



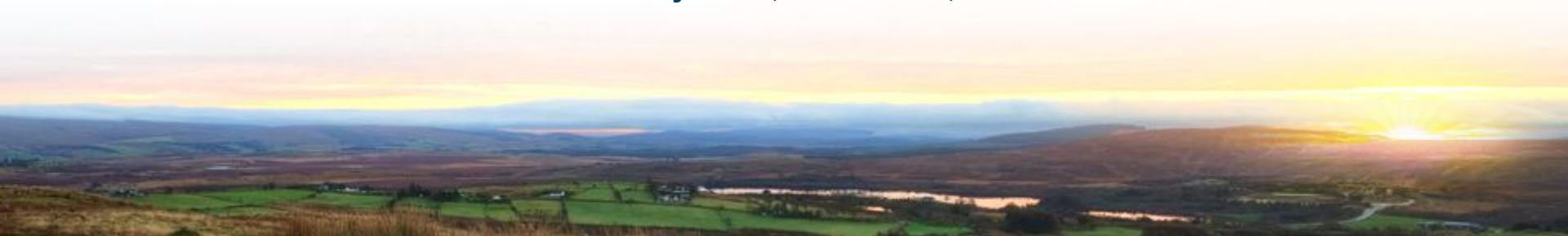
# **Financial Literacy as a Solution to Rising Household Debt**

**Annamaria Lusardi**

The George Washington University School of Business and GFLEC  
Italian Financial Education Committee

**Presentation to the 2019 Annual Commonwealth Central Bank  
Governors Meeting**

**International Monetary Fund, October 16, 2019**



# Three topics

**1** ➤ **Financial literacy**

**2** ➤ **Household debt**

**3** ➤ **Policy and programs**

# Changing landscape for financial security/household choice

## **Changes in financial markets**

- More opportunities to borrow & in large amounts
- Greater complexity of financial instruments

## **Changes in pension systems**

- More individual and private accounts

## **Changes in labor markets**

- Workers change job often
- Wage differential according to skills/education

## **Changes in education**

- Higher cost of education
- Other reasons to plan and save for the future

## **Changes in technology (fintech)**

- Money is invisible
- Apps for decision-making

**To get started**

A number:

**1/3**

# To get started

## 1/3

- People who know the ABC of personal finance
- How many people in the US know the basics before age 50
- How many people in the US know interest compounding in the context of debt

# The S&P Global FinLit Survey

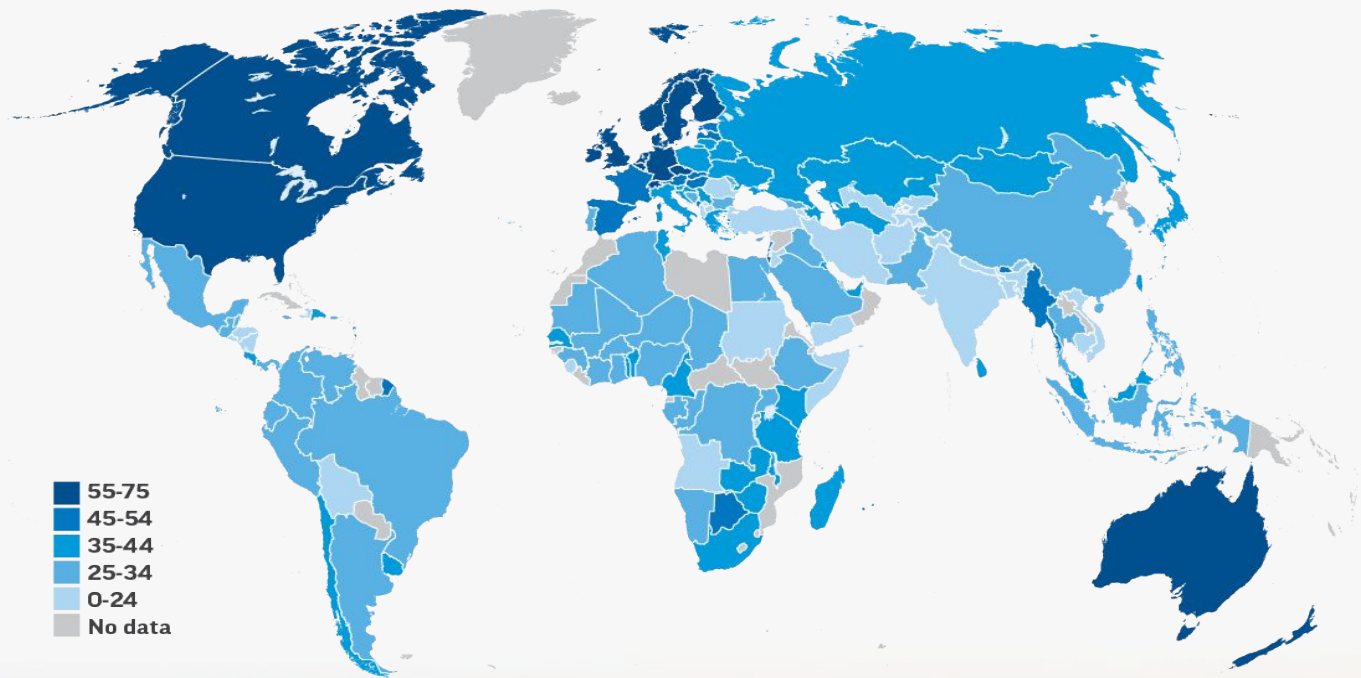
- The largest, most comprehensive, global measure of financial literacy
- Interviewed more than 150,000 adults age 15+ in **more than 140 countries**
- The measure has to be applicable to every country, irrespective of economic structure and financial market development
- The survey covers four topics:
  - Numeracy
  - Interest compounding
  - Inflation
  - Risk diversification

