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Financial Fragility and Resilience in Europe and the US amid COVID-19

Annamaria Lusardi
The George Washington University, GFLEC, and Italian Financial Education Committee

December 2, 2020

Three topics

1. Measurement of financial fragility
2. The role of financial literacy
3. Improving financial resilience

Measuring financial fragility in the wake of the 2007-2008 financial crisis in the US

Touch the pulse of households' personal finances

A simple stress test for households

Looking for a measure of wellbeing

Measuring financial fragility

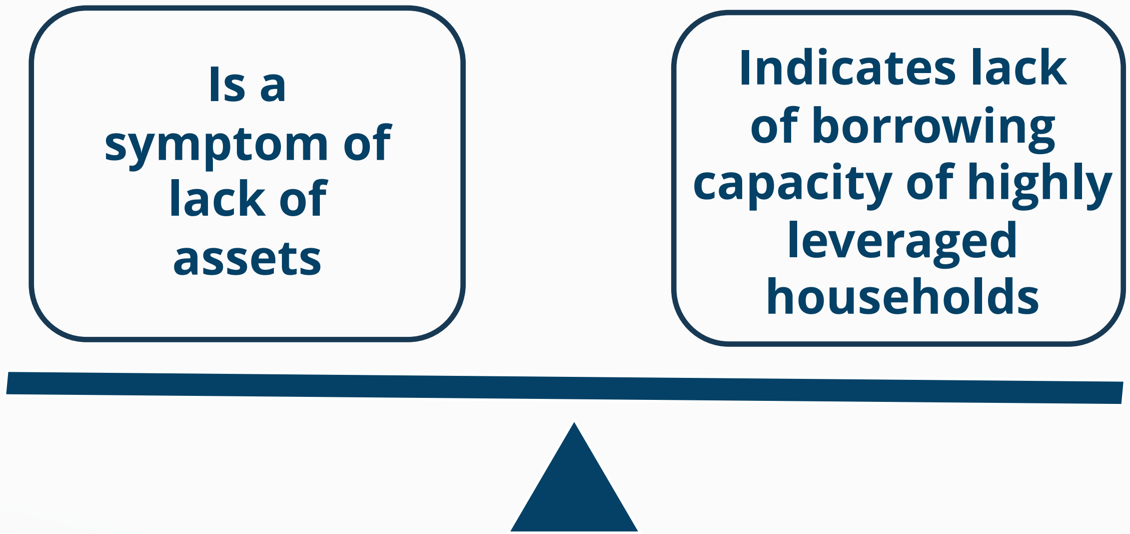
How **confident** are you that you could come up with **$2,000** if an **unexpected need** arose **within the next month**?

