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Chapter 14

# Bringing Financial Literacy and Education to Low- and Middle-Income Countries

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The last decade has seen rising interest in financial literacy, along with public and private measures to improve it. While this interest was initially concentrated in high-income countries (HICs), the enthusiasm has now expanded to the poorer parts of the world. The common theme across all countries is the assessment that the level of understanding of financial issues by individuals is too low, with negative consequences for individuals and the economy. Providing financial education is seen as the key intervention that reduces ignorance and improves outcomes. A few rich countries have established a comprehensive national financial literacy strategy, and many others are considering doing so as well. Many poorer countries want to do so likewise, and are looking for guidance and support. While there has been progress in bringing countries and key country actors together to exchange information and experiences on concepts and practices, there has been less progress regarding convincing guidance for low- and middle-income countries (LICs and MICs) in their ambitions. Conceptual uncertainty concerns the objectives, definition, and measurement of financial understanding; empirical uncertainty concerns the effectiveness of financial education compared to other interventions to improve outcomes. Further, the translation into a low- and middle-income environment may be far from straightforward.

This chapter outlines the approach to financial literacy and education (FLE) for LICs and MICs that is currently being implemented by the World Bank under a trust fund financed by the Russian Federation. These activities focus on the development of methodologies and operational instruments for the measurement of financial literacy (actual capabilities) and effectiveness of financial education. It draws on the parallel stock-taking activities by the Organisation for Economic Co-operation and Development (OECD) in member countries that also benefit from this trust fund. The results of both activities should help countries to better design national strategies and interventions.

To motivate the World Bank-led work program, we begin with some conceptual considerations derived from the FLE discourse in HICs.

This is followed by outlining the special circumstances to consider when translating concepts and approaches to a low- and middle-income environment. Next, we present the approach and programmed implementation for LICs and MICs, that is, the focus of work program of the World Bank. We end with conclusions.

## Lessons and issues from HICs

Over the last decade, major initiatives on FLE have been undertaken by a number of countries on financial literacy, in particular in the Anglo-Saxon world, and the main progress has been made in sharing that experience under the leadership of the OECD. Agencies created in New Zealand (the Retirement Commission in 1995), the United Kingdom (the Financial Service Authority in 2000), Canada (the Financial Consumer Agency in 2001), the United States (the Financial Literacy and Education Commission in 2003), and Australia (the Financial Literacy Foundation in 2005) have taken the lead on financial literacy issues, and their web sites provide a wealth of national and international information, including that on innovative studies and tools. The OECD's Financial Education project of 2003 started an international assessment on how much people know, and the 2005 study was the first stock-taking at international level (OECD, 2005). Furthermore, in 2008, the OECD created the International Network on Financial Education and the International Gateway for Financial Education, to be an international clearinghouse on financial education.[1]

A review of the policy and academic discourse on FLE for the purpose of application in LICs and MICs provides a number of lessons and issues. First, the concept of financial literacy is broadening. Specifically, the interest has shifted from financial knowledge and understanding to include financial skills, competences, attitudes, and behavior. To signal this broader concept, the United Kingdom has coined the notion of financial capability that is increasingly used by others.[2] This change in content and related definition is important, as it has a major bearing on how objectives are defined and measured, and the choice of interventions regarding how to improve them. While there is a consensus nowadays that the broader concept is relevant, it remains the case that defining, measuring, and influencing it still constitute a moving target.

The concept of financial capability we have in mind proposes that financially capable individuals should demonstrate sensible financial behaviors such as drawing up budgets and saving for old age. This requires moving from knowledge to skills to attitudes to behavior (Kempson, 2008). Knowledge includes understanding the purpose of saving and its instruments; skills refer to the capacity to make a saving plan; attitude pertains to the willingness to save; and behavior requires putting aside the savings. In this conceptualization, information and cognitive understanding is the basis of the ultimate desired financial behavior. This information-based cognitive route is also the underlying concept of much financial education, and it is also consistent with academic studies that take course participation (inputs) to measure the impact on cognitive skills (intermediate outputs) or actual behavior (outcomes). Yet, this value chain may not be needed to achieve outcomes, nor may it work the way it is often conceptualized. We say more on the latter later.

