

Cost of Financial Illiteracy

The lack of financial literacy – that is, “financial illiteracy” – in the U.S. is a frequent headline in the news these days, but what is financial literacy?

And why do people need it?



View the Costs of Financial Illiteracy

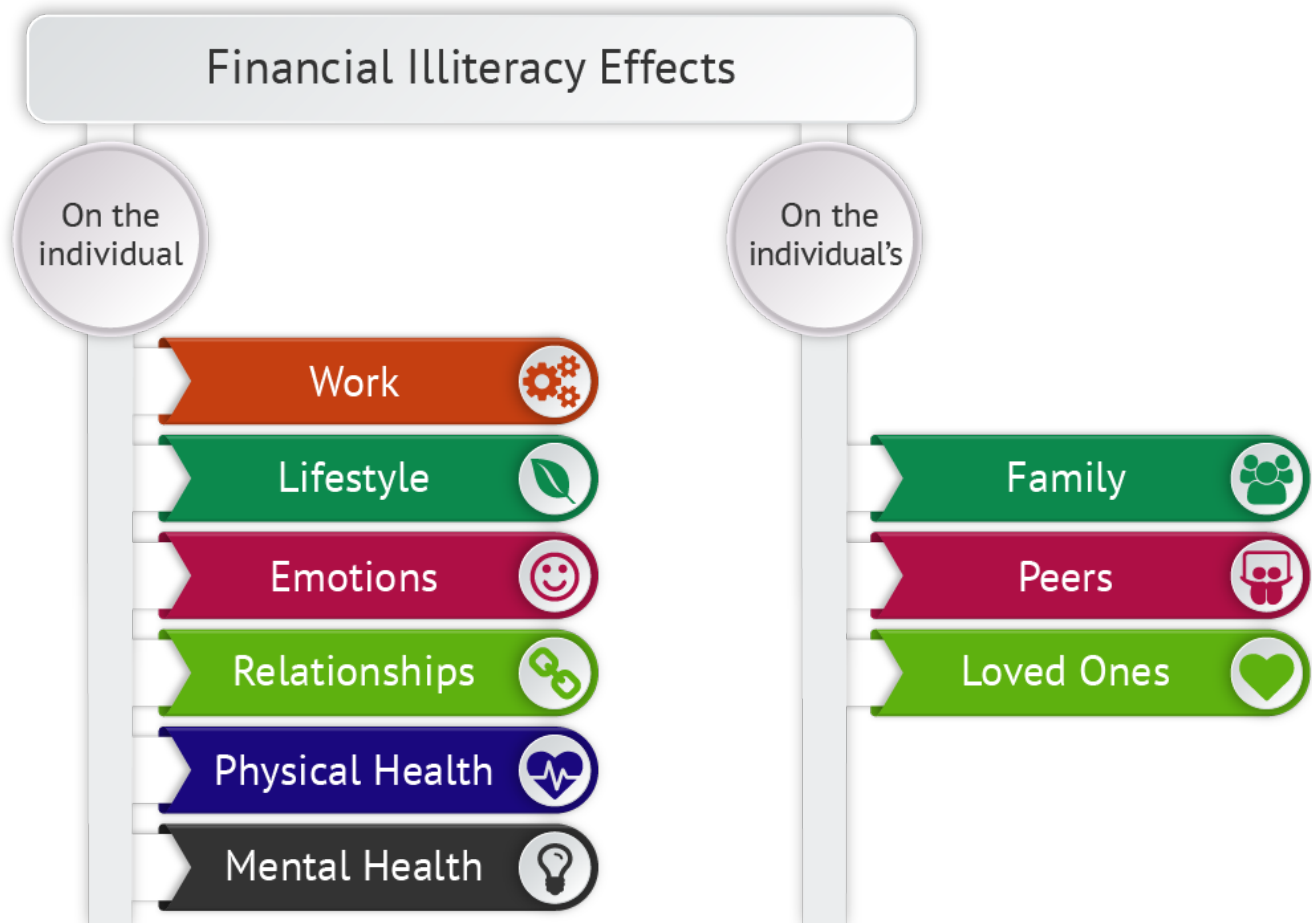
<https://www.financialeducatorsCouncil.org/financial-illiteracy-costs/>



Financial Literacy Defined

A simple definition of financial literacy is understanding the topic of money. But the National Financial Educators Council takes the meaning to a new level. Their expanded [definition](#): Financial Literacy is “Possessing the financial knowledge, behaviors, systems, team, and plan to confidently take effective action that best fulfills an individual’s personal, family, and global community goals.”

