WASHINGTON & LEE UNIVERSITY

Financial Education as a Means of Reducing Poverty

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Poverty 423: Capstone
Professor Beckley
April 14, 2011

Financial Instability for Low-Income Individuals in the U.S.

While money management has always been an issue for some families in the United States, the recent financial recession has hit low-income families the hardest. They have had large amounts of debt, home foreclosures, bankruptcies and unemployment. In 2010, there were around 1,000,000 mortgage foreclosures, which is ten times the average in a given year (100,000 foreclosures). There was an average of 1.5 million bankruptcy filings in 2010, the most bankruptcy filings since 2005.[1] The recession created higher poverty rates than in past years, with 14.3% of the population impoverished in 2009. Families have had a lack of health insurance as well, with 16.7 percent of individuals uninsured in 2009, up from 15.4 percent in 2008. This means that there were 50.7 million individuals without health coverage.[2] In 2007, the number of "medical bankruptcies," which are bankruptcies that are induced by high medical bills, accounted for 62.1 percent of all bankruptcy filings.[3]

Americans of all ages and socioeconomic status have issues managing their finances. Teenagers and young adults have especially been accumulating credit card debt in unprecedented amounts. In 2010, 30 percent of their monthly income was spent on repaying debt, over twice as much as it was in 1992. Forty five percent of college students are in credit card debt, averaging more than $3,000 in debt. Adults are not much better, with 40 percent of American adults living beyond their means. According to a study in 2005, savings rates for families were minus .5

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[1] "Personal Bankruptycy Filings Climb in 2010." *Total Bankruptcy*. 15 Nov. 2010. Web. <http://www.totalbankruptcy.com/blog/tag/statistics/>

[2] DeNavas-Walt, Carmen, Bernadette D. Proctor, and Jessica C. Smith. "Income, Poverty, and Health Insurance Coverage in the United States: 2009." *Consumer Population Reports*. Sept. 2010. Web.

[3] "Obama Sees Bankruptcy Drop in Health Reform Victory." *Total Bankruptcy*. 25 Mar. 2010. Web. <http://www.totalbankruptcy.com/blog/obama-sees-bankruptcy-drop-in-health-reform-victory/>.

percent, which is a negative savings rate.[4] While issues of savings and debt affect families of all socioeconomic status, studies show that these issues often hits low-income families worse than other moderate or upper income families.[5]

Low-income families face many barriers to financial well-being. It is necessary that these barriers be addressed, or they will continue to prevent financial stability. There are many issues that plague low-income families, but I will discuss the most prominent ones that have the biggest impact. These issues are: lack of access to banks and traditional sources of funding, exploitative lenders, credit cards and lack of savings mechanisms. These all have a strong connection to financial literacy, which the rest of the paper will address. After discussing the barriers that low income families face, I will discuss the connection between financial literacy and poverty. Next, I will look at the current effectiveness of financial education in the United States, and then at what makes financial education programs successful. Lastly, I will look at incentive based financial education programs that are run through different mechanisms and discuss their effectiveness. While this paper primarily focuses on financial education as a means of reducing financial instability, I am not arguing against the importance of regulations and policy changes directed at exploitative financial services. These are extremely important initiatives as well, but this paper will show that effective financial education alone can improve the financial well-being of many low-income individuals.

Lack of Access to Banks and Traditional Sources of Borrowing

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[4]"Financial Literacy Statistics." Washington State Department of Financial Institutions. Web. 9 Jan. 2010. <http://www.dfi.wa.gov/consumers/financial_literacy_stats.htm>.

[5] Ganong, Lawrence. "Financial Concerns of Low-Income Families." *Connecting for Baby*. Web.

Access to credit and other financial services that are readily available to most Americans are often unavailable to low-income individuals. Individuals who live paycheck to paycheck and take home low pay cannot afford to pay the transaction costs required by most traditional banking institutions.[6] Low-income families are less likely to hold bank accounts, with nearly 25 percent of those families earning under $18,900 a year being "unbanked," along with 13% of those earning between $18,900 and $33,900.[7] These unbanked individuals are likely to be low-income, work blue-collar jobs, minorities, and to use "fringe banking" services.[8] Some banks offer affordable services for low-income individuals, but there are often barriers to access these banks. There is often a lack of banks in low-income neighborhoods, there is some mistrust of banks among the low-income, and there is a lack of financial education and knowledge about these institutions.

