Financial Literacy and Confidence in the Ability to Fund an Unexpected Need

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Many US families report difficulties covering expenses, paying bills, and setting aside funds for unexpected needs. This study uses data from the 2012 National Financial Capability survey to explore the relationships between subjective and objective measures of financial literacy and individuals' confidence in their ability to come up with $2000 if an unexpected need arises.

Much has been written about the effects of subjective and objective measures of financial literacy in determining the financial behaviors and wellbeing of individuals and families. While some literature has dealt with financial literacy as a determinant of the capacity to maintain emergency funds, relatively little is known about the ability of households to access more moderate sums. This study helps to fill this gap by focusing on the relationship between financial literacy and confidence to come up with $2,000 for an unexpected need. Previous research (Berlin and Kaunitz , 2015;) suggests the lack of a cash margin bears a strong negative relationship with satisfaction measures and a sense of economic security while Ruberton, Gladstone and Lyubomirsky, 2016 found that having even a small buffer of cash improves one's life satisfaction.

Data for empirical analysis were drawn from the 2012 National Financial Capability Study (NFCS) State-by-State Survey Instrument sponsored by the Financial Industry Regulatory Authority (FINRA). Logistic regression was used and analysis was concerned with the odds of individuals having confidence in their ability to come up with $2,000 for an unexpected need. The dependent variable, 'confidence in the ability to fund an unexpected need,' was transformed into a binary variable based on the question, "How confident are you that you could come up with $2,000 if an unexpected need arose within the next month?" The key independent variables included financial literacy variables defined as objective financial knowledge based on the number of correct answers to the five Lusardi and Mitchell (2007) questions (0 – 5), subjective financial knowledge, and subjective financial management ability. This study also analyzes income levels, age and other demographic variables to determine ability to come up with $2,000.

This study found an odds ratio of 1.18 for the relationship between the objective financial literacy variable and the dependent variable indicating that the odds were 18% higher that a respondent with greater objective financial knowledge had confidence that they could come up with $2,000 if needed. Likewise, the subjective financial knowledge variable was positively related with the dependent variable with an odds ratio of 1.22, indicating that the odds were 22% higher that a respondent with greater financial knowledge had the confidence in their ability to come up with $2,000. Similarly, the subjective financial management ability variable had an odds ratio of 1.17 meaning the odds were 17% higher that respondents who reported greater subjective financial management ability had confidence in their ability to come up with $2,000. All findings were significant.

The study finds evidence that both actual and perceived financial knowledge may have a positive effect on the confidence that persons have in their ability to come up with cash for unexpected expenses. It reveals also that increasing an individual's confidence level in the management of finances, subjective financial knowledge, may have a higher bearing in creating positive change for emergency saving or preparedness. These findings are important in the light of other research that found that having access to modest amount of cash can boost life satisfaction, financial well-being and financial security of individuals (Berlin and Kaunitz). This is significant from a policy standpoint because it explains the importance of financial literacy on consumer confidence and consumer behavior in the interest of financial well-being. By analyzing important demographic data, this study makes a contribution to literature expounding the concept that with financial education people are more likely to be confident in their ability to find access to funds for unexpected needs and hold a cash margin.

References

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