Financial Literacy: What Works? How Could it be More Effective?

William G. Gale
Brookings Institution/Retirement Security Project
and
Ruth Levine
Stanford Law School

Financial Literacy Research Consortium Conference
November 18, 2009
Outline

• Growing interest in financial literacy

• Review of previous research

• New directions for financial literacy
Growing concern over financial literacy

• Increasing understanding of the risks in the DC system
  – More apparent with maturation of the 401(k) system
  – More apparent with the recent economic collapse

• Increasing evidence of illiteracy
  – Bernheim
  – Lusardi - Mitchell
  – Many others

• Increasing evidence of the effects of illiteracy
  – On the individual
  – On the family
  – On society at large
Partially as a response to those concerns, increased efforts to provide literacy

- Employers
- Federal, state and local governments
- Consumer groups
- Community service organizations
- Financial institutions
- Massive web presence, including for-profits
Review of Previous Research

• Four traditional formats for financial education
  – Employers
  – Schools
  – Credit and mortgage counseling
  – Community based organizations

• Two related issues
  – Financial planning
  – Simplification
Employer-provided education

• Employers provide a variety of forms of education
  – Survey-based evidence suggests that employer education helps households at the lower end and perhaps middle of the income distribution (Bernheim and Garrett, Lusardi)
    • Subject to some econometric concerns

• Experimental evidence avoids such concerns and suggests virtually no impact
  – But only one experimental study to date
Curriculum mandates in public schools

• Between the 1950s and 1980s, many states mandated some form of financial education

• Bernheim, Garrett, and Maki find strong effects on saving of having been exposed to a financial education curriculum mandate in high school
  – Cole and Shastry generalize the BGM specification and find no impact
  – Other work suggestive – NEFE, Jump$tart – but not conclusive
Credit and mortgage counseling

- Very difficult to analyze – no control group, selected sample (people already have debt problems)

- One controlled study – Agarwal et al. – looks at geographic variation in mandated counseling and third-party review of contracts.
  - They find an impact, but attribute it mainly to third-party review, not to mandated counseling.
Community-based organizations

• Some evidence that the financial education provided as part of IDAs can help raise contributions
  – but no experimental control.
Financial planning

• Lusardi, Lusardi-Keeler, Ameriks-Caplin-Leahy show that planning is correlated with wealth accumulation.

• The question is how much of this is causal. Three approaches
  – Using siblings as IV
  – Using regional house price variation to generate exogenous changes in wealth
  – Using specially designed questions about planning

• Results seem to be causal, but more “bullet-proof” evidence would be welcome
Simplification and saving

• The simplest approach to enrollment is mandatory
• Next simplest is automatic enrollment (opt-out), as in Madrian and Shea
• Lusardi-Keller-Keller and Beshears et al show that giving people simple choices helps boost enrollment
New Approaches

• Private sector efforts

• Public policy: A national campaign

• Public policy: Integrating financial education with other public policies
Private sector efforts

• A very active, innovative, evolving private sector response to the need for more financial planning

• Main policy objective here is to let the private sector function and ensure that information is accurate and conflicts-of-interest revealed
Public Policy: A National Campaign

• US has had many national campaigns – smoking, seat belts, etc.
  – Some to do with saving – war bonds
• People need information
  – From a credible source
  – Collected in one place
  – That is clear and accessible
    • Trade off between universal message that misses some people and targeting different messages to different populations
• People need to be reminded
  – Effects fade out over time
  – Teachable moments matter
• Social networks can help
• Direct messaging – “this is good for you” – often does not help as much as a clever pitch
Two Campaign Caveats

• Previous campaigns have been successful, but even in the best campaigns, often no more than 20% of people change behavior.

• FL/FE campaign has a major handicap relative to other campaigns: The message isn’t simple.
Public Policy: Integrating FL/FE with other policies

• Four ways to raise saving
  – Mandates
  – Incentives
  – Program architecture (e.g., defaults)
  – Information
• Often, these are thought of as substitutes
• For example, a firm trying to encourage workers to contribute to a 401(k), so that the firm reaches a non-discrimination requirement could
  – Raise match rates
  – Introduce automatic enrollment
  – Provide financial education
From a policy perspective, the alternatives should be thought of as complements

- Incentives – encourage people to save by raising the return
- Program architecture – gets people into the program, even if they would otherwise procrastinate
- Literacy efforts – teach them how to manage and use the funds they have stowed away
- Done as a package, each component plausibly improves the effectiveness of each of the other components
Policy Options as Complements: Example

• Savers credit – nice incentive but complex and hence not used
• Automatic enrollment – gets people into the plans, so that they do use the credit
• FL/FE – teaches people about the incentives and the best way to manage the funds they are accumulating
Conclusion

• FL/FE is and should be a first-order concern for policy makers
• The history of interventions is not tremendously positive (which is one way of explaining why FL/FE is a first-order concern now).
• But there is reason for guarded optimism
  – Dynamic private sector
  – Clear ways that the public sector can help
    • Provide credible, simple, accessible, comprehensive information
    • Coordinate policies and incentives to leverage the impact of each