Expanding the definition to include not just knowledge, but also behaviors, systems, a team, and a plan, drives home how many aspects of people’s lives are affected by financial illiteracy. Not being savvy about managing money has an impact on people’s work, lifestyle, emotions, relationships, and health – both physical and mental. And the spillover effects can extend to the person’s family, peers, and loved ones.



Financial Illiteracy Survey: Annual Cost of Financial Illiteracy

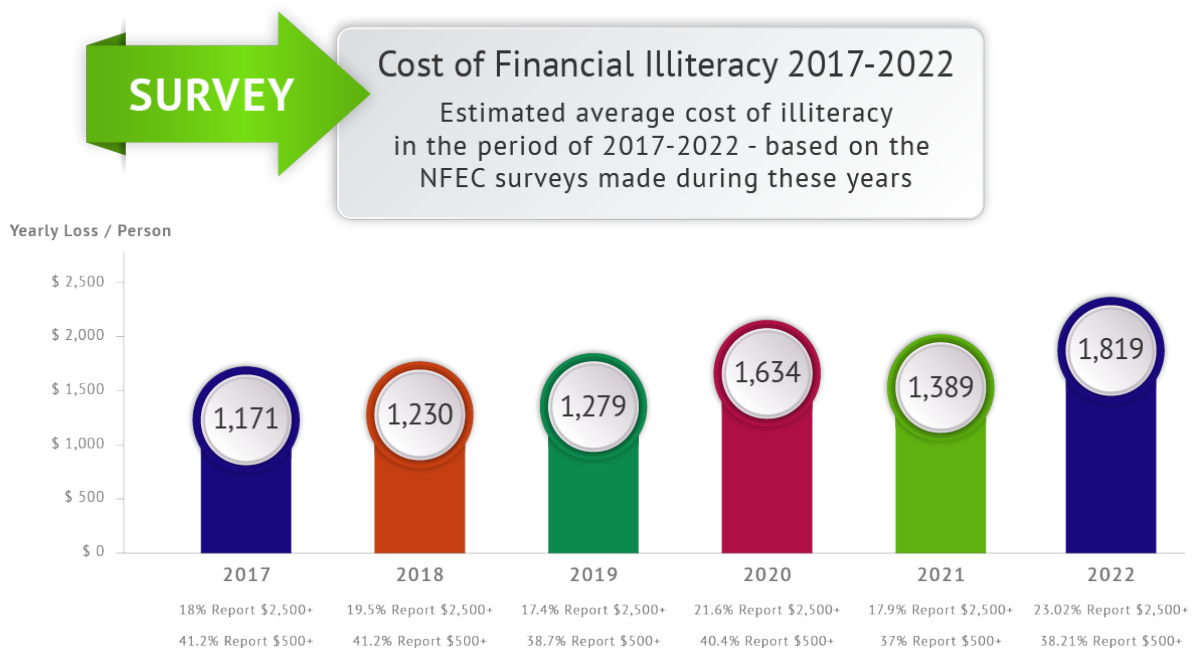
The costs of financial illiteracy can run high, according to recent and ongoing research. Since 2017, the National Financial Educators Council (NFEC) has conducted a survey to clarify how much money people believe they lost during the previous year due to lack of personal finance knowledge.

The annual survey asks U.S. adults to respond to a single question: “During the past year, about how much money do you think you lost because you lacked knowledge about personal finances?” Results are tabulated into five response choices: 1) \$0 – \$499, 2) \$500 – \$999, 3) \$1,000 – \$2,499, 4) \$2,500 – \$9,999, and 5) \$10,000+. Then we calculate the average amount estimated lost across all respondents.