Exploitative Lenders

"Fringe banking" services are commonly used amongst the poor. These services provide alternative means of accessing money without a bank account, but are often extremely exploitative. Examples of fringe banks are check cashing outlets, pawnshops, and most widely used—payday lenders. Sometimes these services are combined in certain locations and sometimes they have their own outlets. Check cashers will cash paychecks for unbanked individuals for a percentage-based fee. These fees can become very expensive for an individual

[6] Blank, Rebecca M., and Michael S. Barr. *Insufficient Funds: Savings, Assets, Credit, and Banking among Low-income Households*. New York: Russell Sage Foundation, 2009: 3.

[7] Fox, Jean Ann, and Patrick Woodall. "Cashed Out: Consumers Pay Steep Premium to "Bank" At Check Cashing Outlets." Consumer Federation of America. Washington, DC: Consumer Federation of America, 2006. 16.

[8] Ibid. 17.

because the check cashing company will charge a membership fee, a first time use fee, and then take an average of two to four percent of the check.[9]

Payday lenders provide a loan service for low-income individuals. Payday lenders are often a last resort for many individuals, but once an individual uses a payday lender, it becomes hard to stop using them. Payday lenders provide low-income individuals with cash immediately and allow individuals to pay them back in a certain period of time (generally 14 days), with a high interest rate. The interest rates vary per state, but generally the APR ranges from 390 to 780 percent.[10] Rebecca Blank, a leading economist on issues of poverty, finds that a family working full time and making under $12,000 a year can spend on average between $250-$500 on check cashing outlets or payday lenders.[11] While these transactions are extremely high cost to individuals, there is no viable alternative option for many of these low-income families.

There are many factors that drive a low-income individual to use a payday lender. When emergencies come up, such as a medical bill, a car problem, or even an expensive gas bill, often times the funds are not available in individuals budgets to pay the bill. While they may have a bank account, it is often hard to get small loans from a bank because of their lack of credit. Once individuals use a payday lender once, it can often times become hard to stop because they can take a large part of a paycheck, making it necessary to obtain more loans.[12] While unbanked populations do use fringe banking services, the “under-banked population” also use these exploitative services. Under-banked individuals have bank accounts but are still low-income and

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[9] Ibid.
[10] Fox, Cashed Out, 8.
[11] Blank, Rebecca M., Savings, Assets, Credit and Banking Among Low Income Households.
[12] Ibid.

often face financial binds. There are around 28 million Americans who fit the under-banked description.[13]

Payday lenders do respond to a need in the market. People who are unable to pay bills in time need some way to get access to cash immediately. Many of the individuals who use payday lenders know it is exploitative, but prefer going to a payday lender over a bank. Often banks can be overwhelming, impersonal and very formal. Payday lenders, on the other hand, know people by name, are extremely friendly, and laid back. While this is a practical niche to fill in the market, payday lenders fill it in an unnecessarily exploitative way. Payday lenders do not charge reasonable fees, nor do they promote money management in the ways that they are mandated by the government. Three fourths of payday lending institutions do not accurately report the fees that they charge openly to the public, nor do they provide any information about smart spending and saving.[14] Payday lenders profit when economic times are down and revel in individuals' economic failure. The financial crisis boosted the net income of Cash Advance, a leading payday lender, to $54 million in 2009, a 41% increase from 2008.[15]

Potential policy proposed by the U.S. Senate in this past year has aimed at putting stronger regulations on payday lenders by capping their interest rates and making more stringent demands on providing information to their customers. Payday lenders have been lobbying strongly against this policy by getting support from different groups and giving money to

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[13] Fox, Cashed Out, 19.
[14] Ibid. 9.
[15] Epstein, Keith. "Profiting From Recession, Payday Lenders Spend Big To Fight Regulation." *The Huffington Post*. Web. 3 Mar. 2010. <http://www.huffingtonpost.com/2010/03/02/profiting-from-recession_n_482297.html>.

political campaigns.[16] In order to stop the exploitative nature of payday lenders, even more stringent mandates need to be set on payday lenders and other options need to be made available to low-income individuals who are in need of quick loans. Possible options involve nonprofits who give reasonable or zero-interest rate loans. Financial education can help alleviate this problem by providing individuals with information about potential non-exploitative financial options as well as help improve individuals' money management skills so they are not forced to use payday lenders in the first place.

Credit Cards

Credit cards often are another exploitative means of borrowing for low-income families. Credit card companies attract low-income users by promising easy access to credit often without checking credit history. Many low-income individuals are unaware of the risks associated with credit card debt when they are first drawn in by credit card companies. While other means of borrowing are often unavailable to low-income individuals, credit card companies actively seek out low-income individuals to offer their lending services. Many do not charge annual fees and will extend access to a credit card despite past credit issues. Some credit card companies purposefully exploit by charging large fees and extending only small borrowing limits, leading to very high interest rates and large fees for individuals.[17] Not all credit card companies aim to be exploitative though. Some credit cards provide a valuable service that can be used effectively when there is proper knowledge and decision-making. Often times, individuals of all income levels end up in severe credit card debt.

