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Financial Fragility in the US: Evidence Beyond Asset Building

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Introduction

Financial fragility is the inability to cope with *emergency expenses* (such as a car or house repair, medical bill, or small legal expense) in a *short* timeframe

Background:

- Lusardi A., Schneider D., Tufano P., 2011. Brookings Paper on Economic Activity.
- This measure was piloted in the 2009 TNS Global Economic Crisis Study.
- In 2009 almost 50% of U.S. households were classified as financially fragile.

2015 National Financial Capability Study (NFCS)

- Online nationally representative sample of more than 27,500 respondents.
- Commissioned by FINRA Investor Education Foundation.
- Offers unique information on financial literacy and capability.
- It started in 2009, financial fragility question asked in 2nd wave in 2012 and 3rd wave in 2015.
- Sample restriction: Non-retired individuals age 25-60. “Do not know” and “refuse to answer” responses for the fragility question are excluded

The 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

Financially fragile

- Don’t know
- Prefer not to say

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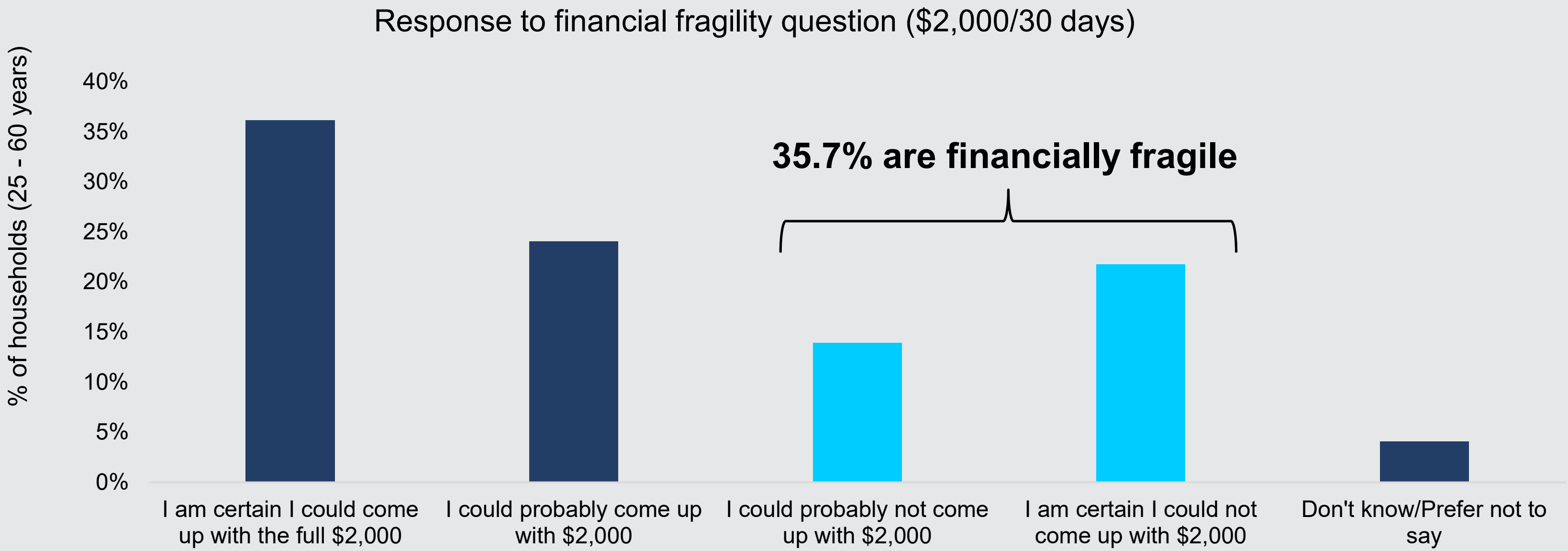
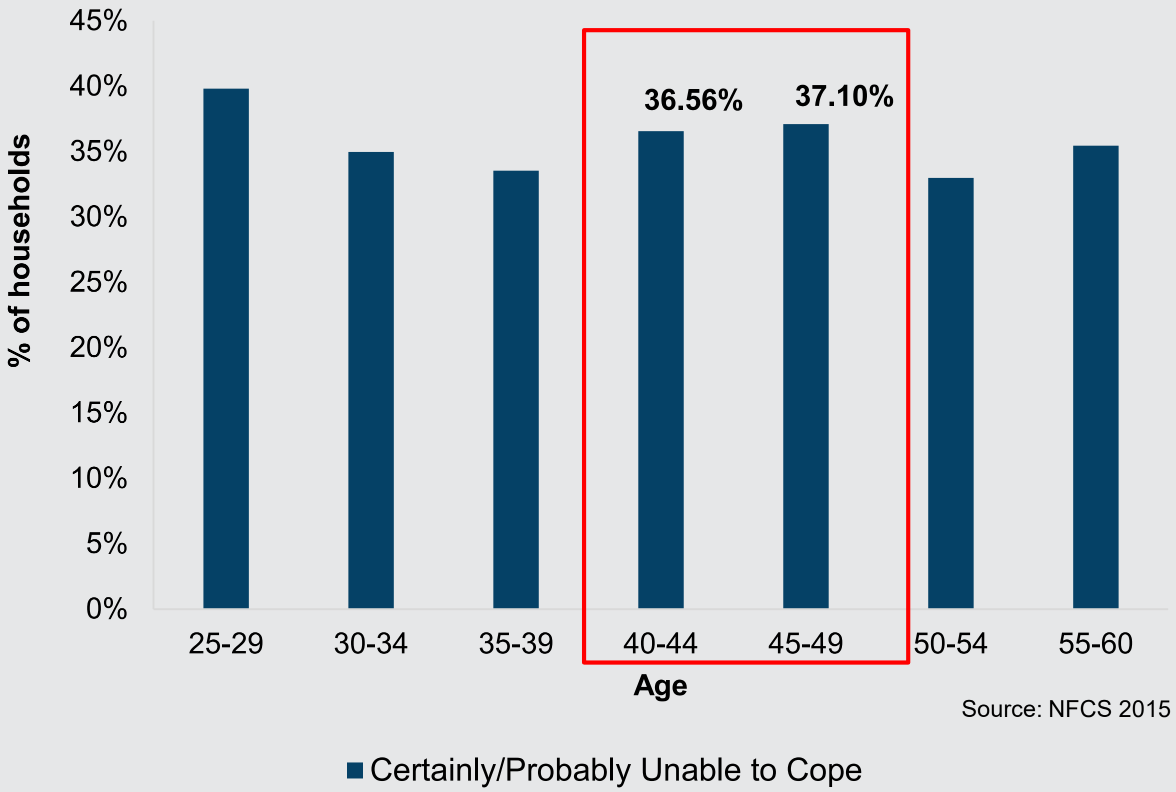
Financial fragility in the U.S.



