The Case for Financial Literacy in Developing Countries

Promoting Access to Finance by Empowering Consumers

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Abstract

This note discusses the importance of financial literacy for consumers in developing countries, especially in the context of the current global financial crisis. It also reviews how leading international organizations are working to strengthen financial literacy throughout the developing world.

Financial literacy is an active process, in which communicating information is only the beginning: empowering consumers to take action to improve their financial well-being is the ultimate goal. Financial literacy is critical for promoting access to finance by creating incentives and environments that promote desired financial behaviors such as saving, budgeting, or using credit wisely. For the nearly 3 billion people living at the bottom of the pyramid, the ability to make good financial decisions is also important. The poor lack resources to cushion them from lost savings or investments or enable them to rebound from adversity. Having access to safe savings products or insurance can greatly affect their financial future. Fees and interest expenses related to financial products—formal or informal—are also likely to represent a higher share of income and thus have a significant impact on well-being.

This note presents empirical evidence on the value of financial literacy programs and makes the case for the importance of further research to determine the most effective financial literacy tools, programs, and public policies, especially in the context of a developing country. Finally, the note describes how the Organisation for Economic Co-operation and Development (OECD), the U.K. Department for International Development (DFID), and the World Bank Group are working to strengthen financial literacy in developing countries.

The Case for Financial Literacy in Developing Countries

I. Introduction to Financial Literacy

The current financial crisis has focused renewed attention on the importance of people being both well informed about their financial options and discerning financial consumers—in short, being financially literate. The origin of the current crisis, which began in developed-country markets, is rooted in housing price bubbles that were fed by providing overextended consumers with access to credit. Financially literate consumers, it is argued, would have been more cautious in taking on credit they couldn't afford.[1] These skills, which are important for consumers in developed-country financial markets, are just as valuable for the poor. For example, over-indebtedness is an issue affecting microfinance clients as well as commercial bank clients. Many developing countries have also experienced asset price bubbles or pyramid schemes, which can lure consumers to make unwise investments. Greater financial knowledge, together with behavioral change to apply the lessons of financial education, reduces the likelihood that consumers—at any income level—will fall prey to unscrupulous salespeople and purchase products or services that aren't in their best interest. Financially savvy consumers are more likely to save their money, compare financial products and services, and discuss money matters with their children.

The current crisis has also highlighted vulnerabilities created by financial innovation and the increasing complexity of financial markets. Loan products became too complex for consumers to easily understand, and disclosure was inadequate to clarify the risks. Derivative financial products in turn became so complex that institutions trading them were also unaware of the extent of risks they were assuming. While this situation occurred in developed-country markets, these same issues are relevant for developing-country markets and for a range of financial products and providers. Developing countries are experiencing rapid growth in the financial sector, the entry of new providers and ever-more complex financial products and

1. Lack of financial literacy explains only part of the current crisis. Several other important factors also contributed to this situation, including lax interest rate policy, poorly aligned incentives in mortgage origination markets, and the reluctance of investors to forgo seemingly safe returns on high-yield mortgage-backed securities.

services, and the inclusion of new consumers to financial markets. These factors, together with a likely contraction of international capital flows, increase the importance of financial literacy for consumers in poor countries.

Financial literacy is a popular topic in both developed and developing economies. As recent difficulties in advanced credit markets have shown, customers everywhere would benefit from having greater financial knowledge. But what is financial literacy? Does it relate to knowing certain concepts, such as the difference between simple and compound interest or between real and nominal inflation rates? Or is it measured by behavior, such as establishing and following a family budget or paying bills and loans on time? For people at the bottom of the economic pyramid in developing countries, is financial literacy a relevant concern? The answer to all of these questions is yes. Financial literacy is a broad concept that includes both information and behavior; it is relevant for all consumers regardless of their wealth or income. The definition of financial literacy used in this note was developed by the OECD:

> Financial literacy is the combination of consumers'/investors' understanding of financial products and concepts and their ability and confidence to appreciate financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being.

