 when just one state required personal finance education (Council for Economic Education, 2020). However, there is still room for improvement, which could happen in the form of mandates in more states and enhanced quality and delivery of personal finance



courses. Financial education in school is most effective when it is a required course with a rigorous curriculum and teachers who are trained to teach financial literacy (Urban et al., 2015). Such requirements limit opportunity gaps, helping to level the playing field by ensuring that all students—not just the ones from highly resourced schools—receive essential knowledge and skills.

In addition, the workplace is the ideal place for continued financial education. Recent research indicates that many employers have interest in providing financial education to their employees (Lucas, 2018), but many hesitate to do so due to cost or capacity barriers, and existing workplace programs vary significantly in quality and content. Thus, our policy recommendation includes raising awareness among employers about the potential effectiveness of workplace financial education programs and provision of guidelines that help streamline implementation and evaluation of such programs. Such guidelines should include information on three program components: (1) financial self-assessments, which help target program content to the needs of employees; (2) minimum content requirements; and (3) timing of the program. A detailed discussion of the benefits of mandating workplace financial education and our recommendations for doing so can be found in Fisch et al. (2019).

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