On the costs of financial illiteracy and how to take care of your personal finances

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What we will discuss today

• Financial literacy research
• How research can guide policy and programs
• What we can learn for our personal finances
A number to get started

1/3
A number to get started

1/3

• Proportion of people in the US who know the ABCs of personal finance before age 50
• Proportion of people who are financially literate around the world
• Proportion of people who were financially fragile before the pandemic started
Financial literacy: The ABCs of personal finance

The Big 3

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?”

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…”

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.*”
Financial literacy in America, by age

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

Source: 2018 NFCS
Financial literacy increases with income... 

- <$25K: 14%
- $25–49K: 23%
- $50–74K: 33%
- $75–99K: 36%
- $100K+: 53%

Financial literacy increases with education...

- High school or lower: 16%
- Some college: 27%
- College degree and more: 49%

Source: 2018 NFCS
Financial literacy among 15-year-old

Every three years since 2000, the **OECD Programme for International Student Assessment (PISA)** has assessed the extent to which students near the end of their compulsory education have acquired the knowledge and skills needed to fully participate in society.

Financial literacy was added in 2012.
### 2018 PISA financial literacy scale

Average scores of 15-year-old students on the PISA financial literacy scale, by education system: 2018

<table>
<thead>
<tr>
<th>Education system</th>
<th>Average score</th>
</tr>
</thead>
<tbody>
<tr>
<td>OECD average</td>
<td>505</td>
</tr>
<tr>
<td>Estonia</td>
<td>547</td>
</tr>
<tr>
<td>Finland</td>
<td>537</td>
</tr>
<tr>
<td>Canada</td>
<td>532</td>
</tr>
<tr>
<td>Poland</td>
<td>520</td>
</tr>
<tr>
<td>Australia</td>
<td>511</td>
</tr>
<tr>
<td><strong>United States</strong></td>
<td><strong>506</strong></td>
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<tr>
<td>Portugal</td>
<td>505</td>
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<tr>
<td>Latvia</td>
<td>501</td>
</tr>
<tr>
<td>Lithuania</td>
<td>498</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>495</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Education system</th>
<th>Average score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>492</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>481</td>
</tr>
<tr>
<td>Italy</td>
<td>476</td>
</tr>
<tr>
<td>Chile</td>
<td>451</td>
</tr>
<tr>
<td>Serbia</td>
<td>444</td>
</tr>
<tr>
<td>Bulgaria(^1)</td>
<td>432</td>
</tr>
<tr>
<td>Brazil(^1)</td>
<td>420</td>
</tr>
<tr>
<td>Peru(^1)</td>
<td>411</td>
</tr>
<tr>
<td>Georgia</td>
<td>403</td>
</tr>
<tr>
<td>Indonesia</td>
<td>388</td>
</tr>
</tbody>
</table>

- 🌟 Average score is higher than U.S. average score at the .05 level of statistical significance.
- 🚫 Average score is lower than U.S. average score at the .05 level of statistical significance.
Who is less financially literate?

- Students from families with low income and educational attainment
- Those who do not have books at home
- Students of color

Differences in financial literacy start early.
Financial literacy in America: A failing grade

% of P-Fin Index questions answered correctly

Distribution of correct answers to P-Fin Index questions

- 22-28 correct (76%-100%): 18%
- 15-21 correct (51%-75%): 34%
- 8-14 correct (26%-50%): 28%
- 0-7 correct (<26%): 20%

Who is less financially literate?

- Individuals with low income and educational attainment
- Women and African Americans and Hispanics
- The young

Differences in financial illiteracy have been growing over time.
Demographic variation: Racial/ethnic groups

% of P-Fin Index questions answered correctly

<table>
<thead>
<tr>
<th>Group</th>
<th>% Correct</th>
</tr>
</thead>
<tbody>
<tr>
<td>Black</td>
<td>37%</td>
</tr>
<tr>
<td>Hispanic</td>
<td>41%</td>
</tr>
<tr>
<td>White</td>
<td>55%</td>
</tr>
</tbody>
</table>