Independent of the type of interventions triggering financial capability, the issue remains of how best to define financial capability. We therefore adopted the working definition of financial capability proposed by Kempson (2008: 3): 'A financially capable person is one who has the knowledge, skills and confidence to be aware of financial opportunities, to know where to go for help, to make informed choices, and to take effective action to improve his or her financial well-being while an enabling environment for financial capability building would promote the acquisition of those skills.'

To operationalize the financial capability concept, the Financial Saving Authority (FSA) proposes five content domains explored in the UK national financial capability survey (FSA, 2005, 2006*a*, 2006*b*, 2006*c*): keeping track, making ends meet, planning ahead, choosing products, and staying informed. This approach was developed bottom-up through focus groups and exploratory studies, and it serves as a consensus approach for how to measure financial capability and identify capability gaps and target groups. It has been applied with adjustments in Ireland (in 2008) and Canada (in 2010), and other countries are also considering this step. Hence, it has the making of becoming the nucleus for an international methodology to measure financial literacy/capability across time and space.

While the content domains seem to have widespread appeal, the challenge is to translate them into questions and coding that take account of national and local circumstances. Ideally, questions and scores should be broadly applicable, but adjustments in questions or coding or both are likely to be required. To do so well will require substantial preparatory work and coordination across countries to achieve comparable results.

## Establishing a results framework and testing

The intensive exchange across countries has favored the development of approaches answering the key questions: why and what, for whom, and how.[3] To establish and implement such a framework in a cross-national context requires: (*a*) a clear formulation of the objectives that a national strategy and individual components seek to achieve; (*b*) a clear presentation of the hypotheses to be tested and how proposed interventions (type of intervention and delivery mode) are conjectured to influence outputs and outcomes; and (*c*) an approach for qualitative and quantitative monitoring and evaluation. In practice, however, key elements of such a framework are often missing.

The objectives for enhanced financial understanding (literacy/capability) are relatively well articulated, and range from increased supply and complexity of financial markets instruments to the need of individuals to take better care of their own against the background of perceived low levels of financial literacy and the consequences for individuals and society (Orton, 2007). But as yet there is no broad consensus on specific outcomes. The link between objectives and proposed interventions should also be designed to test hypothesis based on prior work and measurement. In practice, however, quantitative evaluations often serve to explore potential links. As a result, intervention 'effectiveness' may only be suggestive.[4]

Another point is that the number of (financial education) interventions to improve financial literacy has increased dramatically, but a rigorous monitoring and evaluation of such interventions is still the exception, not the rule. Impact evaluations, when done, are often conducted after the fact, rather than as part of the overall intervention design, which limits quality and value of results. There are many reasons why evaluation is not included in interventions, ranging from lack of understanding by program sponsors to lack of funds.

## Financial education, behavioral finance, and alternatives to impact outcomes

Recent attempts to increase financial literacy/capability have offered limited empirical evidence that they are very effective, to date. A review by Atkinson (2008: 5) concluded: 'there is little in the way of robust evidence to show the overall effect of financial training'.[5] This conclusion was valid for several different types of interventions from academic to workplace training, and in poorer countries mostly around microfinance projects. Reasons for lack of evidence included inappropriately chosen indicators, data problems and estimation issues, little attention to type and quality of the delivery mechanism, lack of control group, predominance of after-the-fact evaluations, and more. In our view, this calls for caution, rather than giving up, until better evidence is at hand. Indeed, there is a need for more and rigorous impact evaluations that are part and parcel of overall program design.

It may be that financial education may actually do very little for financial capability, at least for aspects such as planning ahead. For instance, good academic financial education could increase financial knowledge, and if linked with hands-on training, could improve financial skills—yet there could be no measurable impact on attitudes or even many behaviors.[6] This might occur, for instance, if people lack trust in financial institutions or they have cultural norms requiring interventions outside financial education to be addressed. Furthermore, even if attitudinal problems and inability to plan could be overcome by financial education, there could still be other impediments to change behavior. The behavioral finance literature provides many examples of cognitive biases with regard to attitude, as well behavior including procrastination, regret and loss aversion, mental accounting status quo, and information overload.[7] This has led some authors to question the role of financial education to enhance financial capabilities and to claim that psychology, rather than knowledge, may be key to what people actually do (e.g., de Meza et al., 2008; Willis, 2008). Working in the other direction are studies by Lusardi and Mitchell (2007), indicating that literacy actually does enhance planning and wealth accumulation.

