
Financial Literacy among the Young: Evidence and Implications for Consumers Policy

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Networks Financial Institute

Indianapolis, Indiana

Annamaria Lusardi, Dartmouth College and NBER

Olivia S. Mitchell, The Wharton School and NBER

Vilsa Curto, NBER

Why study financial literacy among the young?

- Young people make many important financial decisions upon entering the labor force, including enrolling in pension or retirement plans, managing credit card and other debt, buying a car or a house.
 - Decisions made at a young age can have a large impact on wealth accumulation over the course of an individual's life.
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National Longitudinal Survey of Youth (NLSY)

- We examine financial literacy using data resulting from a set of questions included in the most recent wave of the NLSY.
 - We find that:
 - Financial illiteracy is widespread among young adults, and particularly acute among groups such as women, African-Americans, and Hispanics.
 - Financial illiteracy can be linked to talents and ability, quality of education, peer influences, and parental background.
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Financial literacy among the young

- We measure financial literacy among the young using three questions added to wave 11 of the NLSY (2007-2008).
 - Respondents are 23-37 years old.
 - These questions were originally added to the 2004 Health and Retirement Study (HRS).
 - These questions have now been added to many other surveys in the U.S. and abroad.
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Measuring Financial Literacy: (I)

Interest Rate/Numeracy

“Suppose you had \$100 in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow?”

- i) more than \$102;
 - ii) exactly \$102;
 - iii) less than \$102;
 - iv) don't know (DK);
 - v) refuse to answer.
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Financial Literacy (II)

Inflation

“Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, would you be able to buy:”

- i) more than today with the money in this account;
 - ii) exactly the same as today;
 - iii) less than today;
 - iv) DK;
 - v) refuse.
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Financial Literacy (III)

Risk Diversification

“Do you think the following statement is true or false? ‘Buying a single company stock usually provides a safer return than a stock mutual fund.’”

- i) true;
 - ii) false;
 - iii) DK;
 - iv) refuse.
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How much do older people (ages 50+) know? (2004 HRS)

Distribution of Responses to Financial Literacy Questions (%)

	Responses			
	<i>Correct</i>	<i>Incorrect</i>	<i>DK</i>	<i>Refuse</i>
Interest rate	67.1	22.2	9.4	1.3
Inflation	75.2	13.4	9.9	1.5
Risk diversif.	52.3	13.2	33.7	0.9

NB: Only **ONE THIRD (34%)** answer all 3 questions correctly.

How much do young people (ages 23-27) know? (NLSY)

Distribution of Responses to Financial Literacy Questions (%)

