Household Financial Fragility: Evidence and Implications

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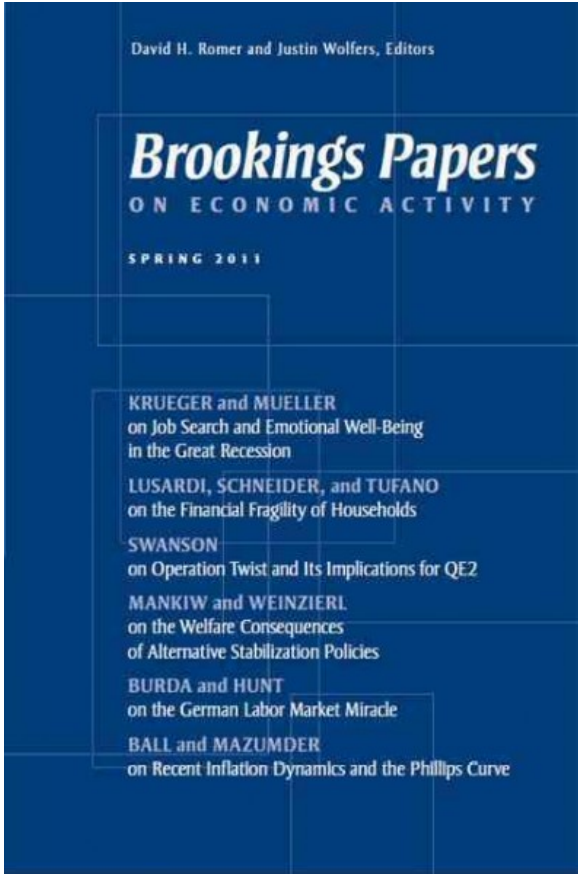
Global economic scenario

- 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

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- 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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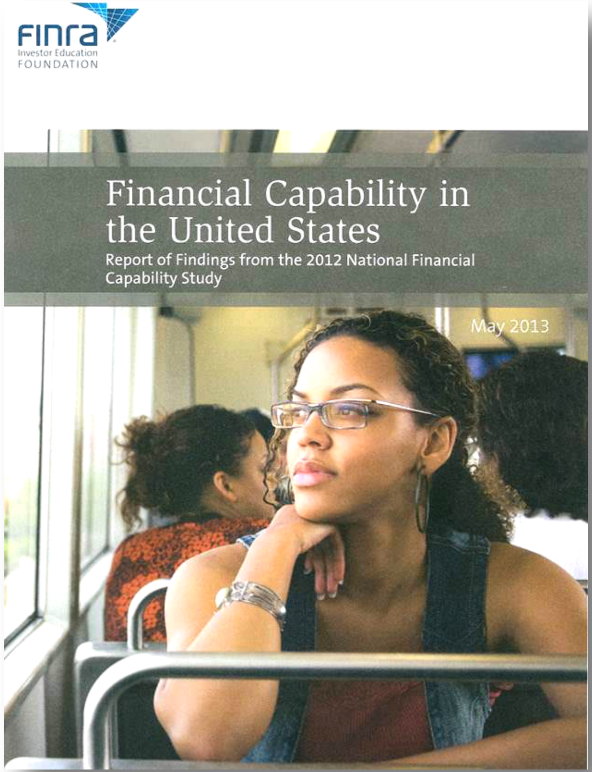
People with these responses are classified as financially fragile.