- 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

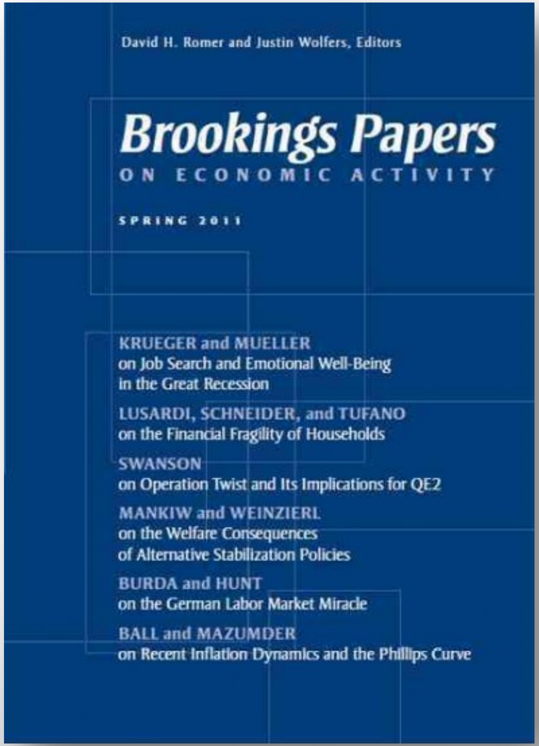
From Lusardi and Tufano, BPEA, 2011

Financial fragility: What this question measures

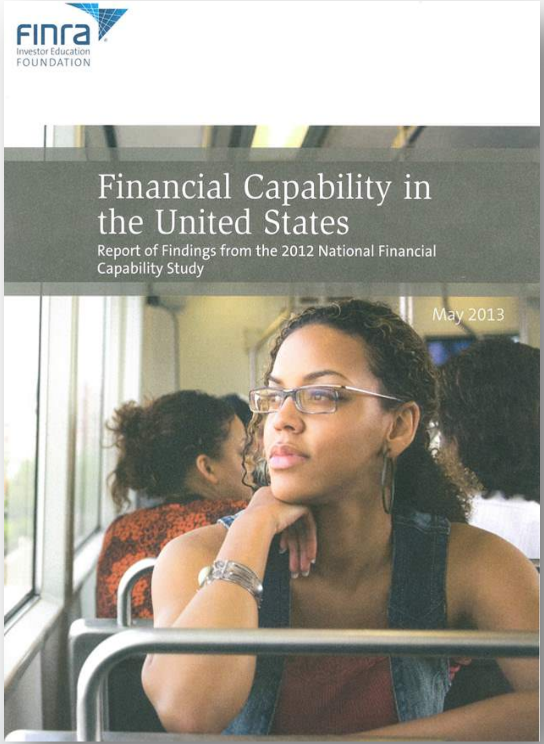


Collecting data over time: 2009 – 2020

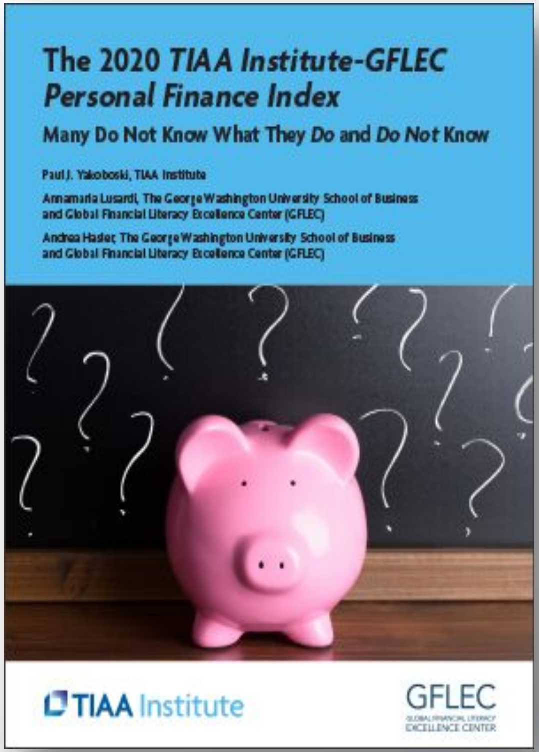
2009 TNS Global Economic Crisis Survey



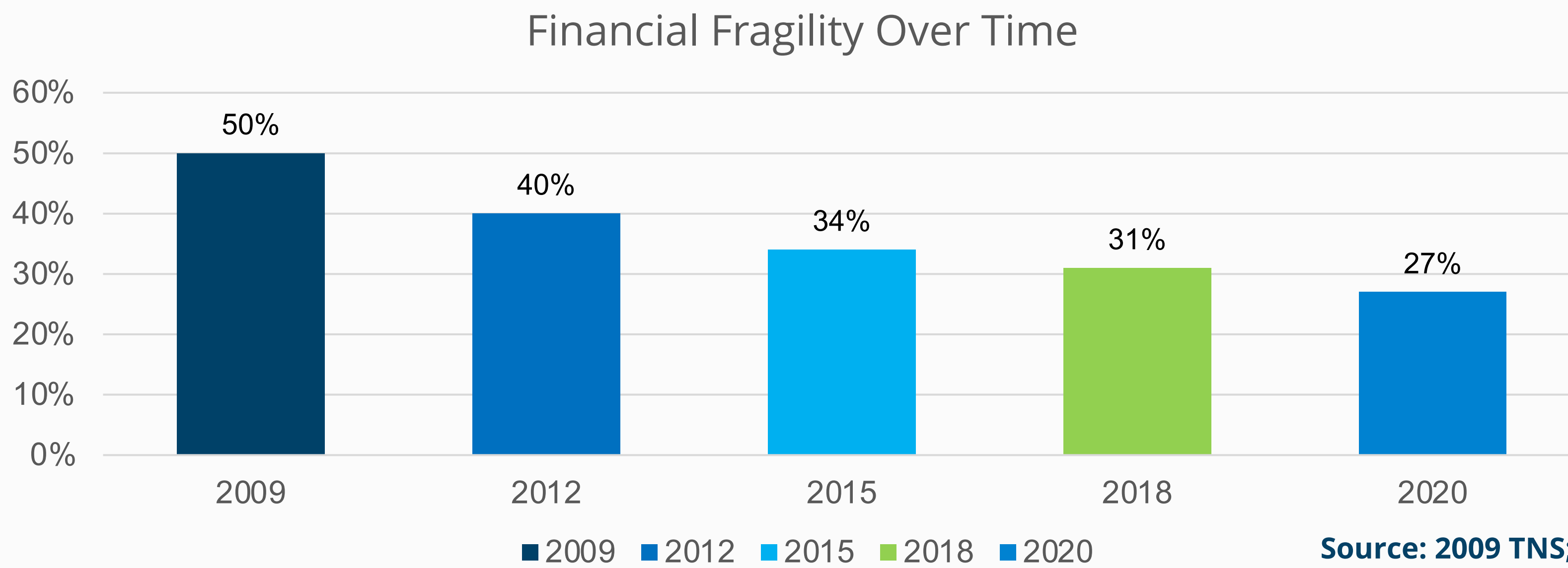
2012 FINRA National Financial Capability Study (NFCS)



2020 TIAA Institute-GFLEC Personal Finance Index (P-Fin Index)



Our long term research on financial fragility



Source: 2009 TNS; 2012, 2015, & 2018 NFCS, 2020 P-Fin Index

Financial fragility has been declining over time, but more than 1 in 4 Americans had difficulty dealing with a mid-size shock when the economy was doing well.

The images of financial fragility when the economy shut down in 2020 and the government shut down in 2019

Long lines at food banks in 2020

Long lines at food banks in 2019

Federal workers line up for free meals, visit food banks as shutdown hits Day 28

abcNEWS

Who are the most financially fragile? Evidence from the 2015 NFCS

Millennials (age 18-34)

- **43% of Millennials are financially fragile**

Women

- **39% of American women are financially fragile vs. 28% of men**

Middle-Income (income $25K-$75K)

