

Presentation to the FDIC

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Financially Fragile Households: Evidence and Implications

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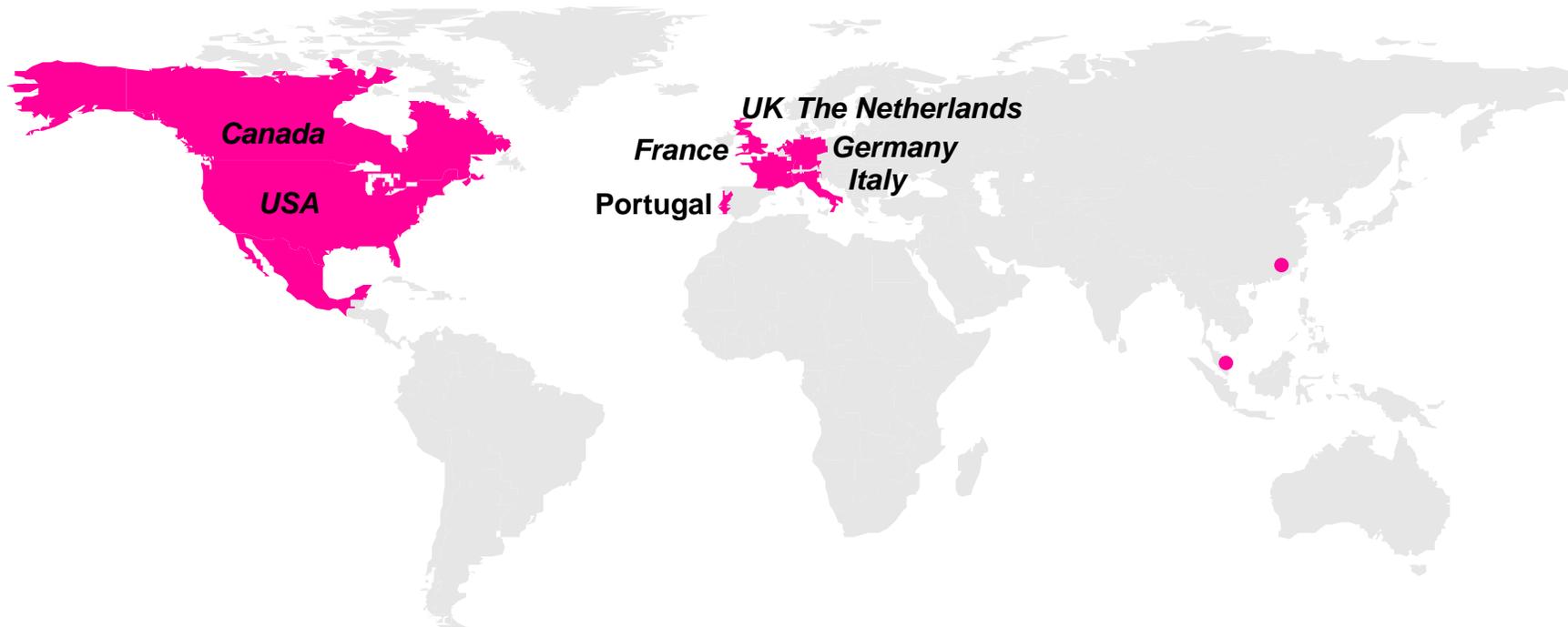
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Our contributions

What is new?

- **Propose a new, broad measure of financial fragility—and document broad fragility in US**
- **Document how American households plan to cope with shocks**
- **Report international comparison of coping ability**

Data: Global Economic Crisis Survey (June-September 2009) fielded by *TNS Global*



- TNS is the world's largest Custom Market Research specialist
- 9,147 interviews in 8 countries around the world.
- Interviews conducted mostly online.
- Survey participation voluntary by country.

Our measure of financial fragility

Sought broad measure of ability to cope

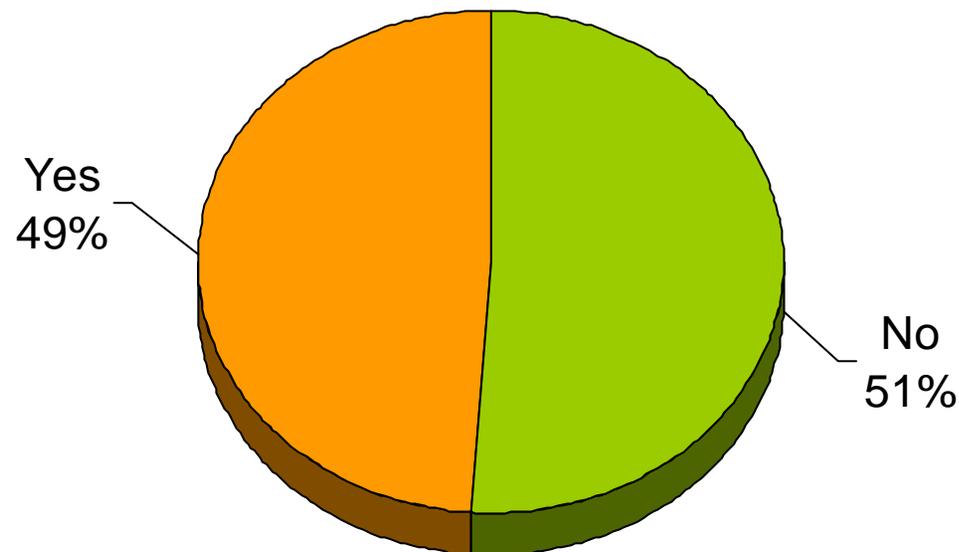
“How confident are you that you could come up with \$2,000 if an unexpected need arose within the next month?”

