The financial fragility of European households in the time of COVID-19 and the role of financial education and literacy

Annamaria Lusardi
The George Washington University School of Business and GFLEC
Italian Financial Education Committee

September 30, 2020

To get started

A number:

1/3

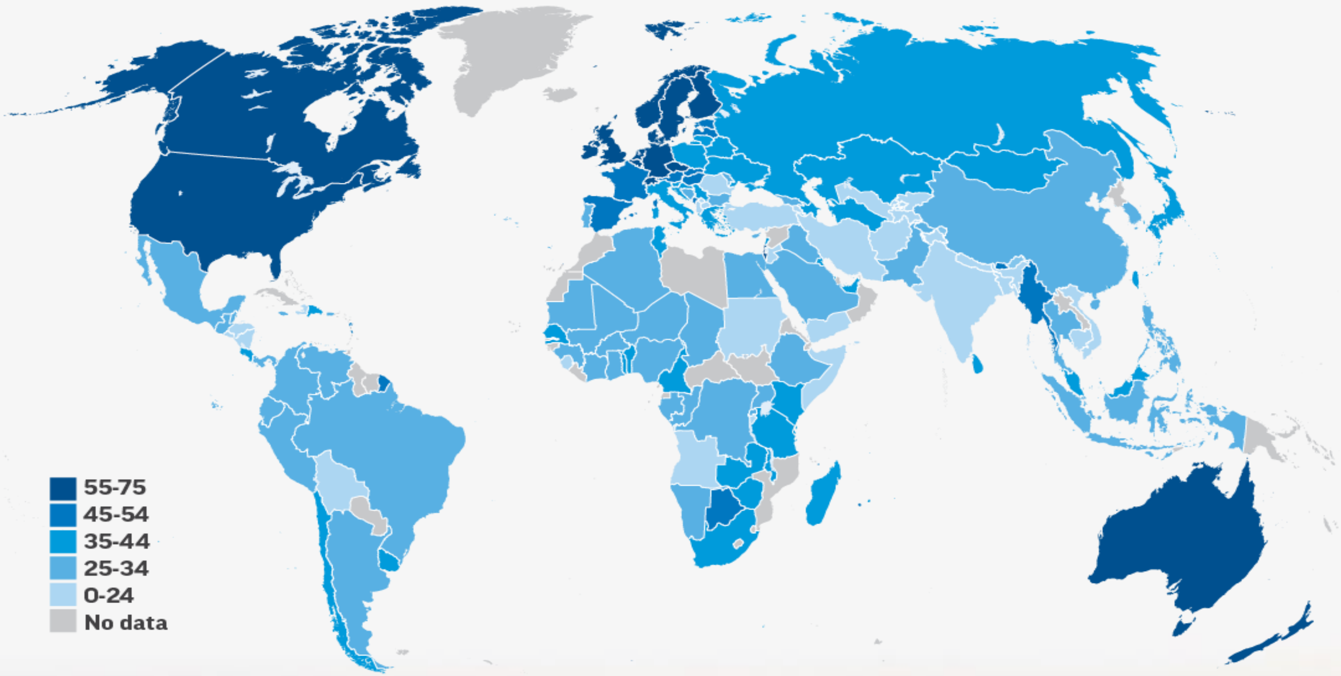
What this number is

1/3

- People who know the basics of personal finance
- This is true both in the US and around the world
- It is also related to knowledge about risk

Financial Literacy Across the Globe (S&P Global Finlit Survey)