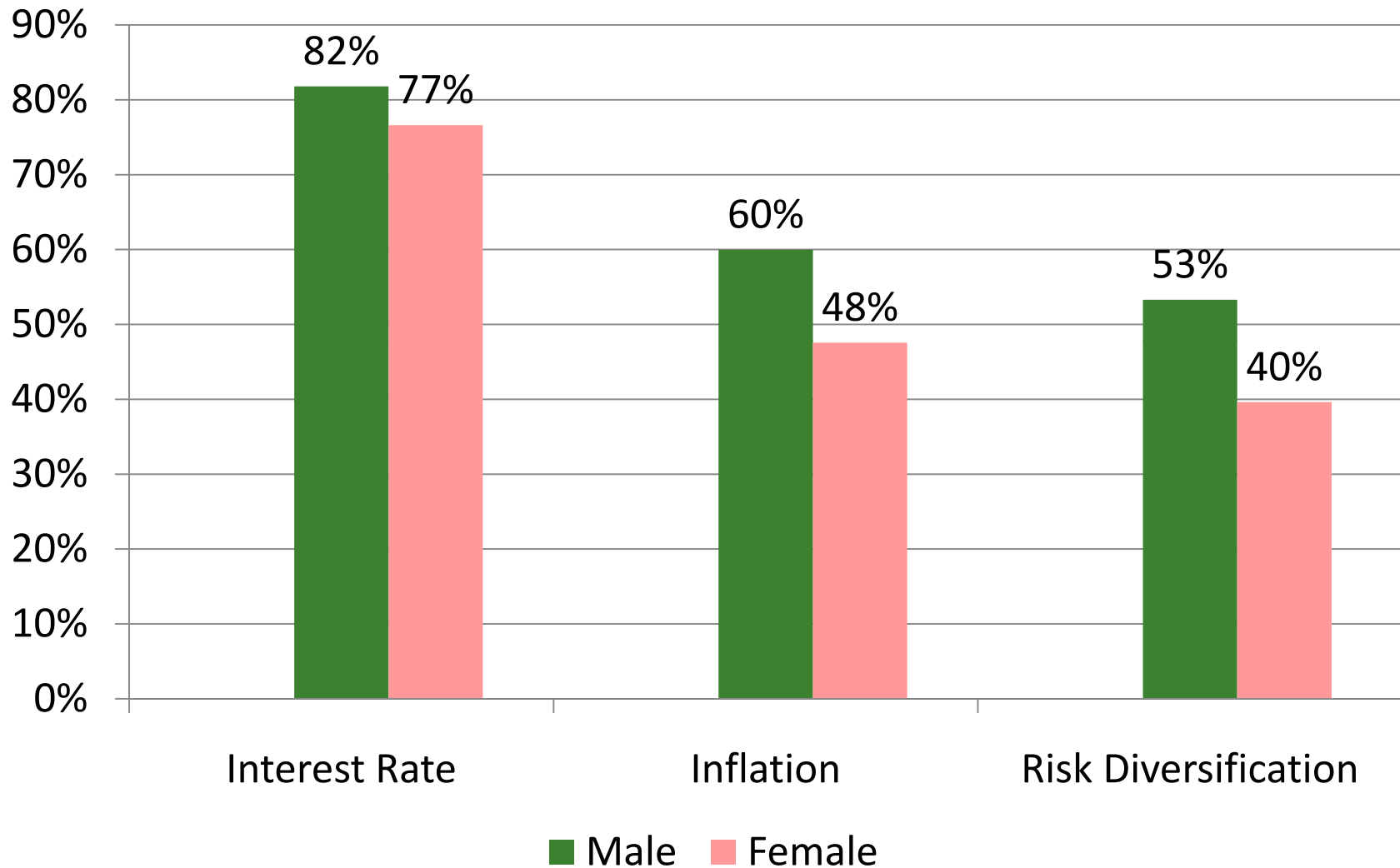
	Responses			
	<i>Correct</i>	<i>Incorrect</i>	<i>DK</i>	<i>Refuse</i>
Interest rate	79.24	14.76	5.87	0.12
Inflation	53.88	30.53	15.41	0.18