[16] Ibid.
[17] Mann, Patterns of Credit Card Use Among Low and Moderate Income Households, 8.

Low-to-moderate-income families use credit cards as a main part of their finances, and often end up with large amounts of credit card debt. Studies show that low-to-moderate-income households have more credit card debt, as a percentage of their income, than more affluent households.[18] Out of families with incomes below $23,000, 31 percent of households have credit card debt. Half of them have debt equaling 10 percent of their income and a quarter of families have credit card debt equaling 25 percent of their income.[19] This debt comes with more fees and high interest rates that can often be very exploitative.

Recent Dodd-Frank legislation passed in 2009 does work to fight credit card exploitation. After studying the most effective ways of protecting consumers from credit card debt, the GAO recommended that the Bureau of Consumer Financial Protection "1) factor into its oversight of credit card debt protection products… a consideration of the financial benefits and costs to consumers, and 2) incorporate into its financial education efforts ways to improve consumers' ability to understand and assess these products."[20] These oversights would help individuals understand the risks associated with credit cards and also have the consumers' best interests in mind. It is not yet clear how these legislations will affect the amount of credit card debt low-income individuals face.

Lack of Savings Outlets

The inability to save and to find savings outlets is something that plagues low-income individuals and leads to the use of exploitative lenders and to financial instability. Americans in general are proven to save substantially less than individuals in other developed countries, but

[18] Ibid. 23-24.
[19] Ibid. 24.
[20] Quinlivan, Steve. "Consumer Costs for Debt Protection Products Can Be Substantial Relative to Benefits but Are Not a Focus of Regulatory Oversight." GAO, 25 Mar. 2011. Web.

low-income individuals are especially vulnerable to low savings.[21] Low-income individuals are excluded from most of society's savings mechanisms, and they often do not know the mechanisms that are available. Savings is not often a priority for those living paycheck to paycheck, especially when savings mechanisms are not readily available. The majority of tax benefits go to the upper income bracket, with little reaching low-income individuals. Many firms for which low-income individuals work do not offer savings plans, and as mentioned above, many low income individuals do not have bank accounts, which is a main savings mechanism.[22] There is a significant opportunity for policy change in terms of tax benefits. Savings could be a lot more appealing to low-income individuals if they received tax benefits for very small amounts of savings, similar to those that individuals with higher income receive.

The ability to save is incredibly important for both low-income families and for moderate-to-upper-income families, but the use of the savings varies greatly. While middle to upper income families may save for retirement, it is crucial for lower income families to save in order to deal with a time of crisis, such as a trip to the hospital or paying for car damages.[23] Savings does not necessarily need to be long term; saving a small sum for a few weeks or a month can be of substantial value. This emergency fund is crucial in order to keep many families afloat during rough times. While much research formerly assumed that low-income families lacked the ability or desire to save, studies have proven differently. Michael Sherraden, a Professor at Washington University, studied a savings program directed at low-income

[21] Loibl, Cazilia, Michal Grinstien-Weiss, Min Zahn, and Beth Red Bird. "More Than a Penny Saved: Long-Term Changes in Behavior Among Savings Program Participants." *Journal of Consumer Affairs* 44.1 (2010).

[22] Blank, Savings, Assets, Credit and Banking Among Low Income Households.

[23] Rank, Mark R. "Asset Building Over the Life Course." *U.S. Department of Health and Human Services*. Nov. 2008. Web. <http://aspe.hhs.gov/hsp/07/poorfinances/LifeCourse/index.shtml>.

individuals. By offering individuals a $200 base savings account along with financial education and other incentives, he found that the majority of participants were able to save.[24] I discuss these programs in detail later in the essay. Another study showed that, when offered, 401K plans have proven to be very successful for low and moderate-income individuals.[25] This proves that when presented with the opportunity, low-income individuals are able to save. Sherraden says that this proves that low-income people are perfectly capable of saving and asset building, but that they lack the institutional opportunities that higher income families are offered.[26]

Connection between Financial Literacy and Poverty

The issues discussed above are all linked to financial literacy. Financial education has been a national policy focus since the 1990s, when it became clear that there was a correlation between lack of financial knowledge and issues of debt and poor money management. It has also recently become a new policy initiative after the recent financial crisis, which many have attributed at least partial responsibility to poor financial decision making by individuals.[27] The definition of what a "financially educated" person is varies from a broad understanding of economics and decision-making to others, which focus more narrowly on issues of budgeting, saving, interest, and insurance. According to Jeanne Hogarth, an economist, the themes that run through the different definitions of financial education include being knowledgeable on issues of managing money, understanding basic concepts about analyzing money and assets, and using

