Financial Education in 2010 and Beyond: Helping Consumers Adapt to a "New Normal"

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This paper describes how recent changes in the economy have affected consumer finances and financial education. Specifically, it describes 10 areas of personal finance that have been impacted by the "Great Recession" and implications for education and practice. While none of these topics are new, they deserve a fresh look as a result of recent economic events. Since the financial crisis erupted, consumers have been adapting to a "new normal" in their financial lives. The aftermath of severe financial crises typically results in three negative occurrences that impact consumer finances: deep and prolonged asset market collapses (e.g., housing prices and equity indexes), significant declines in output and employment, and a dramatic increase in government debt as tax revenues decline (Reinhart & Rogoff, 2009).

Baby boomers, those born from 1946 to 1964, and older members of Generation X behind them, are especially adjusting to a "new financial normal." These are Americans who fully experienced not only one major asset bubble, but two, during long stretches of their working lives. First there was the extraordinary run of high double-digit annual returns in the U.S. stock market during the late 1990s. This was followed by the housing bubble during much of the decade of the 2000s. As noted by Regnier (2009, p. 112), "A generation of Americans grew into middle age thinking that they had more wealth than they really did and that their future was a lot more secure than it really was."

Literature Review

Given the relatively short time frame since the financial crisis began, literature regarding post-crisis financial behavior is limited. In one study, conducted after the financial crisis began by the

FINRA Investor Education Foundation (2009), nearly half of 1,488 respondents reported difficulty paying monthly expenses and bills and a majority did not have funds set aside for emergencies or savings for predictable life events (e.g., retirement). Only 49% of respondents reported that they had set aside funds sufficient to cover expenses for three months. Across all age groups up to age 60, one-third of respondents reported that they were not saving. In addition, nearly one-quarter (23%) engaged in high-cost "alternative" forms of borrowing (e.g., payday loans, pawn shops, and rent-to-own stores).

The 2009 MetLife Study of the American Dream (2009) was also conducted during the financial crisis and included 2,243 online survey responses. One of its key findings was a marked shift in consumer focus from material accumulation to near-term survival. Respondents reported paring spending and focusing more on personal relationships. Nearly half of the respondents, and 66% of those born before 1946, said they already had all of the possessions they needed. Half of the sample said they could only meet their financial obligations for one month if they were to lose their job.

The Nielsen Company (2009) conducted research to assess changes in consumer behavior following the economic downturn. They found evidence that consumers sought safer places to keep their money (i.e., cash equivalent assets), even if it meant a trade-off of lower interest rates. Deposits in all types of investments, except 529 college savings plans, fell between late 2007 and early 2009. Consumers also reduced their spending during this period, leading to a phenomenon known as the "paradox of thrift." This means that, when individuals collectively spend less and save a larger portion of their income, the economy slows down from a reduction in demand, resulting in a loss of jobs.

O'Neill and Xiao (2010) studied consumers' performance of 20 recommended financial practices before and during the financial crisis. An online self-assessment tool was used to collect data between January 2007 and June 2010. The sample of 6,700 respondents was divided into pre- and post-December 2008

cohorts for purposes of comparison. There was evidence of a modest positive difference in the performance of five financial practices following the December 2008 escalation of the financial crisis.

Two recent studies of financial behaviors of college students included a comparison of pre- and post- financial crisis data. Shim and Serido (2010) found that 95% of a sample of 748 students changed their money management practices in response to the recession. On the positive side, the practice of budgeting rose slightly (3%). However, other statistics were somewhat alarming, including a 60% increase in average credit card debt from $95 to $152 and an 85% increase in average educational loan debt from $1,041 to $1,932. There were also large increases in "risky" behaviors, including dropping classes, taking leaves of absence, postponing health care, and using one credit card to pay off another. Richter and Prawitz (2010) found that, even following instruction about credit in a personal finance class, students still reported a desire to acquire more credit cards after the financial crisis had started. Perhaps, this is because credit provides a viable short-term solution for meeting a semester's expenses during tough economic times.

Key Financial Education Topics

The term "new normal" has increasingly been used to describe what is predicted to be an extended period of slow U.S. economic growth, low single-digit annual stock returns, high unemployment, increased frequency of consumer savings and debt repayment, and ultimately, when the financial crisis abates, higher inflation (Hughes & Seneca, 2009; Reinhart & Rogoff, 2009; Wolverson, 2009). In this environment, consumer educators have a rare opportunity to teach financial concepts at a time when public and media interest is high. The following is a description of 10 areas of personal finance that consumers may need to address as they navigate their way through the "new normal."