Risk diversif.	46.57	15.86	37.50	0.07

NB: **LESS THAN HALF (45%)** answer all 3 questions correctly.

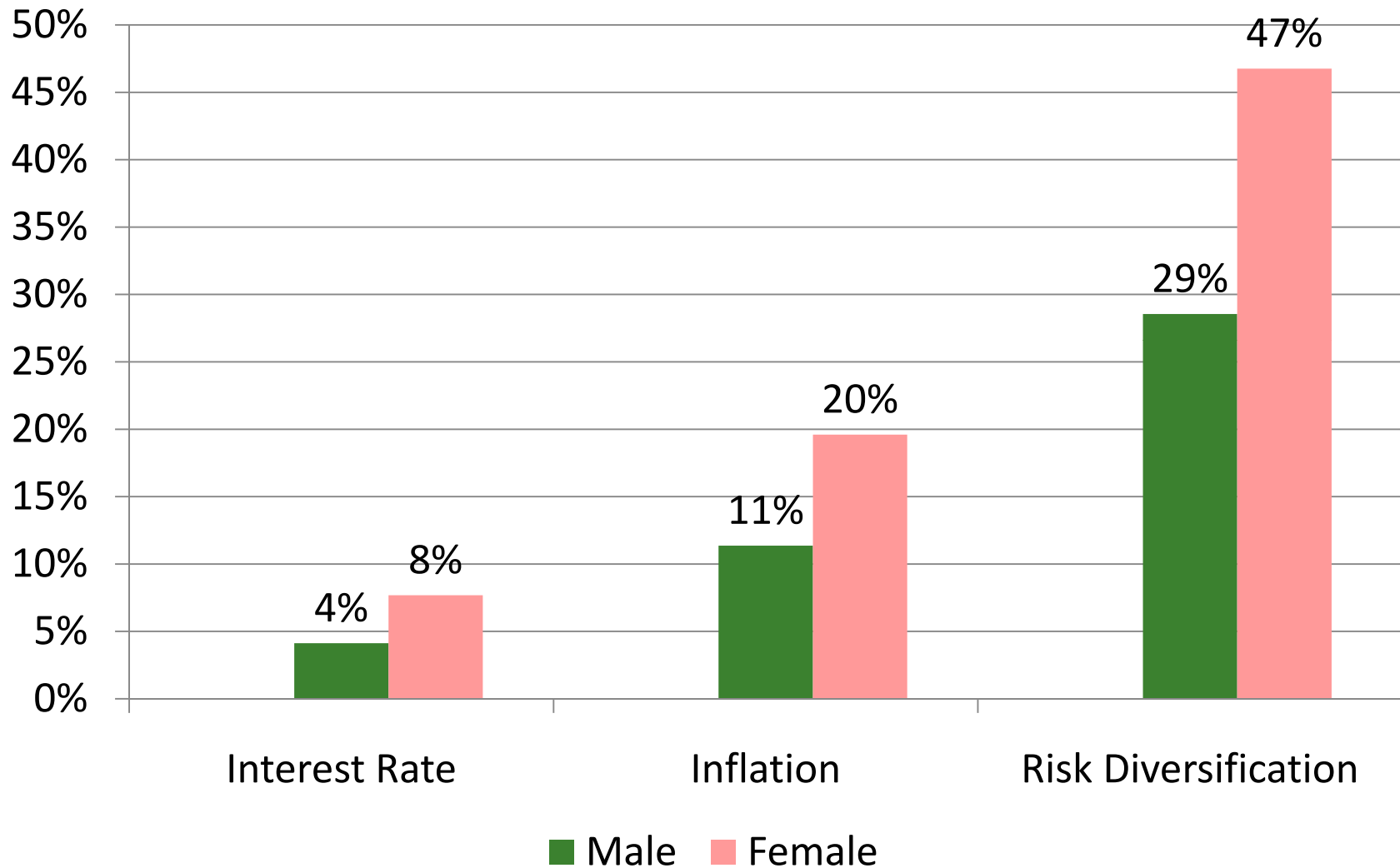
Who knows the least among the young?