Source: NFCS 2015

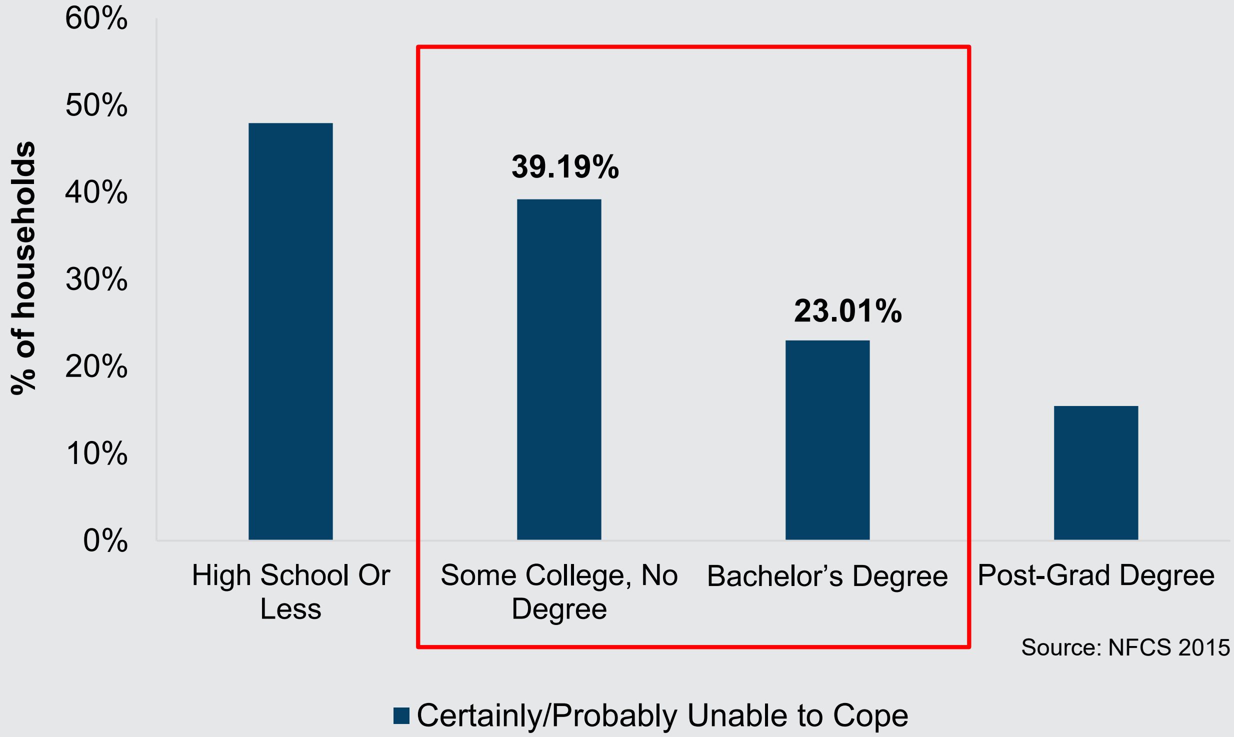
Financial fragility is still **prevalent** in a recovering economy and not only a result of the recession.