- **33% of middle-income people are financially fragile***

*Age 25-60, 2015 NFCS

Source: 2015 NFCS

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...but also

Upper Middle Class

29% of people with income between $50K and $100K are financially fragile

Sample age 25-60

College Graduates

25% of college graduates age 25-60 are financially fragile

Fully Employed

31% of fully employed people are financially fragile

Sample age 25-60

Source: 2015 NFCS

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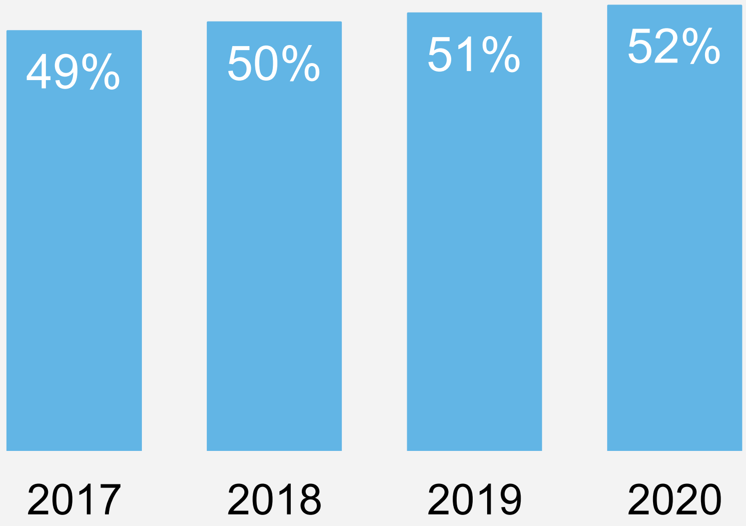
Financial fragility is high among those with low financial literacy

- **Financial literacy (Big Three): Knowledge of simple concepts (interest rates/numeracy, inflation, and risk diversification)**

A richer measure of financial literacy: P-Fin Index (28 questions)

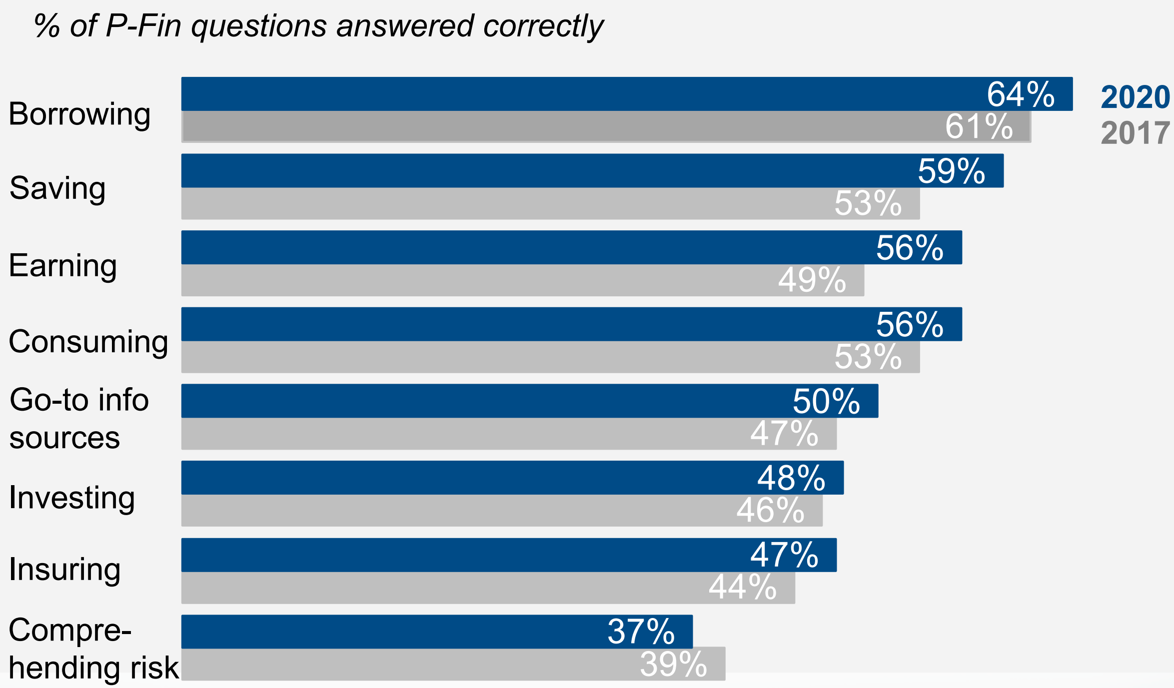
% of P-Fin questions answered correctly



Source: TIAA Institute-GFLEC Personal Finance Index (2017-2020).

