The Importance of Financial Education

Annamaria Lusardi

The George Washington University

Director, Financial Education Committee, Italy

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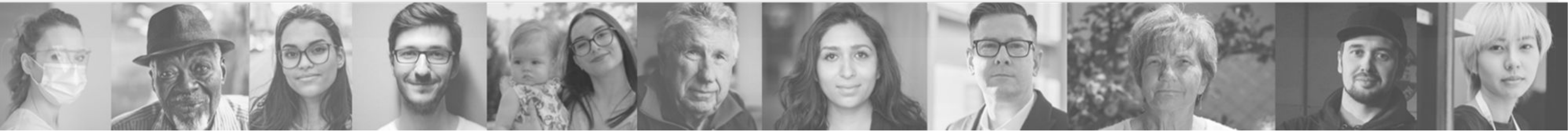
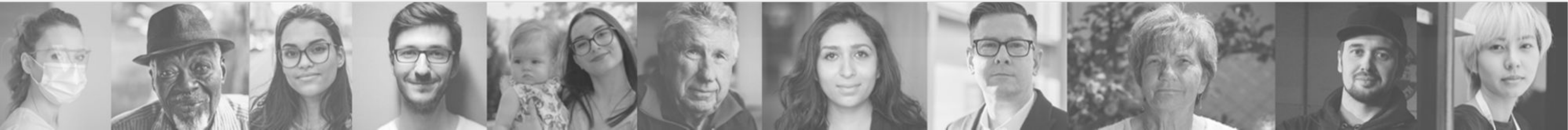
Topics I will cover

1. Data on financial literacy from the US and Italy
2. Financial literacy is too low
3. Fintech is not a substitute for financial literacy
4. We need more financial education: we are not ready!

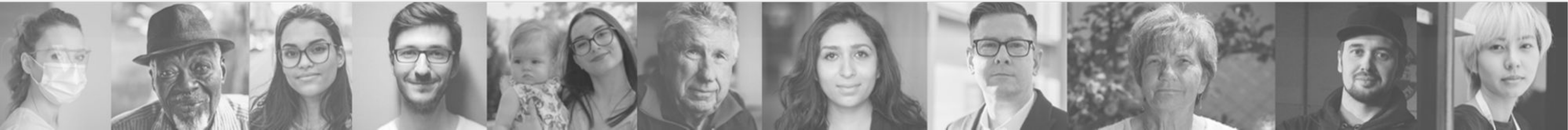


Financial literacy is too low



Measuring personal finance knowledge

- The **TIAA Institute-GFLEC Personal Finance Index** (***P-Fin Index***) is an annual barometer of knowledge and understanding which enable sound financial decision-making and effective management of personal finances.
- The *P-Fin Index* relates to common financial situations that individuals encounter and can be viewed as a gauge of “working knowledge.”
- In addition to personal finance knowledge, it provides information on financial well-being indicators.
- Data is collected since 2016 on a representative sample of Americans (age 18+).



What is unique: 8 functional areas of personal finance

The index is based on responses to 28 questions, with three or four questions for each of the eight functional areas (from National Standards for Finlit).

The *P-Fin Index's* 28 questions cover eight functional areas:

1. **Earning**
2. **Saving**
3. **Consuming**
4. **Investing**
5. **Borrowing**
6. **Insuring**
7. **Comprehending risk**
8. **Go-to information sources**

Inflation: one of the Big Three

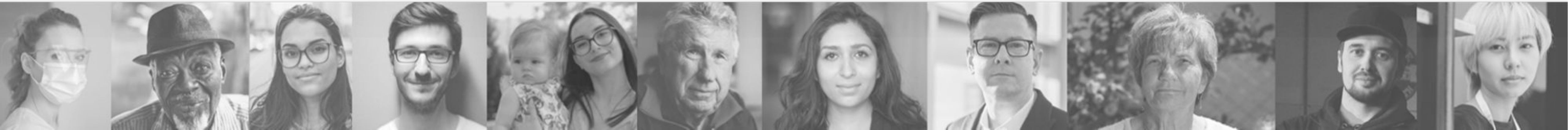
Akiko has $1,000 in savings that earns a 2% rate of return over the course of the year. The inflation rate during the year is 3%. Which statement is <u>true</u>?

- She can afford to buy fewer things at the end of the year.
- She can afford to buy more things at the end of the year.
- It's not clear whether she can afford to buy more things or fewer things at the end of year.
- Don't know
- Refuse to answer

Results:

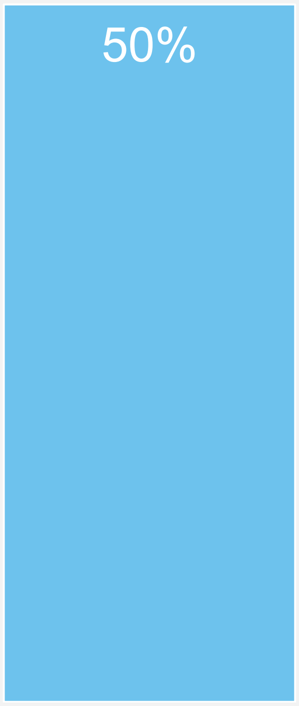
Correct	**54%**
Incorrect	**21%**
Don't Know	**26%**
No Answer	**1%**

Source: TIAA Institute-GFLEC Personal Finance Index (2022).

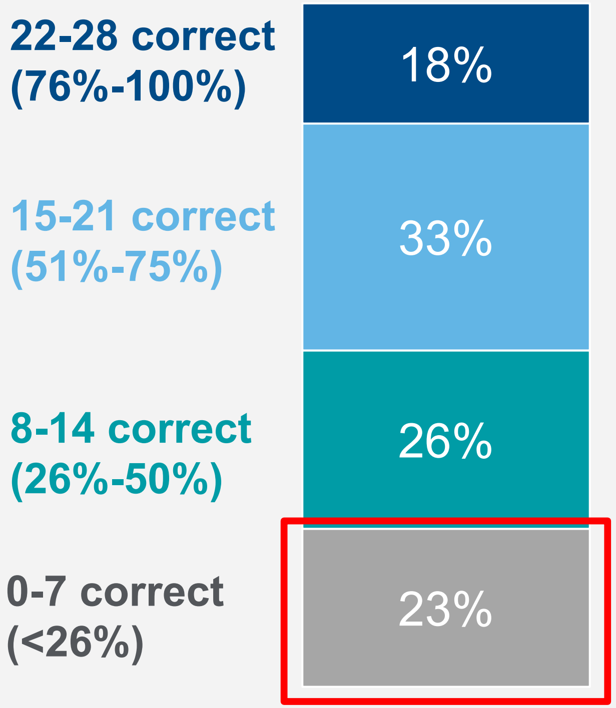


Financial literacy: A failing grade

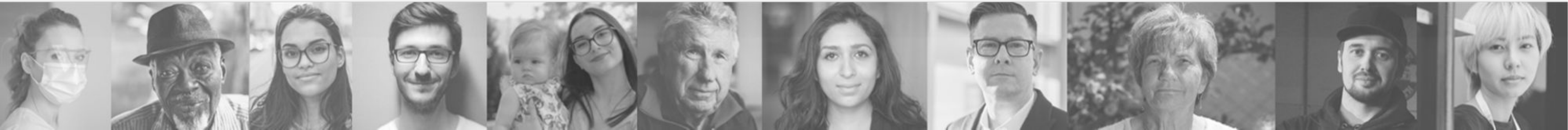
% of P-Fin Index questions answered correctly



