Who lost the most?

- Financial literacy and the financial crisis

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January 2010

The recent financial downturn and economic crisis provided a major challenge for financial institutions, politicians and companies around the world. A major concern currently is how and to which extent private households suffer from the financial and economic crisis and how their financial decision making is influenced by the shock.

The objective of this paper is to determine financial losses suffered by individual households by the end of 2008. Furthermore, we relate financial losses to socio-demographic characteristics and measures of financial literacy in order to determine who suffered the most. The central questions to be answered are: Are individuals with lower financial literacy more frequently affected by financial losses due to the crisis? And are individuals with lower financial literacy affected more severely if loss is measured as a percentage of wealth?

Our analysis is based on SAVE, a representative panel of German households that contains very detailed information on their financial situation and socio-economic as well as psychological characteristics. We use information from the surveys conducted in the early summer of 2008 and 2009 and make extensive use of two special modules of questions regarding the financial crisis and financial literacy that were added to the questionnaire in 2009.

Our analysis reveals that individuals with low levels of financial knowledge are less likely to have invested in the stock market and are therefore in general less likely to report losses in wealth due to the financial crisis. Thus, we confirm the finding by Calvet et al. (2007) that individuals who are aware of their lack of knowledge stay out of risky assets in order to avoid investment mistakes. However, if we condition the analysis on individuals who invested in the stock market we find that individuals with low financial literacy suffered larger losses measured as a fraction of their wealth.

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