If financial education is, in fact, ineffective, then the types of interventions to improve behavioral outcomes would need to be revised. For instance, interventions might instead be guided by behavioral finance and psychological findings, and to some extent this is already happening. In US corporate and some public pension plans (in New Zealand and the United Kingdom), lack of planning and follow-through for retirement saving has led plan sponsors to change the default option, using inertia and status quo bias to overcome behavioral shortcomings. Information overload creating indecision can be addressed by reducing the number of options, such as the number of pension funds to choose from. More broadly, the design of the (financial) choice environment can be adjusted to 'nudge' individuals toward desired behaviors, while keeping their decision autonomy (Thaler and Sunstein, 2008). Other, more direct, approaches to change behavior are also gaining prominence. In some Central European countries, saving behavior was reportedly positively influenced by a 'World Saving Day', linked to an information campaign in schools and peer pressure to take one's moneybank to school. Other efforts to directly influence financial attitude and behavior include 'edutainment' interventions with messages on behavior delivered in TV soaps, TV clips, or street theatre. To date, however, few of these efforts have been subject to rigorous impact evaluation.

## Financial literacy in LICs and MICs

The last few years have also seen a rising interest in financial literacy, in LICs and MICs. This is clear from the number of countries that have started financial literacy initiatives, and held conferences and workshops, and specific initiatives of nations, as well as regional initiatives for LICs. The Partnership on Making Finance Work for Africa, established in 2008, includes a focus on financial capability; the related September 2009 Accra conference brought together some 200 participants from most African countries on the issue of financial capability and consumer protection. Rising international interest in financial literacy for the less affluent has many different motivations, of which three are worth noting here: concerns with the perceived low level of financial capability; concerns with the low level of financial access; and recognition that finance is a critical element for innovation and growth. In this section, we explore characteristics of LICs and MICs that will be important to consider when measuring the level of financial literacy and designing interventions to raise it.

## Definition of LICs and MICs and common relevant characteristics

The World Bank's definition of LICs and MICs is related to their access to World Bank Group financial services, linked to income thresholds measured in Gross National Income (GNI) per capita. LICs are countries with GNI per capita below about US$ 1,100, which makes them eligible for grants and subsidized financing under the International Development Agency (IDA) (the soft lending arm of the World Bank Group). MICs have a per capita GNI between US$ 1,100 and slightly above US$ 10,000, and can access financing under the terms of the International Bank for Reconstruction and Development—IBRD (the market-based lending arm). While these limits are admittedly somewhat arbitrary, they broadly reflect the financial needs and opportunities such as the access (or their lack of) to the international capital market. Five interrelated characteristics seem to be of particular relevance for LIC countries: access, poverty, rural, informality, and risk management. Access to financial instruments in LICs is very limited for a very large share of the population. In most LICs, account accesses is 20 percent or below, while it is 80 percent and above for HICs, with MICs somewhere between. These figures are likely to overstate the access by individuals, as households are considered in the tallies. From a measurement point of view, it is difficult to differentiate financial capability from financial access, as both are interrelated but not the same.

Regarding poverty, LICs do not only have a lower income per capita, but mostly also a much larger share of poor in the population, whether measured as absolute poverty (e.g., those living on below one or two dollars a day) or as relative poverty (e.g., share of individuals having less than, say, 60 percent of the mean income) as income inequality is typically also higher. Absolute poverty induces special behavior, as physical survival gets priority. Observed behaviors may seem to indicate lack of capability, although the individual might behave differently if not poor. This is related to rural residence, as LIC populations live in rural and often sparsely populated areas with limited exposure to financial institutions and products. They tend to have limited cash needs; have assets predominantly in land, cattle, seeds, or gold; and live in larger families and tight-knit communities. This creates special features of planning and saving that may be insufficiently appreciated if behavioral outcomes are assessed only in terms of money.