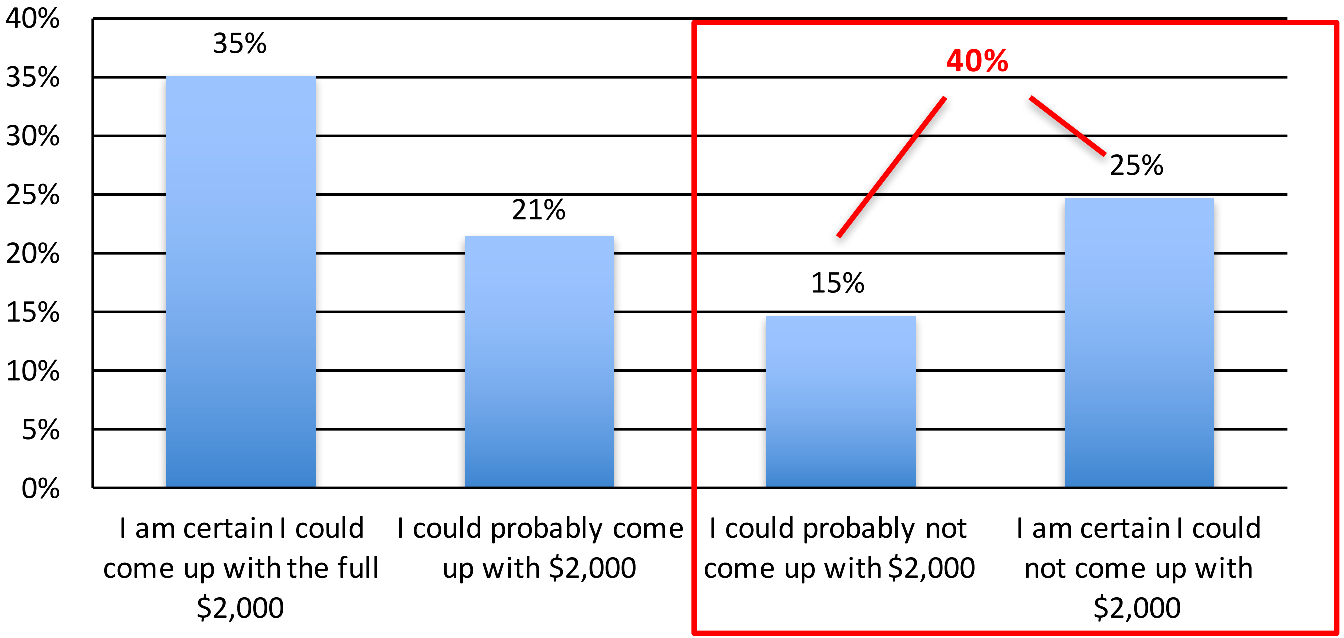
Looking at financial fragility in the US: 2012 National Financial Capability Study (NFCS)

<u>State-by-State Survey</u>: 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



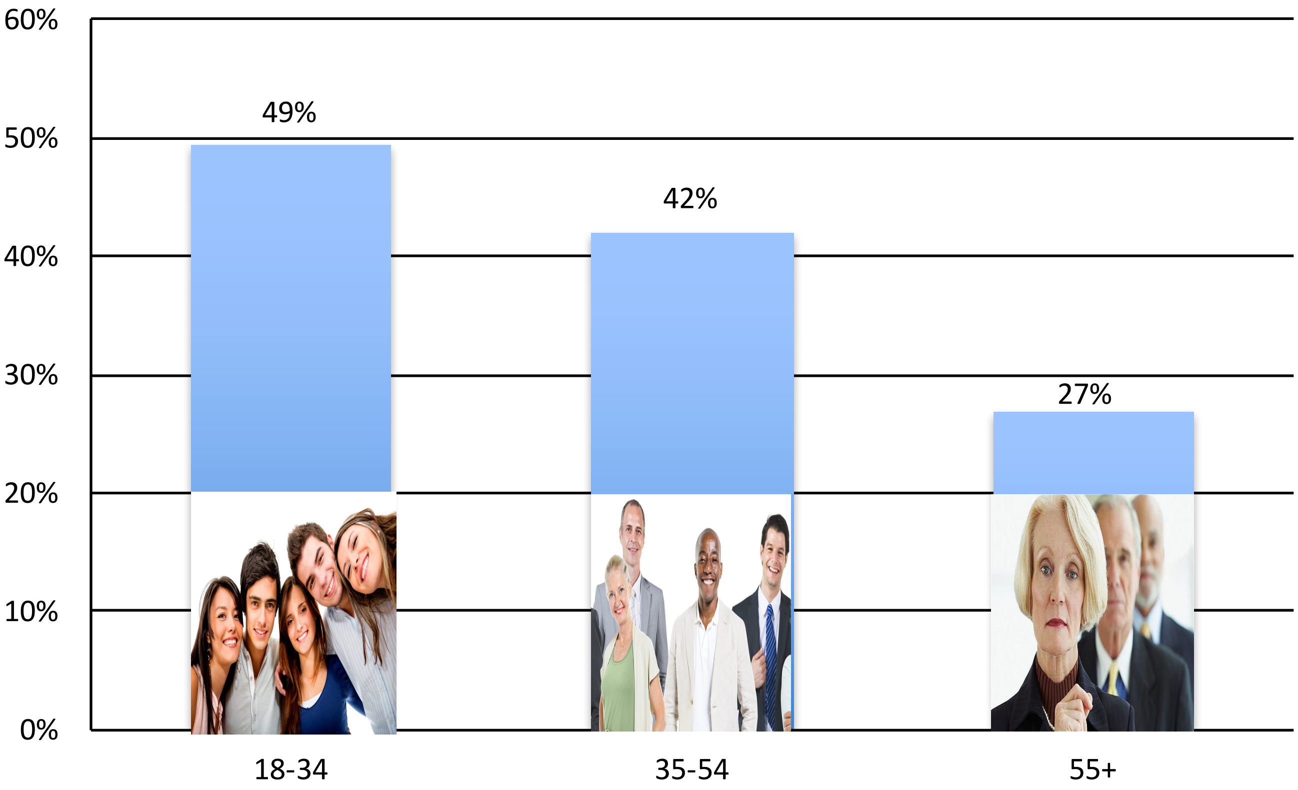
Financial fragility in the US in 2012



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



Who are the most financially fragile?