% of financially literate adults

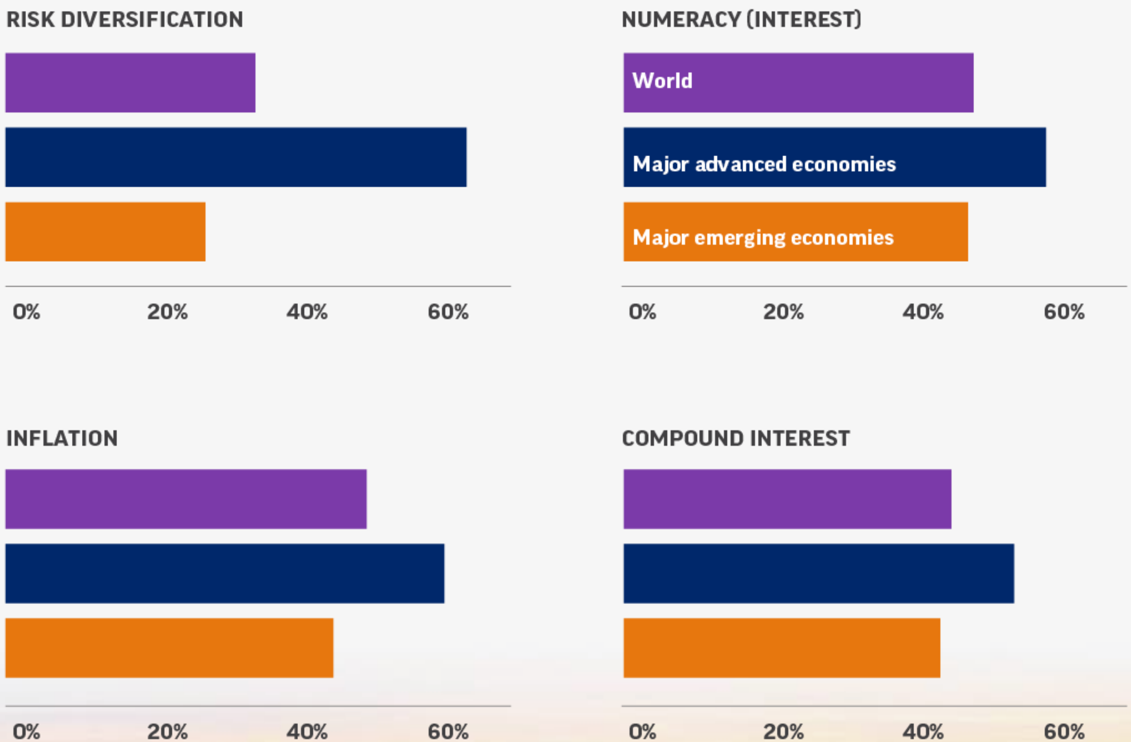


Only 1 in 3 adults worldwide have basic financial literacy

GFLEC
GLOBAL FINANCIAL LITERACY EXCELLENCE CENTER

Financial literacy by topic

% of adults answering correctly



Inflation and simple interest/numeracy is what people know most across countries.

Risk diversification is what people know the least.

Source: S&P Global Finlit

GFLEC
GLOBAL FINANCIAL LITERACY
EXCELLENCE CENTER

Financial fragility: Can people handle shocks?

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.

From Lusardi and Tufano, BPEA, 2011

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.
- Don't know.
- Prefer not to say.

People with these responses are classified as financially fragile

From Lusardi and Tufano, BPEA, 2011

Financial Fragility in the United States – 2018 National Finacial Capability Study

	Fragility
	Probably or certainly could not come up with $2,000 in a month
US Adults	31%

Who has basic financial literacy is much less likely to be financially fragile

GFLEC
GLOBAL FINANCIAL LITERACY EXCELLENCE CENTER

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

MARIA DEMERTZIS (maria.demertzis@bruegel.org) is Deputy Director of Bruegel

MARTA DOMÍNGUEZ-JIMÉNEZ (marta.dominguez@bruegel.org) is a Research Assistant at Bruegel

ANNAMARIA LUSARDI (alusardi@gwu. edu) is Academic Director of the George Washington University Global Financial Literacy Excellence Center