Distribution of correct answers to P-Fin Index questions

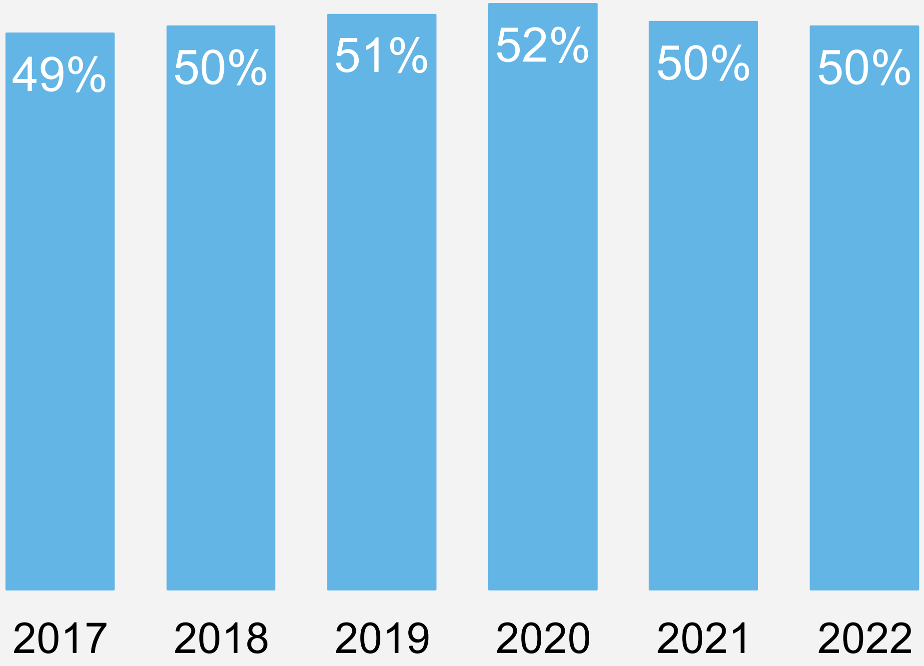


Source: TIAA Institute-GFLEC Personal Finance Index (2022).

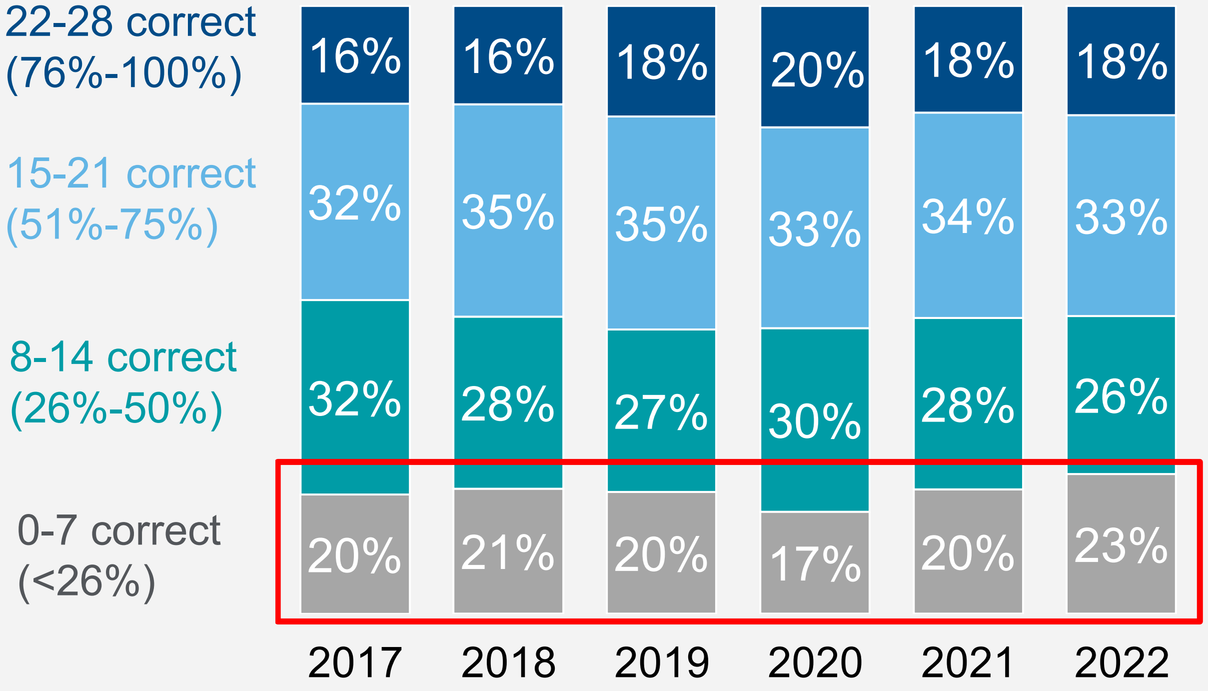


Financial (il)literacy is holding steady: 2017-2022

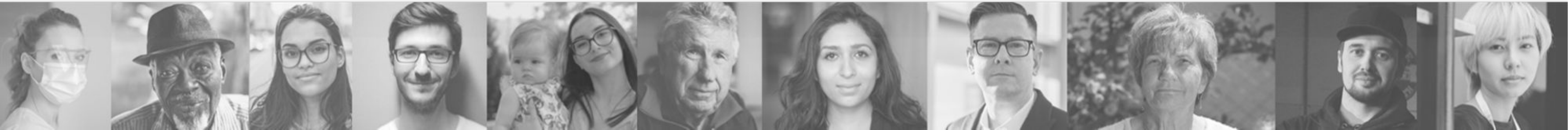
% of P-Fin Index questions answered correctly