The data point to an interesting trend. Between 2017 and 2019, the average amount people estimated they lost due to financial illiteracy increased by about 4-5% each year. In 2020, the average reported estimate spiked to \$1,634 – an almost 28% increase. Then in 2021, the average figure actually went down by about 15%, to \$1,389, which would have been back on track with the 4-5% annual increases we observed prior to 2020.

The 2020 spike may reflect the effects of the COVID-19 pandemic, during which many people became ill while many others were blindsided by job losses, furloughs, and shutdowns. Americans apparently experienced an even tighter pinch due to financial illiteracy and lack of emergency preparedness during this difficult time.

In 2022, the average cost estimated per person due to financial illiteracy was \$1,819. – this is the highest average since the first annual survey took place 6 years ago and correlates with record-high inflation rates and other economic challenges impacting the country.



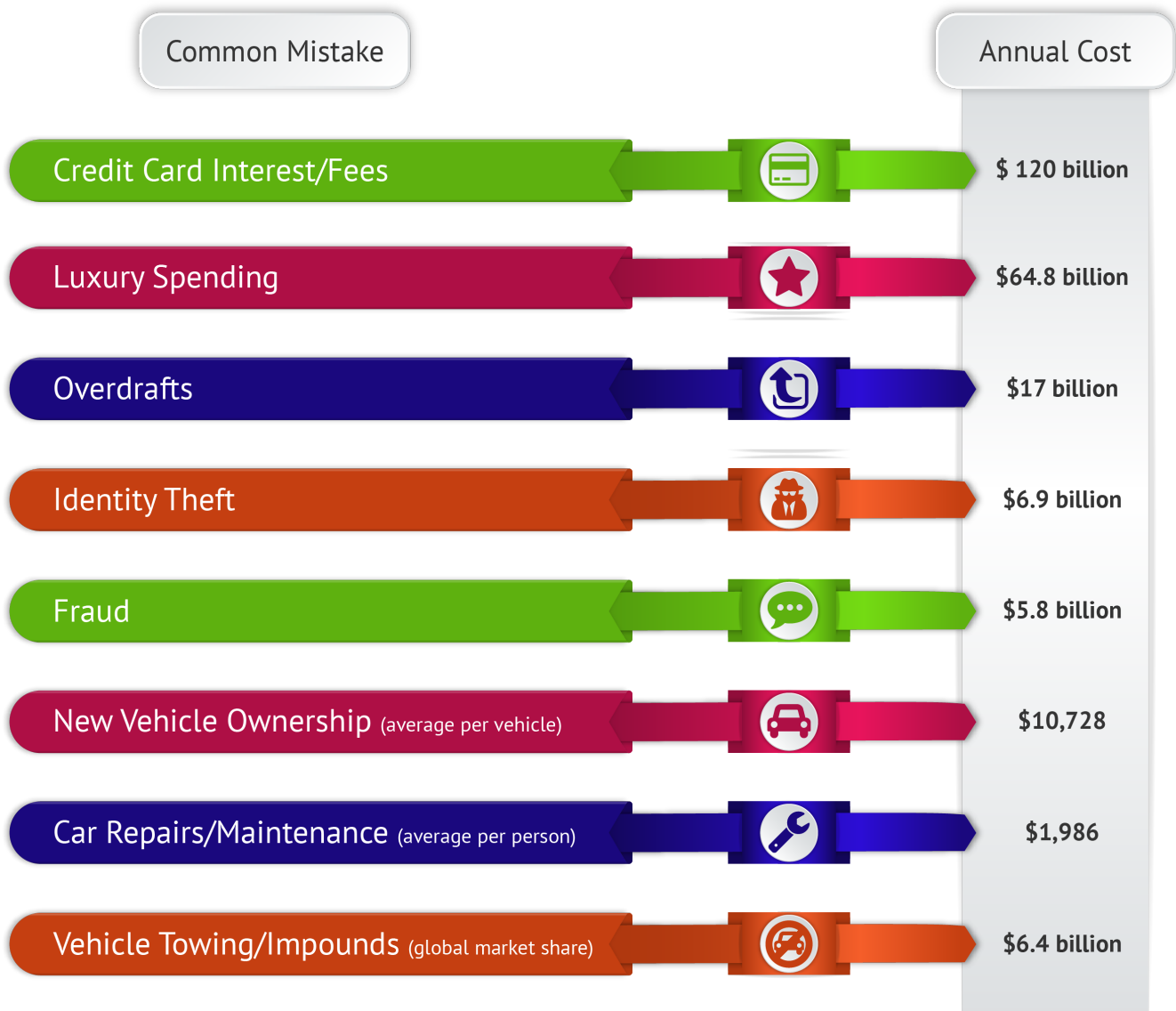
National Financial Educators Council Testing - <https://www.financialeducatorsCouncil.org/financial-illiteracy-costs/>