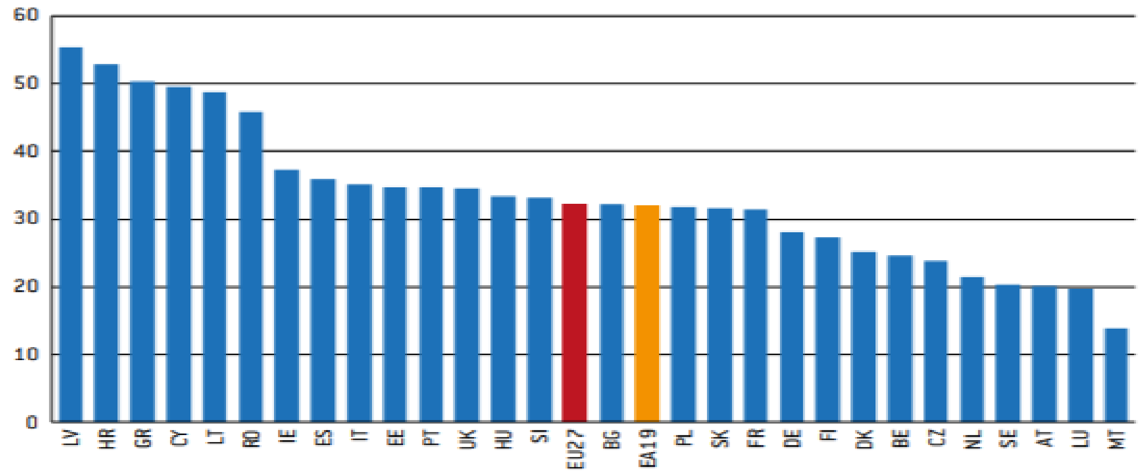
- **THE CONCEPT OF** household financial fragility emerged in the United States after the 2007-2008 financial crisis. It grew out of the need to understand whether households' lack of capacity to face shocks could itself become a source of financial instability, in addition to risks to the stability 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.

GFLEC
GLOBAL FINANCIAL LITERACY EXCELLENCE CENTER

Financial Fragility in Europe (cont.)

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.

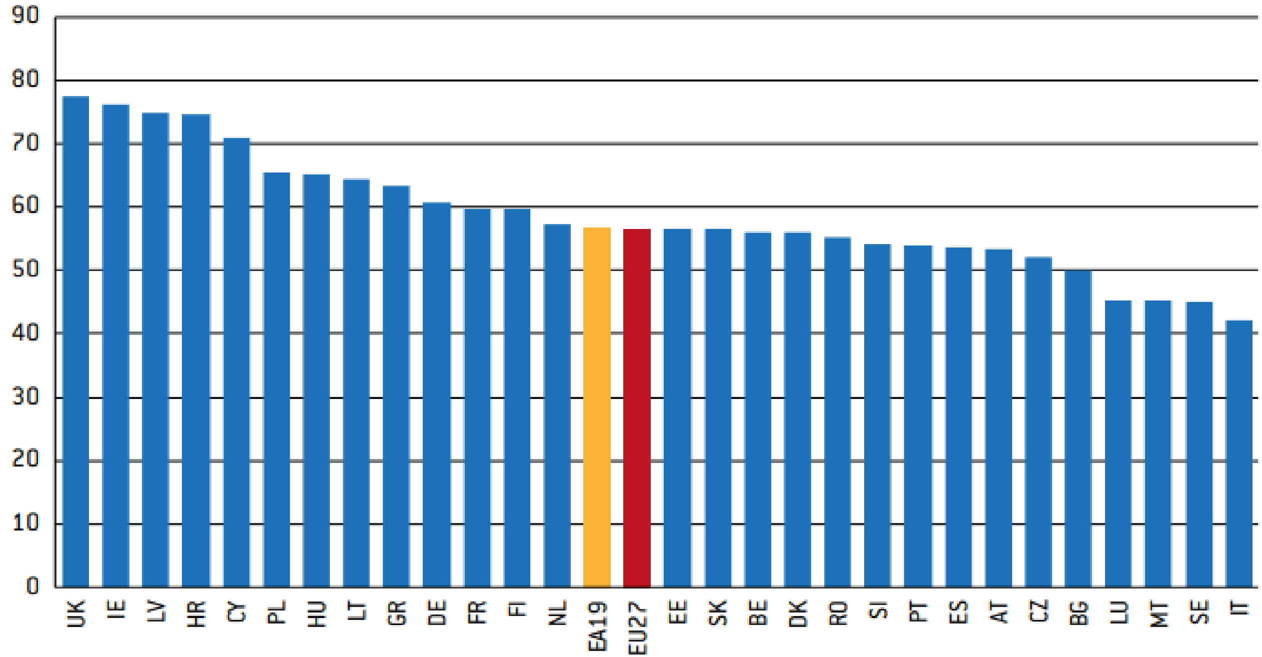
Figure 1: Household inability to meet an unexpected required expense, all households, percentage shares, 2018