[24] Curley, Jami, Fred Sewamala, and Michael Sherraden. "Institutions and Savings in Low-Income Households." *Journal of Sociology and Social Welfare* (2009): 11.
[25] Blank, Savings, Assets, Credit and Banking Among Low Income Households.
[26] Curley, Institutions and Savings in Low-Income Households, 11.
[27] Hogarth, Jeanne, M., and John Kozup. "Financial Literacy, Public Policy, and Consumers' Self-Protection—More Questions, Fewer Answers." *Journal of Consumer Affairs* 42.2 (2008): 127. Web.

this knowledge to plan, evaluate and execute financial decisions.[28] Financially educated individuals are able to manage their finances by doing things like paying bills on time, having good credit, having means of saving and investing, and spending their money wisely.

There is a clear connection between poverty and lack of financial literacy, although the degree and direct connection is somewhat unclear. It is clear that low-income families are misinformed about certain financial matters and that low-income areas lack institutions to help individuals manage their finances. Studies have found that low-income individuals are less likely to receive financial education than their upper income counterparts.[29] Financial education for school aged children is included in only some states' curriculums, and is mandated in fewer. Forty-Eight states and the District of Columbia include economics in their "education standards" and 31 states include personal finance. While 14 states made an economics class mandatory, only four states made a personal finance class mandatory, which is most important to financial literacy.[30] A 2001study demonstrated that individuals who graduate from states with mandatory financial education programs are more likely to have higher net worth and savings levels.[31] This shows that people with lower net worth and savings levels (generally low-income) did not participate in financial education programs.

Research has found a connection between the recent financial crisis and lack of financial literacy.[32] One study correlates between the financial literacy of the individuals who took out

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[28] Hogarth, Jeanne M. "Financial Education and Economic Development." Improving Financial Literacy, Nov. 2006. Web. <http://www.oecd.org/dataoecd/20/50/37742200.pdf>.

[29] Bell, Elizabeth, and Robert I. Lerman. "Can Financial Literacy Enhance Asset Building?" Opportunity and Ownership Project, Sept. 2005. Web.

[30] Ibid.

[31] Hogarth, Improving Financial Literacy.

[32] "Financial Literacy: Getting It Right on the Money." *The Economist*. 3 Apr. 2008. Web. <http://www.economist.com/node/10958702>.

subprime loans in 2006/2007 and their likelihood to fall behind payments. The study found that "those who scored among the highest level for financial literacy were two-thirds less likely than those among the lowest group to experience foreclosure."[33] This shows a strong connection between financial education and the ability to make mortgage payments.[34]

The majority of Americans acknowledge that they do not have the necessary level of financial literacy. Despite believing they don't have adequate financial knowledge, they are not receiving financial education. This shows that there is a discrepancy between the importance people place on financial knowledge, and the actual financial knowledge of individuals. According to one study, less than 30 percent of Americans view themselves as having very good or better financial knowledge, and the majority of individuals in America (65 percent) have not received financial education in the past 12 months. In contrast, 80 percent of individuals find it important that financial literacy be taught. Individuals in this study found that it is important for them to enhance their financial knowledge in order to "save and prepare for the future, feel more confident and informed, feel financially secure and independent, and to make wise choices." These individuals are least confident about and wish they received more education regarding investing, retirement planning and their rights as consumers.[35]

Financial Education Programs

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[33] Hampton, Eli. "Study Shows Correlation between Financial Literacy and Foreclosure." *Credit.com*. 29 Apr. 2010. Web. <http://www.credit.com/news/housing-market/2010-04-28/study-shows-correlation-between-financial-literacy-and-foreclosure.html>.

[34] Ibid.

[35] Godsted, David, and Martha Henn McCormick. "National Adult Financial Literacy Research Overview." Network Financial Institute, Aug. 2007. Web. <http://www.networksfinancialinstitute.org/Documents/2007-NFI-05_AdultFL.pdf>.

There has been a huge push to increase financial education programs in the U.S. since the early 2000s. Financial literacy became a buzzword in the news and many different efforts from the government, nonprofits, and other organizations have worked towards improving financial literacy.[36] Financial mechanisms have become more complex and consumers have many more choices in financial products than previously. While employers formerly provided retirement plans for their employees, individuals are becoming more and more responsible for their own retirement planning and savings. This leaves consumers with many complicated financial decisions to make, requiring a high level of financial knowledge that needs to be taught to many consumers. Financial education and financial literacy programs have come in many different forms. Providers of financial education range from employers, colleges, high schools, faith-based groups, the military, state cooperative extension services, community-based programs, and more.[37]

How are we doing?