Financial fragility across age



- A similar fraction of individuals across all ages are financially fragile.
- Fragility is slightly higher in the middle age group of 40- to 49-year-olds. (Confirmed in regression results)
- Middle-aged individuals are at the peak of financial obligations such as child care costs, student loan repayments, and mortgage payments.

Financial fragility across education levels



- Significantly lower likelihood of being financially fragile with increasing education.
- Effect is highly significant even after controlling for income.
- Substantial educational divide between those who attended college but did not receive a degree and those who received at least a Bachelor's degree.

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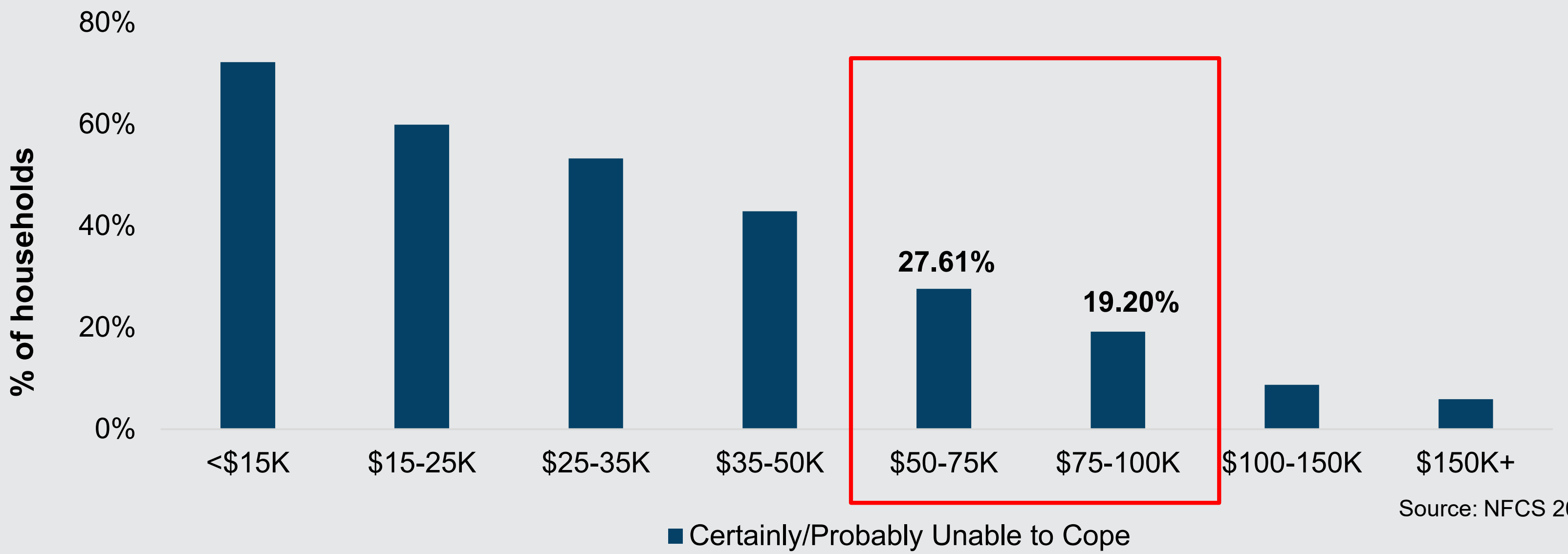
Financial fragility across household income



Source: NFCS 2015

- Financial fragility falls with income but is still high for the middle-income households.
- Nearly 30% of middle-income and 20% of high-income households are financially fragile.
- This is notable, especially when comparing the relative magnitude of the emergency expense ($2,000) to a household’s income level. Thus, financial fragility is not only caused by a **lack of assets**.