Area #1: Planning and Goal-Setting

Past research (Consumer Federation of America, 2008; The Hartford Financial Services Group, 2009; Lusardi & Mitchell, 2007; Updegrave, 2009) has found a positive relationship between financial planning and goal-setting, including higher savings levels, higher wealth accumulation, and greater feelings of control and happiness, compared to those who do not make specific plans. However, other studies have found that relatively few people develop specific written financial goals with a time deadline and a dollar cost as experts recommend (Hogarth, Hilgert, & Schuchardt, 2002; O'Neill & Xiao, 2006, 2010). Financial practitioners may be able to use anxiety resulting from the economic crisis, as a "hook," to encourage consumers to set goals and develop specific plans as a way to maintain some semblance of control over their finances during difficult times. In other words, educators can use consumers' pre-crisis financial status as a reference point for future planning and positive action (e.g., saving). A simple "paper and pencil" *Financial Goal-Setting Worksheet* is available for downloading at http://njaes.rutgers.edu/money/pdfs/goalsettingworksheet.pdf. Online financial calculators such as http://www.dinkytown.net/ and http://www.calculatorweb.com can also be used to calculate savings required to fund future financial goals and to determine whether future plans are realistic.

Area #2: Income/Employment

An estimated 20% to 23% of U.S. workers are operating as consultants, freelancers, free agents, contractors, or micropreneurs, with the percentage projected to rise in coming years to about 40% of the U.S. job market (Greenwald, 2010; Revell, Bigda, & Rosato, 2009). Some people choose to be self-employed while others do so following the loss of a job. The rise of a "freelance nation," where secure jobs with benefits and career paths are being replaced by "project-to-project" assignments for contingent workers, has prompted a variety of financial education needs. Those who are in this situation need to know how to

develop a business plan and think like an entrepreneur. They also need to understand such concepts as small business tax preparation (e.g., Schedules C and SE and estimated tax payments), self-funded health insurance, and retirement savings plans in lieu of employer benefits. Contingent workers also need to understand the process of developing what Garman & Forgue (2008, pp. 81-84) refer to as a "cash-flow calendar." This is where surplus or deficit situations are identified in advance to smooth out uneven cash flow (e.g., during and in between job assignments). Even workers currently earning a steady paycheck are not immune to "new normal" employment trends. Consumer educators should encourage all clients to develop their human capital, "save for a rainy day," and develop back-up employment plans, especially as jobs in the private and public sectors become increasingly unpredictable and entrepreneurial.

Area #3: Budgeting

As noted above, income volatility is increasingly part of the "new normal." Even public school and government workers with the most secure paychecks have had their incomes reduced by mandatory furloughs and/or contact rollbacks. Previous studies (Hogarth, Hilgert, & Schuchardt, 2002; O'Neill & Xiao, 2006, 2010) have found that written household budgets are prepared infrequently. Perhaps "new normal" uncertainty will increase the use of budgets (a.k.a. spending plans) as consumers seek ways to economize, reduce debt, and save. Kies (2008, p. 42) noted that, "one of the few things clients and planners can truly influence is the decision-making process involving cash flow." To download a worksheet that can be completed with a pencil and hand-held calculator, visit http://njaes.rutgers.edu/money/pdfs/fs421 worksheet.pdf. To download a spreadsheet that uses pre-programmed Excel® software to make income and expense calculations with a computer, visit http://njaes.rutgers.edu/money/templates/Spending-Plan-Template.xls. More tech-savvy consumers may prefer online budgeting tools that integrate budget calculations with other financial data (e.g., loans and

investments) and automatically update them. Budgeting Web sites with encrypted user names and passwords are frequently recommended by financial media outlets and include Mint.com (http://www.mint.com), Wesabe.com (http://www.wesabe.com), and Geezeo.com (http://www.geezeo.com), among others.

Area #4: Spending

In the "new normal," frugal living is an important life skill. People used to living beyond their means during an earlier era of easy credit and inflated housing prices may need information to reduce living costs and avoid "frugality fatigue." For consumer educators, this means "back-to-basics" instruction, including needs versus wants, expense prioritization, low-cost substitutions (e.g., clothing from a consignment shop), and living within one's means. Two general approaches to expense reduction include helping consumers reign in small daily expenses, which Bach (2004) refers to as "The Latte Factor™," and helping them trim large monthly expenses such as mortgage payments (e.g., by refinancing) and outstanding debt balances (e.g., by transferring them to lower-rate credit cards or loans or using debt acceleration Web sites such as http://www.powerpay.org).