What people know and how financial literacy is changing over time

Risk & insuring are what people know the least

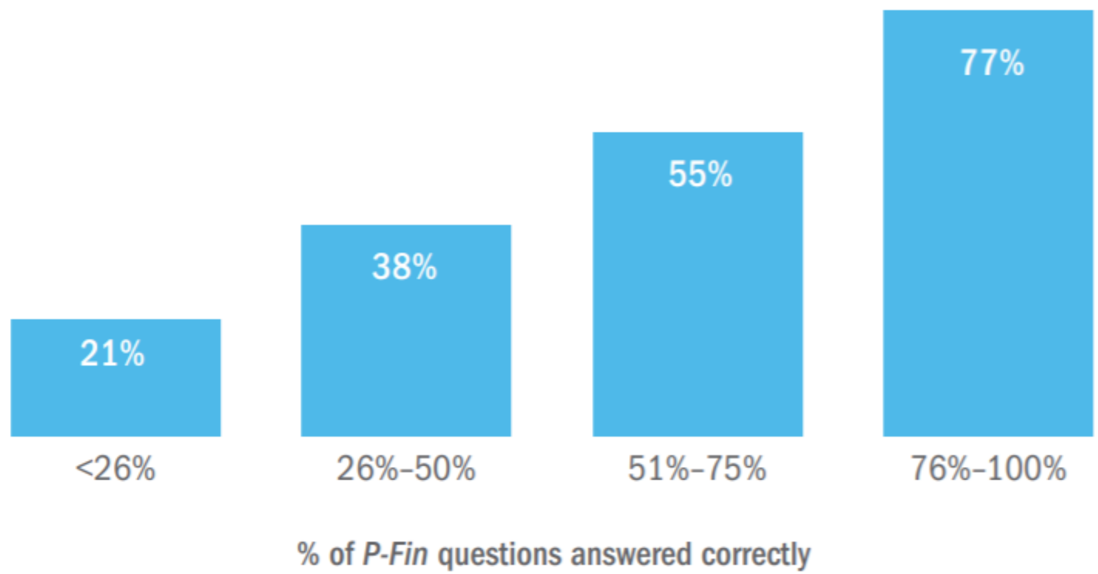


Source: TIAA Institute-GFLEC Personal Finance Index (2017, 2020).

The strong link between financial literacy and financial fragility

Those with greater financial literacy are less likely to be financially fragile.

% who could certainly come up with $2,000 if an unexpected need arose within the next month



Source: *TIAA Institute-GFLEC Personal Finance Index* (2020).

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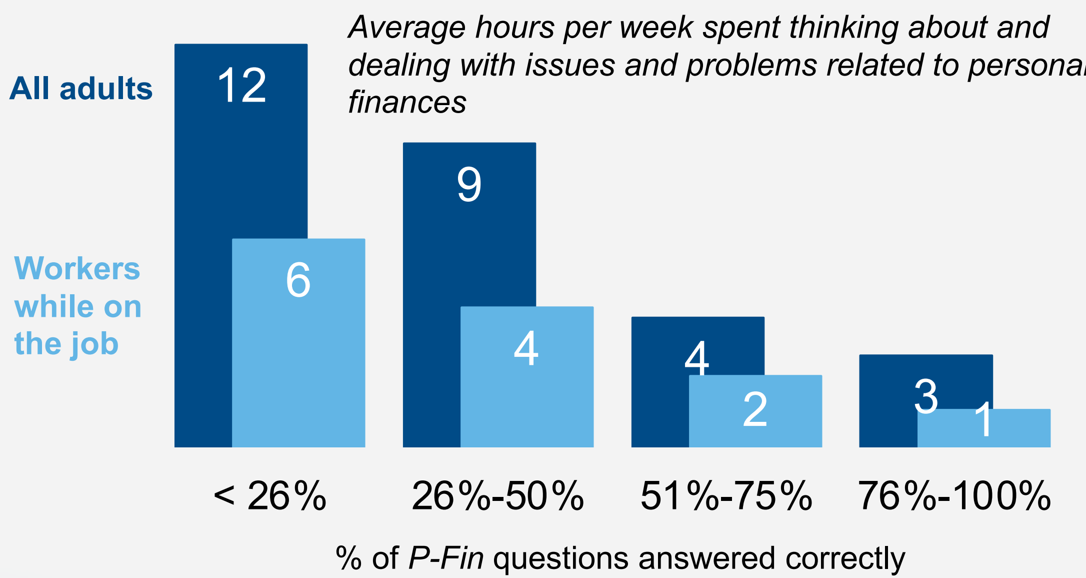
Another indicator: Number of hours per week in total and at work spent thinking about and dealing with personal finance issues



Source: TIAA Institute-GFLEC Personal Finance Index (2020).

Turning to Europe

New evidence from the pandemic: Financial literacy and fragility in Italy (June 2020)


Comitato per la programmazione e il coordinamento delle attività di educazione finanziaria

BVA Doxa

EMERGENZA COVID-19:
GLI ITALIANI TRA FRAGILITÀ
E RESILIENZA FINANZIARIA

Financial literacy proved to be a shield to protect households against shocks

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Financial fragility in Europe: Our Bruegel's policy contribution

Policy Contribution
Issue n°15 | July 2020

The financial fragility of European households in the time of COVID-19

Maria Demertzis, Marta Domínguez-Jiménez and Annamaria Lusardi

Executive summary

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- **THE CONCEPT OF** household financial fragility emerged in the United States after the 2007-2008 financial crisis. It grew out of the need to understand whether households' lack of capacity to face shocks could itself become a source of financial instability, in addition to risks to the stability of banks and the greater financial system. The concept goes beyond assessing the level of assets and encompasses the state of household balance sheets, including indebtedness. It relies also on individual perceptions of the ability to rely on families and friends and other methods to deal with shocks, though such aspects are less easy to measure and rely frequently on self-assessments.
- **IN THE WAKE** of COVID-19, we ask how well-prepared households were in the European Union (including the United Kingdom) to handle an unexpected expense. Two years before the pandemic hit, a substantial share of EU households reported that they would be unable to handle unexpected expenses. In some EU countries, many households had savings equivalent to just a few weeks of basic consumption.
- **WE FIND THAT** one in three EU households is unable to meet an unexpected shock during regular times, let alone during a pandemic. COVID-19-related support measures put in place across the EU are intended to provide economic help to those households where members have lost jobs or face a severe reduction in income. However, in a number of countries where one in two households was already fragile - typically countries that are already economically weaker - state help is likely to be smaller and shorter-lived. Policies that increase financial resilience in structural ways will become necessary in the future.

