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Insights: Financial Capability

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What's Inside:

The Financial Fragility of American Families

The economic crisis that began in 2007 started a wide-ranging spiral that not only weakened the U.S. economy, but also eroded the financial stability of households—exposing the fragility of American families. Stock values dropped, real estate prices plummeted, household wealth shrank, unemployment rates shot up and the tenuous positions of an alarming percentage of U.S. households became all too apparent. Even after the peak of the crisis, the recovery was very slow. This Brief describes how American families are positioned to confront economic shocks and the resources they may—or may not—have available to help them weather such crises.

Measuring financial fragility

U.S. families were exposed to a long and persistent recession that devalued their homes and financial assets. At the same time, it put many workers among the ranks of the unemployed. To measure a family's "financial fragility" in the face of these shocks, Lusardi, Schneider and Tufano (2011) developed a set of questions around a family's capacity to access emergency funds. The questions were added to a new survey, the TNS Global Economic Crisis Study, which was conducted between June and September 2009. In collaboration with Lusardi and Tufano, survey research firm TNS Global (www.tnsglobal.com) used an online panel to collect new data. The question measuring household financial fragility was recently added to the 2012 FINRA Investor Education Foundation's National Financial Capability Study (NFCS), which collected data online from July through October 2012.

In one question, participants were asked:

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

Respondents could reply:

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.

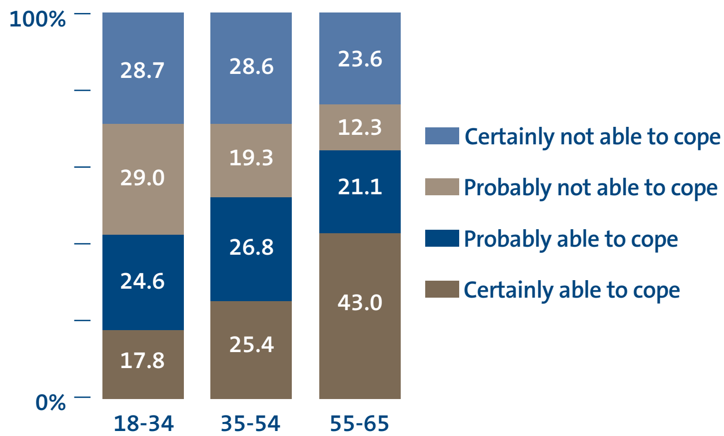
The $2,000 figure was chosen because it is roughly equivalent to the cost of an unanticipated major car repair, a large medical expense, a legal fee or a major home repair. The answers could reflect actual or perceived financial fragility during times of crisis.

Americans' capacity to cope with shocks was found to be very low. Half of the respondents reported that they probably or certainly could not get the funds. Although striking, this is consistent with findings from other studies. For example, only 35 percent of respondents in the FINRA Investor Education Foundation's 2009 State-by-State NFCS responded affirmatively when asked if they "set aside emergency or rainy day funds that would cover your expenses for 3 months, in case of sickness, job loss, economic downturn or other emergencies" (FINRA Investor Education Foundation, 2009; and Lusardi, 2011). Data from the Survey of Consumer Finances, fielded just before the prolonged recession in 2007, showed that many households have few liquid assets: 42 percent of Americans have $2,000 or less in checking accounts, savings accounts and money market mutual funds. In fact, numerous studies on wealth have found that many households have few assets beyond homes and pensions (Lusardi 1999).

Another measure of financial fragility, as related to the $2,000-in-30-days metric, is the self-reported ability to "make ends meet." The Pew Research Center for the People and the Press regularly asks a nationally representative sample of Americans if they "often don't have enough money to make ends meet." Forty-two percent of Americans completely or mostly agreed with that statement in 2009. Similarly, over half the 2009 NFCS respondents reported difficulty in covering monthly expenses and paying bills.

Economic and demographic factors play a role in this limited capacity to respond to emergencies. Households with higher income and greater educational attainment report a greater ability to cope. Conversely, an inability to cope is severe among less educated and low-income populations. But even at middle-class levels, a high proportion of individuals say they are certainly or probably not able to cope. The same is true of just more than half of those who attended college, but did not complete a degree (see Lusardi, Schneider and Tufano, 2011). Although financial fragility is more pronounced among the young, many respondents aged 55 to 65, who are presumably close to retirement and whose wealth accumulation should be peaking, reported difficulty coping with a shock (Figure 1).