- Financial illiteracy is particularly acute among some specific groups such as
 - Women
 - African-Americans
 - Hispanics
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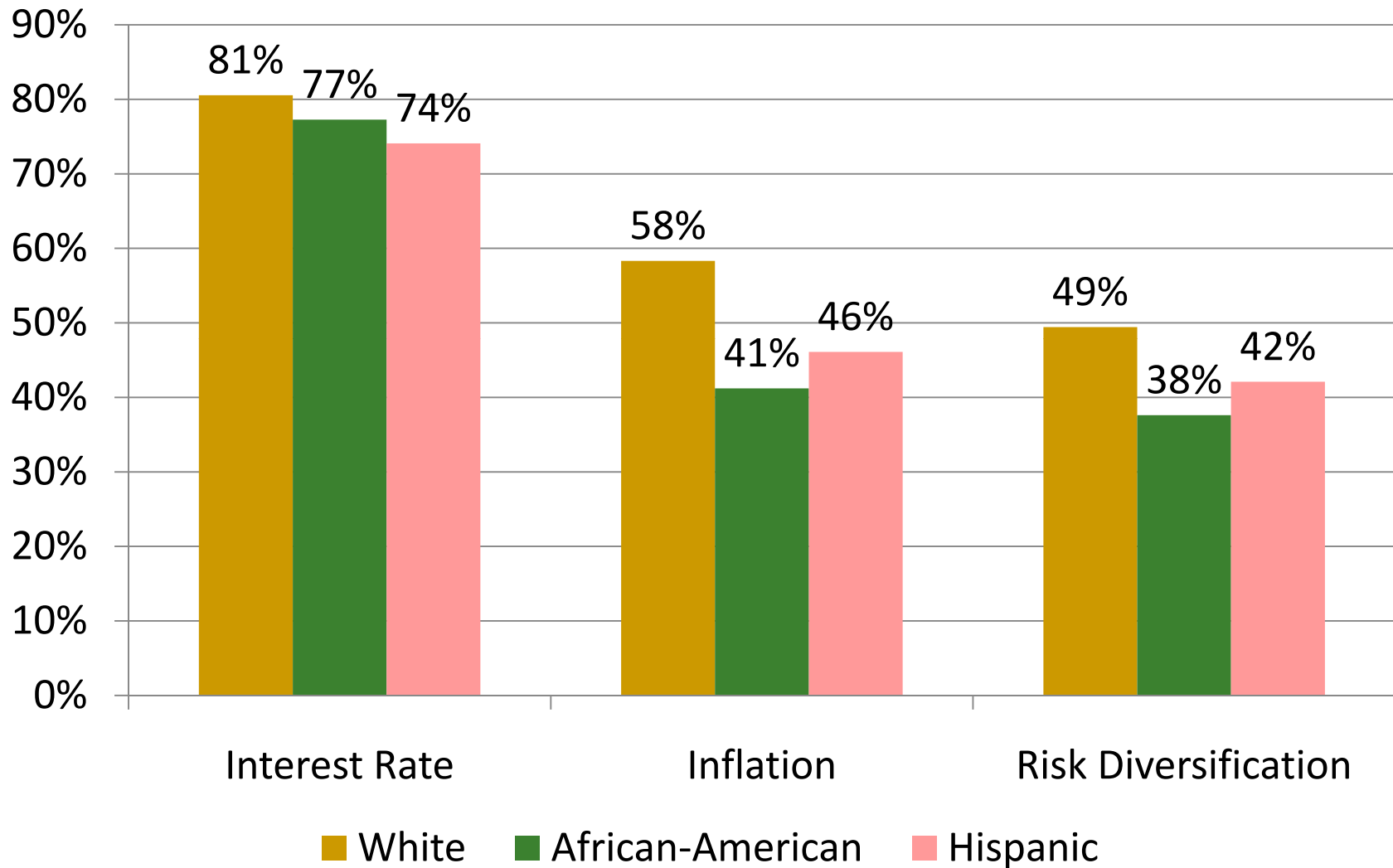
Correct responses by gender