Finding: Half of U.S. respondents claimed they could not (certainly or probably) come up with \$2,000 in a month

Emergency fund: most Americans don't have it

(Source: 2009 FINRA Financial Capability Study)

Have you set aside an emergency or rainy day fund?



Who is most financially fragile?

Looking across demographic groups

- **Low education and income but “middle class” also looks fragile**
- **Young, but signs of fragility even late in life-cycle**
- **Women and families with children**
- **African-Americans and Hispanics**
- **Those who suffered large wealth losses and unemployment**
- **Gamblers**
- **People without any financial education**

Who can come up with \$2000 in a month?

Multivariate regressions

Capacity to come up with funds	
Wealth	+
Income	+
Education	+
Losses in wealth	-
Unemployment	-
Age	+
Female	-
Children in household	-
Live with parents	-
Marital status (vs. married)	ns
Race/Ethnicity (vs. white)	ns
Region (vs. south)	ns
Gambled	-
Financial education	+
Risk literacy	ns

Coping strategies

We further asked:

“If you were to face a \$2,000 equivalent unexpected expense in the next month, how would you get the funds you need?”

- Asked of those who had some capacity to cope
- Allowed to select up to three ways out of 14 options

Coping strategies

- **Drawing from private savings** (1) draw from savings, (2) liquidate or sell investments, (3) liquidate some retirement investments even if it required me to pay a penalty (4) borrow against my retirement savings at my employer
- **Utilizing social networks** (5) borrow or ask for help from my family, (6) borrow or ask for help from my friends (not members of my family)
- **Accessing mainstream credit** (7) use credit cards, (8) open or use a home equity line of credit or take out a second mortgage, (9) take out an unsecured loan
- **Accessing alternative credit** (10) get a short term payday or payroll advance loan, (11) pawn an asset I own
- **Increasing work effort** (12) work overtime, get a second job, or another member of my household would work longer or go to work
- **Selling assets**, (13) sell things I owned, except my home, (14) sell my home

Coping strategies: empirical evidence

How many coping methods?

- More than half of respondents indicate they would use multiple coping methods
- Saving is the most common use of coping, but a sizable fraction of respondents rely on:
 - Family and friends (34%)
 - Credit (30%)
 - Alternative credit (11%)
 - Working more (23%)
 - Selling possession (19%)
- Those who do not use savings are more likely to use more than one method

Coping strategies: empirical evidence

Coping by number of methods

Methods	All	One	Two	Three
Savings	60.6	65.4	63.0	52.8
Family/Friends	34.2	13.4	36.7	60.6
Mainstream Credit	29.5	10.9	38.5	49.5
Alternative Credit	10.8	1.7	7.8	24.5
Selling Possessions	19.1	3.2	20.7	39.5
Working More	22.9	5.3	21.3	47.2

Coping strategies (cont.)

Living close to the edge

- Consider those who would:
 - Pawn possessions
 - Sell their home
 - Take out a payday loan
- Summing those who are sure they could not come up with \$2000
- Gives us a total of 46.5% of respondents who live close to the edge

Coping choices: multivariate results

Characteristic	Saving	Friends and Family	Traditional Credit	AFS	Sell things	Work More
Wealthiest	+	-		-	-	-
Highest income						
Highest Education	+			-		-
Oldest	+	-		-	-	-
Women	+	+			-	-
Kids in Family	-	+		-		
Biggest Wealth losses						
Unemployed	-	+		+	+	
Gamblers			+	+		
Fin Ed				+		
Risk Literacy	+				-	

A pecking order?