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Contributing factors for middle-income households

Contributing factors for relatively high financial fragility rates among middle-income households:

(A) Family size:

- Households with more children are more likely to be financially fragile – fixed family budgets and financial obligations (child care costs and education).
- Financially fragile middle- and high-income households are more likely to have more children.

(B) Debt and debt management, in addition to asset levels, affect ability to manage short-term shocks:

- Middle-income households have assets, but they are often highly leveraged.
- Debt does not decrease, but in fact increase with income.

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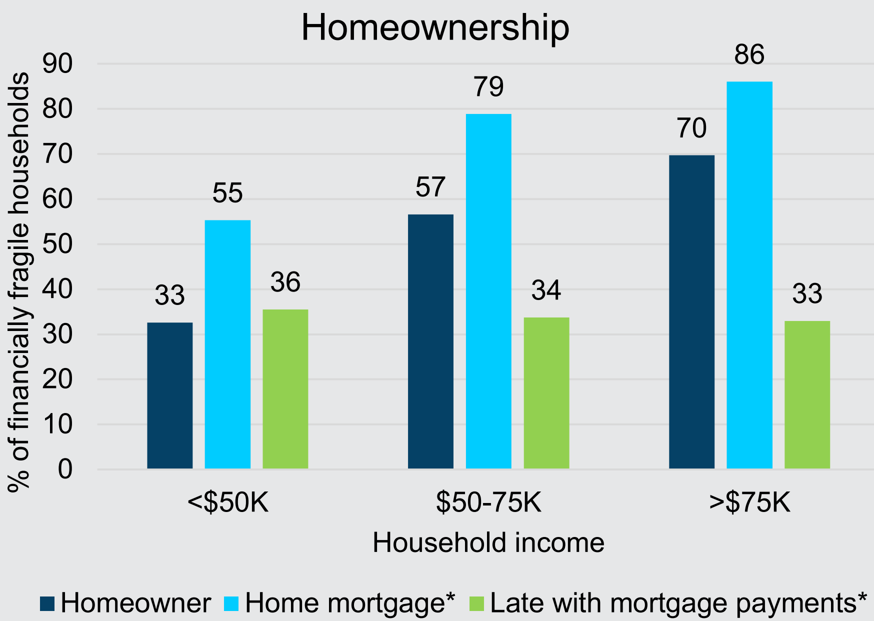
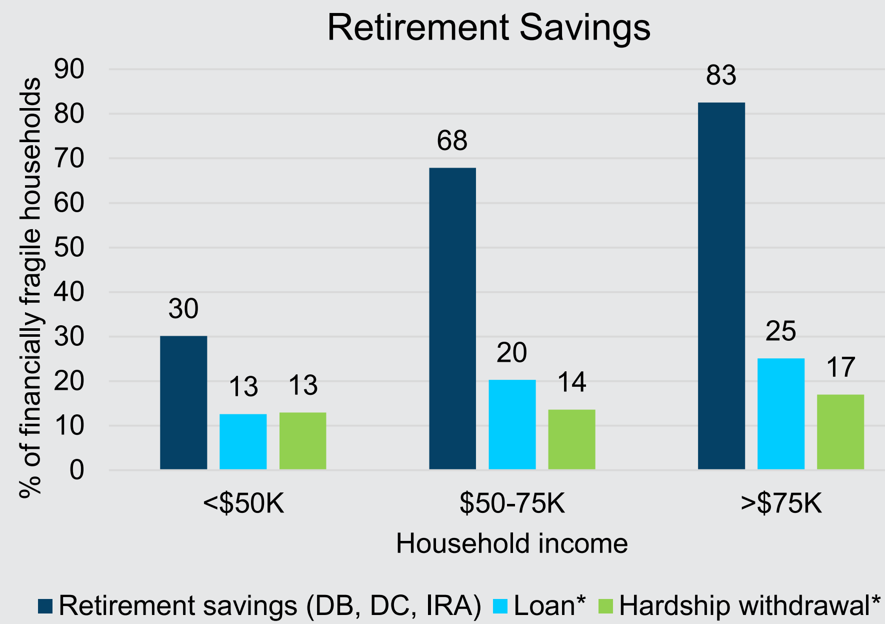
(B) The importance of debt and debt management