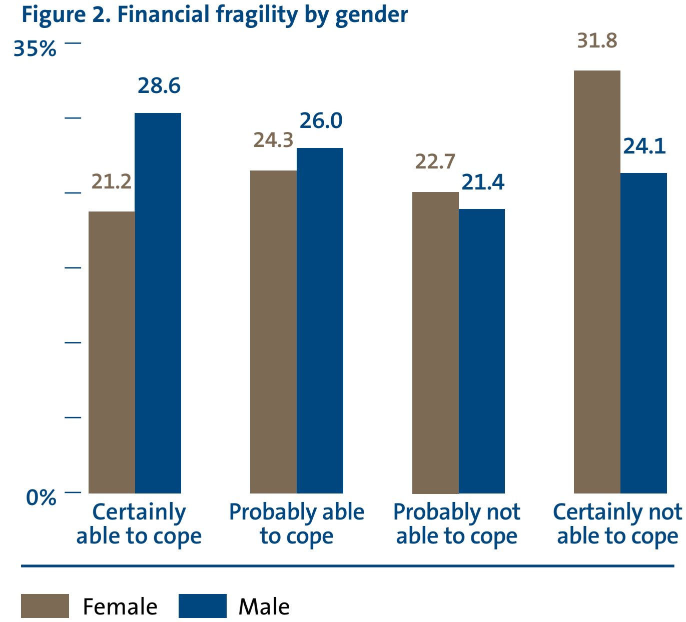
Figure 1. Financial fragility by age



Note: Due to rounding, numbers may not sum to 100 percent
Source: Lusardi, Schneider and Tufano (2011).

Women were less likely to report being probably or certainly able to cope with a financial shock than men (Figure 2). African American and Hispanic households were also disproportionately more fragile, as were respondents in households that included minor children and those in households shared with their parents. These characteristics are, again, consistent with findings from the 2009 NFCS (Lusardi 2011).

Figure 2. Financial fragility by gender



Source: Lusardi, Schneider and Tufano (2011).

Findings from the 2012 NFCS

The economy recovered slowly from the financial crisis and American families continue to display a high degree of financial fragility. Data from the 2012 NFCS show that 40 percent of respondents stated they probably or certainly could not come up with $2,000 within the next month. Women, younger respondents, those with lower income and education levels, and African-American and Hispanic respondents are more likely to have difficulty handling a shortterm unexpected expense (FINRA Investor Education Foundation, 2013).

How confident are you that you could come up with $2,000 if an unexpected need arose within the next month?	Total
I am certain I could come up with the full $2,000	35%
I could probably come up with $2,000	21%
I could probably not come up with $2,000	15%
I am certain I could not come up with $2,000	25%

Note: Due to rounding, "don't knows" and nonresponses, numbers do not add up to 100%.

How do Americans cope with emergencies?

The TNS Global Economic Crisis survey also asked respondents about the strategies families use to cope with shocks. The options were subsequently aggregated into six categories: savings, family or friends, mainstream credit, alternative credit, sale of possessions and increased work. Among the respondents, 54 percent cited multiple coping methods. Thirty-four percent said they relied on family and friends, while a similar proportion, 30 percent, pointed to mainstream credit, mostly through the use of credit cards. Eleven percent responded that they would use alternative credit, such as payday loans or pawnshops, and close to one in five would sell possessions. Overall, about 19 percent of all respondents would resort to what might be seen as extreme measures—pawning possessions, selling homes and/or taking payday loans—to come up with the emergency funds. Adding in respondents who reported an inability to cope with an emergency, the findings suggest that more than 46 percent of all respondents are living close to the financial edge.

> *"More than 46 percent of all respondents are living close to the financial edge."*

Payday lenders now have more storefronts in the United States than McDonald's and Starbucks combined, according to Skiba and Tobacman (2010). Moreover, the NFCS found that more than one in five Americans have used high-cost methods of borrowing, such as payday loans, tax refund loans, auto title loans, pawnshops and rent-to-own stores, in the past five years (Lusardi 2011). In 2012, 30 percent of Americans reported that they used these high-cost methods of borrowing in the past five years (FINRA Investor Education Foundation, 2013).

These findings indicate that individuals can—and plan to—adjust when facing a shock, and their strategies go beyond the formal solutions of using their savings or borrowing funds. Many expect to seek assistance from networks of family and friends. Some plan to add hours of work, even though a second job may not be easy to find during a recession and they are not sure their employers permit additional hours of labor. The survey's results underscore that a focus on savings or liquid assets alone does not offer an accurate assessment of people's ability to weather a shock.

Concluding remarks

A disturbingly large number of Americans are vulnerable to shocks, unable to come up with $2,000 in 30 days. This vulnerability extends to significant groups of the population, including those with higher-than-average income and education. Women, households with children and people living with parents are especially financially fragile, even after accounting for their other demographic and economic characteristics. A notable number of seemingly middle-class Americans are financially fragile, reflecting a substantially weaker financial position than one would expect or a very high level of pessimism. Both of these are important considerations with regard to behavior, public policy and the types of financial vehicles available to households.

Households' own savings are most often tapped to deal with shocks, but the resources of family and friends, formal and alternative credit, increased work hours and the sale of possessions are also used, especially among some subgroups. This suggests that it is important to look beyond precautionary savings in understanding how families cope with financial shocks.

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About this Publication

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