Informality refers to the well-documented form of work in LICs where formal employment (i.e., with labor contract or licensed, and paying social security contributions and income taxes) is restricted to a very small share of the population (often 10 percent or less), whereas the large majority has the status of self-account workers. As a result, managing money and other resources for a large part of the population means managing jointly the accounts of a consumer and a micro-business. Furthermore, residents in LIC's often face natural, security, economic, and other risks, with limited access to formal (public and private) risk management instruments. They also suffer from incomplete financial markets and limited social transfer programs. Hence, short-term weather and other insurances, where they exist, are of primary interest. As short-term risks dominate, long-term planning and saving (e.g., retirement) is often not feasible. In this setting, lack of saving need not signal lacking financial capability or even myopia; it may be rational.[8]

By contrast, MICs may be described as countries that have the characteristics of both LICS and HICs. Some of the population in a MIC will exhibit characteristics and financial behavior as in an LIC, while others as in an HIC. Sub-Saharan Africa is mainly comprised of LICs, while in the (World Bank) regions of Central and Eastern Europe and Central Asia, there are mainly MICs that are furthermore countries emerging from economic transition. This needs to be taken into account when measuring financial capability and designing interventions. Such issues exist to a more limited extent also in HICs with presence of ethnic minorities and other subgroups.

## *Idiosyncratic characteristics that may matter*

Besides these common characteristics, there are a number of more idiosyncratic characteristics that will also influence the why and the what, for whom, and the how of financial literacy programs, in particular in LICs. The following list is not exhaustive, but demonstrative.

- *Why and what.* Policy statements on the objectives of financial literacy in LICs often mirror that of MICs and HICs (or have been copied from there), suggesting that financial literacy should facilitate and increase access to financial services, even if they are only the most basic ones (i.e., bank accounts). Yet, two others in these countries are also important: basic business education and avoidance of overindebtedness.

As most LIC individuals are own-account workers, as mentioned earlier, their financial management typically mixes consumer and business accounts with, at times, detrimental effects for both. Hence, the frequent request of financial capability programs to strengthen basic business education. Yet, the question remains as to how to define, measure, and separate this from the financial capability of such consumers.

A related overriding concern in many (but not all) LICs is the level of debt of major subgroups of the population with formal and informal lenders. This indebtedness is linked, as in HICs, to low levels of financial capability and poverty but may also reflect, at times, cultural issues that have been little explored.

- *For whom.* As few national financial literacy (not capability) surveys have been undertaken in LICs (and MICs), the key target groups have not yet been freely identified. Gender may require a special focus and treatment in capability surveys, as well as education and other intervention programs. In some regions and countries, gender-specific differentiation with regard to financial decisions seems important, such as when women are excluded from key budgeting and planning decisions, or when women both run the day-to-day family business and manage the precautionary saving budget.
- *How.* There are indications that financial capability surveys and interventions in LICs will have to take account of country specificities, with regard to both content domain and delivery mechanism. For instance, in many countries remittances play a major role for household resources. If so, this may affect the measurement of financial capabilities. Similarly, conditional cash transfers are gaining importance on both LICs and MICs, with similar challenges as well as opportunities. A related topic is microfinance institutions in many LICs and MICs, which can influence financial behavior and deliver financial education. Similarly, mobile phones are becoming a primary instrument to provide financial access, in particular to the very poor.
- *Cultural differences.* Last but not least, there are often striking cultural factors that may explain some of the differences in saving behavior and measured differences in financial capabilities. For instance, in most African societies, it is difficult to keep liquid resources away from the

demands of the extended family. There are historic, economic, and anthropological explanations for such requests to share available resources (Platteau, 1996), but the practice leads to low holding of liquid assets in cash or accounts and preferences for illiquid assets for medium- and longer-term needs. This will not only impact measured financial capability, but could also imply that financial education may do little to help.

## Measuring financial capability and the effectiveness of interventions in LICs and MICs: a work program under the Russian Federation Trust Fund

Having explored developments in the area of financial literacy, next we turn to describe the World Bank work program administering the Trust Fund (TF) on FLE sponsored by the Russian Federation. The TF origins are linked to the Russian G8 presidency of 2006, in which FLE was introduced as an important topic in the Pre-Summit Statement by the G8 Ministers of Finance (2006) and an OECD-organized conference in 2006 on the topic in Moscow, with broad international participation. The topic is close to the domestic policy agenda of Russia, as financial literacy of the population is considered much too low but crucial for its economic development. A Russia–World Bank project on FLE is under preparation and should start later in 2010.

