Financial Literacy and Economic Security: 
RAND Research for the Gulf States

RAND Gulf States Policy Forum
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Financial literacy covers both skills and knowledge: managing household finances requires basic mathematics as well as understanding of financial providers, products, and services.
Financial Literacy Is a Pressing National Concern

- Poor financial choices lead to high welfare costs for all
- Financially literate households
  - Build long term well-being by planning and saving
  - Reduce short-term vulnerability by preparing and recovering quickly from shocks
- Financial literacy is low or falling, especially for older adults, women, and young people
- Low income households are particularly at risk
Financial Literacy Is Highly Relevant to the Economic Security of Gulf Coast Households

- Large number of financially vulnerable households
- High density of non-mainstream financial providers such as payday lenders
- Increasing background economic stress
  - Effects of Katrina + mortgage / lending crisis
  - Shift towards individual responsibility for economic well-being
  - Increased complexity of financial decisions
CFED Conducts Research on Financial Literacy Within RAND Labor and Population

RAND Labor and Population
Broad focus on socioeconomic well-being

Center for Financial and Economic Decisionmaking (CFED)
Focus on individual financial decisions over a lifetime, drawing on economics, psychology, and decision science

- Do individuals understand their economic choices?
- How do they gather information and form preferences?
- Do they make decisions that are “right” for them?
- Can policymakers identify and correct systematic mistakes?
Two Studies and One Proposed Project Illustrate RAND’s Experience

- Past project: Financial literacy and common household investment choices (Department of Labor)
- Ongoing work: Financial literacy and the impact of the economic crisis on American households (National Institute on Aging)
- Proposed project: Financial literacy among “unbanked” or financially underserved households (households without a formal bank account)
**Department of Labor Study: Financial Literacy Affects Common Household Investment Choices**

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<th>Context</th>
<th>Overlooking mutual fund fees can hurt long-term savings</th>
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<td>Research question</td>
<td>How does financial literacy affect household investment choices related to mutual funds?</td>
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| Implications | • DOL: proposals to improve fee disclosure in retirement plans, ease plan provision of financial advice  
• More general: Information needs to be paired with immediate decision support and long-term literacy building |
**NIA Roybal Center Study: Financial Literacy and the Impact of Financial Crisis**

| Context | Current economic conditions reflect extreme volatility  
|         | • Home values down by about 25 percent  
|         | • Stock markets down by more than 35 percent  
|         | • Home foreclosures and unemployment on the rise |
| Research question | What effect (if any) does a household’s financial literacy have on how it is impacted by the financial crisis? |
| Implications | Findings will provide a window into the crisis for policymakers, researchers, and advocacy groups  
|             | • How are households affected, and what specific adjustments are they making?  
|             | • How are the effects evolving over time?  
|             | • How does financial literacy affect preparedness / coping?  
|             | • What policy responses are most needed? |
## New Proposal: Financial Literacy Among Households Outside the Financial Mainstream

### Context

- Recent crisis may adversely affect a long-term problem: large number of households do not use formal financial services.
- Such households likely to pay higher costs for services, be less prepared for emergencies and more vulnerable to thefts.

### Proposed research question

What are the connections (if any) between financial literacy, staying “unbanked”, and its effect on household well-being?

### Goals

- Understand how these households perceive their financial environment and choose service providers.
- Estimate the economic impact of remaining “unbanked”.
- Analyze how financial literacy affects unbanked status, relative to other factors:
  - Lack of information, misperceptions of costs/benefits
  - Other costs or service features
  - Non-financial factors: trust, environment, culture
- Identify policy initiatives that are likely to be effective (or not)
What Can RAND Contribute to Financial Literacy Efforts in the Gulf States?

- Financial literacy is already part of many active local initiatives
  - Post-Katrina: literacy-focused programs for individuals and small businesses; for example, Bush-Clinton Fund/Project HOPE
  - Economics courses are mandatory for Mississippi students
  - Mississippi Council on Economic Education programs

Two key questions

- Where would research and analysis add more value to this work?
- What valuable lessons can researchers learn from these efforts?
What Can RAND Contribute to Financial Literacy Efforts in the Gulf States?

Background research on strategic issues
• Review issues, policies
• Study best practices

Surveys and primary data collection
• Assess financial literacy, behavior
• Target specific concerns, groups

Program design
• Integrate financial education into other programs
• Design choice environments for better decisions: simplifying, building "behavioral" incentives

Program evaluation
• Conduct rigorous statistical analysis of program impact and cost efficiency
More about RAND

- The RAND Gulf States Policy Institute--created by the RAND Corporation in 2005 in the wake of hurricanes that devastated Louisiana, Mississippi, and Alabama--conducts policy research on critical issues affecting the region.

- The RAND Corporation is a nonprofit institution that helps improves policy and decision making through research and analysis.

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