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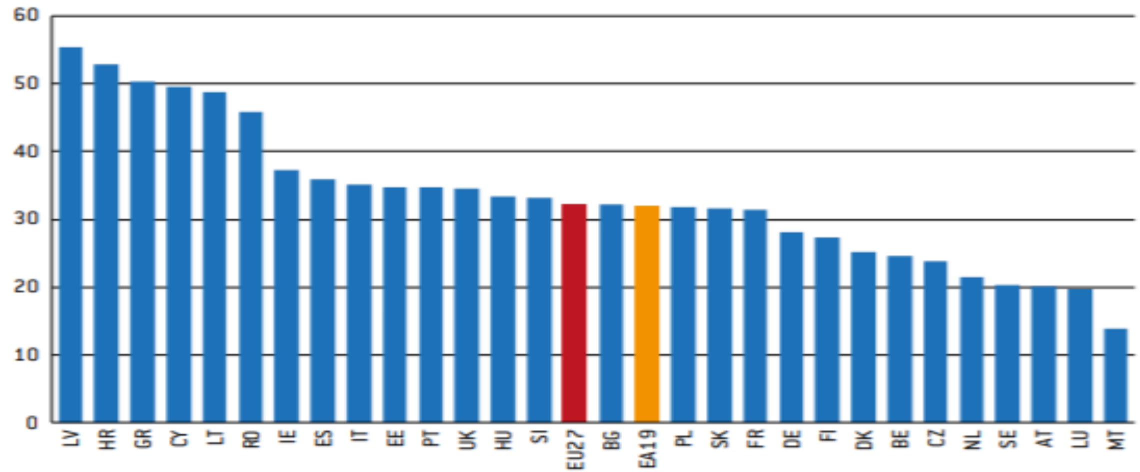
Financial fragility in Europe

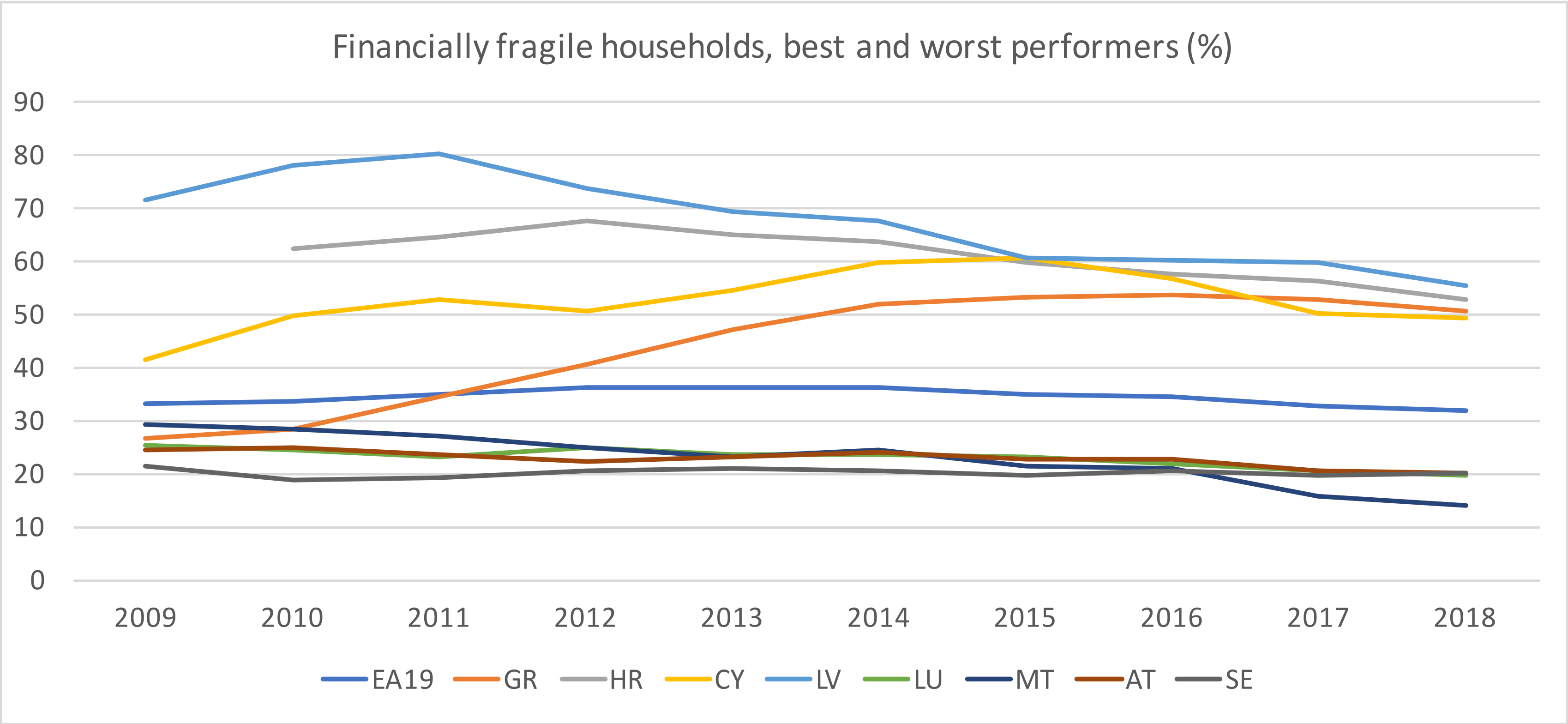
In Figure 1, we plot the share of households that self-reports being unable to deal with an unexpected required expense. The data refers to 2018, a period of growth (albeit moderate) among European countries but, importantly for this exercise, not a period of specific financial stress.