***Being financially literate:***  
Able to answer 3 out of these  
4 topics correctly



# Financial Literacy Across the Globe

% of financially literate adults



**Only 1 in 3 adults** worldwide responded correctly to three out of four topics

# Financial literacy: the ABC of personal finance

## The Big Three

1. “Suppose you had \$100 in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow?”

- ☒ More than \$102
- ☐ Exactly \$102
- ☐ Less than \$102
- ☐ Don't know
- ☐ Refuse to answer

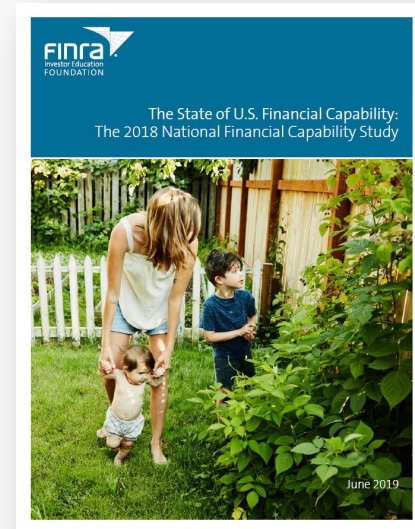
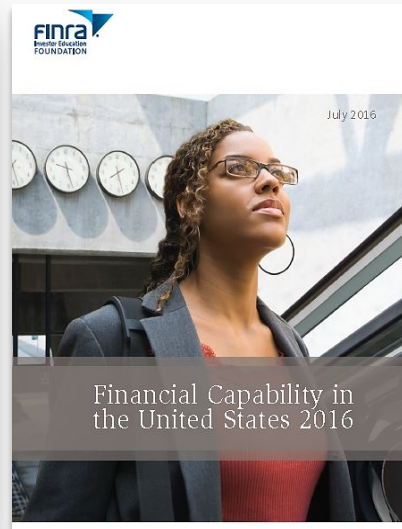
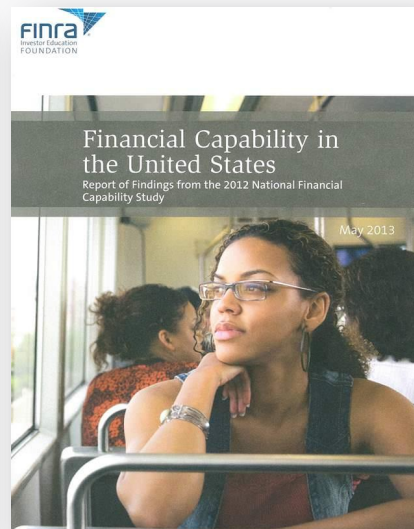
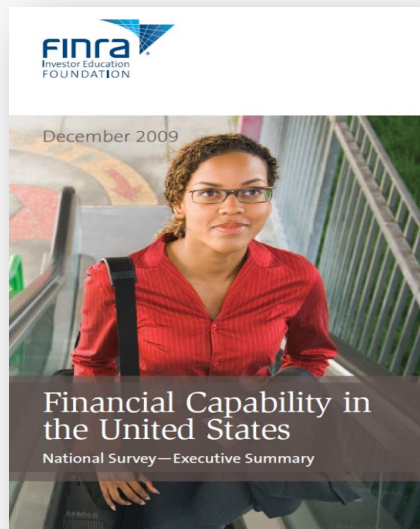
2. “Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, with the money in this account, would you be able to buy...”