Financial education, like all types of education, is about empowering individuals so that they are better equipped to analyze diverse (in this case, financial) options and to take actions that further their goals. Financial education programs cover topics such as budgeting, saving, managing credit, and learning to negotiate. They are delivered in a variety of ways, from broad media campaigns to one-on-one discussions in bank (or debt counselor's) offices. Other common delivery channels include classroom settings, training workshops offered by nongovernmental organizations (NGOs), programs offered in the workplace, and, increasingly, innovative approaches and solutions using technology such as Web sites, multimedia, and "edutainment." Each of these is effective in communicating information, but the most effective financial literacy programs go further: they empower individuals so that they are able to evaluate their options in the financial marketplace and then take appropriate actions in their own self-interest.

Financial literacy is especially important today for several reasons. The financial crisis will reduce access to credit and increase its cost in many developing-country markets, just as it already has in the United States and Europe. Financial literacy can help to prepare consumers for tough financial times, by promoting strategies that mitigate risk such as accumulating savings, diversifying assets, and purchasing insurance. Financial literacy also reinforces behaviors such as timely payment of bills and avoidance of over-indebtedness that help consumers to maintain their access to loans in tight credit markets.

This joint note by the Organisation for Economic Co-operation and Development (OECD), the U.K. Department for International Development (DFID), and the World Bank Group introduces the topic of financial literacy and discusses its relevance for developing countries. The OECD, DFID, and the World Bank are promoting financial literacy in developing and emerging markets because of the positive direct impact this can have on access to finance and savings, which in turn support livelihoods, economic growth, sound financial systems, and poverty reduction.

II. The Economic Case for Financial Literacy

Financial literacy is first and foremost about empowering and educating consumers so that they are knowledgeable about finance in a way that is relevant to their lives and enables them to use this knowledge to evaluate products and make informed decisions. Mounting evidence shows that those who are less financially literate are more likely to have problems with debt, are less likely to save, are more likely to engage in high-cost credit, and are less likely to plan for the future. Financial literacy enables people to make better financial decisions, to appreciate their rights and responsibilities as consumers of financial products, and to understand and manage risk. For poor and rich alike, financial literacy provides greater control of one's financial future, more effective use of financial products and services, and reduced vulnerability to overzealous retailers or fraudulent schemes. Consumer protection regimes, including transparency and disclosure norms and market conduct rules, complement financial literacy efforts. For regulators of financial services, helping people to make informed financial decisions is central to protecting consumers, promoting public awareness, and maintaining market confidence.

Financial literacy helps to improve the efficiency and quality of financial services. Consumers more than ever need a certain level of financial understanding in order to evaluate and compare financial products, such as bank accounts, saving products, credit and loan options, payment instruments, investments, insurance coverage, and so forth. If financial service providers have a significant information advantage over consumers with respect to the financial products and services offered, this can weaken financial markets. Information asymmetry to the advantage of financial institutions and advisers can be very detrimental to consumers in that they will not have the proper tools to fully appreciate their rights and responsibilities as financial consumers, the financial risks they may be exposed to, the terms and conditions of their financial products, and so forth. This can also result in suboptimal choices and decisions by consumers, choices that are most often more costly or not appropriate for their needs. Financially literate consumers help to reinforce competitive pressures on financial institutions to offer more appropriately priced and transparent services, by comparing options, asking the right questions, and negotiating more effectively. They also pressure government authorities to provide market standards and perform appropriate oversight of the financial system. Ultimately, financial institutions also stand to benefit, as informed clients pose less risk and constitute a market for sustainable financial services.

More financially literate consumers increase the demand for, and responsible use of, financial services, help to underpin financial market stability, and contribute to wider economic growth and development. For example, consumers who are more financially literate are more likely to understand the importance of saving and to take action in that respect.[2] Improved financial literacy could potentially play a positive role in boosting the low savings

2. For one example, see results of recent research in Australia conducted by the Commonwealth Bank Foundation, *Improving Financial Literacy in Australia: Benefits for the Individual and the Nation* (Commonwealth Bank

rates in the world's poorest countries, particularly in Sub-Saharan Africa. Other potential economic benefits include the use of financial products to facilitate business transactions (for example, through loans to finance capital expansion and letters of credit to expedite exports and imports), better investment decisions, and improved household consumption through the more responsible financing of durable goods, schooling, and investments for retirement.