Figure 1: Household inability to meet an unexpected required expense, all households, percentage shares, 2018



Source: Eurostat, EU-SILC. Notes: EU27 displays the average of all EU member states after January 2020 (those exhibited except the UK). EA19 is the euro-area average.

Financial fragility in Europe over time



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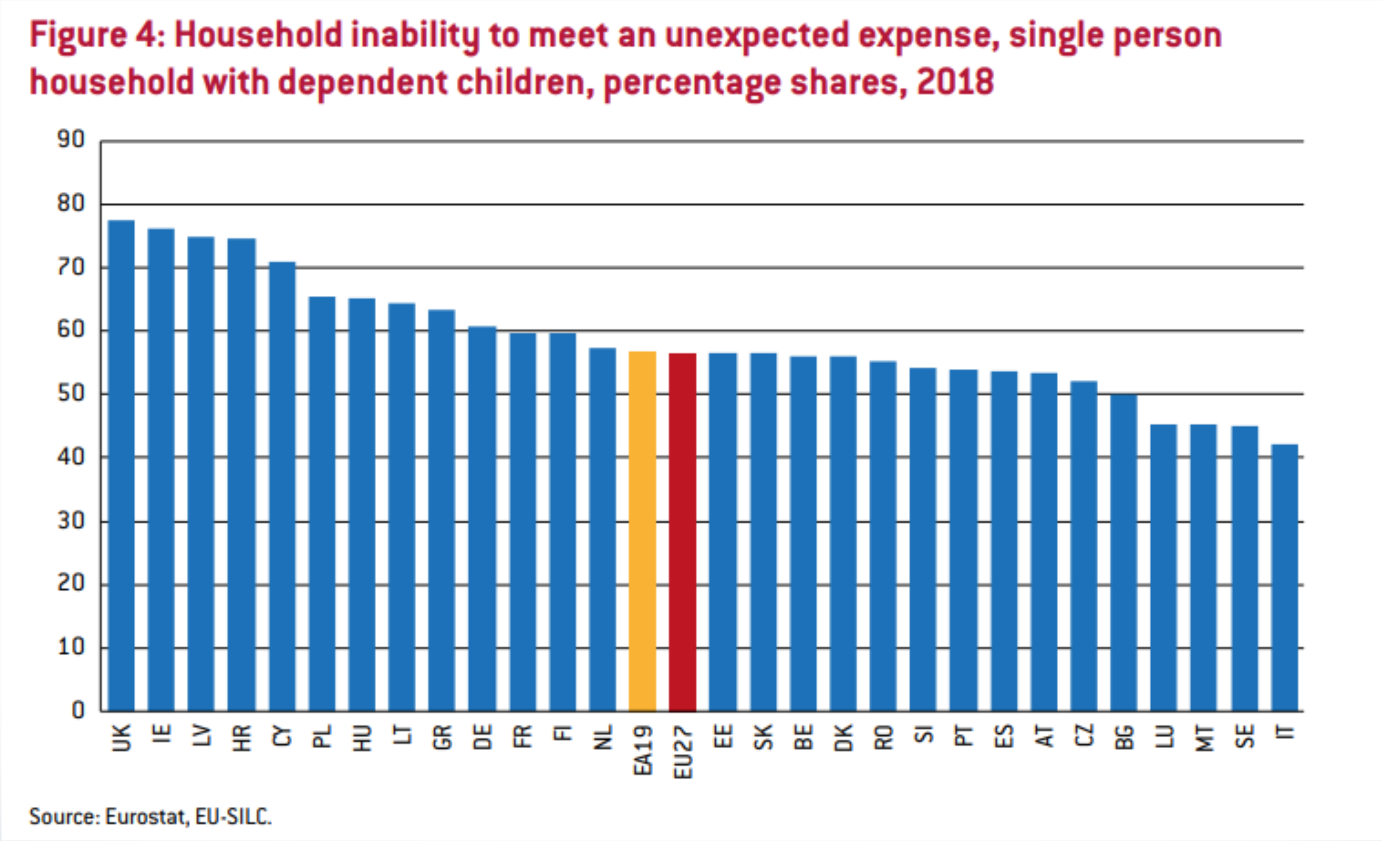
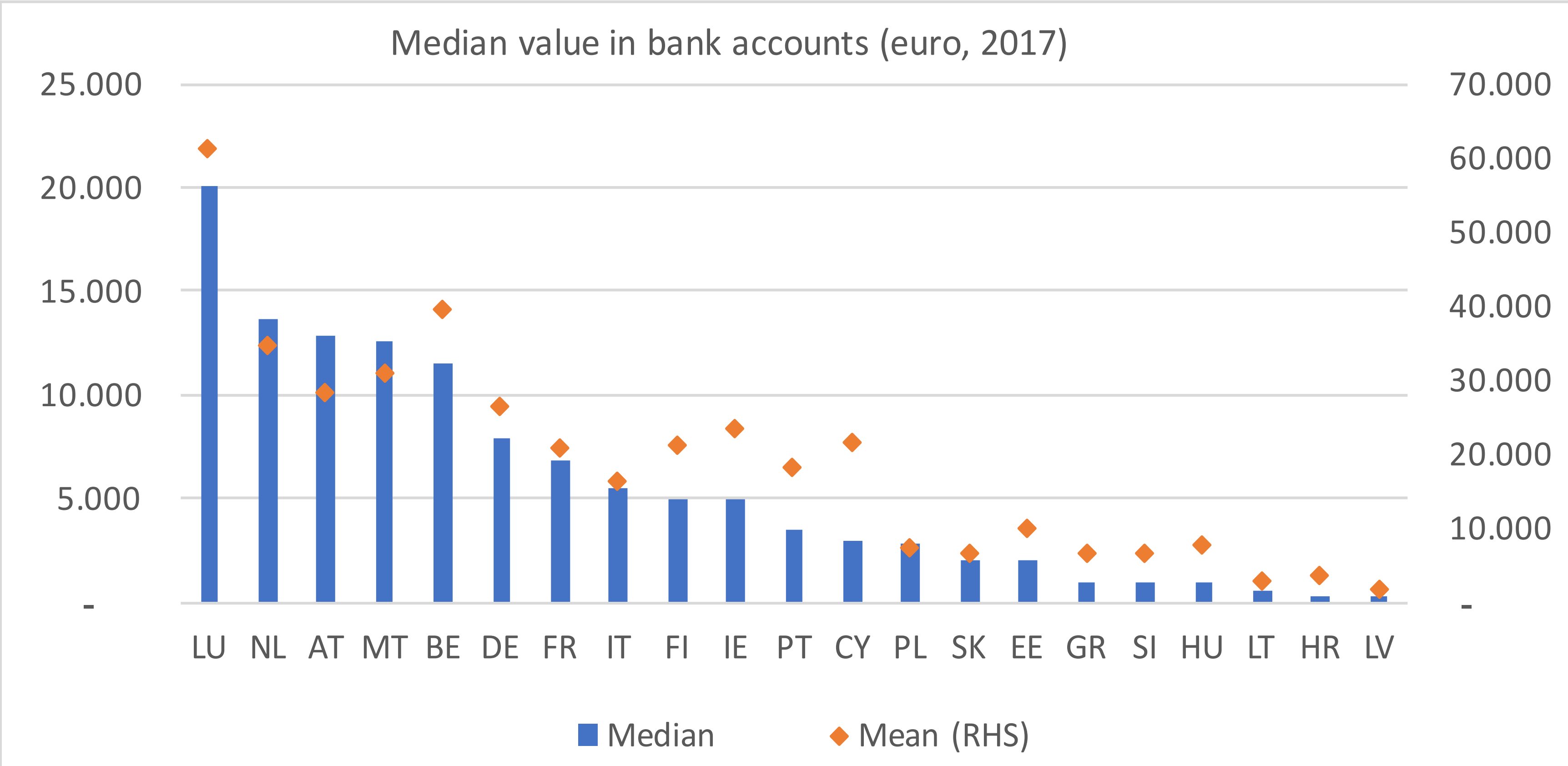
Financial fragility in Europe: Single parent households