Area #5: Credit Use

Consumers may find it harder to obtain credit in the "new normal," as creditors have tightened their lending standards. In addition, provisions implemented under the *2009 Credit Card Accountability, Responsibility and Disclosure (CARD) Act* have resulted in many creditors adjusting their interest rate and fee structures to compensate for lost revenue from now-prohibited practices (e.g., universal default and two-cycle billing). A key credit education concept is that revolving consumer debt can be risky behavior for households with reduced or fluctuating income. Compared to households with high debt balances, those with little or no consumer debt have increased flexibility to adjust their lifestyles downward, when necessary, which reduces financial stress. Other relevant credit topics to teach include the following:

factors to consider when selecting a new credit card; strategies to increase credit scores; specific provisions of the CARD Act; the high cost of making minimum payments (a "teachable moment" topic now that creditors are required to provide this information on monthly billing statements); and benefits of charging no more than can be repaid immediately.

Area #6: Taxes

Given the exploding federal budget deficit and post-financial crisis stimulus spending, income taxes will most likely increase in the future (McQueen, 2009). Even if no new tax increases are passed, federal marginal income tax rates are scheduled to rise in 2011, because tax reductions in the *2001 Economic Growth and Tax Relief Reconciliation Act* will expire at the end of 2010 (Evans, 2003). Federal estate tax exemptions will also revert back to 2001 levels. On a micro level, consumers will need help readjusting to higher tax rates. In particular, they may need assistance in re-calculating their W-4 form withholding allowances so that they correspond to "new normal" income volatility. Some consumers may also need educational assistance with tax issues related to employment transitions such as: making estimated tax payments if they plan to report self-employment income; understanding unemployment insurance benefits; and making tax-related decisions about whether, and when, to convert traditional IRA balances to Roth IRAs. Two other tax-related investment decisions that consumers need to reconsider are related to weighing the pros and cons of making unmatched contributions to tax-deferred saving plans and deciding when to sell appreciated capital assets (given an expected rise in future federal income tax rates).

Area #7: Homeownership

In the late 2000s, the U.S. housing bubble burst. By third quarter 2009, almost one in four U.S. homeowners with mortgages (23%) were "underwater" (Simon & Hagerty, 2009). This means that they owed more on their loans than their

property was worth. Meanwhile, those with positive home equity were impacted by declining home values, as foreclosures and short sales depressed housing prices (McQueen, 2009). "New normal" topics related to homeownership include the following: front- and back-end debt ratios; homeownership for shelter versus "flipping" of real estate for a quick profit; buyer qualifications for a mortgage and/or homebuyer incentives; sellers accepting the reality of lower prices; buying versus renting or buying a second home while prices are relatively low; and strategies (e.g., principal prepayment) to pay off a home mortgage prior to retirement to free up cash flow for other expenses (e.g., health care and travel).

Area #8: Saving

As the financial crisis escalated, the U.S. savings rate rose to 4.3% at the end of 2009. Although still low compared to 10%+ savings rates and 20%+ savings rates in the early 1970s and early 1940s, respectively, this was still an increase from previous savings rates in the 1% to 3% range (Employee Benefit Research Institute, 2010). Unfortunately, as people started to save more, interest rates on cash equivalent assets (e.g., certificates of deposit and money market mutual funds) plummeted. In early 2010, some short-term certificates of deposit (CDs) were paying less than 1% as the Federal Reserve cut interest rates to stimulate business, thereby hurting savers (Sloan, 2009). For example, a $100,000 CD that earned 5% ($5,000 annually) in the mid 2000s might be earning 0.75% ($750 annually) in 2010, a decrease of $4,250 in annual income or $354 per month. When savings accounts earn so little, they lose ground to taxes and inflation.

Consumer educators can provide information to consumers about how to shop around for higher-yielding savings vehicles, including cash alternatives such as online bank accounts, credit union CDs and savings accounts, and Series EE and I U.S. savings bonds. There is also a need to continue to motivate people to save for emergencies and future goals and to help them identify ways to "find" money to save from household cash flow (e.g., expense reduction and automation). Innovative savings education

programs include *America Saves* (http://www.americasaves.org) and *Save to Win* (http://www.savetowin.org). *Save to Win*, a new program operated by credit unions, is a cross between a CD and a lottery (for more details, see Zweig (2009)).