Many studies since the 1990s seek to determine the effectiveness of financial education programs in the U.S. There are a range of different programs, evaluation methods, and levels of effectiveness that studies identify. While some studies show financial education as relatively ineffective, most find them effective to some degree when they are designed properly. Financial education is very hard to measure, and there currently are no widely used evaluative measurements that accurately measure the success of a financial education program.[38]

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[36] Hogarth, Financial Education and Economic Development, 4.

[37] Braunstein, Sandra, and Caroline Welch. "Financial Literacy: An Overview of Practice, Research and Policy." Federal Reserve Bulletin, Nov. 2002. Web: 448.

[38] Walstad, William B., Ken Rebeck, and Richard A. McDonald. "The Effects of Financial Education on the Financial Knowledge of High School Students." *Journal of Consumer Affairs* 44.3 (2010): 483-498: 337.

Regardless of the relative success of certain financial education programs, it is clear that more needs to be done in order to improve the financial literacy in the U.S. A study done by the FINRA Foundation showed that in 2010, Americans, on average, were only able to answer three out of five basic and fundamental questions about financial concepts.[39] This statistic, coupled with the continuous high levels of debt and poverty in the United States, shows that we have more work to do in order to create a financially literate population.

What Makes a Program Successful?

There are many different types of financial education programs. There are general financial literacy programs geared at youths and adults that teach general money management practices such as budgeting and saving. There are programs that target a specific need offered by an interested party, such as retirement savings programs offered by employers. There are also programs geared towards a specific purchase such as buying a house.[40] There are hundreds of different financial education programs and methods throughout the country, and researchers find evaluating the effectiveness of these programs particularly hard. It is hard to tell the effects of a program on long-term financial well being since many studies fail to track individuals long term.[41] While not all studies find strong positive correlation between financial education and financial well being, most find at least some positive correlation.

[39] Halbert, Gary D. "More on the Financial Literacy Crisis." *ProFutures Investments*. 8 Feb. 2011. Web. <http://profutures.com/article.php/728/>.

[40] Fox, Jonathan, Suzanne Bartholomae, and Jinkook Lee. "Building the Case for Financial Education." *Journal of Consumer Affairs* 39.1 (2005): 197. Web.

[41] Lyons, Angela C., Lance Palmer, Koralalage S. Jayaratne, and Erik Scherpf. "Are We Making the Grade? A National Overview of Financial Education and Program Evaluation." *Journal of Consumer Affairs* 40.2 (2006): 208-210. Web.

Different financial education programs are necessary for people in different positions in their lives, and the methods of these programs vary. Financial education for youth is different from financial education for adults, but both can be necessary. Educating the youth in elementary and high school is important as a preventative and prescriptive measure. Many children, especially low-income children, are exposed to poor money management practices in their families. They are in a formidable stage in their lives where they are not yet making serious money decisions, but soon will be entering adulthood. Martha McCormick, a research coordinator at Indiana State University, notes that "children are in stores and retail venues an average of two to three times weekly, exceeding in a typical week the time dedicated to reading, church attendance, youth groups and household activities." This means there is much time for youth to be influenced by advertisements and to be encouraged to spend money they may not have.[42] The principles required for youth education are very different from those that are required for adult education. Adult education is much more remedial. It is often in response to preexisting financial issues, or in hopes of gaining access to capital such as a house. Since adults and youths are in very different places in their lives, it is important that the financial education program caters to the needs of the age group.[43]

Youth Programs

Youth are probably the most important target audience for financial education in terms of prevention. Youth are important because if they can learn to be financially literate at a young age when they are not yet managing their own money (on a large scale), they can become

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[42] McCormick, Martha Henn. "The Effectiveness of Youth Financial Education: A Review of the Literature." Association for Financial Counseling and Planning Education, 2009: 70. Web.

[43] Ibid. 71.

financially literate adults. This in turn can prevent cyclical poverty, which can have many negative effects on a family.[44] Youth are in a prime place in their lives to learn the money management skills necessary for the future instead of having to remedy poor financial decisions. According to the Department of Agriculture's Cooperative State Research, Education and Extension Service, "many young people are unskilled in managing their personal finances, yet this crucial life skill will greatly affect their future economic well-being."[45]

While successful adult financial education targets a participant-defined goal, youth programs need to be more general by teaching basic money management principles. Martha McCormick identifies several factors that lead to an effective youth education program such as relevant program design, effective motivation, providing education at an early age, providing effective teachers and incorporating savings mechanisms. The factors she discusses most prominently are: relevant program design, effective motivation, and providing education at an early age.