III. Empirical Evidence of the Importance of Financial Literacy

There is widespread agreement that levels of financial literacy worldwide are unacceptably low, but relatively little objective and comparative data exist on this point. OECD country-level survey data confirm this view, with consumers consistently performing poorly on tests of financial literacy. A common test question involves compound interest, which is critical to evaluating the return on savings and investments. In Australia, only 28 percent of respondents can calculate compound interest, and in the United States, the figure is even lower, at 18 percent among adults in the "baby boom" generation. Moreover, consumers rarely practice basic financial skills, such as budgeting, developing a regular savings plan, or planning for retirement.[3]

Consumers also tend to overestimate their financial skills and knowledge. At the same time as data show very low general levels of financial literacy, respondents often feel they know more about financial matters than is actually the case. Studies and surveys conducted in Australia, Canada, the United Kingdom, and the United States have shown that, in many financial areas where consumers feel the most comfortable, they are unable to solve basic problems or answer simple questions correctly.[4] Overconfidence is of particular concern and may lead vulnerable consumers to ignore important signals, information, or basic prudence measures before entering into a contractual agreement with a financial service provider.

Developing countries have especially low levels of financial literacy. In India, for example, more than half of laborers surveyed indicated that they store cash at home, while borrowing from moneylenders at high rates of interest. This pattern of behavior (high-interest loans and no-interest savings, with the attendant high risk of theft—or "frittering away"—of savings) worsens their financial situation.[5] Lack of financial literacy is often tied to lack of access to financial products or failure to use them even when they are available. In Zambia and six other African countries, only 29 percent of adults have a bank account and 50 percent use no financial products at all.[6] In South Africa, a recent survey found that nearly 60 percent of the people surveyed do not understand the term "interest." In Zambia, more than two-thirds

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Foundation, 2006), which shows that improved financial literacy brings large benefits for both the economy and the individual.

3. OECD, *Improving Financial Literacy: Analysis of Issues and Policies* (Paris: OECD, 2005); Annamaria Lusardi and Olivia S. Mitchell, "Financial Literacy and Retirement Preparedness: Evidence and Implications for Financial Education," *Business Economics* (January 2007): 35–44.
4. See OECD, *Improving Financial Literacy*, and the Financial Consumer Agency of Canada survey of awareness, attitudes, and behavior of financial consumers, 2006.
5. Max New York Life, "How India Earns, Plans, and Saves, 2008" (New Delhi: National Council of Applied Economic Research, 2008). Reported in the *Financial Express, Businesswire India*, February 8, 2008.
6. DFID, "UK Backs Lessons in Banking to Help Africa's Poor" (London: DFID, January 25, 2008). http://www.dfid.gov.uk/news/files/alexander-lessons-in-banking.asp.

of people are unfamiliar with basic financial products and tools such as checking accounts, automated teller machines, and debit cards.[7]

Financial literacy programs can make a difference. In the United States, an evaluation of the American Dream Demonstration's Financial Education Program found higher saving rates correlated with the number of hours of training received, up to 12 hours.[8] Another study showed that workplace financial education was correlated with higher rates of saving, especially for consumers who were previously saving little or nothing.[9] Many other programs and policies have been evaluated and shown to be effective at imparting financial knowledge and changing behavior. Not all programs, however, are successful over the long term. More research needs to be done to understand what works so that high performers can be learned from and replicated or leveraged in new communities and that scarce resources can be directed to the most effective programs.