- ☐ More than today
- ☐ Exactly the same as today
- ☒ Less than today
- ☐ Don't know
- ☐ Refuse to answer

3. “Do you think the following statement is true or false? *Buying a single company stock usually provides a safer return than a stock mutual fund.*”

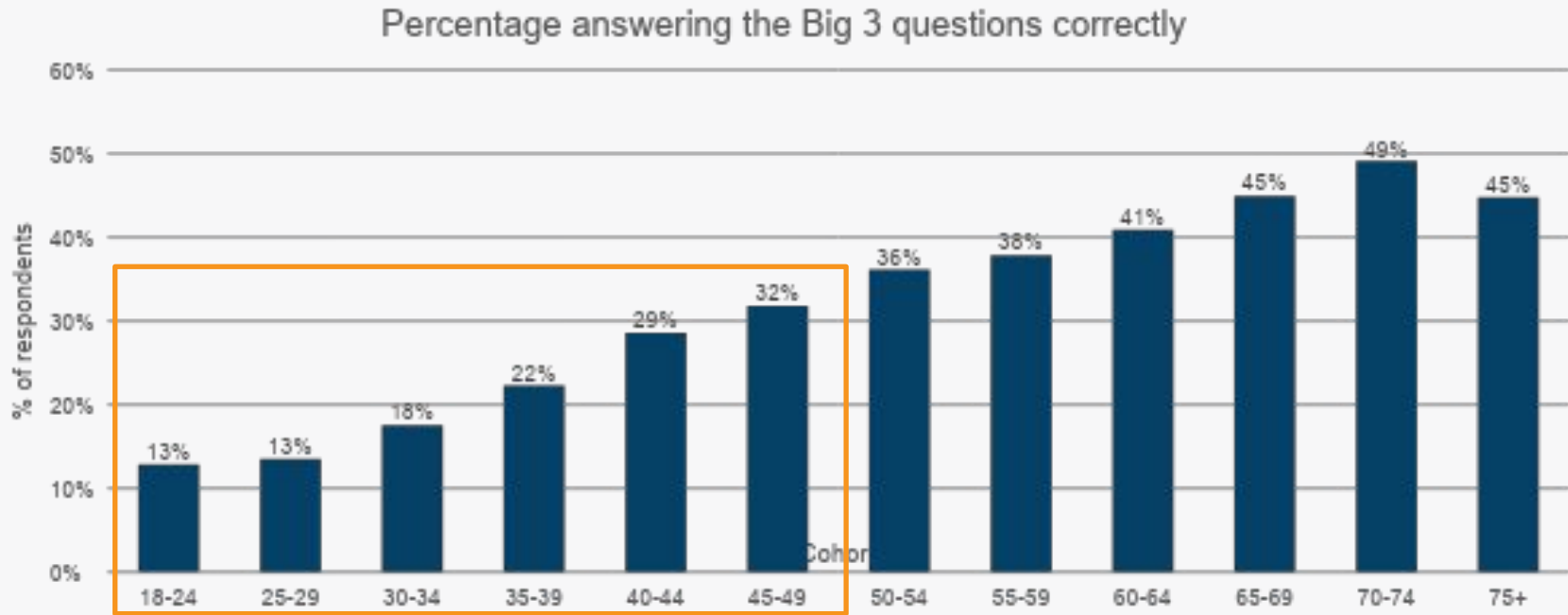
- ☒ True
- ☐ False
- ☐ Don't know
- ☐ Refuse to answer

# Collecting data: The US National Financial Capability Study (NFCS), from 2009 to 2018



**We collaborated with the FINRA Foundation to design survey questions on financial literacy and capability.**

# Financial literacy increases slowly with age/cohort (2018 NFCS)



Source: US 2018 NFCS

**1/3 of Americans** know these 3 basic concepts by age 50 even though many financial decisions are made well before that age

# Knowledge of interest compounding in the context of debt

*Suppose you owe \$1,000 on a loan and the interest rate you are charged is 20% per year compounded annually. If you didn't pay anything off, at this interest rate, how many years would it take for the amount you owe to double?*