- **Theory: Order of coping mechanism relates to direct financial costs, transaction costs, social cost, effort.**
- **Like firms, households turn first to internal resources**
 - **Cheaper on all dimensions**
- **Households then turn to debt next or to family and friends, depending on relative cost**
- **Households finally turn to alternative methods (AFS, selling things, working more)**
- **Testable implications for future work**

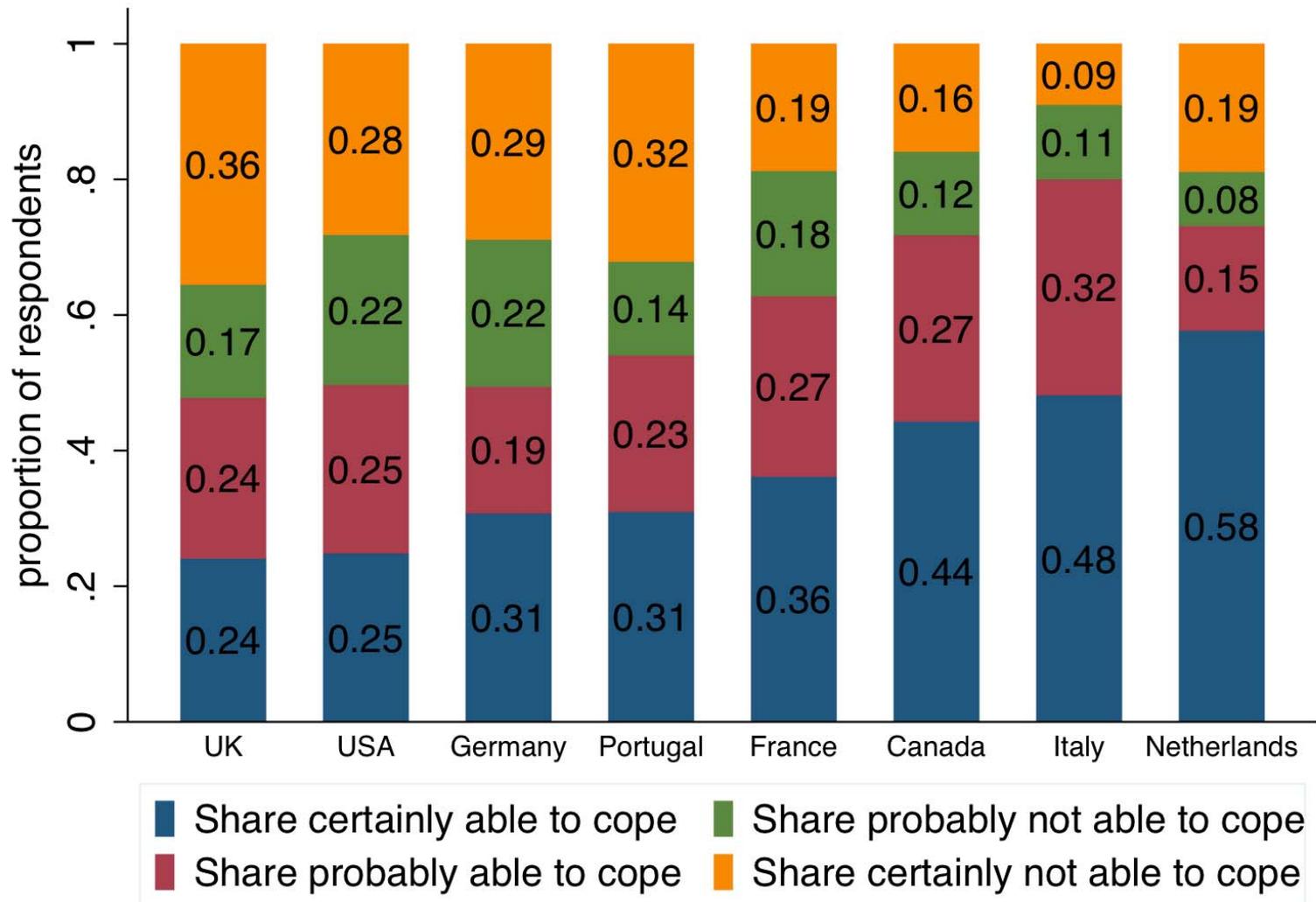
International comparison

Evidence from 8 high-wealth countries

- **In addition to the US, we use data from:**
 - **Canada**
 - **UK**
 - **Germany**
 - **The Netherlands**
 - **France**
 - **Italy**
 - **Portugal**

- **Similar questions were asked**

Capacity to come up with funds



International comparison

Explanation for differences across countries

- **8 observations—not amenable to formal statistical analysis, but...**
 - **Not attributable to mix of personal characteristics by country (pooled multivariate)**
 - **National differences are not attributable to PPP differences**
 - **Not related to level of poverty or unemployment**
 - **Not related to level of social safety net**
 - **Not related to measures of financial development**
- **Coping mechanisms broadly similar**

Concluding comments

- **High levels of financial fragility in the United States, including among seemingly well-off**
- **Several rich countries are financially fragile**
- **Need to go beyond precautionary saving to explain how people cope with shocks**
 - **Other methods**
 - **Lack of risk literacy**
 - **Prevalence of gambling**