Financial know-how of Americans in short suppy

By Brenda Cronin, Wall Street Journal

Some household balance sheets have mended during the recovery but that may be thanks less to fiscal stewardship than the improving economy.

In fact, Americans' grasp of concepts such as investment risk and inflation has weakened since the recovery began in mid-2009. Research released last week shows that on a five-question test (Take the test here), respondents did worse in 2012 than in 2009. The average number of correct answers fell to 2.9 in 2012 from 3.0 on the test in 2009.

The test, along with a wide-ranging survey of financial capability of more than 25,000 American adults, was conducted during the fall and funded by the Financial Industry Regulatory Authority Investor Education Foundation.

"People are finding it a little easier to make ends meet," Finra Chief Executive Richard Ketchum said in presenting the 2012 National Financial Capability Study results last week in Washington. "More respondents have rainy-day funds, which puts them in a better position to deal with life's unexpected events…But there are still very significant concerns," he said, adding that debt continues to be a serious problem.

Patterns of spending and saving changed little between the two studies: 41 percent of respondents still say they spend less than their income, 19 percent spend more than it and 36 percent spend roughly what they earn.

In the most recent study, 40 percent of respondents said they had no trouble covering their monthly expenses, a slight improvement from 36 percent in 2009.

Although many respondents were short on financial education, they didn't lack confidence about managing their books. Researchers said they found "a disconnect between self-perceptions and actions in day-to-day financial matters." Many people who gave themselves high marks for managing their finances also were using non-bank borrowing methods, such as payday loans, or had overdrawn their checking accounts.

The survey focused on four areas of financial capability: making ends meet, planning ahead, managing financial products and financial knowledge and decision-making. (The five-question test was part of the fourth area, financial knowledge.) Researchers sliced the data by age, gender, ethnicity and education as well as census division and state.

It isn't surprising that the worst downturn in the U.S. since the Great Depression hasn't produced better personal financial habits, said Annamaria Lusardi, who was part of the team that designed the questions for the Finra test and survey.

Although the tattered economy often was front-page news throughout the recession, she said, simply reading about markets and the economy is no substitute for financial-literacy education at school or work.

"It's not that people learn because we're in a financial crisis," said Ms. Lusardi, a professor at George Washington University and director of the school's Global Center for Financial Literacy. "We can't expect people to learn about inflation by osmosis."

She emphasized that young people in particular need education not only on asset and wealth-building, but on managing debt. The study found that debt remains an acute problem for those with lower incomes and less education – as well as the young.

Among young people ages 18 to 34 years old, 43% have used often high-cost methods of borrowing, such as pawn shops or rent-to-own establishments, Lusardi said, compared with about

30% of the entire population.

“That means… young people are basically becoming accustomed to financial transactions that require non-bank institutions and that are also high-cost,” Ms. Lusardi said.

Young people also are likely to have precarious finances and scant savings socked away for emergencies. When asked if they would be able, in one month, to come up with $2,000 for an unexpected expense such as car repairs, 49 percent of 18-34-year-old respondents said probably not. That contrasts with 27 percent of respondents age 55 or older who said they couldn’t, and 42 percent of those between ages 35 and 54.

Planning for further down the road also got short shrift: 40% of respondents said they had set aside a rainy-day fund that they could live on for three months; 56 percent said they hadn’t.

Survey questions on housing yielded good and bad news. While the number of 0% down payments on homes fell by 5 percent from 2009 to 2012, foreclosures inched up, with 3.7 percent of respondents in 2012 involved in one, compared with 3 percent in 2009.

“Financial literacy is this new skill and we need to live in this new world of individual responsibility,” Lusardi said. “Very few countries have taken the initiative to improve financial literacy and capability… If you don’t do that, this is not something that grows with you or that people acquire by their daily lives.”