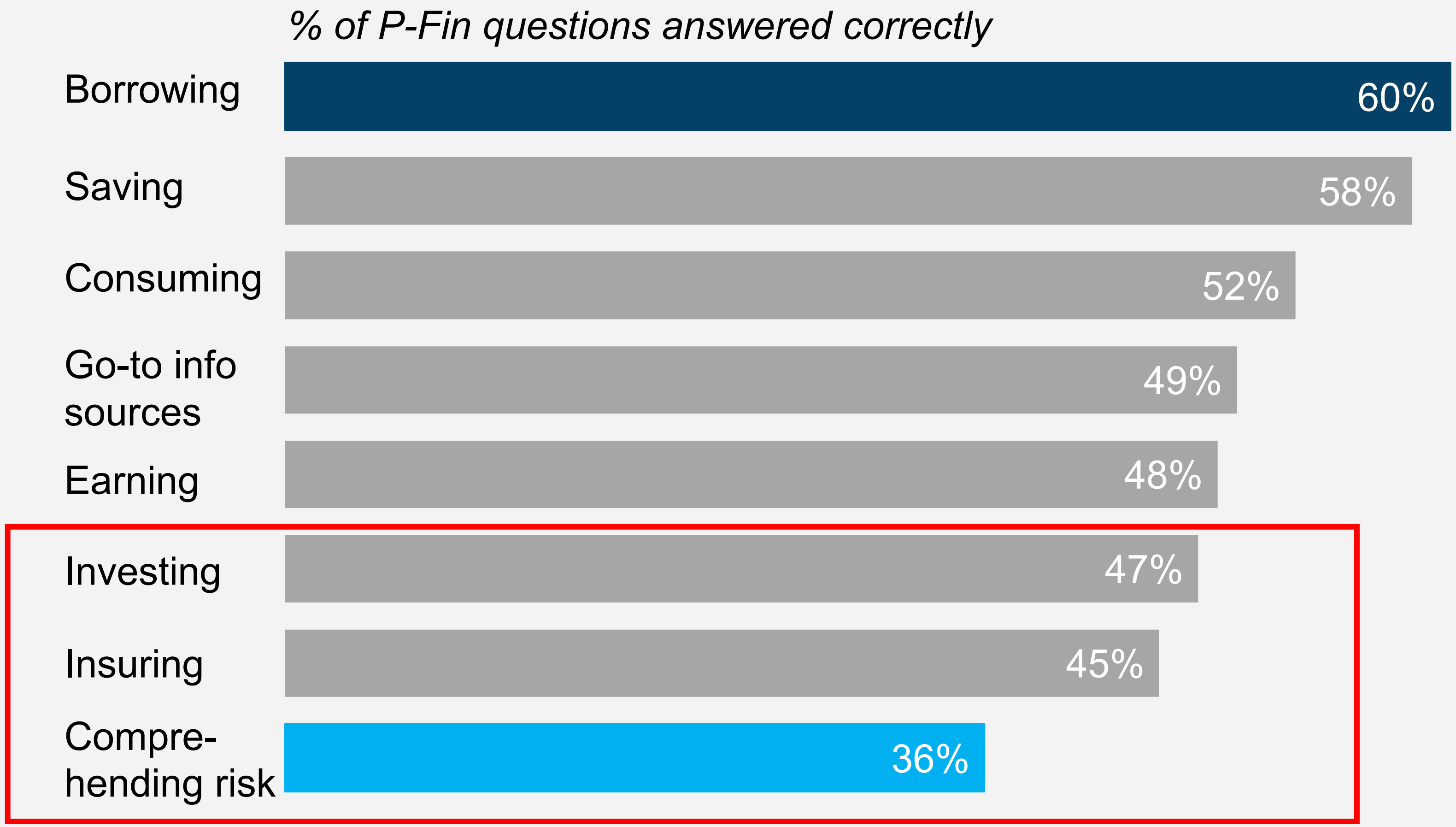
Distribution of correct answers to P-Fin questions



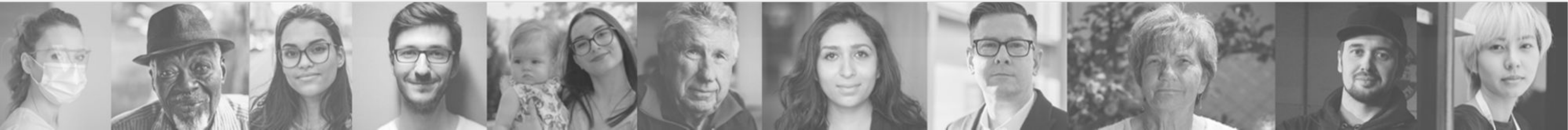
Source: TIAA Institute-GFLEC Personal Finance Index (2017-2022).



What do people know the most and the least



Source: TIAA Institute-GFLEC Personal Finance Index (2022).



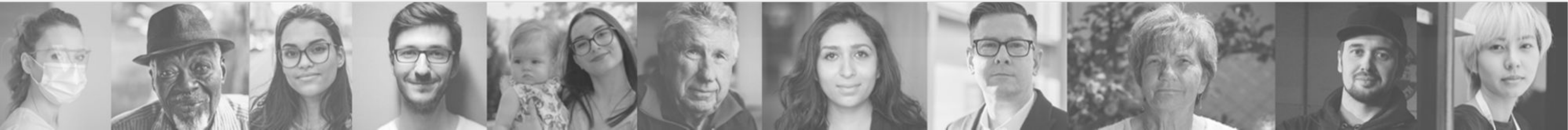
How much people know about “Calculated risk”?

Which of the following indicates the highest probability of getting a particular disease?

- There is a one-in-twenty chance of getting the disease
- 2% of the population will get the disease
- 25 out of every 1,000 people will get the disease
- Don’t know
- Refuse to answer

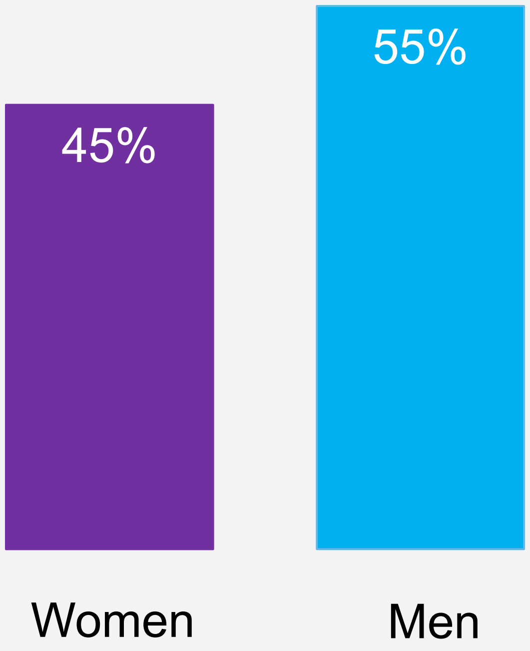
Results:	
Correct	**28%**
Incorrect	**19%**
Don’t Know	**53%**
No Answer	**0%**

Source: TIAA Institute-GFLEC Personal Finance Index (2021).