Identifying optimal "teachable moments" is critical to absorbing the messages of financial education. There are times when consumers may be particularly attuned to receiving and acting on financial education messages. These "teachable moments" include positive situations, such as starting a new job, getting married, or having children, as well as negative situations, such as experiencing a financial crisis. Some research suggests that these are times when financial literacy efforts may be especially effective. For example, in a study of U.S. consumers with low initial credit scores, those who received credit counseling reduced their use of revolving debt by 12 percent more than borrowers who did not receive counseling. They also reduced the number of accounts held, the total amount of debt, and the use of credit cards.[10] In another study, low-income households in the United States who received mortgage counseling faced less than half the default risk of households who did not receive counseling. The counseled households also increased their financial sophistication and were better able to evaluate optimal behavior with respect to defaulting on a loan or refinancing.[11]

Evidence on the impact of financial literacy programs in developing and emerging markets is more limited, but promising new evidence is emerging. Few financial literacy programs exist in developing or emerging markets. Where they do exist, rigorous impact evaluations have rarely been performed. Still, there are some useful preliminary insights about the value of financial literacy in developing countries:

- Two massive savings campaigns in Uganda included radio, posters, token gifts, and community events, coupled with outreach by more than a dozen local savings institutions. In a three-year period, 300,000 new bank accounts were established.[12]

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7. Nicholas Godfrey, "The Economic Case for Financial Literacy," Internal Working Paper (London: DFID, 2008).
8. Mark Schreiner and Michael Sherradan, *Can the Poor Save? Saving and Asset Building in Individual Development Accounts* (New Brunswick, NJ: Transaction Publishers, 2007).
9. B. Douglas Bernheim and Daniel M. Garrett, "The Effects of Financial Education in the Workplace: Evidence from a Survey of Households," *Journal of Public Economics* 87:7-8 (2003): 1487–519.
10. Gregory E. Elliehausen, Christopher Lundquist, and Michael E. Staten, "The Impact of Credit Counseling on Subsequent Borrower Behavior," *Journal of Consumer Affairs* 41:1 (2007): 1–28.
11. Valentina Hartarska and Claudio González-Vega, "Evidence on the Effect of Credit Counseling on Mortgage Loan Default by Low-Income Households," *Journal of Housing Economics* 15 (2006): 63–79.
12. http://www.microfinancegateway.org/resource_centers/savings/practitioners/_workingbothends. No research has been done to understand whether and how those accounts have been used over time.

- Research on outcomes associated with the Global Financial Education Program showed a marked increase in the financial knowledge of participants in Bolivia and the Philippines.[13]
- The Guatemalan microfinance institution Fundación Génesis Empresarial found that clients who took part in a financial education program improved their repayment rate, borrowed more, and had fewer problems in their microfinance group.

IV. Ongoing Challenges

Evaluating financial education is inherently difficult. As financial literacy is getting more policy attention in many countries and more funding from all sources is being provided to assist in the development of financial education programs and initiatives, the need to evaluate such programs is also increasing. But little evaluation is currently taking place, and the evaluations conducted so far have shown mixed and inconclusive results. These results can be explained, in part, by the inherent complexity and difficulty of measuring the effectiveness of financial education.[14] In the absence of a solid methodology supported by a set of reliable and comparable financial literacy data at the international level, progress will be difficult to achieve on that front.[15]

Making the case for financial literacy and then monitoring the impact of programs are complicated by the lack of baseline survey data. Very few countries have undertaken nationally representative surveys of financial literacy or financial capability. Without baseline data, progress toward objectives cannot be measured. Baseline surveys also can be a catalyst for raising awareness on the topic and for a dialogue on what are the key aspects or skills people need to be financially capable.

Financial education and financial literacy are only one part of an effective policy response to empowering consumers in the financial marketplace. It is important to recognize that financial literacy and education are a complement to, not a substitute for, financial regulation. Public policy has a role to play in setting standards for disclosure and establishing common formats for information. More efforts are needed to strengthen these consumer protections and to develop the institutional capacity to monitor and enforce them.