Area #9: Investing

The financial crisis taught investors valuable lessons such as the need to acknowledge their "true" (bear market) risk tolerance level and adjust expectations about investment rates of return downward. Investors experienced firsthand the extreme volatility of the stock market during times of uncertainty and the limits of diversification as a short-term defensive strategy against market losses (Stovall, 2010). Even target-date mutual funds, which contain several asset classes and adjust their weightings to match the time remaining before a future date, suffered deep losses (McQueen, 2009). Consumer educators need to teach investors about investment characteristics and past historical performance. By doing so, they can help reduce the incidence of fear-driven "panic" selling. Investment education is especially important for young adults so they are not terrified of stocks like many who came of age during the Great Depression were. Otherwise, these young people could lose decades of wealth-building. Other investment lessons that can be learned from the financial crisis include how to: avoid complex and highly leveraged investments; select broadly diversified investments; seek low-cost and tax-efficient investments; rebalance portfolio asset class weightings periodically; and avoid market timing (Reichenstein & Swedroe, 2009). A useful educational resource for investment education is the eXtension *Investing for Your Future* course at http://www.extension.org/pages/Investing_for_Your_Future.

Area #10: Retirement Planning

The "Great Recession" created a new retirement reality, especially for millions of baby boomers who are starting to retire. Many people suffered large losses in retirement savings plan accounts such as IRAs and 401(k)s. In addition, employer

supports, such as traditional defined benefit pensions and retiree health insurance, have been eroding over time. Consumer educators can capitalize on consumers' heightened desire to "see where they stand" and "make up what they lost" as entry points for instruction. With respect to the former, a good place to start is a retirement savings needs analysis. According to the Employee Benefit Research Institute's *2010 Retirement Confidence Survey* or *RCS* (Helman, Greenwald, Copeland, & VanDerhei, 2010), less than half of U.S. workers (46%) have tried to calculate how much they need to save to live comfortably in retirement. A simple tool to calculate retirement savings is the American Savings Education Council's *Ballpark Estimate* at http://www.choosetosave.org/ballpark/.

With regard to the latter, studies to determine the best retirement recovery strategies have found that measures need not be drastic. Working a few years longer than planned (T. Rowe Price, 2008) and suspending annual inflation adjustments on asset withdrawals (Fahlund, 2009) are among the most effective methods. Financial advantages of extending one's working years include the following: fewer years of retirement left to finance; more years in which to accumulate savings for retirement; more years to earn Social Security and/or defined benefit pension benefits; and continued eligibility for health insurance benefits (National Endowment for Financial Education, 2010).

Of course, a question remains whether older workers will be able to find work. Helman, Greenwald, Copeland, and VanDerhei (2010) found a large disconnect between expectations and reality. In the *2010 RCS*, 41% of retirees reported that they left the workforce earlier than planned for reasons such as health problems, downsizing, and family caregiving. The current economy exacerbates this problem, making investments in human capital and networking with colleagues essential to increasing an older worker's chances of remaining employed.

Summary and Implications

This article reviewed 10 areas of personal finance and suggested specific ways that consumer educators can use the current economic climate as a springboard for financial education efforts. The financial crisis and its aftermath have provided an opportunity to revisit basic financial topics that are not new, but may be of greater interest to consumers given recent economic events. This does not mean that financial education in the "new normal" will be easy. Financial educators will continue to face challenges in getting their messages across and will need to use a variety of outreach methods that are tailored to individuals or groups. As always, motivating people to take positive action to improve their finances is a challenge and educational programs must address learners' real and/or perceived fears and obstacles. Teaching personal finance content alone, without addressing the context of target audiences, is simply not enough to be effective.

Another key component of effective financial education programs is addressing emotional and relationship issues that underlie financial decisions. An example is someone who is hesitant to save money because, in the past, it always ended up becoming the "family emergency fund." Financial planning often involves complex decisions that affect a number of people. When household resources are constrained as they are in a tough economy (e.g., reduced income), financial decisions can sometimes pit "doing what is recommended" (e.g., repaying consumer debt) against "doing what is necessary" (e.g., helping a loved one deal with an emergency).

By recognizing learners' needs, hopes, and fears, and incorporating them into motivational financial education programs, consumer educators can impart valuable knowledge and skills necessary for people to manage financial resources effectively during tough times. Where possible, incorporating recommended financial practices directly into financial education programs (e.g., "hands-on" completion of credit report request forms and 401(k) plan enrollment documents) may help facilitate

positive action, as can "point of purchase" tools, such as financial calculators, that are available to use when financial decisions need to be made. The years ahead are a "teachable moment." Let's make the most of them.

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