*Less than 2 years;*

*At least 2 years but less than 5 years*

*At least 5 years but less than 10 years*

*At least 10 years*

*Do not know.*

*Prefer not to say*

We have also designed a measure of debt literacy (Lusardi and Tufano, 2015)

**How many know about the working of interest compounding  
(Source: NFCS, 2018)**

**About 1/3**

# Changing the statistics

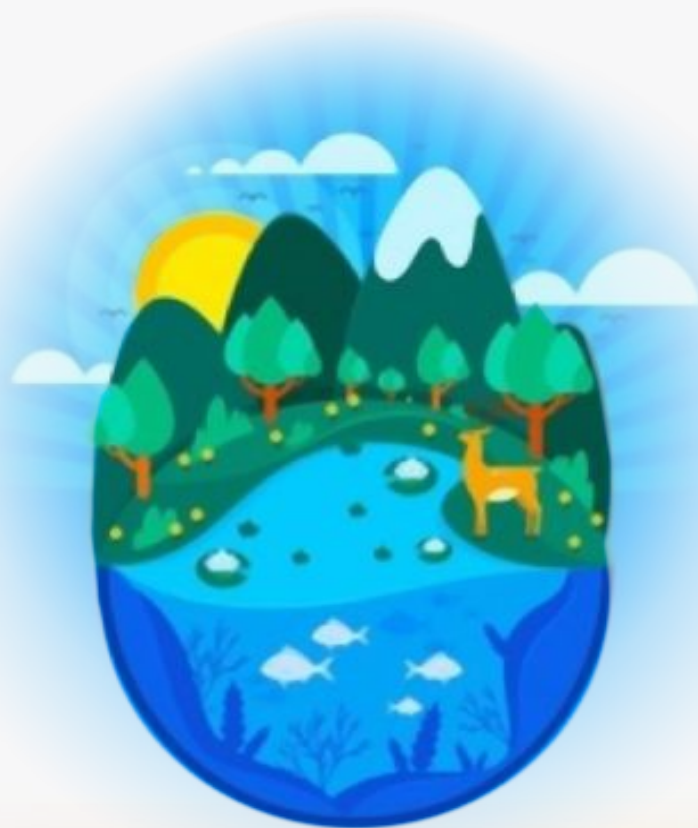
These numbers cannot be our destiny

- Changing the statistics
- Building our future
- A new ecosystem

# Building an ecosystem

## We need many components

- Financial literacy is an essential one
- It is the foundation (like water)
- Financial inclusion and financial regulation work better with financial literacy



## Topic 2

# Household debt

# Household Debt in the US (whole sample)

Many households have collateralized but also uncollateralized debt

## 2018 FINANCIAL SITUATION OF AMERICANS IN 2018

Assets		Debt and Financial Obligations	
Has a checking or saving account	93%	Occasionally overdraws checking account*	19%
		Has carried over a credit card balance and paid interest*	48%
		Demonstrated at least one expensive credit card behavior*	42%
		Has unpaid (past due) medical bills	24%
		Has an auto loan	34%
		Has a student loan for him/herself	19%
		Used at least one form of AFS	28%
Owns a home	60%	Has a mortgage *	57%
		Has a home equity loan *	17%
Has a retirement account through current or previous employer	58%	Made some form of withdrawal from the retirement account he/she has through his/her employer*	16%
Has a retirement account that he/she set up him/herself	35%	Made some form of withdrawal from the retirement account that he/she set up him/herself *	16%
Has other investments aside from a retirement account*	36%		
Observations		27,091	

# Household Debt in the US (Age 25-60)

High share of households  
using high cost methods  
of borrowing

## 2018 FINANCIAL SITUATION OF AMERICANS AGE 25-60

Asset		Debt or Financial Obligation	
Has a checking or saving account	92%	Occasionally overdraws checking account*	23%
		Has carried over a credit card balance and paid interest*	55%
		Demonstrated at least one expensive credit card behavior*	51%
		Has unpaid (past due) medical bills	29%
		Has an auto loan	38%
		Has a student loan for him/herself	23%
		Used at least one form of AFS	33%
Owns a home	57%	Has a mortgage *	68%
		Has a home equity loan *	18%
Has a retirement account through current or previous employer	61%	Made some form of withdrawal from the retirement account he/she has through his/her employer*	20%
Has a retirement account that he/she set up him/herself	32%	Made some form of withdrawal from the retirement account that he/she set up him/herself *	23%
Has other investments aside from a retirement account*	34%		
Observations		16,708	

# High cost borrowing

Many Americans in 2018 — **29%** — have used one of these methods in the past 5 years