Financial literacy should be developed hand in hand with improving access to financial markets and services. To date, policy makers and practitioners have traditionally tackled financial exclusion through supply-side measures such as developing "no frills" bank accounts for low-income consumers and encouraging the mainstreaming of microfinance to bring affordable banking services to the poor. The challenge now is to ensure that better product design goes hand in hand with financial education to expand access to financial services, an

13. Global Financial Education Program, "Assessing Outcomes of Financial Education," *Financial Education Update* 2:2 (Winter 2008): 2–3. http://www.globalfinancialed.org/documents/financial_education_update_vol2_issue2.pdf.
14. For a discussion of the difficulties and limitations of measuring financial education, see Financial Services Authority, *Evidence of Impact: An Overview of Financial Education Evaluations*, FSA Consumer Report 68 (London: Financial Services Authority, July 2008). Also see Professor Elaine Kempson's recent presentation on this topic: http://www.ifc.org/ifcext/economics.nsf/AttachmentsByTitle/CON_FinLitSeminar_2008_Kempson/$FILE/Kempson_EmpiricalEvidence_Presentation.pdf.
15. See the proposed methodology in Alison O'Connell, "Evaluating the Effectiveness of Financial Education Programmes," OECD consultant report (Paris: OECD, 2008).

issue just as relevant to a significant portion of consumers in OECD member countries, such as minorities or low-income groups, as it is in many developing countries.

Improving the effectiveness of financial literacy programs will require the better integration of new insights from behavioral economics and social research. Why do so many consumers fail to save or budget their money when they intuitively know that doing so could improve their financial well-being? Why do some financial literacy programs achieve significant changes in participants' behavior, while others have only minimal impact? The fields of behavioral economics and psychology are providing valuable insights on the financial behavior of consumers that can improve the effectiveness of financial literacy programs. The following are a few of the most important findings:

- Some consumers may be particularly impatient or place a high premium on immediate satisfaction compared with future consumption, which could explain the failure to save or plan adequately for retirement. When financial literacy programs make taking action easy, such as signing up for a pension plan immediately after an informational seminar or within a set period of time (for example, within a month of joining the firm or attending the seminar), participation rates in the retirement plan are substantially higher.[16]
- People may not act in accordance with theories of economic rationality when confronted with certain kinds of decisions (those involving potential loss or ambiguity or those taken in isolation), and this can lead to financially inferior decision making. As an example, when individuals are faced with investment decisions they do not understand, they tend to spread their investment across the options rather than to allocate funds on a more efficient or optimal basis.[17]
- An individual's psychological makeup or type of personality may help to explain why some individuals are more willing and able to plan for their financial future, while others fail to do so or take excessive risks. Financial planners use personality tests, such as Myers-Briggs, to help them to identify the best way to approach and serve different clients. Other consultants work directly with consumers to try to help them to understand how their attitudes and personality may be affecting their financial decision making.[18]

More needs to be done to address the limitations of financial education programs and the behavioral factors, such as inertia or passivity, that reduce their effectiveness.

16. James Choiand, David Laibson, and Brigitte Madrian, "$100 Bills on the Sidewalk: Suboptimal Saving in 401(k) Plans," NBER Working Paper 11554 (Cambridge, MA: National Bureau of Economic Research, 2005).
17. National Endowment for Financial Education (NEFE), *Closing the Gap between Knowledge and Behavior: Turning Education into Action*, White Paper (Columbus, OH: Association for Financial Counseling and Planning Education, 2005); NEFE, "Closing the Gap between Knowledge and Behavior: Turning Education into Action," Financial Counseling and Planning 17:1 (2006): 73–90. Also see Shlomo Benartzi and Richard H. Thaler, "Naïve Diversification Strategies in Defined-Contribution Saving Plans," Journal of Economic Perspectives 15:3 (2001): 47–68.
18. Judy McKenna, Karen Hyllegard, and Ray Linder, "Linking Psychological Type to Financial Decision-Making," *Financial Counseling and Planning* 14:1 (2003): 19–29. Also see Kathleen Gurney, *Your Money Personality: What It Is and How You Can Profit from It* (Sarasota, FL: Financial Psychology Corporation, 1997).