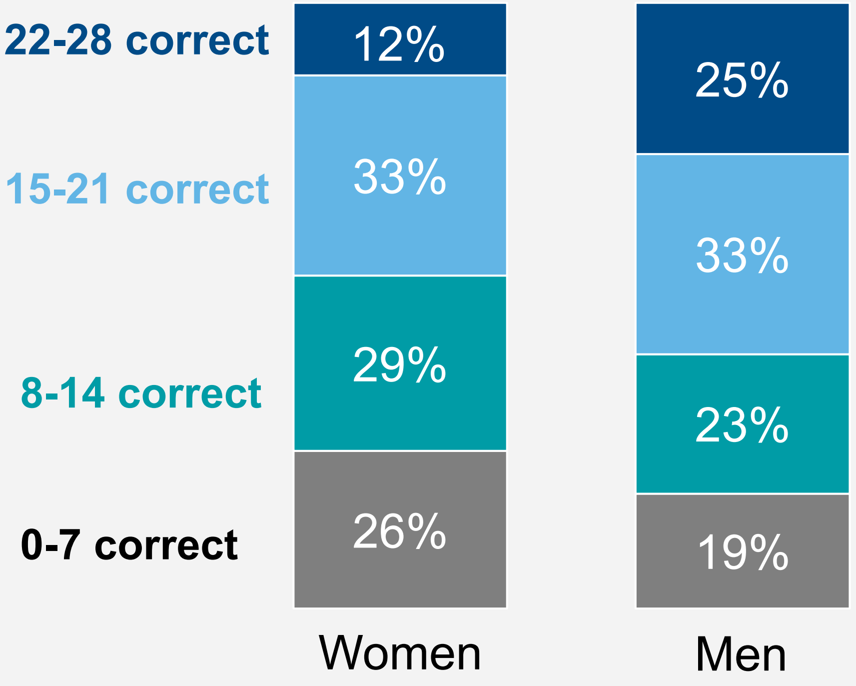


Demographic variation: Women and knowledge

% of P-Fin questions answered correctly



Distribution of correct answers to P-Fin questions



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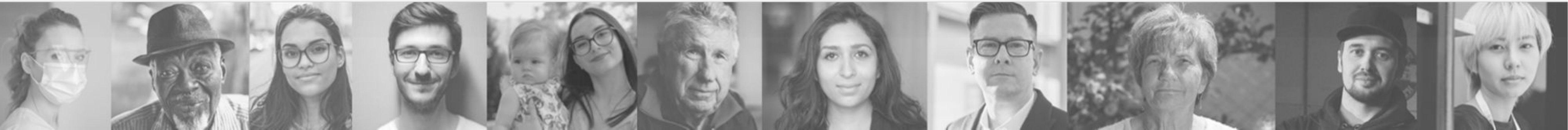
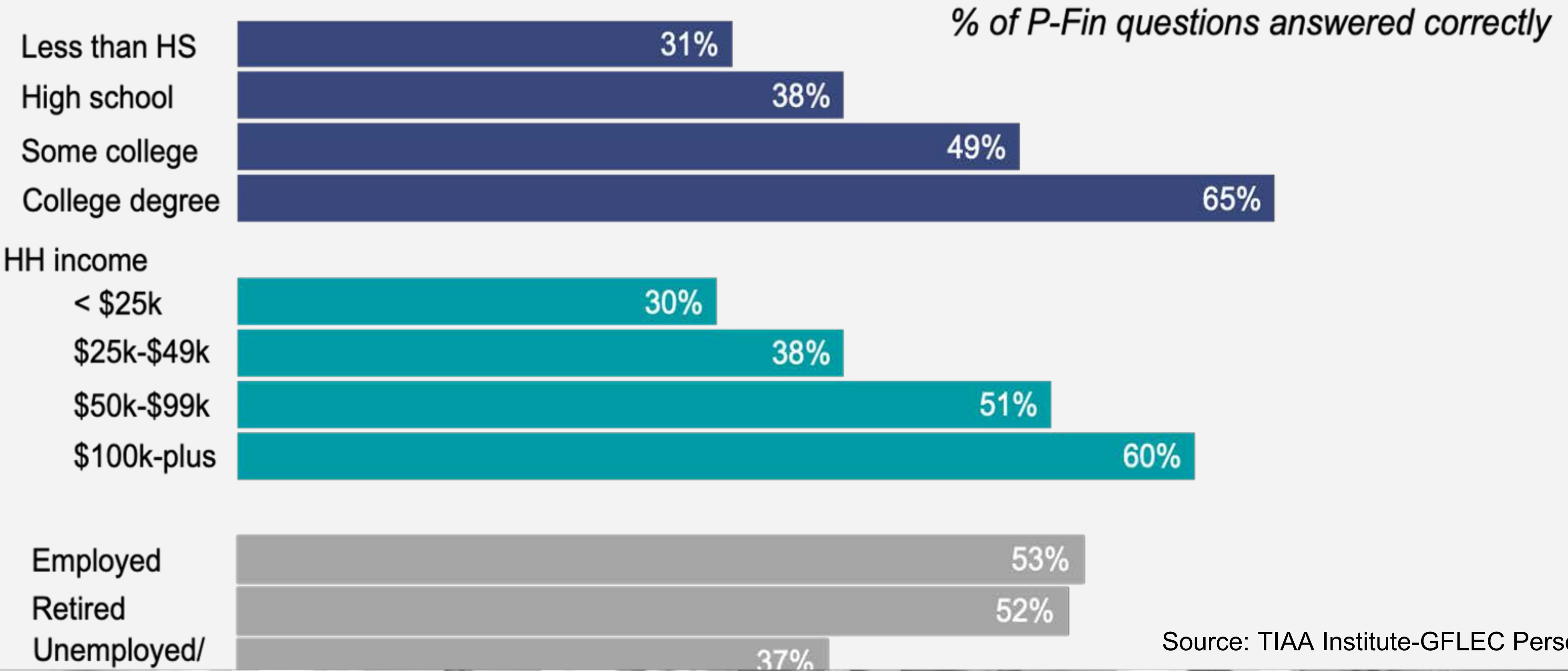


Large variation in financial literacy across demographics



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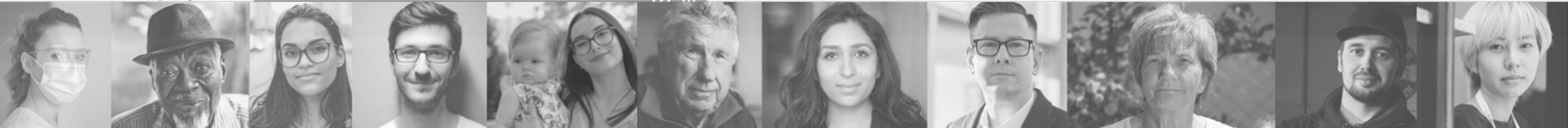
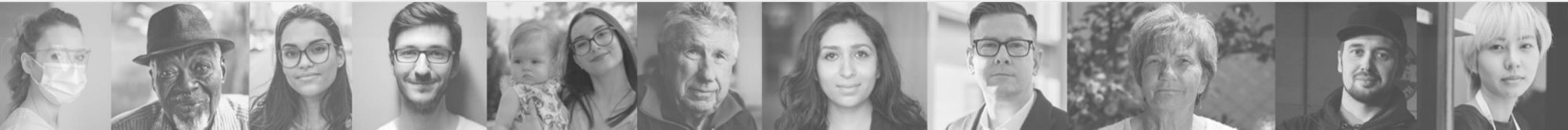


Financial literacy matters

Financial literacy is linked to positive personal finance outcomes.