Relevant Program Design

Financial education should target the relevant issues for the time and for the educational level of the children. The issues must be taught in a way that children can understand and will engage in. The prominent issues in today's world should be taught. McCormick says that using the "age old piggy bank savings and numeration techniques" is not as effective as playing games that teach children the idea of using banks and ATM machines, bill paying, monthly statements,

[44] Hogarth, Financial Education and Economic Development, 4.
[45] McCormick, The Effectiveness of Youth Financial Education, 72.

retirement savings, etc. These issues are more important for their long-term understanding of money management.[46]

Effective Motivation

Children need to know why they should be financially literate and understand concepts of money management. A study done by Mandell and Klein (2007) shows the reasons why certain students did not improve their financial literacy after participating in Jump$tart financial education programs in high schools. Mandell and Klein state that, "low financial literacy scores among young adults, even after they have taken a course in personal finance, is related to lack of motivation to learn or retain these skills."[47] Students generally experience apathy towards the issues of financial management, rather than motivation to understand it. She suggests students need to feel personally connected with the issue and understand how it applies to their life.[48] Although this is not addressed, incentive approaches for high school students, such as savings matching programs, could be effective and should be researched.

Early Education

The earlier that financial education can be started, the better. Teaching financial concepts in elementary school provides more time for children to understand the concepts and apply them to their lives than high school aged students, who already have certain spending and money management habits. Most of the information that children learn about money management comes from things like watching television or listening to discussions of family and friends. This information can often times be inaccurate, and according to Suiter and Meszaros (2005),

[46] Ibid. 73.
[47] Ibid.
[48] Ibid.

"the longer we wait to provide personal finance education, the more time teachers will spend correcting misinformation."[49] It also is harder to convince students to change their habits and to listen to the teachers once they have been set in their habits.

Adult Education Programs

Adult financial education programs have a wide variety of goals. The aim of financial education programs as a whole is to improve the financial literacy of Americans in order to prevent financial instability and poverty. Adult financial education programs are different from youth programs in that they should target a specific participant-defined goal. It is important to gauge what the participant needs (i.e. becoming a homeowner, reducing debt, or saving for requirement) and then plan the education based on these factors.[50] This applies to both individual counseling sessions and group sessions. In group settings, there must be a common goal amongst the participants so that they can all relate and work towards the same common goal.

An intensive study done by Jeanne Hogarth and Josephine Swanson identified what made adult financial education programs successful for low-income individuals and where there was a disconnect between the "teachers" and the "students." Hogarth and Swanson show that many principles of regular adult education for low-income individuals apply for financial education. The three principles that they identify as extremely important in effective financial education are: experience as a teacher, learner control and learner differences.[51]

Experience as a Teacher

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[49] Ibid. 74.
[50] Ibid.
[51] Hogarth, Jeanne M., and Josephine Swanson. "Using Adult Education Principles in Financial Education for Low Income Audiences." *Journal of the Family Economics and Resource Management Division of AAFCS* (1995): 141.

One of the main principles for effective financial education is teaching in relation to experience. It is important that the learners are able to relate to the teacher and can discuss their experiences in the context of learning. Many of the individuals interviewed said that they learned a lot from the experiences of others and that they learn better when they are shown something rather than being told something. The learners who were interviewed emphasized how their life experiences have taught them many of the things they know, but educators seemed not to place as strong a value on life experiences. They did agree with learners that educators should be sensitive and empathetic to the learners, though. In order to be effective, the educator must relate to the learner on a personal level and make the learner feel comfortable. One woman who was interviewed spoke about an effective financial counselor she had: "She gave us her own personal experience, how much trouble she had, which helped."[52]

Learner Control

It is important that the educators take on a supportive role for the learners so they can help increase the learners' motivation. Instead of a typical authoritative role that teachers are often thought to have, a financial educator for adults is much more effective as a trusted peer. Ways in which an educator can provide a supportive atmosphere are by sitting next to learners instead of across from them, conversing in a casual way that creates a good rapport, and listening attentively to the learner's problems. The educator should try to put the control of the learning on the learner, so that the learner sets the immediate goals, such as wanting to pay off credit card

[52] Ibid. 142.

debt. By allowing the learner to set the initial agenda, the learner trusts the educator more as time goes on.[53]