DK responses by gender



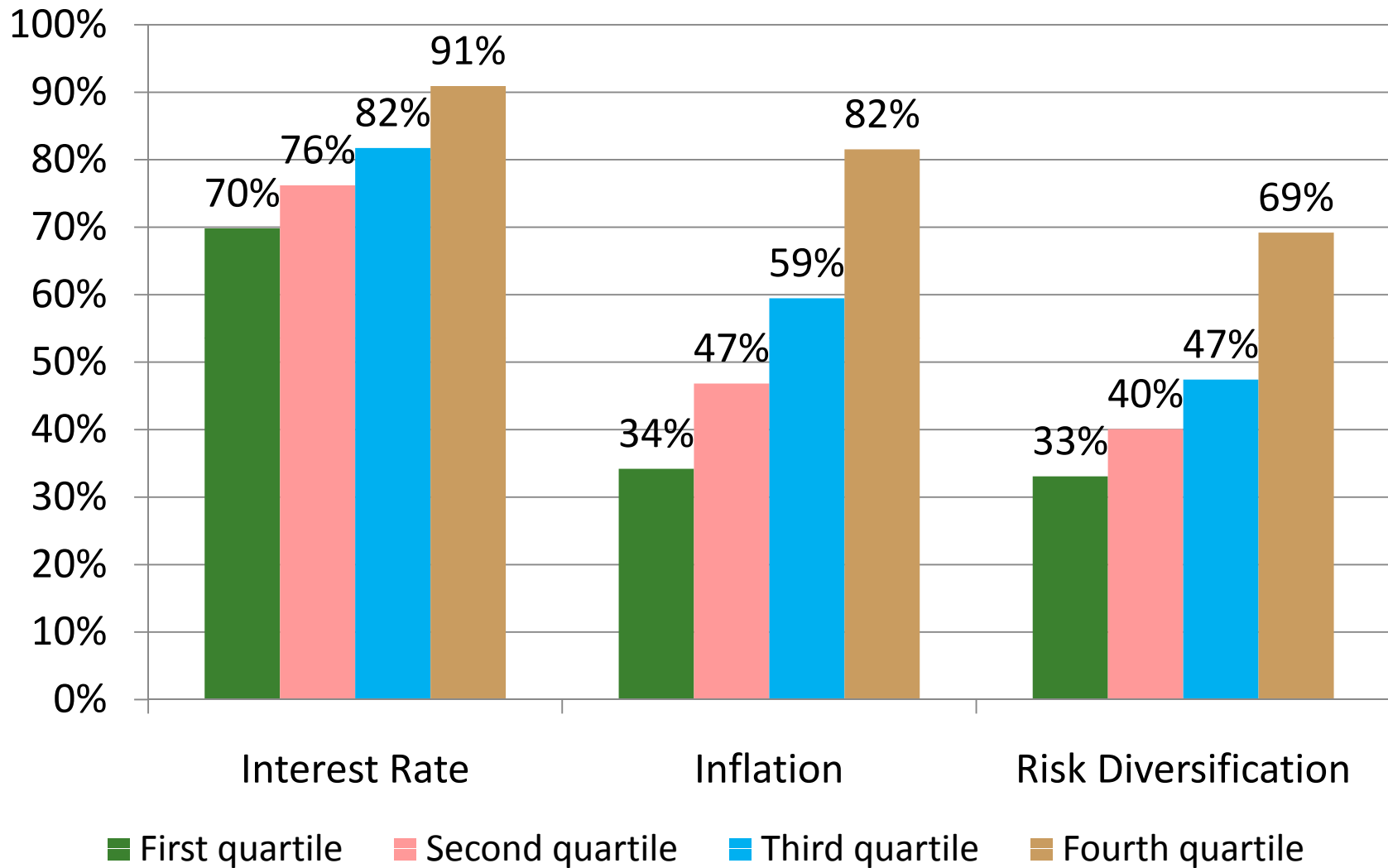
Correct responses by race/ethnicity



Knowledge or cognition?

- Use data on test scores (ASVAB or Armed Services Vocational Aptitudes)
 - Unique information not present in other datasets
 - Multivariate analysis shows that test scores matter a lot for financial literacy, but other variables remain statistically significant
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Correct responses by ASVAB Score



What affects financial literacy of young people?