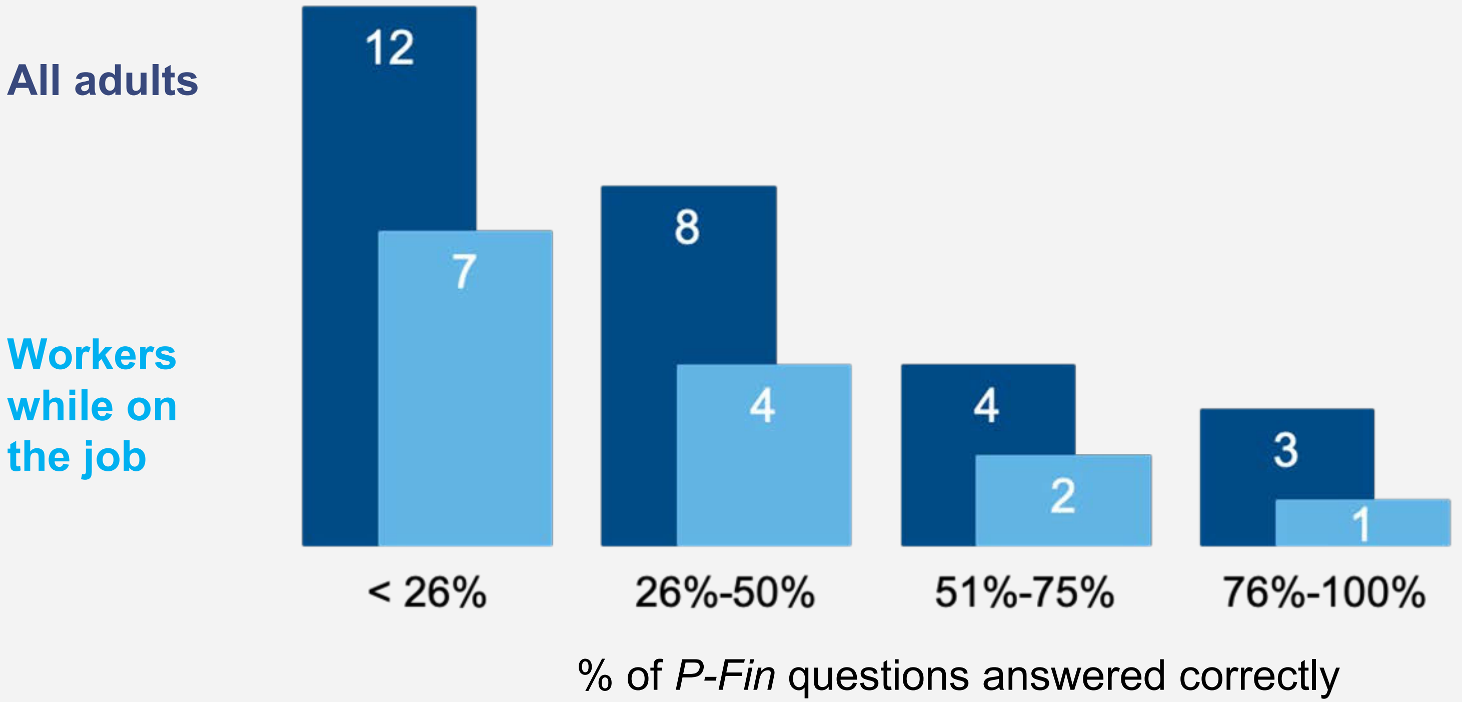
People who are financially literate are:

- less likely to be financially fragile
- less likely to overdraw checking accounts
- more likely to plan for retirement
- more likely to invest in the stock market
- less likely to have problems with debt



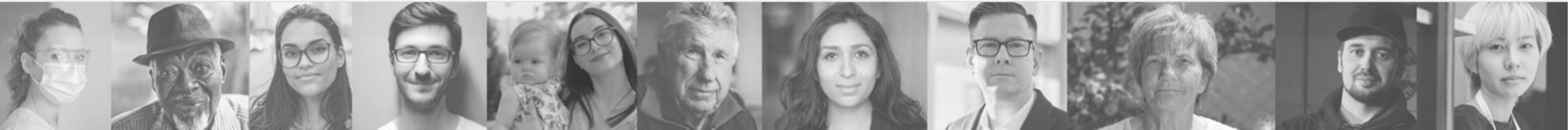
A simple measure of the cost of financial illiteracy

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



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

Source: TIAA Institute-GFLEC Personal Finance Index (2022).

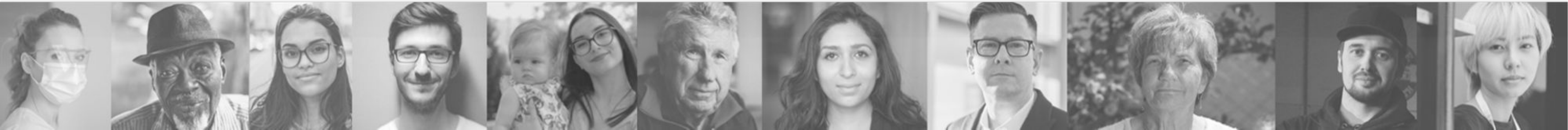


What we learn from data and research

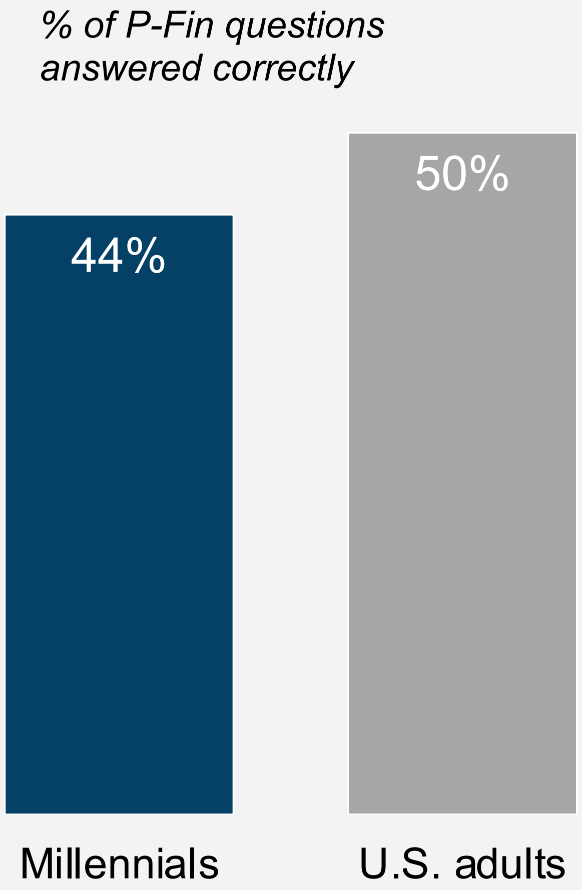
- Very low levels of financial literacy
  - Do not take financial literacy for granted even in rich countries