Learner Differences

Regardless of income, learners vary in their educational capacity, their learning styles and their motivation. It is important that educators are aware of these differences and are able to cater to different learning styles and needs. Sometimes there are literacy barriers or language barriers, and often times individuals are embarrassed when they do not understand something and do not want to ask for help. Many of the individuals studied said that often times, lack of motivation was attributed to dislike of public assistance. Ways in which educators can improve this is by avoiding inappropriate topics, insensitive delivery and making the learners feel like they are inadequate. Also, the timing of educational programs is important. Educators must find the best way to reach individuals and work around conflicts with jobs and family responsibilities.[54]

Individual vs. Group Counseling

While previous literature focused on financial education in a group setting, more recent literature has focused on the importance of one-on-one financial counseling or coaching. This is especially important for adult financial education. Children can effectively be taught in group settings at school, where they are used to learning with their peers. While children do not have specific financial issues, adults who are receiving financial education generally do. It is important that an individual family's finances are being examined and that the individual feels

[53] Ibid. 142-143.
[54] Ibid. 143.

personally motivated to go through the counseling.[55] A study done by Braunson and Welch shows that homebuyers who participated in individual counseling had a 34 percent lower delinquency rate than those who received no counseling, while those who received group counseling had 26 percent lower delinquency rates.[56] This shows that individuals who receive one-on-one counseling are better able to solve their financial issues and it is more likely to be permanent.

Possible Role for Banks

While there are many times in which an adult may need financial education, the prime time for financial education is when an individual needs to borrow. As explained above, banks are often reluctant to offer loans to low-income individuals, especially those with poor credit. In order to be able to offer more services to the poor, banks could offer small loans to low-income individuals along with providing mandatory financial education. Banks should be willing to do something like this because it would meet Community Reinvestment Act (CRA) requirements. This would provide a valuable and non-exploitative service to the poor, but would also help the banks through creating more financially literate individuals who then can become traditional banking customers.

Policy Suggestions

While sound financial education alone can lead to improved financial stability among individuals, policies can help to promote financial knowledge. In today's complex world of financial choices, there must be some ways in which the government helps to protect consumers

[55] Hogarth, Financial Literacy, Public Policy, and Consumers, 131-133.
[56] Braunstein, Financial Literacy.

from getting in financial trouble. Hogarth and Kozup introduce policy suggestions that could help prevent financial instability by increasing financial knowledge. One policy suggestion is to have financial information mandates similar to that of mandated nutritional information on food labels. Financial institutions would be required to put information on their financial products so that consumers know what risks are associated with the loan or the mortgage they are buying. This would also help streamline financial education efforts to help individuals understand specific information. Another policy alternative suggested by Hogarth and Kozup is for consumers to have to demonstrate a certain level of financial literacy before they can purchase a mortgage, stock, bond, etc. Governments could require financial counseling before purchasing certain complex financial products.[57] There are potential issues with such policy implementations though. These policies could be viewed as taking a paternalistic approach that limits consumer sovereignty, especially to the poor or uneducated. It could be viewed conversely though, as these financial regulations would actually be promoting consumer sovereignty instead of taking it away. By getting financial education before making important purchases, consumers would have more freedom because they would understand the decisions in front of them. More research would also need to be done to determine the effectiveness of implementing such policies.

There is also potential government policy change in tax credit. While currently middle to upper income individuals receive a tax credit for saving for things like retirement, low-income individuals do not receive anything for saving small amounts. Small savings are all that many low-income individuals are able to muster, and these savings are still important. There has been some advocacy for the government to offer a small tax credit to low-income families if they save

[57] Hogarth, Financial Literacy, Public Policy, and Consumers' Self-Protection, 133-134.

small amounts.[58] This could be an effective way for financial education programs to market their efforts without having to find their own incentives as in the programs discussed below. Programs can be promoted by informing low-income individuals that if they participate and save a certain amount, they will receive a tax credit from the government.

Incentive Based Programs

Many low-income individuals are very busy and do not feel motivated to take financial education classes or meet with a financial counselor without either being required or being given some sort of incentive. There has been an increase in programs that try to incentivize financial education to low-income individuals. Individual Development Account (IDA) programs have been a very popular and successful incentive based approach to incentivizing financial education and promoting savings. The program was proposed by Sheradden in the early 1990s and was implemented in many different states beginning in the late 1990s. In order to participate in the IDA program, an individual must be below 200% of the poverty line. The participants must save for asset-building purposes, such as buying a house, business development, or postsecondary education. The IDA program matches the savings of the individuals either 1:1, 2:1 or more, depending on the program. Participants are required to save regularly, although modestly. The participants are required to receive financial counseling during their time in the program. After three missed deposits, an individual is generally terminated from the program.[59] Since there are sanctions on behavior, many individuals do not participate or finish the program.

