Understanding Financial Wellbeing Over the Lifecourse: An Exploration of Measures

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Abstract

After financial shocks affected many households during the Great Recession, policymakers and researchers have expressed growing concern for the financial wellbeing of Americans. While economic conditions have improved, survey data from 2015 report that less than half of Americans have three months of living expenses saved in case of an emergency (National Financial Capability Study, 2015). In addition, only 39% report figuring out how much they need to save for retirement and half worry about running out of money in retirement (National Financial Capability Study, 2015). Financial knowledge is also misconstrued during this period: while actual financial knowledge declined from 2009 to 2015, perceptions of financial knowledge have increased over the same period (National Financial Capability Study, 2015). While these data snippets paint a picture of the level of financial capability of Americans, the field uses a variety of measures ranging from objective financial situation to financial knowledge to assess the financial health of households. Each outcome depicts a different sliver of information regarding household finances. To understand the financial wellbeing of households, one must create a measure that speaks to the full picture. This begs the question: how does one measure financial wellbeing? Further, does this measure provide consistent information regarding households' objective and subjective financial situations?

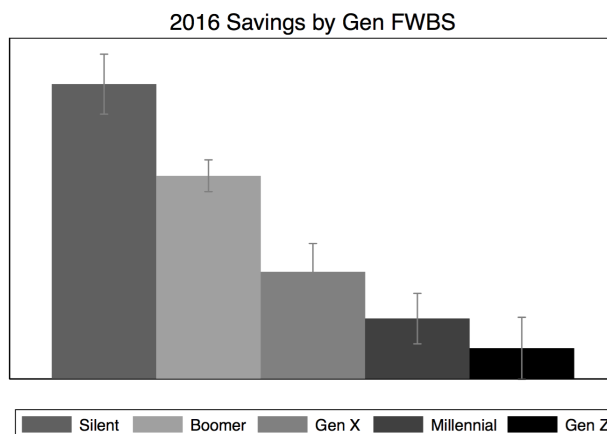
Previous work measures financial outcomes in what we classify into four main categories: status, inclusion, hardship, and literacy. Studies measuring status consider measures such as assets, debt, and income, whereas those measuring inclusion tend to focus on whether or not an individual is banked or has access to traditional accounts. Those focusing on hardship often ask whether or not individuals have missed payments or have emergency savings, and financial literacy is measured through either perceived financial knowledge or actual factual knowledge, often using the "Big 3" or the "Big 5" questions. This paper is the first to consider a new measure, financial wellbeing, and to explain how this new measure compares with other common measures in the literature.

Similar to the way economists consider utility as a prime measure of individual wellbeing and seminal work by Angus Deaton points to subjective wellbeing as the most important measure for individual happiness, this paper will use a new measure created by the Consumer Financial Protection Bureau's Financial Wellbeing (FWB) Scale to examine what types of commonly measured outcomes directly relate to the FWB scale. The FWB scale is designed to be independent of income, and a separate construct from savings, hardship, or financial literacy.

To understand how FWB differs from other common measures of financial status, inclusion, hardship, and knowledge, we draw upon a common economic theory: the life cycle model. In this model, individuals accumulate wealth over the lifecycle and spend

down their assets post retirement. This means that income and assets increase as individuals age until retirement, when they begin to decrease. Debt holds the opposite pattern. We show how other financial measures, including knowledge and hardship, evolve over the lifecourse. Then we contrast these measures with the patterns of FWB over the lifecourse. We then use a combination of measures that produce a pseudo-FWB measure for those using datasets that do not include the specific FWB measure to examine how closely approximated the measures are.

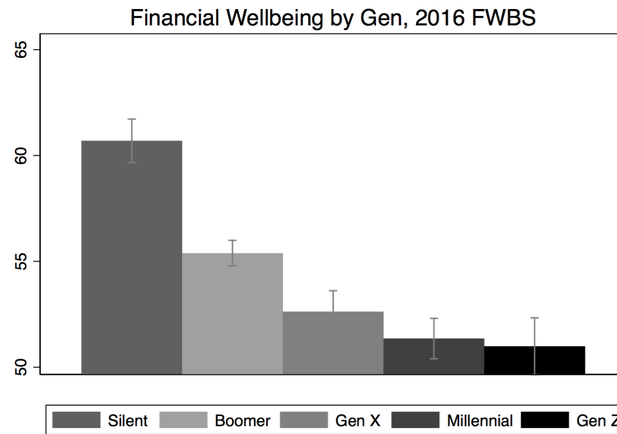
Figure 1: Savings by Generation, FWBS 2016



We contribute to the literature in three new ways. First, we are one of the first papers to study the new measure of financial wellbeing. Second, we use a well-developed model to understand how it differs from other constructs often used in evaluating financial interventions. Third, we create a measure that mimics financial wellbeing with variables that closely match the ten-item scale. This allows previous researchers to use measures that are already in existing datasets to construct a variable close to financial wellbeing.

This paper primarily employs new data from the Consumer Financial Protection Bureau's 2016 national Financial Well-being Survey data to better understand financial wellbeing over the life cycle. To understand lifecycle effects of financial outcomes, we split our data into generational cohorts using as follows: (1) Silent Generation: Born from 1928-1945, (2) Baby Boomers: Born from 1945-1964, (3) Gen X: Born from 1965-1980, (3) Millennials: Born from 1981-1995, (4) Gen Z (Alpha): Born from 1995-2010. We document standard lifecycle earnings behavior in these data that are reflective of other datasets, where earnings increase with age but at a decreasing rate as people get older; Americans post retirement exhibit decreased earnings with increases in age. We further demonstrate a comparable pattern in savings with these data (Figure 1).

Figure 2: Financial Wellbeing by Generation, FWBS 2016



After validating known economic trends in these data, we explore some of the novel measures in the financial well-being data. First, we look at the variation in measured financial well-being scores over the lifecycle (Figure 2). Using a flexible specification with nonlinearities in age that controls for pre-existing factors such as parental education and gender, we show that younger cohorts (those under 30 years of age) have lower financial well-being scores and scores modestly increase with age until individuals reach approximately 60 years of age. For all individuals older than 60, there is no further difference in financial wellbeing?that is well-being plateaus. Second, we examine how well people answer objective questions about financial knowledge using the same specification. We find there are no statistically distinguishable difference in financial knowledge over the lifecycle after age 20. Using a set of measures of financial ability, we show there are also no differences in financial skill by age. Finally, we show measured financial wellbeing score appears to represent a construct that is not directly captured in income and savings metrics. It further suggests that financial knowledge and financial skills are not directly imbedded in financial wellbeing.