Even when looking at bank accounts, many households did not have liquid assets to deal with shocks



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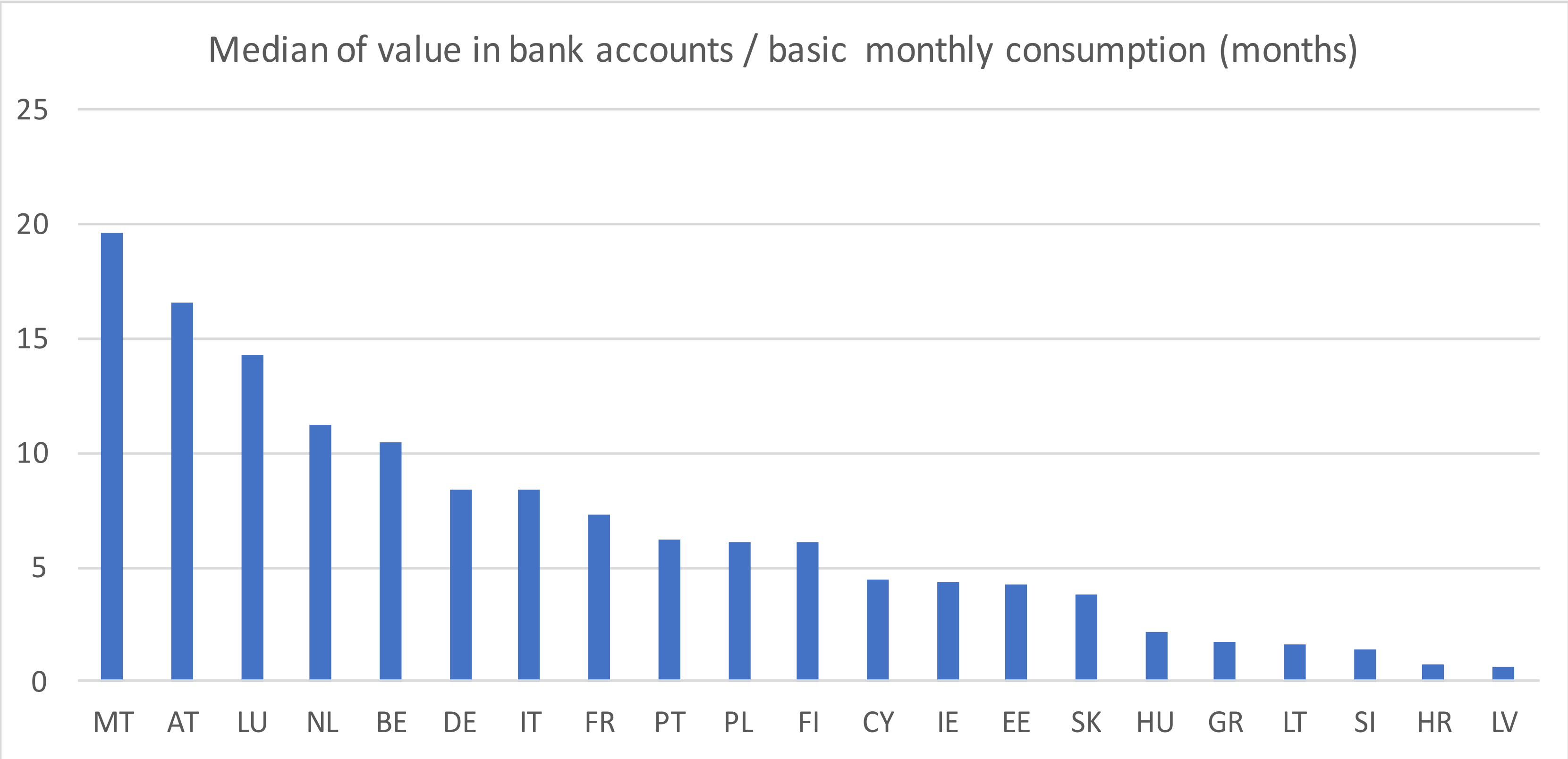
How long liquid assets can support consumption