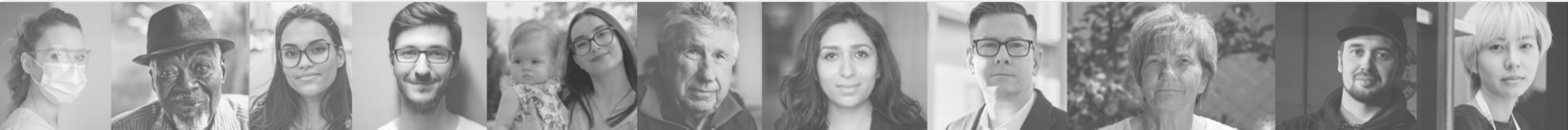
- Financial illiteracy is widespread
  - Need interventions that can be scaled up to see changes at the aggregate level

- Large heterogeneity across demographic subpopulations



Special report on Fin-tech





Fin-tech activities

How often (never, sometimes, frequently) do you use your smartphone to do the following:

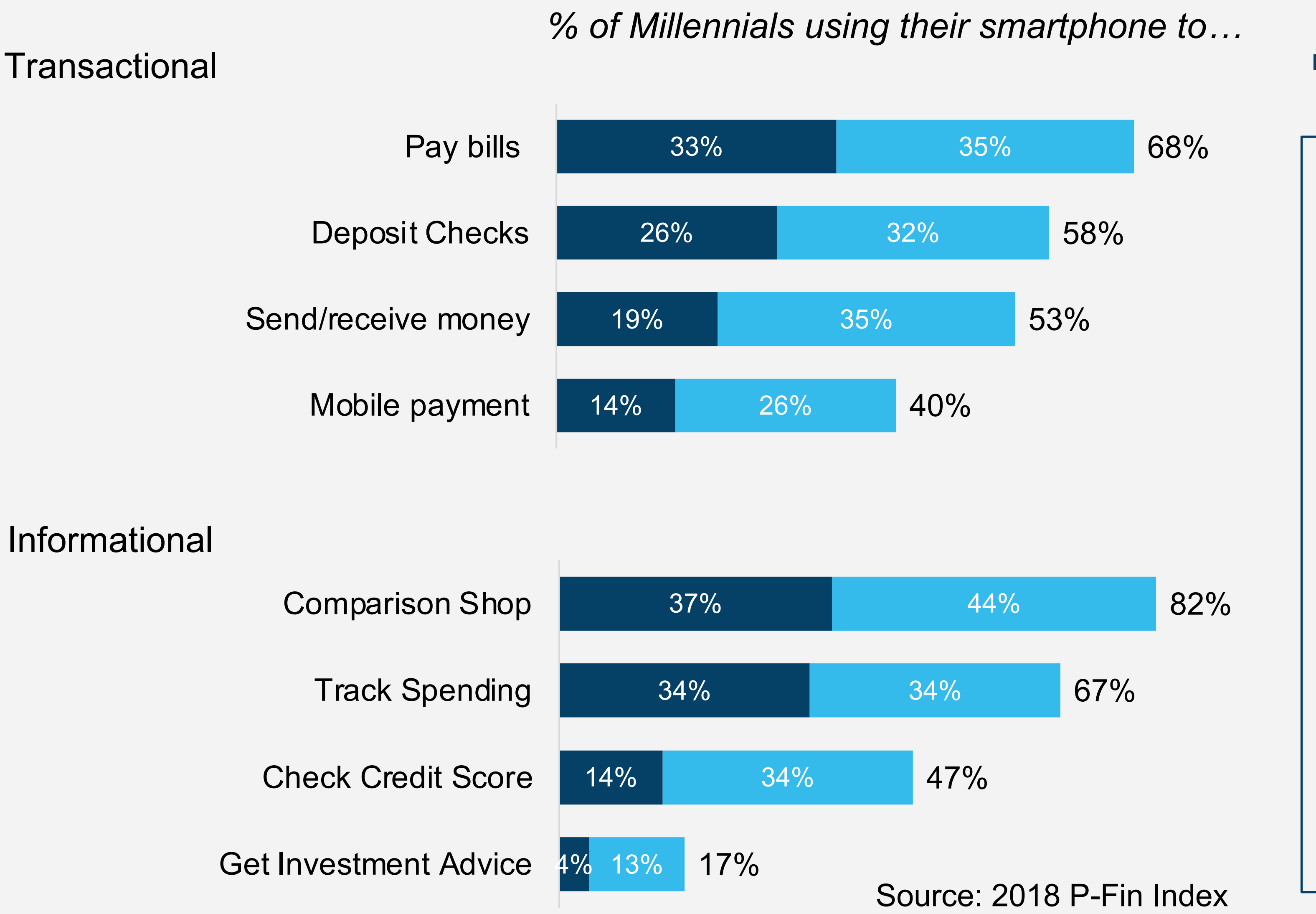
Transactional activities:

- Deposit checks into a bank account
- Send or receive money from friends, family or other individuals
- Pay for a product or service in person at a store, gas station, or restaurant, i.e., making mobile payments
- Pay bills

Informational activities:

- Track the amount you spend and what you spend it on
- Compare prices or product features when shopping
- Check your credit score
- Get personalized investment advice