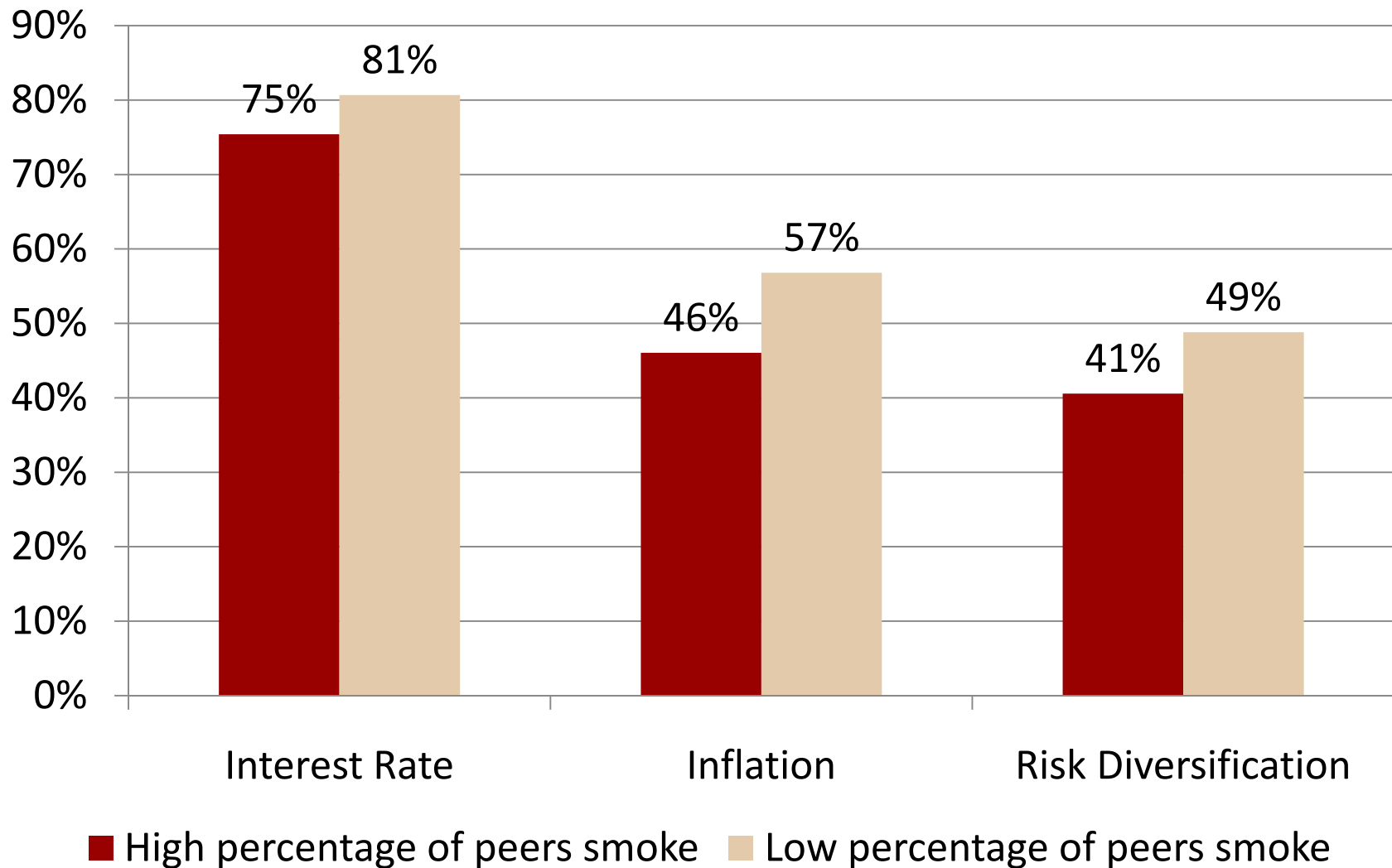
■ Peer effects

- Low financial literacy if high percentage of high school peers smoked
- High financial literacy if high percentage of high school peers planned to attend college

