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**Research Report**

## The Role of Financial Literacy and of Financial Education Interventions in Developing Countries

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# The Role of Financial Literacy and of Financial Education Interventions in Developing Countries

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# The Role of Financial Literacy and of Financial Education Interventions in Developing Countries

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Financial literacy has received increased attention since the global financial crisis and the literature confirms that it is correlated with higher household well-being. In parallel, financial education programs have grown in popularity and an increasing number of countries are developing national financial education strategies and making more investments in related programs. However, the evidence from field experimental research linking financial education interventions and household financial outcomes in developing countries provides mixed results. New findings from recent experiments suggest that well designed and targeted training programs can indeed be successful in increasing formal savings and promoting responsible financial behaviors.

Financial literacy has received increased attention since the global financial crisis underlined the importance of financial knowledge for consumers. Evidence suggests that individuals took on financial products without clearly understanding their characteristics, including, above all, their risks. Results by [Lusardi and Mitchell \(2014\)](#) confirm that around the world, more than five years after the crisis started, people have alarmingly low personal financial management knowledge and skills. While financial literacy in the developed world can be crucial in avoiding financial risks, it can also be key in the developing world that is for benefitting from the recent global efforts to increase financial access. Indeed, access to finance helps to equalize opportunities and reduce inequalities, thus increasing the range of services and credits available to household and enterprises; while bank accounts offer privacy, decreased risk of theft, and reliability to individuals who want to save.

## Evidence on financial literacy from developing countries

A growing literature suggests that greater financial literacy is correlated with higher take-up rates of financial products, greater household well-being, and better retirement planning. For example, [Honohan and King \(2009\)](#) show a positive relationship between financial knowledge and the use of financial products and services in Africa. Likewise, in Colombia and Mexico, [Bruhn and Reddy \(2014\)](#) find that higher financial capability is related to a higher probability of using formal financial products (bank accounts, credit cards, or bank loans). Comparable findings come also from the literature on micro-insurance. For instance, [Giné et al. \(2008\)](#) suggest that, in rural India, lack of product understanding is one of the most important reasons rainfall insurance is not purchased.

Evidence from Chile illustrates that financial literacy is correlated with individual wealth ([Hastings and Mitchell, 2011](#) and [Behrman et al., 2012](#)) and retirement planning ([Landerretche and Martinez, 2013](#)). In Mexico, more financially literate

individuals were more likely to choose pension accounts with lower administrative fees ([Hastings and Tejada-Ashton, 2008](#)) and, in China, individuals learning about interest compounding increased their pension contributions ([Song, 2013](#)).

### Evidence on financial education interventions

These findings suggest that financial knowledge leads to responsible financial behavior, thus contributing to the growing popularity of financial education programs. According to the [2014 World Bank Global Financial Development Report](#), a survey of financial sector practitioners around the world (central bankers, finance ministry officials, and academics) showed that 78 percent of the respondents considered the lack of financial knowledge to be a major barrier to financial access among the poor. Correspondingly, most chose financial education as the best policy option to improve the access of low-income borrowers to finance.

Unfortunately, the evidence on the efficacy of financial education interventions in developing countries is limited. [Cole et al. \(2011\)](#), the only published randomized evaluation of a financial literacy training program designed to promote savings behavior among poor households, finds no effect in Indonesia. More specifically, the authors assess a randomized intervention offering financial education about formal banking to more than 500 unbanked households. They find that the intervention does not increase savings; only increasing demand for bank accounts for those with limited education. [Bruhn et al. \(2013b\)](#) add pessimism showing that, in Mexico, interest among the urban population in attending financial education classes was particularly low. [Miller et al. \(2014\)](#) reviews the literature on the issue in a meta-analysis study and conclude that financial education interventions have limited impact. While influencing some financial behaviors, like record keeping, they are generally ineffective with respect to other aspects, such as loan default.

### Policy lessons for program design

Nonetheless, few recent working papers offer positive expectations about the role of financial education in the developing world and provide a number of useful policy lessons. Presenting experimental evidence from India, [Calderone et al. \(2014\)](#) suggest that financial education, when paired with access to bank accounts, can lead to significant increases in formal savings by poor households. Likewise, [Bruhn et al. \(2013a\)](#) assess the impact of a high school financial education program, incorporated in the standard curriculum during three academic semesters in Brazil, reporting a positive impact on savings for purchases and behavioral change (i.e. likelihood of financial planning and greater participation in household financial decisions).

Conveying information through engaging program designs seems equally successful. [Berg and Zia \(2013\)](#) evaluate the impact of financial education messages delivered through a soap opera in South Africa, finding that viewers had greater financial knowledge and were more likely to engage in responsible financial behaviors (such as borrowing from formal sources and avoiding gambling).

Similarly, programs focused on providing simple and useful information were found to be more effective than programs delivering advanced and detailed notions. For example, [Drexler et al. \(2014\)](#) showed that a "rule of thumb" training (i.e. teaching easily implemented decision rules without explaining the underlying concepts) for micro-entrepreneurs in the Dominican Republic improved business practices and outcomes, as compared to a control group that received a more complex accounting-based training. Along the same lines, [Fiorillo et al. \(2014\)](#) suggest that providing account-holders with useful information about saving planning was effective, even without combining it with other financial information.

Lastly, financial education seems more successful when delivered in groups or spread through network effects. [Giné et al. \(2011\)](#) find that financial literacy materials are likely to have a larger positive impact among farmers in Kenya when also distributed among the farmers' social contacts, while [Cai et al. \(2013\)](#) suggest that social networks increase the chances of purchasing weather insurance in rural China.

Future work on financial literacy services should focus on how financial education programs can be optimally targeted to participants, paying attention to the issues highlighted above. For example, interventions that are offered along with access to bank accounts seem to have higher chances of success than interventions targeted to an unbanked population. Also, the content of the training should be carefully designed, providing select, useful, notions and delivering information in groups (to exploit peer effects) through engaging tools.

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