

The Influence of Financial Literacy on Personal Financial Decisions in China

Deen Tao² and Gangde Geng^{1,*}

¹School of Economics and Management (School of Tourism), Dalian University, Dalian 116622, P. R. China

²Ge Zhi Xin Primary School, Dalian 116000, P. R. China

*Corresponding author: 821799317@qq.com

Introduction

China's financial market has experienced rapid growth in recent years, leading to an increasing diversification and complexity of financial products. This expansion offers individuals a broader range of asset allocation options, resulting in numerous financial decisions that directly impact their financial security and future quality of life. Financial literacy plays a crucial role in personal financial decision-making and is closely linked to individual financial behaviors. Individuals with high financial literacy tend to incur lower economic and informational costs, enabling them to better understand complex financial products and make informed decisions. Therefore, examining the relationship between financial literacy and personal financial decision-making is a topic of significant importance. Using data from the 2019 China Household Finance Survey, we uncover a strong relationship between financial literacy and personal financial decisions in China.

Research Questions

- Q1:** How does financial literacy affect individuals' investment decisions in risky financial assets?
Q2: What impact does financial literacy have on the proportions of risk-free and risky financial assets held by individuals?
Q3: How does financial literacy influence personal debt decisions?

Methodologies

- For whether to hold risky financial assets (binary variable), a Probit regression model is adopted.
- For proportions of risk-free and risky financial assets (truncated variables), a Tobit regression model is utilized.
- For personal debt (continuous variable), an OLS regression model is applied.

Mathematical Formulas

$$F = \frac{0.1915F_1 + 0.1540F_2 + 0.1243F_3 + 0.1001F_4 + 0.0987F_5}{0.6687} \quad (1)$$

$$Y_1 = 1(\alpha \text{ financial_literacy} + \beta X + \mu > 0) \quad (2)$$

$$Y_2 = \alpha \text{ financial_literacy} + \beta X + \mu, \quad Y = \max(0, Y_2) \quad (3)$$

$$Y_3 = \alpha \text{ financial_literacy} + \beta X + \mu \quad (4)$$

Table

Variable Names and Assignments

Variable Names	Explanation
Whether to Hold Financial Assets	Yes = 1, No = 0
The Proportion of Risk-free Financial Assets	The Proportion of Risk-free Financial Assets on Total Financial Assets
The Proportion of Risky Financial Assets	The Proportion of Risky Financial Assets on Total Financial Assets
Debt	The amount of the debts
Financial Literacy	Factor Analysis Results of Comprehensive Scores
Gender	Female = 0, male = 1
Age	Actual Age of Residents
Education	Junior High School or Below = 1, Senior High School or Secondary School = 2, College or University = 3, Master's or Doctor's Degrees = 4
Marital Status	Unmarried = 0, Married = 1, Divorced or Widowed = 2
Health Status	Average, Bad, Very Bad = 0 (Unhealthy), Very Good, Good = 1 (Healthy)
Living Area	Western Region = 0, Central Region = 1, Eastern Region = 2
Working Income	Low Income = 0, Middle Income = 1, High Income = 2

Results

The Impact of Financial Literacy on Individuals' Holdings of Risky Financial Assets, the Proportion of Risk-free, the Proportion of Risky Assets and Debt

Variable	Risky Financial Assets	the Proportion of Risk-free Assets	the Proportion of Risky Assets	Borrowing Balance
Financial Literacy	0.383*** (17.041)	-0.178*** (-13.315)	0.178*** (13.315)	0.045** (2.185)
Controls	yes	yes	yes	yes
Constant	0.021*** (8.103)	0.772*** (20.667)	0.228*** (6.109)	293.507*** (8.643)
Observations	1,600	1,600	1,600	1,600

Conclusion

Based on the data of China Household Finance Survey in 2019, this paper analyzes the impact of financial literacy on individuals' holding of risky financial assets, the proportion of risk-free financial assets and the proportion of risky financial assets, and personal debt decision-making. We find that financial literacy has a significant positive impact on individuals holding risky financial assets, and individuals with higher financial literacy are more likely to invest in risky financial assets. Secondly, financial literacy has a significantly negative impact on the proportion of the amount of risk-free financial assets held by individuals, and a positive impact on the proportion of the amount of risky financial assets. The improvement of financial literacy level will increase individuals' investment in risky financial assets. Furthermore, financial literacy also has a significantly positive impact on personal debt decisions. Individuals with high financial literacy have a deeper understanding and cognition of financial markets and credit products, and can obtain more credit resources and better borrowing conditions, so as to make more debt decision.

Moreover, gender, age, education background, marital status, health status, living area and income show different impacts. Gender, education, living area and income show positive impacts, age illustrates negative impacts, and marital status and health status have no significant influence.