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: Single parent households (cont.)

Figure 4: Household inability to meet an unexpected expense, single person household with dependent children, percentage shares, 2018



Source: Eurostat, EU-SILC.

Building a new ecosystem

We need many components

- Financial literacy is an essential one
- It is the foundation (like water)
- We need to refocus after the crisis

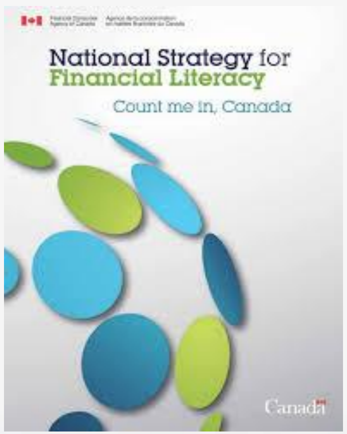
Advice for public policy

Building a financial resilient society

- Need to focus on well-being
- Add financial literacy among indicators of well-being
- Toward a more inclusive society

Policy work: National strategies for financial literacy

More than 70 countries have done or are doing a national strategy for financial literacy



GFLEC
GLOBAL FINANCIAL LITERACY
EXCELLENCE CENTER

Policy work: Italy

In July 2017, I was appointed by Italy's Minister of Economy and Finance as director of the new Financial Education Committee

The Committee is in charge of designing the national strategy and implementation program for financial literacy

Follow our work on www.Quellocheconta.gov.it

Concluding remarks

Financial literacy is like **reading** and **writing: it is an essential skill to thrive in the 21st century**

- It is very important to be financially literate as early as possible
- Financial literacy is a stepping stone for financial resilience and financial well-being