When the average is generalized to represent the approximate 254 million adults living in the U.S., the estimated total lost money caused by financial illiteracy totaled over \$436 billion in 2022.

What are the Costs of Financial Illiteracy?

Plain and simple: financial illiteracy costs money. Making financial mistakes carries a price tag, and even minor consequences can add up quickly.

How Much Americans Pay for Financial Illiteracy



Here are some common mistakes people make that can be costly:

Overdrafts

It's great to have overdraft protection on your checking account, but while that service may be convenient, it's far from free. Among retail banks, the median fee for an overdraft on your debit card is \$34, according to the Consumer Financial Protection Bureau (CFPB).

The CFPB also says most debit card overdraft fees are incurred on transactions of \$24 or less. How ridiculous is it to pay \$34 extra for something that costs under \$24?

The CFPB estimates that American consumers spend [\\$17 billion a year](#) on overdraft and non-sufficient funds fees.

Luxury Spending

People all around the world spend money on luxury items they don't really need and often can't afford, but according to Statista, the [U.S. is in the lead](#) – with Americans spending \$64.8 billion in 2020.

Premium accessories like watches, jewelry, sunglasses, and handbags hold the largest share of the luxury goods market (36%). So while you may need a purse, do you really need a Louis Vuitton?



Credit Card Interest and Fees

The Federal Reserve tracks the average interest rates U.S. consumers pay for a variety of financial products. For credit cards, the [average interest rate as of May 2022](#) was 16.65%.

But that average doesn't reflect the impact of a person's credit score. Good credit earns you a lower interest rate. That means people with bad credit can be paying 25%, even 30% in interest on a credit card. And since financially illiterate people are more likely to have bad credit and to carry credit card balances, that means financial illiteracy costs people a lot more in interest.

Here's a simple calculation to illustrate. Say you owe \$3,000 on a credit card with an APR of 25%.

Simple Credit Card Interest Calculation

Divide the APR by 365 to get the card's "daily periodic rate":

$$.25 \div 365 = .000685$$

Then multiply that rate by the average daily balance. If it's \$3,000:

$$\$3,000 \times .000685 = \$2.06$$

Then multiply that number by the number of days in the billing period:

$$\$2.06 \times 30 = \$61.80$$

You may not think \$61.80 a month is a high price to pay, but remember that amount is added to your balance – meaning your balance increases and you'll owe more in interest for the following month.

In addition to the interest, the credit card company charges a late fee if you don't make a payment on time. A typical late payment fee is \$40. You also incur fees each time you make a cash withdrawal on a credit card.

The CFPB reports that [Americans pay \\$120 billion](#) annually in credit card interest and fees.

Identity Theft Scams and Fraud

Phishing emails. Bank accounts or credit cards opened in your name. Fake antivirus software. Fake news clickbait. Fake shopping websites. Bogus calls from Social Security. The number and sophistication of online scams and fraud attempts are growing by the minute.

While financial illiteracy is not always the cause of falling for a fraudulent scheme, those who lack money knowledge and awareness are more susceptible to these scams. The [FBI reports](#) that Americans lose \$6.9 billion annually to identity theft, and [Statista](#) places the total value of money lost to fraud in the U.S. at \$5.8 billion a year.

