Household Financial Fragility: Evidence and Implications

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Global economic scenario

- Many economies are recovering from the financial crisis and Great Recession
- Data show that large segments of the population continue to face financial difficulties
- Several years after the Recession, many people feel they are not financially secure
Background work

- Financially Fragile Households: Evidence and Implications. Lusardi, Schneider, and Tufano (2011)
- Propose a new measure of financial fragility
- Document how American households cope with shocks
Our measure of financial fragility

• How confident are you that you could come up with $2,000 if an unexpected need arose within the next month?
Our measure of financial fragility

• How confident are you that you could come up with $2,000 if an unexpected need arose within the next month?

  – I am certain I could come up with the full $2,000.
  – I could probably come up with $2,000.
  – I could probably not come up with $2,000.
  – I am certain I could not come up with $2,000.
  – Don’t know.
  – Prefer not to say.
Why this measure?

- Measuring ability to cope within one month, not immediately
- Measuring ability to cope with a midsize shock (e.g., medical bill or car repair)
Why this measure?

- We allow for multiple ways to come up with the money, not only precautionary savings
  - Networks (e.g., family, friends)
  - Debt instruments (e.g., credit cards) can play a role
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People with these responses are classified as financially fragile.
Looking at financial fragility in the US: 2012 National Financial Capability Study (NFCS)

State-by-State Survey: Online survey of more than 25,000 respondents (roughly 500 per state + DC)

• Includes financial fragility measure

• Survey offers unique information on financial literacy & capability

• The data provide an encompassing overview of Americans’ personal finances
Financial fragility in the US in 2012

Note: Percentages do not total 100 percent because “do not know” and “prefer not to say” answers are not reported in the figure.
Financial fragility by age

% of respondents certainly or probably unable to come up with $2,000 in case of unexpected emergency

- 18-34: 49%
- 35-54: 42%
- 55+: 27%
Who are the most financially fragile?

- 44% of American women are financially fragile vs. 34% of men
Who are the most financially fragile?

THE UNBANKED

• 72% of the unbanked are financially fragile
...but also

UPPER MIDDLE CLASS

- 29% of people with income between $50,000 and $100,000 are financially fragile\(^1\)

\(^1\) Sample age 25-60
...but also

COLLEGE GRADUATES

• 25% of college graduates age 25-60 are financially fragile
...but also

FULLY EMPLOYED

- 31% of fully employed people are financially fragile\(^2\)

\(^2\) Sample age 25-60
What we find

• Women are more fragile
• Those with low income and low educational attainment and the unbanked are financially fragile
• Even the middle class and upper middle class feel fragile
• Having a college degree and a full time job are not guarantees of financial security
Fragility and financial literacy

LOW FINANCIAL LITERACY

• **40%** of people who do not know at least 1 of the 3 basic financial literacy concepts (interest, inflation, risk) are financially fragile
How do people cope?

- Lusardi, Schneider, and Tufano (2011), using data from the US in 2009, show that people use many methods of coping

- While many indicating savings, one in three indicate relying on family and friends

- Credit and borrowing is also mentioned by many, though credit is not a good way to insure against shocks

- Some are living on the financial edge: more than 25% of Americans in 2009 would cope by selling their home, pawning possessions, or relying on payday loans
What we find in our more recent work

- Financial fragility measures at least 2 aspects of personal finance
  - It is a symptom of lack of assets
  - It measures lack of borrowing capacity of highly leveraged households
Financial fragility and financial satisfaction

- Financial fragility goes beyond looking at one individual behavior, for example saving or borrowing
- Moving toward measuring well-being: this measure also correlates strongly with financial satisfaction
- Financial fragility has consequences!
Highlighting this topic

- The lack of short-term savings in the US is the topic of a recent documentary film.
Thinking Money documentary

• The financial fragility question was asked in on-the-street interviews

• Many people admitted they would not be able to come up with $2,000 in one month

• Here is one of them!
The secret shame of the middle class

Nearly half of Americans would have trouble finding $400 in a crisis. I'm one of them.

By Neal Gabler
Implications for financial education

- Financial fragility is pervasive
  ➢ Need robust interventions

- People use many methods of coping
  ➢ Need to move away from targeting one behavior

- Some of the methods people use are very expensive and do not provide insurance
  ➢ Credit becomes expensive when most needed

- Do not underestimate the power of family, friends, people around us. After all, we insure by pooling resources!
Implications for financial education (cont.)

• Importance of targeting women
  ➢ Multiplier effect

• Importance of equipping the young with the skills to succeed in today’s complex financial markets
  ➢ Importance of financial education in school
More implications

• Implications for policy
  ➢ Incentives for short-term savings
  ➢ Stress test for households’ financial capability

• Implications for research
  ➢ Financial fragility question could be used in many surveys

• Implications for pension design (people do not have enough liquidity)

• Extension to study gender effect
Final remarks

• Life often looks like a series of bad draws

• Macro conditions are important and recessions and low growth can take a toll on personal finances

• Low levels of financial literacy around the world indicate that people do not have the knowledge needed for financial decision-making
Life is a storm

The Storm on the Sea of Galilee
Rembrandt, 1633
Question

Should financial resilience be part of public policy?
Contact and further information

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