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Turns Out, It Appears We Can't Agree On What An Emergency Fund Is For

Elizabeth Bauer

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How well do American save?

It seems the alarm bells are being incessantly sounded: Americans are not saving enough, and not only do they not have enough saved for retirement, they're up to their eyeballs in debt and they're getting suckered into payday loans.

We heard plenty of alarm bells in May of last year, when the Federal Reserve released its latest report on the "Economic Well-Being of U.S. Households" (since this is an annual survey, we're pretty much due for the next one).

At CNN, "40% of Americans can't cover a $400 emergency expense."

At MarketWatch, "Why 4 in 10 adults can't cover a $400 emergency expense."

At CNBC, "Fed survey shows 40 percent of adults still can’t cover a $400 emergency expense."

Sure seems like the facts are clear, and the only thing in dispute is the extent to which the cause of this is irresponsibility, lack of financial literacy, or a sluggish and/or inequitable economy.

But at the time I first read this report, it didn't quite sit right with mebecause that very same survey reports that half of all Americans do have three months' worth of emergency savings , which is a much more positive statistic. And last week a scholar at the Cato Institute, Alan Reynolds, has dug further into the raw numbers behind that headline figure, observing that the specific question did not ask whether Americans *could* pay an emergency expense from their savings, but what they *would*do. In fact, the Fed report authors treat "could" and "would" as identical.

Now, as it happens, Reynolds misinterprets the data as well. Survey-takers had the ability, among multiple answer choices, to choose more than one response; one presumes that the 59% percent that the Fed reports says could/would cover a $400 emergency expense by cash or its equivalent (that is, paying off a credit card at the next statement) is based on all survey-takers who answered with *one or more* of these cash/cashlike answers, but Reynolds *adds up* the percentages from these individual responses and overstates the percentage of Americans who could cover the expense without borrowing.

Nonetheless, while 50% of Americans said they would/could pay off the cost with cash, and 36% said they'd charge it and pay it off right away, a further 18% said they'd charge it and pay it off over time -- does that mean they don't have cash, or that they do but want to hold onto it, and don't understand how costly credit card interest charges are? Reynolds also observes that, in a related question, 85% of Americans reported that the $400 expense would not affect their ability to pay their other bills in full.

Again, I don't want to start shouting that the Fed is trying to pull a fast one on us, but the idea that 40% of adults don't have even $400 for a car repair, while a full 50% (the report says "half" without a precise number) have a 3-month emergency fund sounds . . . off.

Then, today, what caught my eye was a new press release from NORC, the survey group at the University of Chicago, more known for their General Social Survey. The headline: "Most Working Americans Would Face Economic Hardship If They Missed More than One Paycheck."

The actual question?

"How many paychecks in a row could you miss before you would be unable to pay for necessities (such as food, rent/mortgage, car loan) without using savings?"

Now, the actual responses people give to this question are almost besides the point because the entire objective of having savings is to be able to cover expenses such as these in a time of missed paychecks (for whatever cause: job loss, government shutdown, disability, parental leave). Yes, for two-earner couples where the survey-taker's partner's income is sufficient to pay household expenses, that person may respond that they could miss an infinite number of paychecks, but, well, to be honest, I'm a bit mystified as to how it was that only 8% of survey-takers responded with "other" (which included "unsure" or not answering the question).

This survey then asked:

"If your household missed paychecks and you had no additional savings, where would you get money to pay for essentials (such as food, rent/mortgage, car loans)?"

But, again, this asks what people would do once they've exhausted their savings. It says nothing about how at-risk households are of having to go into debt due to missed paychecks, though, interestingly enough, there's an element of "one of these things are not like the other" with answer choices generally being variations on ways to borrow, except for one: "seek a job in the 'gig economy'" -- yet one presumes that for people in the real-world situation of missing paychecks, job-hunting is something that they're already doing, and the question of whether to take on a lower-paying or part-time job something that is ongoing.

So what is going on?

My initial title for this article was "Are Financial Literacy Advocates Jumping The Shark?" but that sounds a bit too accusatory, and as I mulled the puzzle over some more, I began to wonder:

Are we looking at a mismatch in understanding of what an "emergency fund" is?

Financial advice website The Balance told its readers, this past February, "What You Should Spend Your Emergency Fund on and When to Use It." Their answer: don't spend it on car repairs or home repairs. Save it for catastrophic events such as the simultaneous job loss of both spouses, or a "major medical catastrophe." To be sure, they assume that, at the same time as readers build an emergency fund, they are simultaneously saving for these home repairs and similar expenses in a separate fund. And Dave Ramsey on his website does give his readers permission to use their emergency fund for any "unexpected, immediate expense" with the instruction to replenish the fund as soon as possible.

If survey-takers or survey-writers think of their "savings" or "emergency fund" as reserved for the serious-est of emergencies rather than for minor unexpected expenses, then they might indeed hesitate to tap into it for repairs and prefer to borrow instead, and cause the financial state of Americans to appear to be worse off than is actually the case.

Or is it really just a poorly-designed survey?