

How Do We Make Financial Education Policy Work? How Research on Personal Financial Practices Associated with Wealth Accumulation Can Enhance the Effectiveness of Financial Educational Programs

Key differences are identified in financial and investing practices of householders who had similar opportunities to build household wealth over their lifetimes but differ markedly in terms of accumulated household wealth nearing retirement.

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Introduction

To paraphrase Ferguson (2008), an economic historian, a society that expects individuals to take responsibility for managing their own finances and to determine how much to save for retirement is storing up trouble for the future if its citizens are ill-equipped to make wise financial decisions (p. 14). And perhaps “the future” is now. While the current financial crisis is often attributed principally to “abusive lending practices” adopted by the banking sector, it was also caused by “unwise” borrowing decisions made by the public (Ferguson, 2008; Mishkin, 2008, p. 1). To address such poor decision making, the government has proposed a policy of “fostering financial and economic education” for the consumer (Bernanke, 2010). While the intent is well meaning, funding and implementation of such policies should occur only if the available evidence suggests that financial education programs are effective. Recent reviews have indicated that the success of such programs is, at best, mixed (e.g., Bell, Gorin, & Hogarth, 2009; Willis, 2009).

Argued here is that one reason for these mixed results concerns how learning content and curricula are selected for inclusion within these programs. Studies reporting the results of program evaluations over the last decade were examined here in terms of the basis of, and rationale for the selection of program content. In most cases, little or no information was provided about the rationale underlying the content, leaving us to infer that, in general, content is designed based on traditional notions of “best practice”. For example, the 153 page report by the Federal Deposit Insurance Corporation (FDIC) on the longitudinal evaluation of one of its flagship financial education programs (FDIC, 2007) devotes 2 pages (pp. 6-7) to describing the program curriculum. Within these pages, there is a description of the curriculum objectives, intended audience, and structure and content but no information is provided about the empirical basis of, and rationale for the selection of the curriculum content.

Proposed here is that program effectiveness will be greatly enhanced if the learning content of personal financial education programs is informed more by empirical demonstrations of best practice than by traditional notions of best practice. Furthermore, we assert that program content will be effective to the extent that it is informed by the identification of personal financial practices associated with enhanced financial outcomes. Described below is a study conducted with the aim of identifying such practices, which was funded by the Financial Industry Regulatory Authority Investor Education Foundation.

Study Approach

The study described here involved a research approach known as the Expert Performance Approach (Ericsson & Smith, 1991). When adapted to the personal finance domain, this approach first involves identifying individuals with high levels of financial outcomes and then studying these individuals to identify a) the personal financial management practices that lead to these levels and b) how the individuals learned these practices.

Method

Householders who differed markedly in current household wealth nearing retirement but had similar opportunities to build household wealth during their lifetime were identified using an approach informed by Venti and Wise (2000). To elaborate, households ($n = 291$; one husband and one wife in each household; M age = 55.36 years) with similar householder demographics, such as householder age, incidence of divorce (none), and number and age of children, were first identified. Householders then completed a comprehensive survey of their lifetime

income. Income categories within the survey included: the value of the householders' assets at age 18; their lifetime earnings (derived from social security records); and gifts and inheritance received since age 18. Householders also completed a comprehensive survey of their current net worth. Net worth categories included: liquid assets such as money in bank accounts; illiquid assets such as the value of any properties owned; defined benefit and contribution plan information, from which future retirement wealth was imputed; and mortgages, loans, and other debts.

The relative-return of each household was then calculated as the proportion of current household net worth to household lifetime income. On the basis of differences within the sample on household relative-return, a group of low relative-return households ($n = 40$) and a group of high relative-return households ($n = 41$) were formed. Groups did not differ significantly on key demographic variables including: householder age, ethnicity, and length of marriage; number and age of children; and household geographic location. They also did not differ in terms of the value of household lifetime income. However, households in the high group had, on average, nearly four times the net worth of those in the low group.

Within each group, the husband and wife within each household were then asked to complete a survey, the development of which was informed by prior research (i.e., Bell et al., 2009; Hilgert, Hogarth, & Beverly, 2003), about i) personal financial learning activities and ii) personal financial management practices. Householders were asked how frequently they had engaged in each activity outlined in the survey in general throughout their lifetime. The two groups were then contrasted in terms of the frequency of the householders' activities during their lifetime.

Results

Key findings related to personal financial learning activities were as follows. Wives (but not husbands) in the high, compared to low, relative-return group reported receiving more frequent instruction about personal finance from romantic partner(s) during their lifetime. Wives (but not husbands) in the high group also reported seeking financial information from their employers more frequently during the lifetime. Also of interest are the learning activity variables for which no significant differences between groups were found. There was no significant difference between groups in terms of the frequency with which: family members, friends, and romantic partners of the householders discussed personal finance in general conversation; family members provided guidance and instruction to the householders about personal financial management; householders received education about personal financial management at high school, college, or a continuing education institution. There was also no significant difference between groups in terms of the frequency with which householders had deliberately sought out personal financial management information from family members, romantic partners, and friends, or from books, newspapers/magazines, television, internet, and radio.

Key findings related to personal financial management practices were as follows. Husbands and wives in the high relative-return group, compared to the low relative-return group, reported that they more often paid their monthly credit card balances in full during their lifetime. Furthermore, fewer wives in the high group reported missing a household bill deadline during their lifetime. Also, husbands and wives in the high group reported that they undertook four types of savings activities more frequently during their lifetime: owning a savings account and striving to save into it; saving money out of each paycheck; saving for long-term goals; and making extra mortgage principal payments. Furthermore, wives in the high group reported that they more often built and maintained an emergency fund. Husbands in the high group also reported that they calculated their household's net worth more often during their lifetime. In addition, they more frequently forecasted the amount of money required for them and their spouse to retire.

There were several management practice variables for which no significant differences between groups were found. There was no significant difference between groups in terms of the frequency with which householders had: kept financial records; tracked spending; reconciled their checkbooks each month; planned upcoming spending; reviewed their credit report annually; and compared offers between credit cards before applying for one. There was also no significant difference between groups in terms of the frequency with which householders had: spread money over different types of investments; consulted with a financial professional; compared investment products before acquiring one; and comparison shopped for major purchases.

Discussion

The research described here afforded the identification of personal financial learning activities and management practices associated with high levels of household wealth. The finding that some activities and practices more than others are associated with wealth accumulation provides an empirical basis for the selection of learning content and curricula in personal financial educational programs. These programs can then be subjected to

testing in terms of their effectiveness for enhancing financial literacy and in turn financial outcomes in other populations. Future research should attempt to replicate this study with larger and more representative populations to identify those activities and practices that appear most commonly associated with wealth accumulation.

Conclusion

If the government's policy of fostering financial and economic education is to be effective, there needs to be a sound empirical basis for educational program content and evaluation. While there has been some recent consideration about how to achieve this with regard to program evaluation (e.g., Willis, 2009), there has been little consideration about how to achieve this with regard to program content. It is hoped that the research approach and study described here will help change this situation. Alerting researchers, practitioners, and policy makers to the importance of carefully considering educational program content will lead to the creation and implementation of more effective programs, which will in turn better equip citizens to make wise financial decisions.

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Endnotes

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