Discussions with Russian government officials during the Moscow conference led to the idea and proposal for a TF that should assist in the implementation of the Summit Statement; the TF was established in October 2008. The TF will finance joint and individual work programs of OECD and World Bank with a total amount of $15 million over three years. The two key objectives of this work program are (*a*) to provide an operational country-tested instrument for LICs and MICs to allow them to implement national capability surveys that deliver results which are comparable across time and space; and (*b*) to develop and test a toolkit to better assess the effectiveness of financial education and related interventions to improve financial capability. The financial capability program will be tested in two stages: Stage 1 will explore the domains, questions, and coding in eight country pilots, resulting in a draft questionnaire. Stage 2 will test the questionnaire in the same and possibly other countries. A final phase is anticipated, where the results and lessons are translated into an operational survey instrument on financial capability, available as a public good.

The financial evaluation education program consists of three interrelated components: the development of an M&E toolkit for financial education and related interventions; financial support of impact evaluations for country-specific intervention projects; and financing integrated impact evaluations of financial education projects.

Specific programs to be evaluated will include the following:

- *Formal financial education* (one-to-one and classroom-based): targeting school children, people working in informal economy, or generally low-income consumers;
- *Social marketing/edutainment*: targeting people working in informal economy, generally low-income consumers, including opportunities created by significant life events, such as birth of a new child, death in family, health-related problems, etc.;
- *Financial education for micro-enterprise*: targeting people working in informal economy, farm households, or other subgroups representing low income population;
- *Opportunities provided by government-to-people transfers*:
  - Conditional Cash Transfers (CCTs)
  - matching defined contributions (MDC) saving arrangements, and
  - other government-to-people transfers.

In order to lend better for findings from the funded pilots to be generalized, all projects are expected to measure the effect of financial education programs on knowledge enhancement; measure the effect of financial education programs on changing behavior; and measure the extent to which the change in behavior improves decision-making and enhances the financial well-being of consumers. Each will require an evaluation assessing the delivery mechanisms as well as the objectives, outcomes, and impacts of the financial education programs. A combination of process evaluation and impact evaluation will be used, including qualitative research methods (in-depth interviews, focus groups, or observation techniques) and quantitative experimental studies.

Each study must determine both causality and attribution, and must be able to show to the most rigorous extent possible that the observed outcomes were caused by the intervention being evaluated. It must also control for, or otherwise dismiss, other possible explanations for the observed outcomes, and unobserved factors that might determine heterogeneity in outcomes.

## Conclusion

HICs have expressed strong interest in, and supported, many FLE activities that provide a rich albeit incomplete material to guide FLE activities in low- and middle-income world. While progress has been made to move from a knowledge-based concept of financial literacy to a behavior-based concept of financial capability, more remains to be done. In LICs and MICs, there are some common as well as idiosyncratic characteristics that mitigate against a simple transfer of concepts of how to measure financial literacy/capability and how to improve it. Common characteristics for LICs include low access to finance, high poverty, rural population, high informality, and special risks profiles. Idiosyncratic characteristics include issues of trust, differential gender considerations, and cultural norms that differ across countries. MICs naturally have something in common with both the rich and poor countries, for different parts of the population. This complexity calls for adjustments in the way financial capability is defined and measured, and how financial education and related programs are provided. The Russia trust-funded World Bank activities should importantly improve the understanding of the working of FLE in LICs and MICs and assist in design and implementation of effective national strategies and programs. As this is a multiyear work program in progress, the interactions with the international research community will be crucial to participate in the work and to provide feedback and guidance.

## Endnotes

[1] See the OECD website for events and documents: http://www.oecd.org

[2] In this chapter, we use the term 'financial literacy' interchangeably with financial capability.

[3] For elements of such a framework, see Microfinance Opportunities (2006, 2009), Kempson (2008), Kempson and Atkinson (2009), Mundy (2009) and O'Connell (2009).

[4] For a discussion, see Ravallion (2008, 2009).

[5] See Orton (2007), Atkinson (2008), Mundy (2009), and O'Connell (2009).

[6] Microfinance Opportunities (2009) suggests a measurable impact on knowledge and skills, although little is observed regarding outcomes in Bolivia and Sri Lanka; the financial crisis may be responsible for this result.

[7] DellaVigna (2009) has a recent and excellent survey on psychology and economics.

[8] See Holzmann and Jorgenson (2001) on the Social Risk Management framework and its implications.

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