VI. OECD, DFID, and the World Bank: Working to Make a Difference on Financial Literacy

To address the financial literacy deficit, further action is needed at both the international and national levels. Raising the level of financial literacy, particularly in low-income developing countries, will require addressing seven interrelated challenges. These include the need for the following:

1. Enhanced international dialogue in the area of financial education,
2. Better integration of financial literacy into financial sector development and education sector programs,
3. Integrated national approaches to tackling financial literacy; that is, national financial education strategies defining the roles and responsibilities of various stakeholders,
4. More pilot programs to test and refine financial literacy approaches, tools, and materials,
5. Rigorous evaluation to inform the priorities of current programs, benchmark current levels of financial knowledge, and measure the impact over time of initiatives to improve financial capability,
6. New and improved research, including baseline surveys of financial capability, to raise awareness, provide more information, and disseminate the lessons learned, and
7. Identification of good practices and development of international guidelines.

The OECD, DFID, and the World Bank Group are committed to working together and with others to respond to these challenges and to do more to support efforts in this important area. Below are descriptions of what each of these organizations is doing to advance the field of financial education and financial literacy.

The OECD

Responding to the concerns of member governments, the OECD launched a comprehensive, high-level project on financial education in 2003. This project has produced a large number of concrete outcomes in three main areas: analysis, standard setting, and international cooperation.

Analysis. A key milestone of the OECD project is the publication, in 2005, of the first major study on financial education at the international level, entitled *Improving Financial Literacy: Analysis of Issues and Policies*. The OECD has since then developed analytical papers and methodologies on a wide range of issues related to financial literacy. The current analytical work focuses on financial education in selected sectors (credit and pensions), locations (schools, workplaces), and institutions (financial intermediaries). It also address the more fundamental issues related to vulnerable consumers, risk transfer to households, behavioral factors affecting financial literacy, as well as new methodologies to assess financial education and literacy.

Standard setting. In 2005, the OECD Council formulated its first international *Recommendation on Principles and Good Practices for Financial Education and Awareness*. These principles address the role of government, financial institutions, and employers and the design of financial education programs. With the support of the G-8 Finance Ministers, who called on the OECD in 2006 to undertake "further development of financial literacy guidelines based on best practices" as well as the OECD Council's invitation to identify further good practices, the OECD confirmed its international leadership on the development of guidelines and standards in financial education. In 2008, this work included two new OECD recommendations on financial education in pensions and insurance, while current work, developed by various OECD committees and hundreds of government delegates, focuses on the development of international guidelines and good practices in a variety of fields, such as credit, schools, annuities, pension information, and methodologies to assess the effectiveness of financial education programs and to measure financial literacy. Such good practices are addressed not only to OECD countries but also to all other economies, taking into account their national context. Through wide public consultations that the OECD has organized regularly since 2007 and the new OECD International Network on Financial Education, which regroups representatives from more than 50 countries and international organizations, the OECD provides further opportunity for the whole international community to contribute directly to its work aimed at developing future international guidelines.

International cooperation. The OECD is providing an international forum in which to exchange information on recent national experiences in financial education using a three-prong strategy. First, the OECD has held high-level international events and global forums on financial education in India, Indonesia, Mexico, Russia, Turkey, and the United States and is planning international conferences and events to be held in Brazil, France, Lebanon, and South Africa in the coming years. These events allow key financial education stakeholders to engage in a dialogue on financial education in the international arena, to share experiences, and to discuss best practices, including OECD's international principles and good practices. Second, the OECD has recently established the International Network on Financial Education (INFE), which brings together high-level public officials from more than 50 OECD and non-OECD countries to discuss issues, new developments, experiences, and programs related to financial education. The network allows government experts to exchange good practices and to discuss international OECD guidelines and principles in the area of financial education and awareness before they become publicly available. Through the recent creation of three expert subgroups, the INFE also is advancing analytical work aimed at developing standardized methodologies for measuring financial literacy and assessing financial education programs and is developing policy recommendations on the integration of financial education in schools. Finally, an important new component of the OECD strategy is the International Gateway for Financial Education, www.financial-education.org, which was launched in 2008. The gateway serves as an international clearinghouse for financial education programs and issues around the globe and as a platform for the exchange of information, including on emerging good practices.