Vehicle Costs

According to Kelley Blue Book, the [average cost of a new car](#) as of August 2022 was \$48,301. Although many people need a vehicle to get to work, school, appointments, or to haul children around, buying a new car is a losing proposition. New cars drop as much as 30% in value the minute they're driven off the lot.

Financial illiteracy comes into play in this situation because people with inadequate money knowledge are more likely to make impulse purchases and buy items that don't fit within their budgets. The U.S. Census puts the [median household income](#) at \$70,784 as of 2021. Even on a 60-month loan, the monthly payment for a \$50,000 vehicle is likely to be well over \$800. How many people's budgets can easily absorb a payment that high?

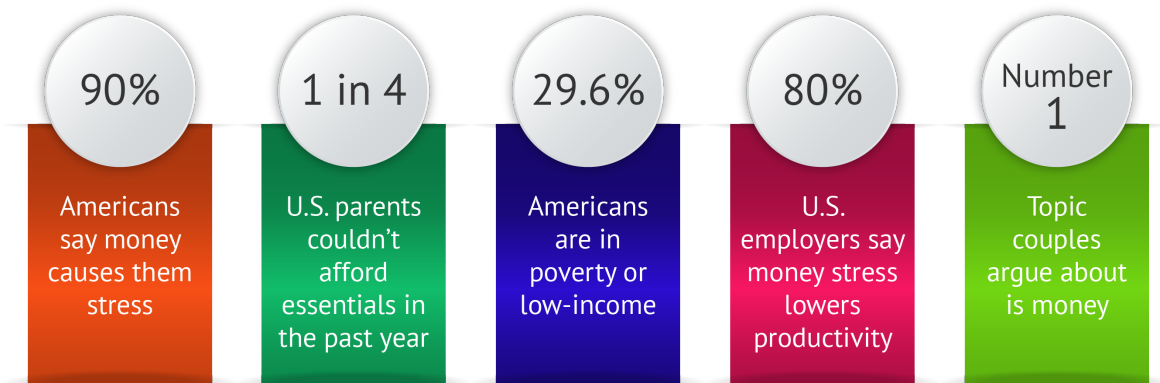
Financially illiterate people also often overlook or underestimate the additional costs of owning a vehicle beyond the monthly payment. AAA's annual [Your Driving Costs](#) report places the average annual cost of new vehicle ownership in 2022 at \$10,728 – or \$894 a month. And car repairs and maintenance average almost \$2,000 a year.

On top of that, people who lack money management skills are more likely to have their vehicles towed and impounded. Some reasons for vehicle impounds include expired registration, illegal parking or unpaid parking tickets, suspended license, DUI arrests, or suspicion that the vehicle is unsafe. According to a [Knowledge Sourcing report](#), the global market share of the towing industry was \$6.4 billion in 2020.



Personal Impact of Financial Illiteracy

Financial illiteracy not only has personal impact on multiple aspects of an individual's life, but also extends far beyond – reaching into people's families, social networks, employers, communities, and the country as a whole.



Consider these statistics:

