Discussion of “Piecing Together a Portfolio Puzzle: Accounting for Why Households Borrow High and Lend Low”

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Annamaria Lusardi
Dartmouth College & NBER
Main point of this paper:

■ Borrowing High Lending Low (BHLL) is not an important puzzle

➢ Cost of BHLL is low for majority of households
Some considerations

- Reasons for why households may want to hold a demand deposit balance and a credit card balance:
  - Credit cards and demand deposits are not perfect substitutes. Reasons to hold demand deposits:
    - demand for liquidity
    - precautionary demand for liquidity.
  - Most demand deposits require minimum balances. There are overdraft penalties.
  - Financial management reasons: exploit low rates on credit card balances transfers, strategic default.
Cost of BHLL

What is the cost of BHLL?

- Calculations are (inevitably) crude and should be interpreted as such (sometimes are upper or lower bounds).
- SCF data may not report accurately credit card balances (Gross and Souleles 2002). The average number of credit cards per person is 6 and hard to collect data for each card.
- Holding credit card balances is not the only way in which households borrow high.
Assessing the finding about the cost of BHLL

- The (unadjusted and adjusted) cost of BHLL is low for majority of households:
  - Would like to see distribution among specific groups: those with low education, young people, single-earner families.
  - Why waste money? Paying off credit card debt first is a good financial practice.
  - Are people indeed doing these cost calculations (and acting accordingly)?
Doing calculations

- Financial illiteracy is widespread among the population (see surveys by National Council on Economic Education, Jump$tart Coalition, and the Health and Retirement Study).

- Households have difficulties making very simple economic calculations (Lusardi and Mitchell 2006a, 2006b).
If the chance of getting a disease is 10 percent, how many people out of 1,000 would be expected to get the disease?

If 5 people all have the winning number in the lottery and the prize is 2 million dollars, how much will each of them get?

Let’s say you have 200 dollars in a savings account. The account earns 10 percent interest per year. How much would you have in the account at the end of two years?
### Financial Knowledge and Literacy Among Early Baby Boomers (age 51-61)

<table>
<thead>
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<th>Question Type</th>
<th>% Correct</th>
<th>% Wrong</th>
<th>% DK</th>
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<tbody>
<tr>
<td>Percentage Calculation</td>
<td>83.6</td>
<td>13.2</td>
<td>2.7</td>
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<td>Lottery Division</td>
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<td>34.1</td>
<td>9.5</td>
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<td>Compound Interest</td>
<td>17.9</td>
<td>78.6</td>
<td>3.1</td>
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Bankruptcy rates

- The number of families going bankrupt has increased three-fold during the expansion of credit cards.

- While not all bankruptcy are mistakes, some may be a sign of mis-management of personal finances.