Academic Research on Financial Literacy

Prof. Annamaria Lusardi
The George Washington University School of Business
Academic Director, Global Financial Literacy Excellence Center
Investors need basic financial knowledge

- Big 3 questions:
  - Numeracy/interest rate
  - Inflation
  - Risk diversification

- *Being financially literate*: How many can answer these 3 questions correctly?

- These 3 questions have been used in 15 countries: Financial Literacy around the World (FLAT World) project
Financial literacy over time in the US

% of people correctly answering big 3 questions

- 2009: 39%
- 2012: 34%
- 2015: 32%


- Financial knowledge did not increase since 2009
Financial literacy by age in the US
(% answering Big 3 questions correctly)

- Financial knowledge increases very slowly with age
- Less than 1/3 know 3 basic questions by age 40 even though most important decisions are made well before that age
Risk is the most difficult concept to grasp

<table>
<thead>
<tr>
<th></th>
<th>Correct</th>
<th>Incorrect</th>
<th>Don't know</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rate question</td>
<td>75%</td>
<td>13%</td>
<td>12%</td>
</tr>
<tr>
<td>Inflation question</td>
<td>59%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Risk question</td>
<td>46%</td>
<td>10%</td>
<td>44%</td>
</tr>
</tbody>
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Source: 2015 NFCS data

- “Do not know” responses to risk diversification question are dramatically high
- Our recent data from 10 European countries shows that risk-related concepts are the least understood
Financial literacy among investors

- Financial knowledge is not much higher among investors
- Only 1 in 2 investors answer correctly 3 basic questions

Source: 2015 NFCS data
Financial sophistication

• More complex questions were asked in other surveys, for example:
  ➢ Assets pricing
• Knowledge of sophisticated concepts is lower
  ➢ E.g., 43% of investors have assets pricing knowledge
• Economic/finance jargon is not understood
  ➢ “Don’t know” responses increase when jargon is used
  ➢ Especially important for women
Mismatch between actual and perceived financial knowledge

- Despite low levels of financial literacy, Americans have high self-perceptions of their financial knowledge
- The mismatch is high among investors too
Implications from academic research

• Need to step up the effort on financial education
  ➢ Important to prepare the next generation of investors
• Because risk is particularly difficult to grasp, visualization or other strategies may help
• Different strategies to communicate with investors
  ➢ Keep the message free of complex terminology
  ➢ More targeted messages to population subgroups
Contact and further information

Annamaria Lusardi

Global Financial Literacy Excellence Center (GFLEC)
E-mail: alusardi@gwu.edu
Webpage: www.gflec.org
Twitter: @A_Lusardi
WSJ blog: http://blogs.wsj.com/experts/tag/annamaria-lusardi/