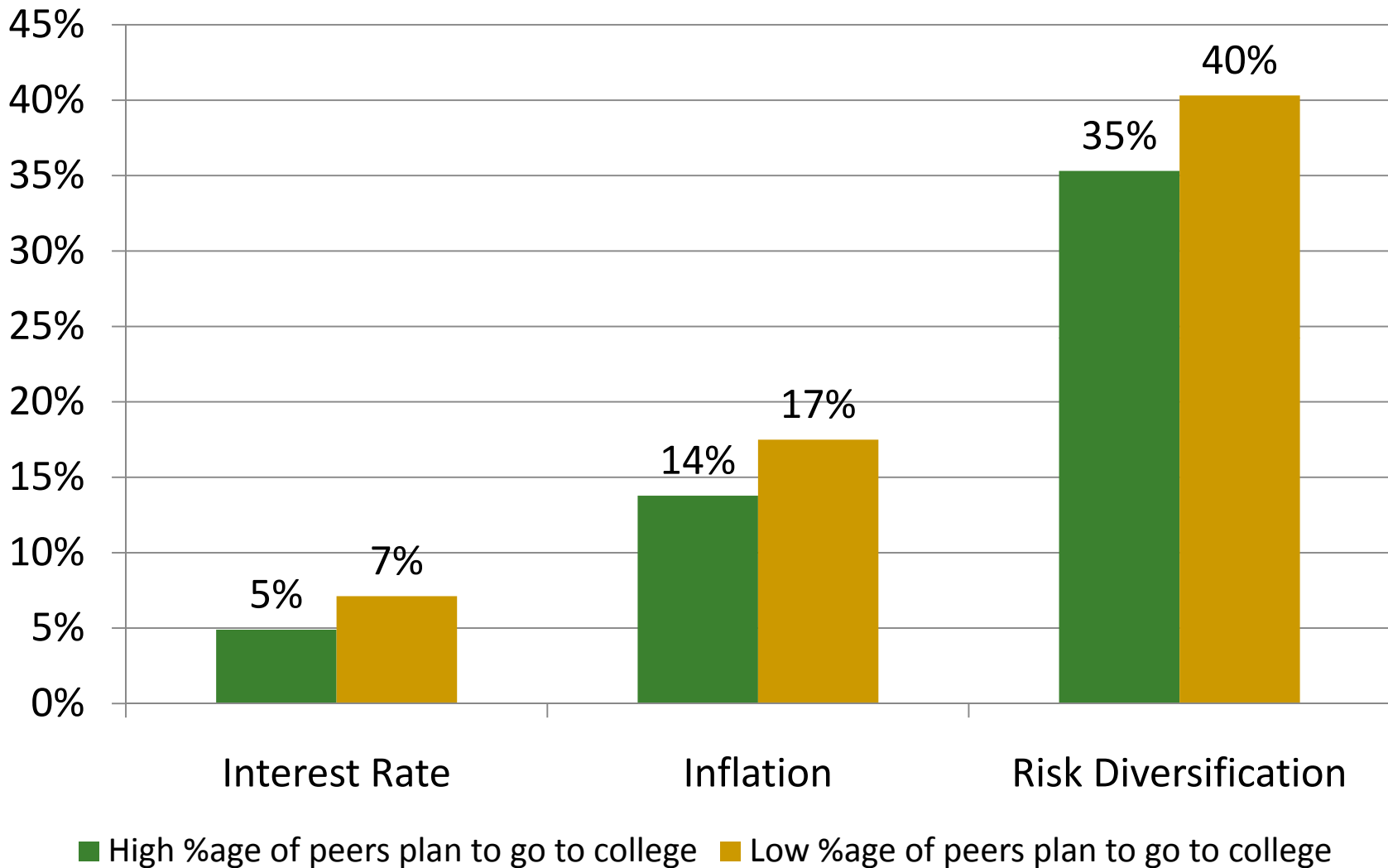
■ Parental background

- High financial literacy if parents have high education
 - High financial literacy if parents own stocks
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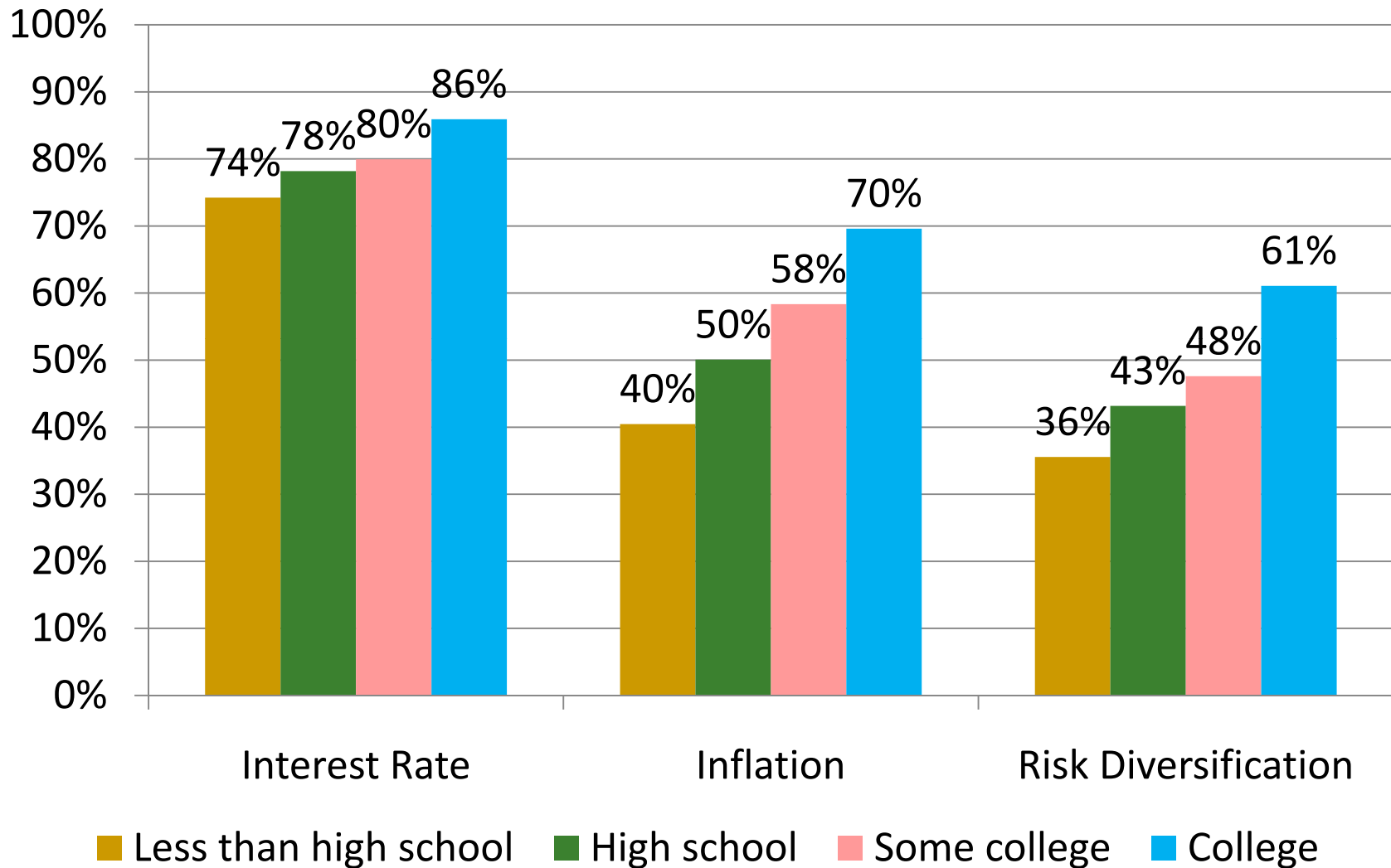
Correct responses by peers smoking