A quote from a central banker in Europe

"Many like us have long considered financial literacy as an essential tool for individuals to manage their financial affairs wisely and to be prepared for the unexpected. But following the outbreak of COVID-19, financial literacy became a survival skill which everyone needs to build greater resilience and to navigate a sea of uncertainty."

Vice Governor Luís Máximo dos Santo, Banco de Portugal.

Some considerations

- Financial fragility was high even before the COVID-19 pandemic
    - Many families would not have been able to face a mid-size shock, let alone a big one
- Financial fragility remains high even when the economy does well
    - Low levels of precautionary savings
- There are large differences in financial fragility among the population
    - Some groups were vulnerable well before COVID-19
- Financial illiteracy is another source of fragility
    - People know little about risk and risk management

Looking forward

Looking forward

- The crisis gives us an opportunity to reimagine the future and we cannot go back to the "normal" before the pandemic because that normal was not good enough.

- Need to work toward a more resilient society

- New policies and programs are needed and some are underway
  - OECD Recommendation on Financial Literacy
  - European Commission integrated financial literacy in its Capital Markets Union (CMU) Action Plan

Looking forward: Policies and programs

To change the statistics, we need large and scalable programs, such as:

- Financial education in school
  - Starting from elementary school to college and beyond
- Financial education in the workplace
  - There are costs to employers for the financial illiteracy of employees
- Financial education where people go to learn
  - Websites, museums, theaters…

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Public policy : Toward a new ecosystem

Building a financially resilient society

- Add financial literacy among indicators of wellbeing/aggregate statistics to monitor
- Toward a more inclusive society

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Some of the programs done by GFLEC based on our data and research

Fast Lane initiative: Promoting financial education in high school

- Provides research-based guidance and support for (1) students, (2) teachers, (3) school administrators, (4) parents/guardians, (5) policy makers, and (6) community members

- Making sure young people are on the fast lane to financial prosperity

Personal Finance course at the George Washington University

- Personal Finance courses for undergraduate and graduate students
- Extensive coverage of risk and risk management
- Paying attention to gender and other differences in financial literacy
- Material available for free on our website

Financial education in the workplace (targeted to Millennials)

Set-up:

- Design of a low-cost, easily-replicable financial education program called «Five Steps to Planning Success»
- Covering five basic financial planning concepts that relate to retirement
- Delivery models: written narratives and online videos
- Evalutation: control and treated groups using online survey (Rand ALP)

Program:

- Targeted to young workers
- Covered concepts that people know the least, for example risk, in a simple story

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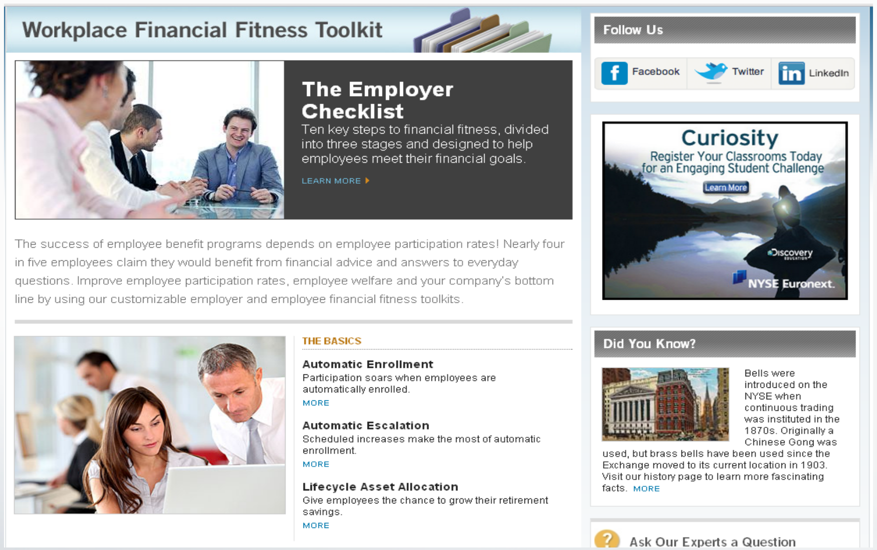
Short video about risk: Don’t put all your eggs in one basket

Assessed effectiveness of different methods of teaching using Rand American Life Panel (ALP)

Scaling up

We built a toolkit for NYSE to promote financial wellness in the workplace



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Life sometimes is a storm

The Storm on the Sea of Galilee
Rembrandt, 1633

Should household financial resilience be part of public policy?

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Thank you!