Millennial Fin-tech activities



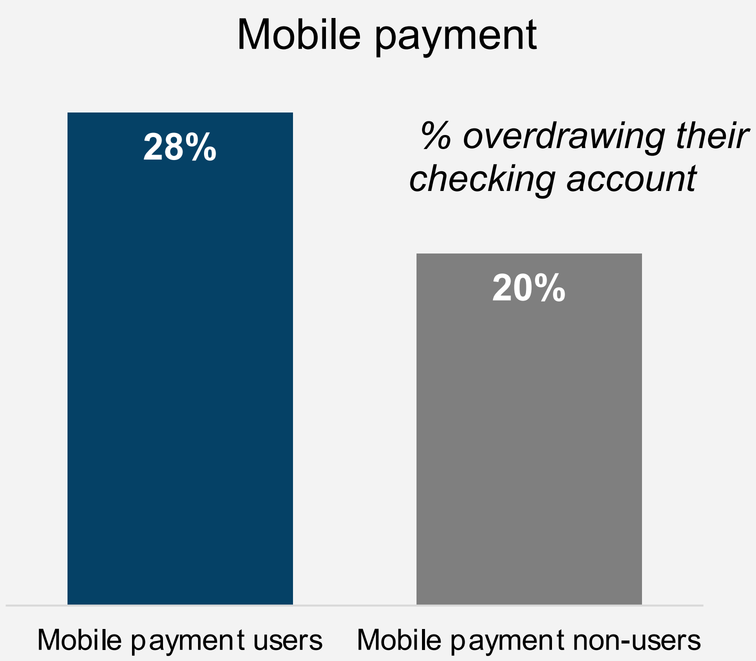
Source: 2018 P-Fin Index

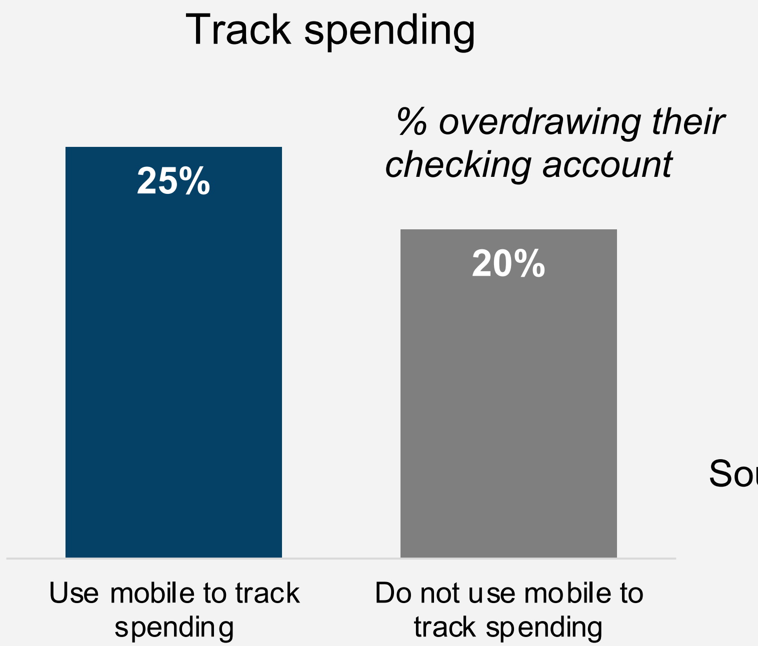
Across age: The use of Fin-tech activities are more common among older than younger Millennials.

Little or no consistent variation by demographics or financial literacy in fin-tech use.

Fin-tech activities (which vary in purpose and nature) attract different users with different needs and economic circumstances.

Fin-tech and personal finance outcomes

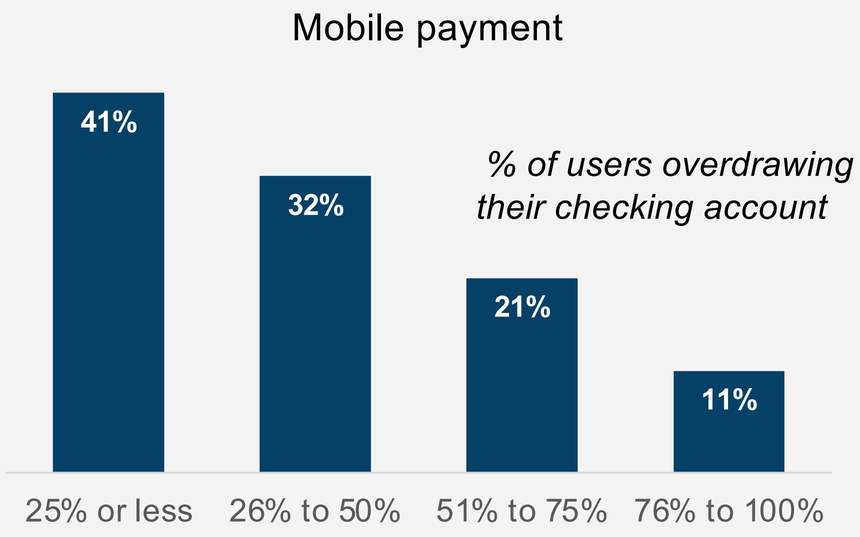


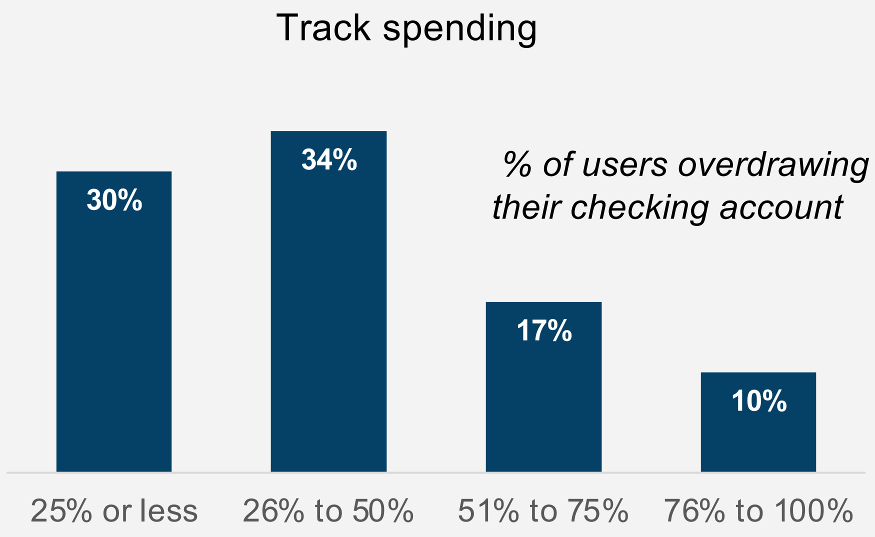


Source: 2018 P-Fin Index

- Millennials who make mobile payments are more likely to overdraw their checking account.
- Significant difference even when controlling for demographic factors (such as gender, income, education, employment status).
- Track spending is expected to improve cash flow management, but users are not less likely to overdraw their checking account (difference is not statistically significant).
- Just correlation, but no causality measured: We cannot say whether fin-tech use increases the likelihood of poorer personal finance practices.

Role of financial literacy





	Occasionally overdrawing checking account
Uses m-payments	+
Financial literacy	−
Financially literate mobile payment users	−

Respondents who use mobile payments and are financially literate are much less likely to overdraw their checking accounts.