Payday loans (14%)

Pawn shops (18%)

Advance on tax refunds (10%)

Auto title loans (11%)

Rent-to-own stores (12%)



# Expensive credit card behavior (from Lusardi and Tufano, 2015)

**In the past 12 months, which of the following describes your experience with credit cards?**

**In some months, I paid the minimum only (35%)**

**In some months, I was charged a fee for late payment (16%)**

**In some months, I was charged an over the limit fee for exceeding my credit line (10%)**

**In some months, I used the card for a cash advance (13%)**



# Summary statistics

Some indicators:

- Indebtedness
- Financial fragility

# Indebtedness

How strongly do you agree or disagree with the following statement: I have too much debt right now.

- 1 = "Strongly Disagree"
- 2
- 3
- 4 = "Neither Agree or Disagree"
- 5
- 6
- 7 = "Strongly Agree"
- Don't know
- Prefer not to say



# Indebtedness

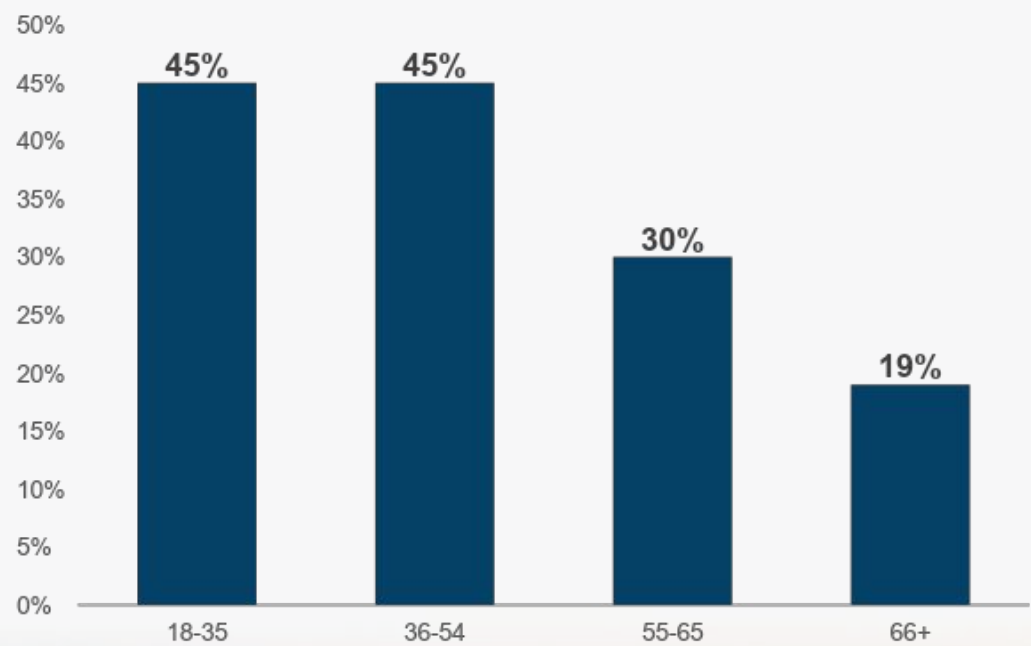
How strongly do you agree or disagree with the following statement: I have too much debt right now.

- 1 = "Strongly Disagree"
- 2
- 3
- 4 = "Neither Agree or Disagree"
- 5
- 6
- 7 = "Strongly Agree"
- Don't know
- Prefer not to say