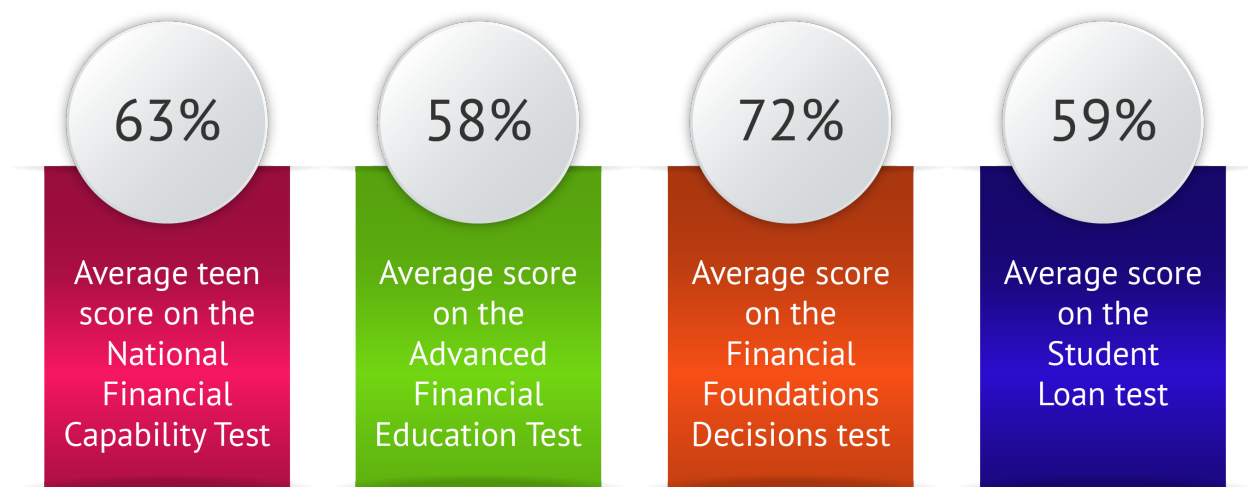
- The total combined percentage of Americans who were low-income or in poverty in 2021 was 29.6%. The 2021 poverty rate was 12.8%, up from 12.3% in 2019. ~[U.S. Census Bureau](#)
- In September-October 2022, one out of every four U.S. parents said there had been times in the past year when they could not afford food, housing, or health care. ~[Pew Research Center](#)
- A 2022 study found that 90% of Americans say money has an impact on their stress levels. ~[Thrive Global and Discover](#)
- Eighty percent of employers in the U.S. report that financial stress is lowering their employees' productivity, and they lose almost half a trillion dollars a year due to employees' financial stress. ~[Forbes](#)
- In a 2019 survey, employees with money worries were 4 times more likely to suffer from depression and 3.4 times more likely to suffer from anxiety and panic attacks. ~[401K Specialist](#)
- People with poor financial health face physical and mental health issues like lack of sleep, insomnia, inability to think, and emotional disorders. ~[American Celiac](#)
- A 2019 study at the University of Tennessee, Knoxville identified money as being one of the hot issues in marital conflict that are most difficult to address. ~[Rauer et al., 2020](#)
- According to Business Insider, money is the number one topic couples argue about, and money-related conflict is frequently cited as the reason for divorce. ~[Business Insider](#)
- Financial illiteracy is linked with economic hardship, which in turn is associated with disruptive family processes, including marital distress and harsh parenting. ~[Neppel et al., 2016](#), Journal of Family Psychology

Financial Literacy Test Data

Measuring financial literacy is vitally important because the complexity of the financial landscape is growing rapidly, and so is people's personal responsibility for their own finances.

Lacking money knowledge leads to mistakes on important financial decisions, which can have dire consequences. For example, [close to half of Americans](#) don't expect to be able to retire comfortably; and [credit card debt](#) has reached over \$900 billion. And almost [40% of Americans](#) say they don't have anyone to ask for trusted financial guidance.

The NFEC conducts multiple tests and surveys to measure the status of financial literacy in the U.S. each year.



More than 70,000 people across the U.S. have completed the NFEC's 30-question National Financial Capability Test, which measures general knowledge of financial literacy and earning income. The average scores to date break down by age group as follows: 10-14 years old, 57%; 15-18 years old, 63%; 19-24, 71%; 25-35, 76%; 36-50, 77%; and 50+, 78%.

The NFEC also conducts an Advanced Financial Education Test that asks more difficult questions focused on financial literacy alone. Almost 13,000 people across the country have taken the test to date, with an average score of 58%.

The NFEC's brief, 8-question Financial Foundations Decisions quiz evaluates people's ability to make entry-level financial decisions. The average score among the 30,847 participants so far has been 72%. Please note that the average among those aged 15-18 years is 60.09%.

The NFEC is helping address the student loan crisis by conducting a 12-question test that measures students' ability to make responsible student loan decisions. The 8,904 people who have taken this test to date have scored an average of 59%.