Distribution of correct answers to P-Fin Index questions

- **22-28 correct (76%-100%)**
  - Black: 6%
  - Hispanic: 24%
  - White: 8%

- **15-21 correct (51%-75%)**
  - Black: 26%
  - Hispanic: 26%
  - White: 38%

- **8-14 correct (26%-50%)**
  - Black: 37%
  - Hispanic: 37%
  - White: 38%

- **0-7 correct (<26%)**
  - Black: 36%
  - Hispanic: 29%
  - White: 25%

The costs of financial illiteracy
Financial fragility in America

Long lines at the food banks at the start of the pandemic!
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.
Financial fragility in America before the pandemic

Financial Fragility Over Time

Financial literacy matters for financial fragility

Among those who are NOT financially literate, 37% could not come up with $2,000 within 30 days.

Source: 2018 NFCS
Those with greater financial literacy are less likely to be financially fragile.

Strong negative correlation between financial literacy and financial fragility

24% 33% 58% 75%
< 26% 26%-50% 51%-75% 76%-100%

% of P-Fin questions answered correctly

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

Source: TIAA Institute-GFLEC Personal Finance Index (2021)
A simple measure of the cost of financial illiteracy

Average hours per week spent thinking about and dealing with issues and problems related to personal finances

All adults

<table>
<thead>
<tr>
<th>% of P-Fin questions answered correctly</th>
<th>&lt; 26%</th>
<th>26%-50%</th>
<th>51%-75%</th>
<th>76%-100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>People</td>
<td>11</td>
<td>9</td>
<td>5</td>
<td>3</td>
</tr>
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</table>

Workers while on the job

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</tr>
</thead>
<tbody>
<tr>
<td>People</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>1</td>
</tr>
</tbody>
</table>

People spend an average of 7 hours per week thinking about and dealing with financial issues and problems. An average of 3 hours per week occur at work.

Translating research into action

We need large and scalable programs

• Financial education in school
• Financial wellness programs in the workplace
• Financial education in the community (libraries, museums, theaters, churches, town halls, or other places where people go to learn)
GFLEC initiative: Fast Lane for finedu in high schools

- Provides research-based guidance and support for (1) students, (2) teachers, (3) school administrators, (4) parents/guardians, (5) policy makers, and (6) community members
- A resource center with tailored toolkits
- Making sure young people are on the fast lane to financial prosperity

fastlane-education.org
Personal finance course at GW since 2012

- Personal Finance courses for undergraduate and graduate students
- Based on our data and research
- Takes into account the large differences across students based on their demographic background
- Material available for free on our website: https://gflec.org/education/personal-finance-course/
Suggestions for personal finance

Five steps to financial freedom

• Take care of your finances
• Build a good credit score (it’s your personal finance GPA)
• Build and keep a buffer stock of savings
• Make good use of time
• Invest in education and in financial markets
Take care of your finances

How:

• Dedicate time each week to your personal finances, even 10-15 min will do

• Keep track of expenses

• Read about this topic; improve your financial literacy
Build a good credit score

Build a credit history and keep track of your score, it will save you a lot
Build and keep a buffer stock of savings

It is very important to have emergency savings

• Save small amounts regularly
• Rebuild the stock if you spend it out
• Avoid using debt or credit cards to deal with shocks
• Having $2000 can go a long way to prevent financial stress
Make good use of time

All young people have a great resource: time

• Start saving as soon as possible
• Save consistently over time
• With long horizons in front of you, you can take risk
Invest in education and financial markets

Invest in your talents and in financial knowledge

• Education has a good return, particularly in certain fields

• Many jobs of the future have not been invented; invest in skills that make you adaptable to changes

• Interest rates are low or zero: Grow your wealth by investing in the stock market; diversified index funds are what academics recommend
Financial literacy is like water in an ecosystem

- One of many ingredients needed for one’s financial life to flourish
- It is an essential component (i.e., the foundation), but people do not have enough of it
Living well

• Just as we ensure access to clean water to protect quality of life, we must provide people with the resources and skills needed to be more financially resilient, more financially secure, and less worried about their future.
Thank You!

More info at www.gflec.org. For any questions, you can reach me at alusardi@gwu.edu