**People with these responses are classified as over-indebted**

# Who are the most over-indebted?



Source: 2018 NFCS

# 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.

*From Lusardi, Schneider and Tufano, BPEA, 2011*

# 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**?

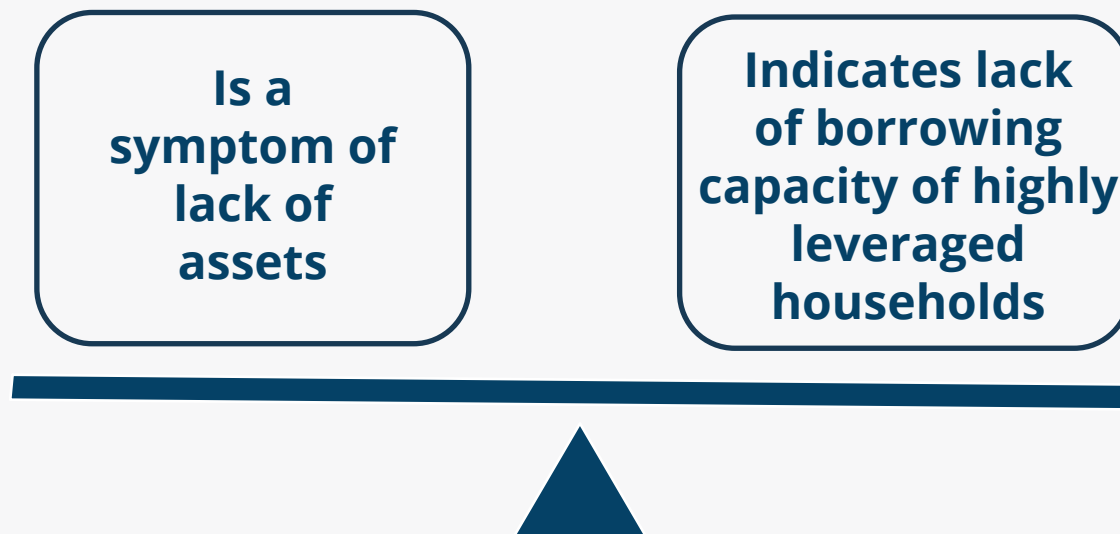
- I am certain I could come up with the full \$2,000.
- I could probably come up with \$2,000.
- I could probably not come up with \$2,000.
- I am certain I could not come up with \$2,000.
- Don't know.
- Prefer not to say.



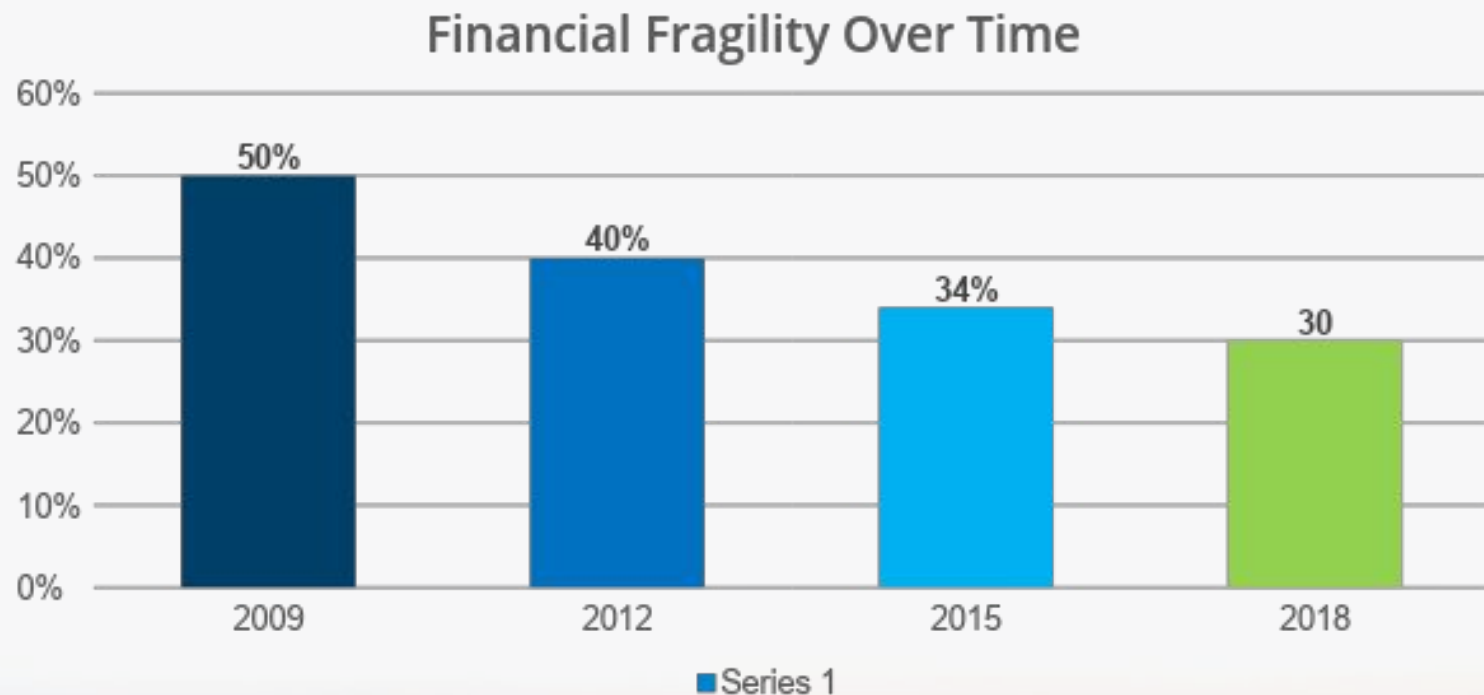
**People with these responses are classified as financially fragile**