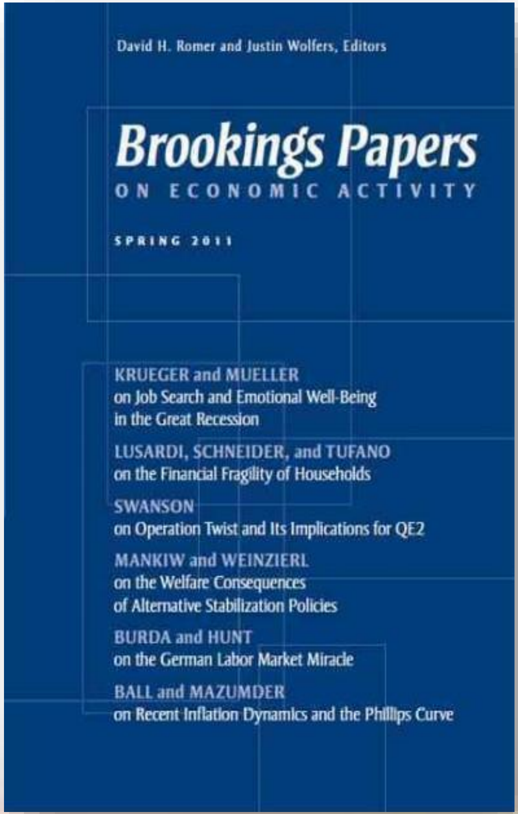
GFLEC
GLOBAL FINANCIAL LITERACY EXCELLENCE CENTER

Looking ahead

Short definition of financial literacy: **A vision for the future**

The question is**: Which future do we want to build?**

Research papers cited in this presentation


David H. Romer and Justin Wolfers, Editors

Brookings Papers ON ECONOMIC ACTIVITY

SPRING 2011

KRUEGER and MUELLER on Job Search and Emotional Well-Being in the Great Recession

LUSARDI, SCHNEIDER, and TUFANO on the Financial Fragility of Households

SWANSON on Operation Twist and Its Implications for QE2

MANKIW and WEINZIERL on the Welfare Consequences of Alternative Stabilization Policies

BURDA and HUNT on the German Labor Market Miracle

BALL and MAZUMDER on Recent Inflation Dynamics and the Phillips Curve


DOI: 10.1111/fima.12283

ORIGINAL ARTICLE

Financial Management WILEY

Financial literacy and financial resilience: Evidence from around the world

Leora Klapper[1] | Annamaria Lusardi[2]

[1]Development Research Group, The World Bank, Washington, DC

[2]Global Financial Literacy Excellence Center (GFLEC), The George Washington University School of Business, Washington, DC

Correspondence
Leora Klapper, Development Research Group, The World Bank, 1818 H St. NW, Washington, DC 20433.
Email: lklapper@worldbank.org

Funding information
Standard & Poor's Ratings Services; McGraw Hill Financial Inc

Abstract

We measure financial literacy using questions assessing basic knowledge of four fundamental concepts in financial decision making: knowledge of interest rates, interest compounding, inflation, and risk diversification. Worldwide, just one in three adults are financially literate—that is, they know at least three out of the four financial concepts. Women, poor adults, and lower educated respondents are more likely to suffer from gaps in financial knowledge. This is true not only in developing countries but also in countries with well-developed financial markets. Relatively low financial literacy levels exacerbate consumer and financial market risks as increasingly complex financial instruments enter the market. Credit products, many of which carry high interest rates and complex terms and conditions, are becoming more readily available. Yet only around half of adults in major emerging countries who use a credit card or borrow from a financial institution are financially literate. We discuss policies to protect borrowers against risks and encourage account holders to save.

1 | FINANCIAL LITERACY: WHAT IT IS AND WHY IT MATTERS

Without an understanding of basic financial concepts, people are not well equipped to make decisions related to financial management. People need to be financially literate to make informed financial choices regarding saving, investing, borrowing, and more. Overall, financial literacy matters on many levels. In a world of escalating financial complexity, there is an increasing need for basic financial knowledge (Lusardi & Mitchell, 2014). For example, with governments in many countries pushing to boost access to financial services, the number of people with bank accounts and access to credit products is rising rapidly. Moreover, changes in the pension landscape transfer decision-making responsibility to participants who previously relied on their employers or governments for their financial security after retirement.

The potential benefits of financial literacy are manifold. People with strong financial skills do a better job planning and saving for retirement (Behrman, Mitchell, Soo, & Bravo, 2012; Lusardi & Mitchell, 2014). Moreover, individuals with

© 2019 Financial Management Association International

Financial Management. 2019;1–26. wileyonlinelibrary.com/journal/fima 1


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

MARIA DEMERTZIS (maria.demertzis@bruegel.org) is Deputy Director of Bruegel

MARTA DOMÍNGUEZ-JIMÉNEZ (marta.dominguez@bruegel.org) is a Research Assistant at Bruegel

ANNAMARIA LUSARDI (alusardi@gwu.edu) is Academic Director of the George Washington University Global Financial Literacy Excellence Center

- 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.

GFLEC
GLOBAL FINANCIAL LITERACY EXCELLENCE CENTER

Thank you!

Thank you!