Public Disclosure Authorized

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54002

Finance & PSD Impact

MAY 2009

The Lessons from DECRG-FP Impact Evaluations

ISSUE 5

The fifth in our impact series presents results on a careful evaluation of a financial literacy program in Indonesia. Despite the recent hype of the benefits of financial literacy programs in both the media and policy-making circles, this research is the first systematic and scientific evaluation of one such program.

Valuing Financial Literacy: Evidence from Indonesia

Bilal Zia

Financial literacy has come to play an increasingly prominent role in financial reform in both developed and developing countries, and is portrayed in global policy circles as a panacea for many recent crisis-related financial ills. Many developed and developing countries, have set up special *Financial Literacy Panels* that are charged with developing financial literacy programs for the general population.

But do financial literacy programs actually work? That is, do such programs enable households to enter the formal financial system? A new nationally representative survey coupled with a randomized experiment in Indonesia provides a first step towards answering these questions.

Financial literacy is strongly correlated with use of financial services, savings and retirement planning.

A compelling body of survey evidence from developed countries shows that households with low levels of financial literacy tend not to plan for retirement, borrow at higher interest rates, acquire fewer assets and participate less in the formal financial system relative to their more financially-literate counterparts.

Our study, conducted in collaboration with the World Bank Jakarta office, is the first such comprehensive survey of financial literacy in the developing world. In Indonesia we find that financial literacy is indeed a powerful predictor of demand for formal savings, loans and insurance services.

Yet, as with any observational study, it is certainly possible that other factors explain some or all of these observed relationships. For example, individuals with lower levels of financial literacy may also have lower levels of education, be less interested in financial matters, be poorer, or have different discount rates.

A randomized experiment finds no impact of financial literacy training for the general population

To estimate the *causal* relationship between financial literacy and demand for financial services, we conducted a field experiment in Indonesia alongside the household survey. This enables us to investigate whether financial literacy programs do lead to greater financial access.

We study use of one of the most basic, but perhaps most valuable financial services, savings accounts. Half the unbanked households from our survey were offered free financial literacy education, focusing on the costs and benefits of opening a bank savings account. These literacy seminars are 2-3 hours in length, are group based, and are offered at a convenient village location.

Although take-up of the financial literacy program is high, the results of the experiment show that the program has no effect on the likelihood of opening a bank savings account for the general population.

The financial literacy program only has a positive effect for uneducated and financially illiterate households.

Although the effects of the financial literacy program are negligible for the general population, we do find that *ex-ante* uneducated and financially illiterate households do benefit from such programs, in that providing such households with financial literacy education does induce them to open formal bank

Do you have a project you want evaluated? DECRG-FP researchers are always looking for opportunities to work with colleagues in the Bank and IFC. If you would like to ask our experts for advice or to collaborate on an evaluation, contact us care of the Impact editor, David McKenzie (dmckenzie@worldbank.org)

accounts: the likelihood of unschooled and financially illiterate household heads opening a bank savings account as a result of financial literacy training is 12% and 5%, respectively.

Financial incentives have a much larger effect than financial literacy programs for the general population.

As a secondary experiment, we provided randomly selected households a small financial incentive (ranging from US$ 3 to $14) if they opened a bank savings account. We find that even the smallest incentive payment has a positive effect on the likelihood of opening bank savings account for the general population.

Does this mean financial literacy programs simply do not work?

While our results show a very weak causal link between greater financial literacy and better financial access, our metric of measurement may be somewhat imperfect. Indeed, better financial literacy may make households better financial planners, make them save more informally, and may lead to improvements in welfare that are not captured in our study.

In order to measure the external benefits of financial literacy programs, we are repeating our research exercise in India with a detailed follow-up survey which will allow us to measure such benefits.

Another aspect to consider is that perhaps a more comprehensive financial literacy program is necessary, one delivered over several weeks rather than a few hours. This kind of in-depth and prolonged focus may be necessary to change behavior among households.

It is important to keep in mind, however, that longer courses will be more expensive to provide, and getting people to attend the full course will require additional logistical resources. Doing so may not be the most efficient use of available financial resources. Specifically, based on our current research results, the value of the financial incentives serve as an upper bound on how much should be spent on financial literacy programs if the goal is to improve banking access. For our study, we find financial incentives are more than two-times more cost-effective than the financial literacy program in inducing financially illiterate households to open bank savings accounts.

Policy Implications

1. Financial literacy programs should be carefully targeted.

The greatest bang-for-the-buck is when financial literacy programs are targeted towards households that are uneducated or financially illiterate. Careful attention should be paid to targeting financial literacy programs towards such populations.

2. Focus on alternative means of improving access, such as providing financial incentives.

We find that demand for bank accounts is highly sensitive to small financial incentives. This is consistent with the observation that banks in the United States offer cash gifts or presents to those opening a new account, and suggests that efforts to reduce the price of financial services, for example through encouraging competition, may be effective in facilitating financial development.

3. Little is known about the consumer protection aspect of financial literacy training, so more experiments are needed.

The aspect of financial literacy training that has attracted most interest in the current financial crisis is its potential to protect consumers from undertaking opaque and risky transactions. Little is known about the efficacy of programs designed to protect consumers in this way.

For further reading see:

Cole, Shawn, Thomas Sampson and Bilal Zia, "Financial Literacy, Financial Decisions, and the Demand for Financial Services: Evidence from India and Indonesia", Harvard Business School Working Paper 09-117.

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