DFID

The U.K. Department for International Development recently announced the creation of a new fund to improve financial know-how among the world's poorest people. The Financial Education Fund is designed to respond to the rising demand for financial education, enhance awareness of financial literacy, and catalyze the provision of financial education by both the public and the private sectors. The fund will seek to bring forward the best ideas on how to improve the financial literacy of poor consumers and businesses in Africa. Begun in fall 2008, it will fund proposals from government, the private sector, and the NGO sector

Box 1. The Financial Education Fund

In many parts of Africa, well over 80 percent of the population have no access to basic financial services or fail to provide for large or unexpected expenditures and retirement. Surveys indicate that one of the reasons for this is their lack of financial capability. In response, DFID has created the Financial Education Fund (FEF) as a path-finding program to catalyze financial education initiatives in selected African countries. The FEF will support projects that test alternative approaches to financial education. The FEF will also work with national policy makers, regulators, and industry associations to support national policy making and coordination on financial education.

Challenge Fund

The FEF will operate as a challenge fund. The challenge fund methodology has proven very useful for exploring pioneering areas in the financial sector. A challenge fund awards one-off grants according to predetermined selection criteria to successful applicants on a competitive basis over multiple funding rounds that are widely and publicly advertised. A fund manager is appointed to market the fund, develop a pipeline, and support interested applicants. The grants are awarded by an independent Investment Panel, in this case with expertise in financial education and related fields. The initial start-up capital is £4 million (US$6.3 million).

Focus

The FEF will award grants to both public and private entities as well as NGOs. Non–private sector entities include government institutions, NGOs, local community organizations, training institutes, professional and industry umbrella associations, and consumer bodies. In the case of privately owned institutions (private sector employers, financial services providers, and private training firms, among others), additional requirements must be met to ensure that the FEF only funds the public good component of the project and does not subsidize product marketing. All private sector applicants must provide minimum levels of matched funding.

To be eligible, projects must target the financially excluded, be unlikely to take place without public funding, and potentially have wider social and economic impacts. Moreover, the FEF will seek out innovative approaches to financial education. FEF projects can address any aspect of financial capability, provided it targets increased or changed use of financial services. The design of the projects funded by FEF must help to assess impact and learn lessons from the interventions. Particular consideration will be given to projects that have the potential for rapid scaling up and for replication across other countries. The initial target countries are Botswana, Ghana, Kenya, Namibia, South Africa, Tanzania, Uganda, and Zambia. The maximum grant size will be £250,000 per project to be spent over a maximum period of 24 months.

Tackling market failure and public policy

Both private supply of and public support for financial education in African countries are very low. This is due to both market failure and policy deficit. To address these challenges, the FEF will fund four categories of projects:

- Financial education projects implemented by public institutions and NGOs,
- Financial education projects implemented by privately owned institutions,
- Evaluations of existing financial education services, and
- Strategic interventions that improve the enabling environment for financial education in target countries.

For more information, see www.financialeducationfund.org.

for financial education projects that have the potential for rapid scaling up and for replication across other countries and regions. DFID welcomes interest from any organization that wants to join this global investment fund. DFID also welcomes interest from those wanting to contribute to the fund. If the fund is successful, DFID hopes that it will pave the way for a second, larger phase.

The World Bank

The World Bank Group is working to strengthen financial literacy and financial education on several fronts: by undertaking analyses, such as impact analysis of financial literacy programs, and developing data on financial literacy; by incorporating financial literacy in the agenda to expand access to finance, including new technological approaches to financial inclusion; by strengthening financial consumer protection frameworks; and by promoting a multisector approach to the topic encompassing finance, education, and social protection, through national economic strategy processes. In fall 2008, the Russian Federation established a Financial Literacy Program Trust Fund of US$15 million at the World Bank to support work on the topic. The OECD is also a recipient of some of these funds. Information on the World Bank work on financial literacy can be found at www.financialinfrastructure.worldbank.org.