*From Lusardi, Schneider and Tufano, BPEA, 2011*

## Financial fragility: What this measure does



# Many Americans are still financially fragile (2018 NFCS data)



Source: 2009 TNS; 2012, 2015, & 2018 NFCS

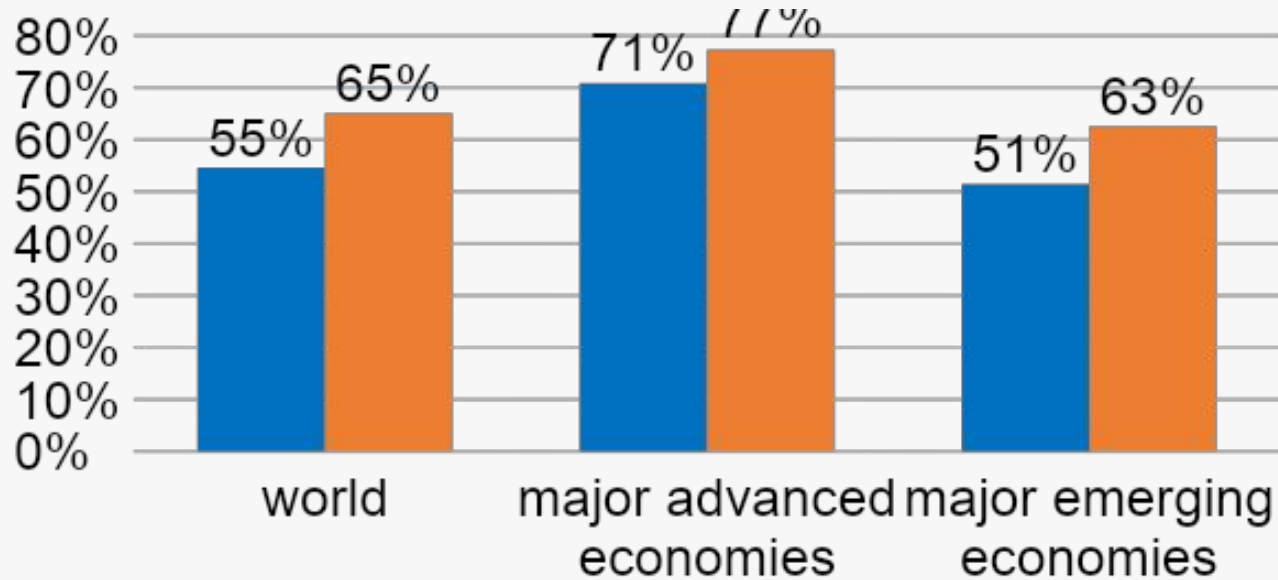
# The link with financial literacy



Who is able to answer the “Big 3” questions:

- is less likely to have too much debt
- is less likely to be financially fragile
- is less likely to use high cost borrowing