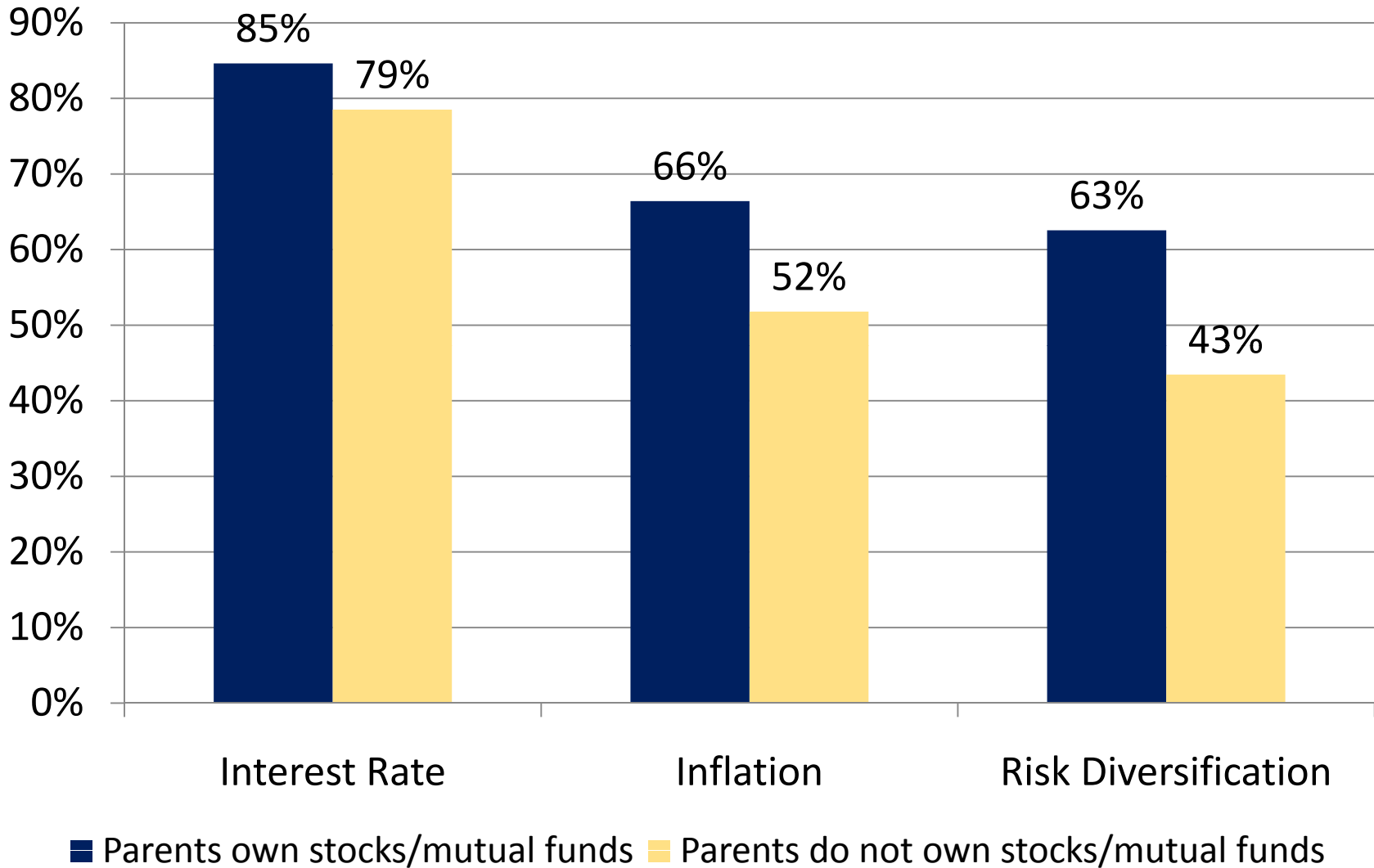
DK responses by peers going to college



Correct responses by biol. mother's education



Correct responses by parents owning stocks



Results from Multivariate Analysis

- Important predictors of financial literacy:
 - Gender
 - Race/ethnicity
 - Talents and ability
 - Teachers interested in students
 - High percentage of peers who smoke
 - Biological mother's education
 - Parents owning stocks
 - Parents having retirement savings
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Implications for Financial Education

- The young seem unprepared to make financial decisions
 - They have low financial knowledge
 - Fin education programs need to be targeted to specific segments of the young population
 - There are large differences across demographics, even within a narrow age group
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Implications for Financial Education (cont.)

- While the young seem to learn from others around them (peers and parents), some may lack these opportunities for learning
 - Role for schools in improving financial literacy
 - It is hard to evaluate the effectiveness of financial education programs among the young
 - According to the life-cycle theory, they should not necessarily save
-