WOMEN

- **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?

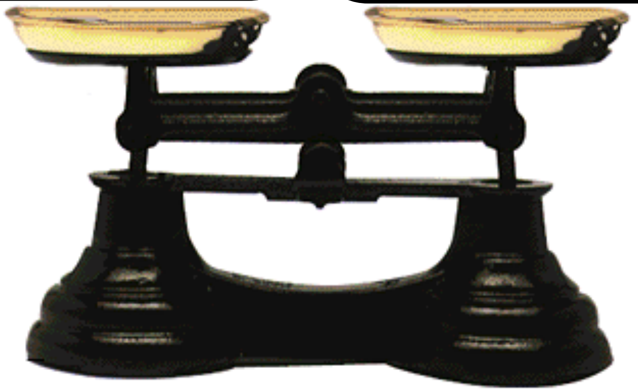
- Lusardi, Schneider, and Tufano (2011), using data from the US in 2009, show that people use many methods of coping
- While many indicating savings, one in three indicate relying on family and friends
- Credit and borrowing is also mentioned by many, though credit is not a good way to insure against 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

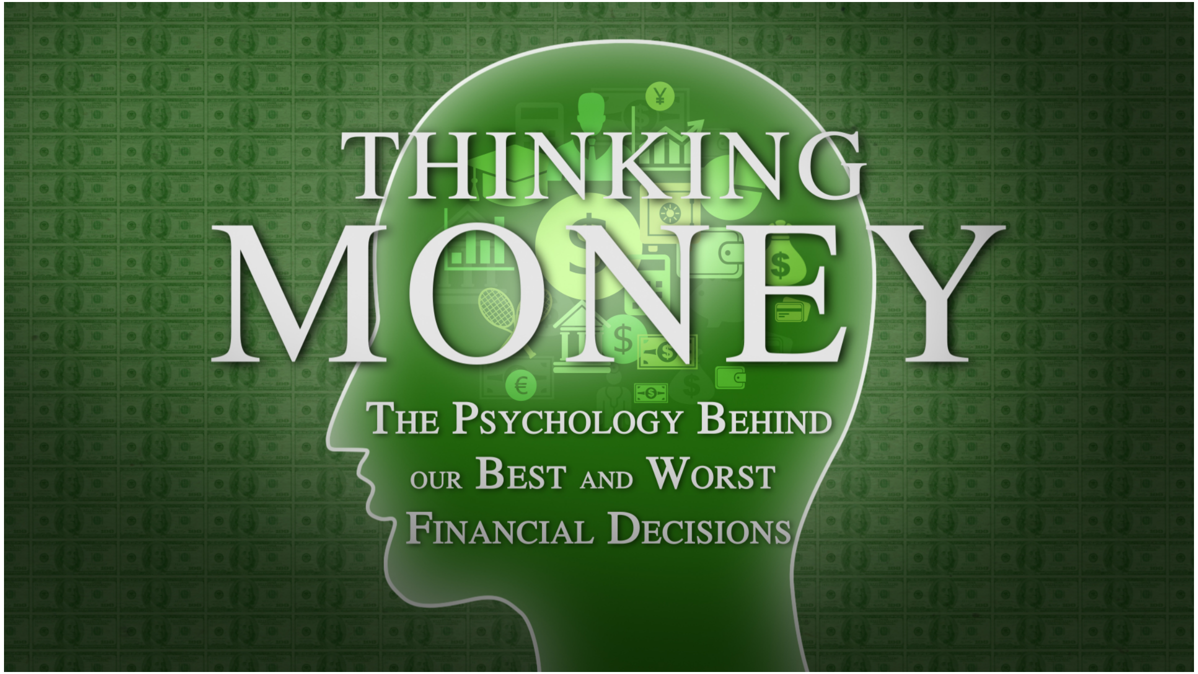


Financial fragility and financial satisfaction

- 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!

If My Wallet Could Talk

Financial Literacy Month Interview Series

GFLEC

GLOBAL FINANCIAL LITERACY
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The Atlantic
How Islam Created Europe
p. 22
The Right Way to Brag
p. 33
THE MONEY REPORT
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
Warren Buffett's Son Steps Up
p. 70
The Case for Loan Sharks
p. 64
How Animals Think
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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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