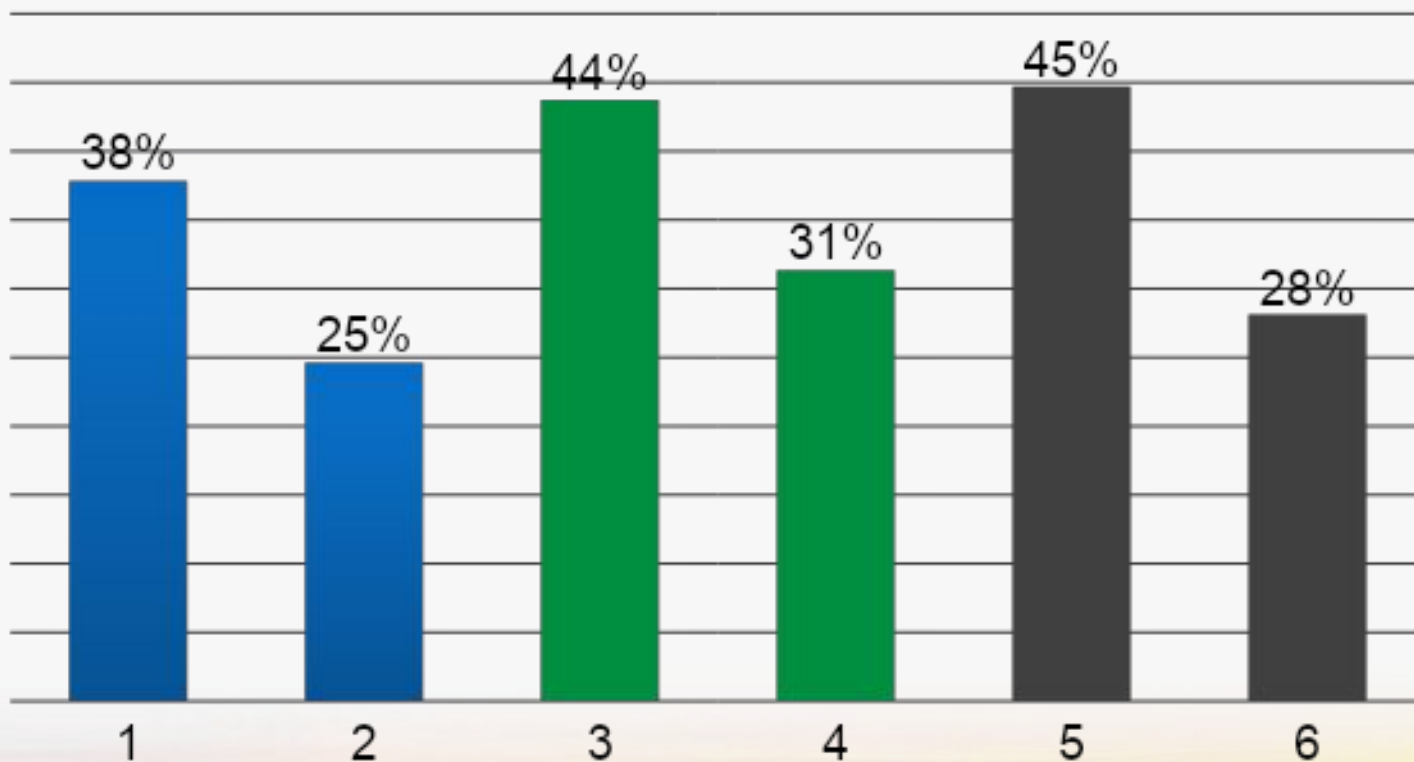
# Account use among account holders who save: Global Survey



- No understanding of compound interest
- Understanding of compound interest

Source: GFLS & Global Findex database

# Financial literacy and financial inclusion (Global Survey)



## Topic 3

# Using evidence to build programs and advise policy

# Given widespread financial illiteracy

## Need for large and scalable programs

- Financial education in school
- Financial wellness programs in the workplace
- Financial education in the community (libraries, museums, theaters, other places where people go to learn)



# Advice for public policy : Toward a new ecosystem

## Building a financial resilient society

- Add financial literacy among indicators for policy
- Toward a more inclusive society



# Financial education

With financial education, we are forming the next generation of customers, workers, and citizens

Need to change the statistics we have seen so far

Need to have a long-term view

## Policy question

Short definition of financial literacy: **A vision for the future**

The question is: **Which future do we want to build?**



## A quote: Financial literacy is the best line of defense

*Well-informed consumers, who can serve as their own advocates, are one of the best lines of defense against the proliferation of financial products and services that are unsuitable, unnecessarily costly, or abusive.*

***Ben Bernanke, Former Chairman of the Fed***

# References

Klapper, L. and A. Lusardi, “Financial Literacy and Financial Resilience: Evidence from Around the World,” with Leora Klapper, *forthcoming Financial Management*.

Lusardi, A., O.S. Mitchell and N. Oggero, “Financial Vulnerability in Later Life and its Implications for Retirement Well-being,” forthcoming in *Remaking Retirement? Debt in an Aging Economy*, edited by Annamaria Lusardi and Olivia S. Mitchell, Oxford University Press.

Lusardi, A. and P. Tufano, “Debt Literacy, Financial Experiences and Overindebtedness,” *Journal of Pension Economics and Finance*. October 2015, 14(4), pp. 329-365.

Lusardi, A. and C. de Bassa Scheresberg, “Financial Literacy and High-Cost Borrowing in the United States,” NBER Working Paper n. 18969, April 2013.

Lusardi, A., D. Schneider and P. Tufano, “Financially Fragile Households: Evidence and Implications” *Brookings Papers on Economic Activity*, Spring 2011, pp. 83-134.

**Thank you!**