	Income		
Financially fragile respondents	<$50K	$50-75K	>$75K
Unpaid medical bills	38%	41%	35%
Expensive credit card behavior*	68%	70%	67%
Use of alternative financial services	42%	38%	37%

Source: NFCS 2015

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(B) Debt and debt management, in addition to asset levels, affect ability to manage short-term shocks.

- Middle-income households have assets, but they are often highly leveraged.
- Debt does not decrease, but in fact increase with income.

(C) Financial literacy levels are very low especially among financially fragile households.

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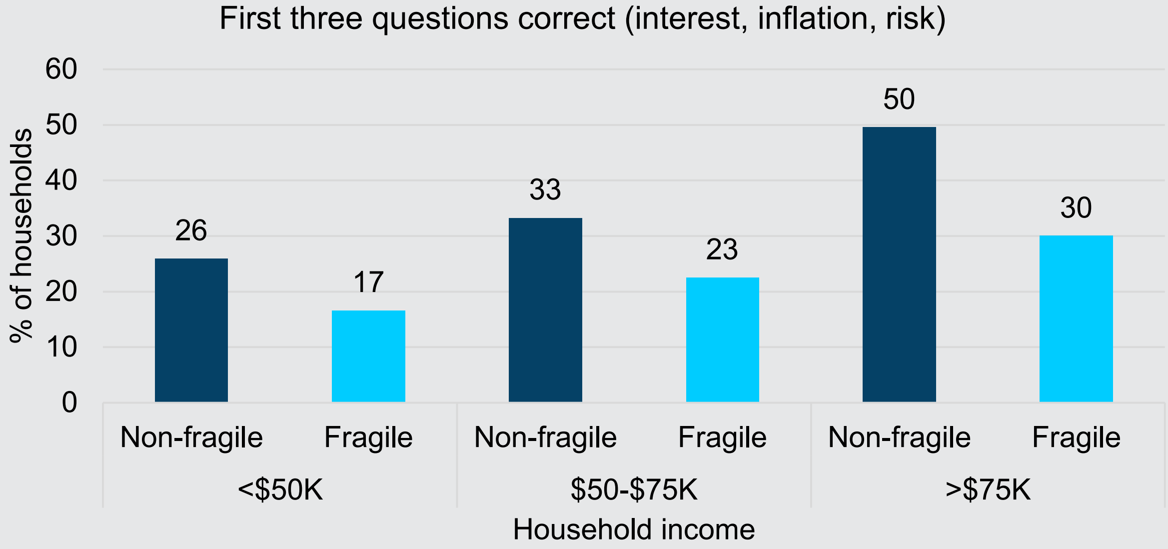
(C) The importance of financial literacy



- Financial literacy is low overall. Even among high-income and non-fragile.
- Significant difference between financially fragile and non-fragile.

Dependent variable: Financial fragility (dummy = 1 for financially fragile respondents)	Income <$50K	Income $50-$75K	Income >$75K
Financial literacy:			
First three questions correct (interest, inflation, risk)	-0.097***	-0.046**	-0.043***
	(0.017)	(0.019)	(0.010)
Controls	Yes	Yes	Yes
Observations	6,874	3,519	5,781
R-squared	0.085	0.075	0.061

- Financially literate households are significantly less likely to be financially fragile and this holds for all income levels.
- This effect is independent of the effect that overall education has on fragility.

Source: NFCS 2015. Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1

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Conclusion

- Financial fragility is **prevalent** in a recovering economy and not only a result of the recession.
- A **broad** cross-section of the population is financially fragile. It is not only a problem of the young, low-income, and low-education.
- Financial fragility has short- and **long-term consequences**. It is associated with a lower likelihood of planning for retirement.
- Recommendations:
  - Financial education in schools, colleges, and the workplace, especially targeting the vulnerable subgroups.
  - Tools that incentivize precautionary savings: Institutionalizing short-term savings in a manner similar to retirement accounts.
  - Promoting financial planning to help reduce debt levels.

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Thank you!

Questions? Contact me at **ahasler@gwu.edu**

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