FINANCIAL CAPABILITY:
LITERACY, BEHAVIOR, AND DISTRESS

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Abstract

This paper inspects the influence of individual financial knowledge and financial behavior on the probability of financial distress. Undertaking data of the 2015 National Financial Capability Study of the United States, this research looks at three measures of financial distress: difficulty in paying bills, worrying about retirement savings and being late with a mortgage payment. A financial literacy index is constructed using questions pertaining to financial knowledge, including different ranges of complexity. A financial behavior index is determined using questions about individuals' financial decision-making relating to budget management, savings, credit, and insurance. In addition to the influence of socioeconomic factors, the conclusion suggests that financial literacy is important for the prevention of financial hardships, although financial behavior emerges as having a stronger impact. Moreover, we find that individuals who have experienced a negative income shock are more likely to be financially distressed.