Analytical approaches. The World Bank has begun to invest resources in efforts to evaluate the impact of financial literacy programs. This is an area where the World Bank Group has a comparative advantage, given the institution's deep base of analytical skills and experience with rigorous project monitoring and evaluation. The development of data on financial literacy is another area where the Bank will be increasingly involved so that baseline information is available for benchmarking progress over time. Local literacy surveys are now under way in Russia and elsewhere. The next step is to conduct a global survey of literacy levels. Some of this further survey and analytical work will be funded by the Financial Literacy Program Trust Fund.

Access to finance and technological solutions to financial inclusion. The World Bank is working on many fronts to strengthen access to all kinds of financial services (including savings, credit, insurance, retirement savings, working capital, and investment capital for small businesses) in developing countries. These efforts include strengthening financial infrastructure to reduce the cost of transactions and looking at new technological solutions such as mobile banking, smart cards, and the use of point-of-sale networks where the Consultative Group to Assist the Poorest (CGAP) is active through its Technology Program funded by the Bill and Melinda Gates Foundation. Financial literacy is a key component of all these strategies. For example, credit bureaus, which are a critical part of a country's financial infrastructure, have been shown to work more effectively when customers are knowledgeable about the information they collect and how it will be used. In the case of new technologies such as mobile banking, levels of penetration and use depend heavily on customers' familiarity and level of comfort with the device and product offerings.

Financial consumer protection frameworks. Starting in 2006, the World Bank Group developed a pilot program of country diagnostic reviews of consumer protection and financial literacy in six countries in Europe and Central Asia. These reviews focus on regulatory issues including disclosure for consumers, mechanisms for resolving disputes, as well as ways in which different financial market institutions, from commercial lenders and microfinance providers to credit bureaus, can benefit from providing financial education as part of their market outreach. For the diagnostic reviews, the World Bank is developing a set of good practices for financial consumer protection. The good practices have been tested in five countries and are available at www.worldbank.org/eca/consumerprotection, which also includes the country reviews published to date. The review of financial consumer protection frameworks will be extended to other countries and regions in the future.

Country development strategies taking a multisector approach. Financial literacy requires a multisector approach to make the most of public policy interventions and private initiatives. The finance and education sectors are at the core of these efforts, but other sectors are also involved, such as social protection and agriculture and rural development. The World Bank, which works with developing countries across all of these sectors and which contributes to economywide development strategies, is in a unique position to promote this kind of multisector approach in national strategies.

Next Steps

Where should we go next to improve the ability of consumers in developing countries, including those in deep poverty, to better understand and navigate the financial marketplace and their financial decisions? This paper presented evidence that financial education and financial literacy is important and required, but also recognized the fact that most of these impact evaluations have been performed on programs or courses offered in developed countries. Our conclusion is that this is not a reason to slow efforts on this front in developing and emerging markets, as there is a pressing need to strengthen financial literacy and sufficient evidence to suggest that targeted interventions can be effective. It is, however, a reason to focus additional resources on project monitoring and evaluation for financial education and literacy efforts in these markets. It also suggests that efforts to promote networking and sharing of insights on what is and isn't working—both within and across countries—will pay high dividends.

Six priority actions for strengthening global work on financial literacy are identified below:

1. Perform impact evaluations of financial literacy programs in developing countries to enhance our understanding of what works in different communities, including costs and benefits of different programmatic approaches;
2. Support financial literacy programs and projects to develop insights on effective interventions, including new innovative approaches, and to provide test cases for rigorous impact evaluations;

3. Develop international guidelines and standards for financial literacy initiatives and consumer protection frameworks in financial markets and assist stakeholders in implementing those guidelines and standards;
4. Extend baseline surveys of financial capability to developing countries to generate comparable data on current levels, to monitor progress toward goals, and to provide a reference point for impact evaluations;
5. Promote the exchange of information on financial literacy between public and private sectors and across institutions such as international donors, bilateral development agencies, NGOs, and financial institutions; and
6. Apply lessons from behavioral economics and social marketing to this topic so as to maximize results and the ability of consumers to receive information and then take action.

For more information on what the OECD, DFID, the World Bank, and CGAP are doing on financial literacy, please contact:

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