New data from Italy

- Panel data set: 2020-2022
- Large sample: 5000 observations
- Data on financial, insurance and pension literacy and measure of financial well-being

Collected to inform the work of the Italian Financial Education Committee

Measuring financial literacy

The Big Three

"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?"

- [x] More than $102
- [ ] Exactly $102
- [ ] Less than $102
- [ ] Don't know
- [ ] Refuse to answer

"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
- [x] Less than today
- [ ] Don't know
- [ ] Refuse to answer

"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
- [x] False
- [ ] Don't know
- [ ] Refuse to answer

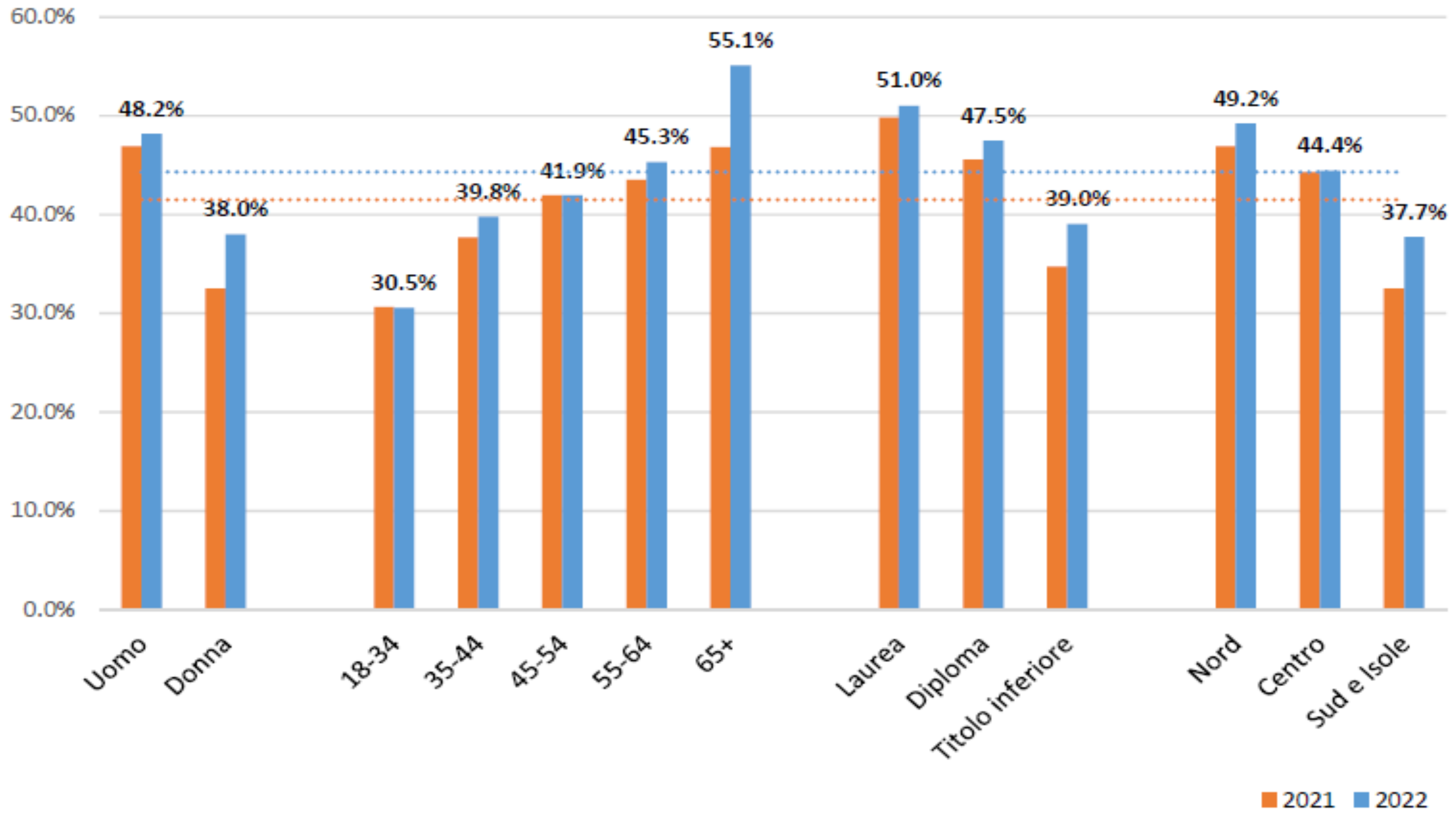
How much do Italians know?

Tab.12 - Big three (percentuale di risposte corrette a tutte e 3 le domande)

2020	2021	2022
44,6%	41,5%	44,3%

Financial literacy across demographic groups

Fig. 10 - Indice di conoscenza finanziaria ottenuto con le "big three": percentuale di individui con alta conoscenza (risposta esatta a tutte e 3 le domande)



We are not ready

Research says that financial education works

Journal of Financial Economics
Available online 3 October 2021
In Press, Corrected Proof

Financial education affects financial knowledge and downstream behaviors

Tim Kaiser [a], Annamaria Lusardi [b], Lukas Menkhoff [c], Carly Urban [d]

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https://doi.org/10.1016/j.jfineco.2021.09.022

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Abstract

We study the rapidly growing literature on the causal effects of financial education programs in a meta-analysis of 76 randomized experiments with a total sample size of over 160,000 individuals. Many of these experiments are published in top economics and finance journals. The evidence shows that financial education programs have, on average, positive causal treatment effects on financial knowledge and downstream financial behaviors. Treatment effects are economically meaningful in size, similar to those realized by educational interventions in other domains, and robust to accounting for publication bias in the literature. We also discuss the cost-effectiveness of financial education interventions.

We need more financial education

Large and scalable programs are needed to change the statistics

1. Financial education in the workplace (for the adults)
2. Financial education in school and college

We need to make financial education mandatory




Our arguments for making workplace fin educ mandatory

Harvard Law School Forum on Corporate Governance

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Defined Contribution Plans and the Challenge of Financial Illiteracy

Posted by Jill E. Fisch (University of Pennsylvania Law School), Annamaria Lusardi (George Washington University), and Andrea Hasler (George Washington University), on Friday, June 14, 2019

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Tags: 401(k), Corporate liability, ERISA, Information asymmetries, Investor protection, Liability standards, Retirement plans
More from: Andrea Hasler, Annamaria Lusardi, Jill Fisch

Editor's Note: Jill Fisch is the Saul A. Fox Distinguished Professor of Business Law and Co-Director, Institute for Law and Economics at the University of Pennsylvania Law School; Andrea Hasler is Assistant Research Professor in Financial Literacy at the George Washington University School of Business; and Annamaria Lusardi is the Endowed Chair of Economics and Accountancy at the George Washington University School of Business. This post is based on their recent article, forthcoming in the *Cornell Law Review*.

Thank you!

For information, you can reach me at alusardi@gwu.edu