A Practical Tool to Measure Financial Literacy

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Background

Many have measured financial literacy in a variety of populations. Although the assessment instruments vary, often they are quite long. For example, the Jump$tart Coalition instrument consisted of 56 questions (Mandell, 2008). Rand (2004) used 48 knowledge-based questions to assess financial literacy in low-income workers. Bell, Gorin, and Hogarth (2009) used 77 questions that asked respondents to self-assess their financial situation. At the opposite extreme, Lusardi and Mitchell (2005) used three questions to measure financial literacy.

An alternate brief instrument to assess financial literacy would be useful. One model to follow by Weiss et al. (2005) is introduced as a brief assessment for medical staff to use to evaluate patient health literacy (see Figure 1). This poster introduces a model adapted to financial literacy (see Figure 2).

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<u>Health Literacy Definition</u> – "The degree to which individuals have the capacity to obtain, process, and understand basic *health* information and services needed to make appropriate *health* decisions" (Weiss et al., 2005, p. 514).

<u>Issues of Limited Literacy</u> - "Individuals with limited literacy have less knowledge about their health problems, more hospitalizations, higher health care costs, and poorer health status than those with adequate literacy" (Weiss et al., 2005, p. 514).

<u>Claim</u> – Patients need to understand both text and numbers to successfully deal with today's health care system.

<u>Benefits of Tool</u> – Knowing a patient's health literacy skills helps clinicians and health care administrators tailor health information in a format the patient can understand.

<u>Ultimate Goal</u> – Help providers improve patient physical well-being.

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<u>Financial Literacy Definition</u> – The degree to which individuals have the capacity to obtain, process, and understand basic *financial* information and services needed to make appropriate *financial* decisions.

<u>Issues of Limited Literacy</u> – Xiao et al. (2010) states "financial knowledge is strongly associated with financial behaviors" (p. 16). Lusardi (2008) states that financial illiteracy can lead to financial mistakes, such as excessive borrowing or high-cost mortgages.

<u>Claim</u> – Individuals and families need to understand both text and numbers to successfully deal with today's financial system.

<u>Benefits of Tool</u> – Knowing an individual's financial literacy skills helps financial service providers and counselors tailor information in a format a consumer can understand.

<u>Ultimate Goal</u> – Help providers improve consumer financial well-being.

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Figure 1.   *Figure 2.*

<u>Both Tools</u> – Measure some math skill, skill in locating information, and abstract reasoning, with a commonly-used item.

Purpose

The bank statement assessment is configured to measure an individual's ability to understand, manage, and analyze their financial situation numerically (see Figure 3). Combined with a qualitative assessment of knowledge and a behavioral aspect, this may create a well-rounded assessment tool. On its own, the measurement tool may be useful for banks as they attempt to understand their customers' needs, knowledge, and usage of their services. It may provide insight into educational seminars provided by banks, credit unions, or other financial institutions for their clients. Early intervention may be a more promising approach than providing counseling during or after bankruptcy, and these initiatives deserve some attention.

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It may also prove useful for financial planners attempting to gain an understanding of their clients' knowledge base. If a coordinated effort were applied to collecting data from this brief questionnaire, policy and program decisions would be better informed. Although a large portion of the US population is banked, and presumably familiar with bank statements, the instrument may not be a fair way to measure the financial literacy of the unbanked.

July 1st Bank Statement:

Current balance:

Checking account	$ 500
Savings account	$ 1,000
Supplemental savings	$ 500
* 6 Month Certificate of Deposit at 1%	$ 5,000
** Christmas Club	$ 1,000

Income & Expense Information:

Income after taxes (take-home pay)	$ 5,000
Monthly bills (excluding mortgage)	$ 3,800
Mortgage	$ 1,000
Current value of home:	$ 150,000
Equity in home:	$ 35,000

This account requires no minimum balance in checking or savings accounts.

Q 1.
According to the current balances, before getting paid and before paying any bills, if you spend the entire amount of your available money, how much will you spend?
$ _____

Q 2.
Assume it is July. If you don't spend any of your available money and nothing else changes in your bank account, how much money will you have available 6 months from now?
$ _____

Q 3.
You receive your paycheck on August 1st. You place your paycheck in your checking account and pay all your bills on August 2nd. How much money is available in your checking account at the end of the day on August 2nd?
$ _____

Q 4.
Is your mortgage too large for your income? Circle one.
Yes   No   I'm not sure

Q 5.
Assume you do not need to increase your savings. Suppose you decide to invest $200 per month. Can you afford this? Circle one.
Yes   No   I'm not sure

Q 6.
Do you think the following is true or false? "Buying a single company stock usually provides a safer return than a stock mutual fund" (Lusardi & Mitchell, 2005). Circle one.
True   False

* Certificate of Deposit opened on June 1st.
** Christmas Club funds will be available on November 1st for holiday shopping.

Answers: 1) 500 + 1000 + 500 = $2,000, 2) 500 + 1000 + 500 + (5000*1.01) + 1000 + (200*6) = $9,250, 3) 500 + 200 = $700, 4) Yes (1,000/5,000 = 20%), 5) Yes, 6) False

Figure 3.

References

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Acknowledgements