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[58] Zdenek, Robert O. "Building Wealth: Tax Credits and Savings Can Help Low-income Families Build Assets." *National Housing Institute*. Jan.-Feb. 2003. Web. <http://www.nhi.org/online/issues/127/bldgwealth.html>.

[59] Loibl, More Than a Penny Saved, 100-101.

Accurate data on the results of IDA program participants' financial well being after program participation has been released in recent years. It is clear that IDA programs have had a positive effect on the financial well being of those participants who were able to complete the program (about 50% drop). There is some bias in which individuals decide to do the program and stay with it compared to those who drop out or do not participate, since these participants have decided to persevere through the program. There has also been a decline in these programs due to their high costs and to a lack of funding. Regardless, the programs have still been revolutionary and very effective when in place.[60] Loibl discusses eight successful components of IDA programs: *access, information, incentives, facilitation*, *expectation*, *selection*, *time* and *demographic*.[61] The program provides *access* to financial institutions, social workers, and microenterprise professionals. *Information* is provided through financial education classes and one on one classes, and *incentives* are given through the savings matching aspect of the program. *Facilitation* is provided through budgeting training, credit counseling, and asset purchase assistance. *Expectation* is managed through social pressure, and it is found that attending meetings with peers increased the savings of participants more than any other factor.[62] *Selection* represents that the program generally recruits low-income individuals who have been successful at other social sector programs such as Habitat for Humanity. There is significant *time* spent on the program (on average 24.5 months), which gives the participant time to make a personal

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[60] Ibid. 120.
[61] Ibid. 101.
[62] Tufano, Peter, and Daniel Schneider. "Supporting Saving by Low- and Moderate-income Families." *Focus* 27.1 (2010): 23.

transformation. The *demographic group* found to be the most successful in this program is working adults with children, which motivates their interest.[63]

Incentive based programs come in other forms than IDA programs. There are many Community Development Financial Institutions (CDFIs) that now provide affordable financial services to low-income individuals, some of which include financial education components. An example of a successful community financial service that combines financial education is Opportunity Credit Union (OCU), in Vermont, which is one of 300 community development credit unions. Its mission is to provide affordable financial services to an underserved population in Vermont. It offers counseling-based lending and financial services to low-income individuals, which allow them to expand small businesses, buy a home, or fix their cars. Hogarth gives two reasons why this model of a program is successful: "(1) when people come to OCU they are in an especially teachable frame of mind, because they want something like a car or a house, and (2) OCU has a wide array of practical tools that help people learn by doing. These tools include no-fee savings accounts, sub-accounts to accumulate funds for specific need and goals, and "tracker" loans to build or repair credit."[64]

There are a number of other incentive-based programs. They cannot all be examined in this paper. Some are run through universities, nonprofits, government organizations, and schools. They vary in type and in objective, but they all offer some incentive for financial education. A problem with the majority of these programs is that they are not going to reach the poorest of the poor. Stringent requirements for programs such as the IDA program make it hard for extremely low-income people to participate. This does not mean these programs are not

[63] Loibl, More Than a Penny Saved, 120.
[64] Hogarth, Financial Education and Economic Development, 11.

useful. Another big issue with incentive based programs is that they often require significant amount of funding. Programs like the IDA program are not self-sustainable, so there needs to be a constant source of funding which is not always available. This is one of the major problems with IDA programs and why the model is not used more. It hasn't been possible to receive continuous funding for programs such as these on a large scale.

Evaluative Issues

There are issues with the way that financial education programs are currently evaluated. The first step for improving the future of financial education is to improve the methods of evaluating the effectiveness of financial education on a national scale. Since there are many different attempts at financial education, there is no central measure for judging the effectiveness of a program. A common method of measuring financial education is essential for fully understanding what makes an effective program.

This is not to say that developing a central evaluative method is easy. Theorists disagree as to what measures should be used and how the measure can apply to different programs. Currently measurements range from quantitative measures such as savings rates, debt levels, wealth accumulation, delinquency, and participation in retirement savings programs, to more subjective measures such as changes in participant satisfaction levels or the participants' attitudes. A study by Angela Lyons et al. finds that most programs evaluate effectiveness using "program output" criteria such as the number of programs and program participants. They believe these measurements are inadequate since they do not address change in knowledge or financial behaviors, which are key components of financial education. The lack of a consistent and national measurement for evaluating financial education programs inhibits the ability to compare programs and to have a base standard.[65]

Studies also find that many evaluative measures of financial education have methodological problems and biases. Michael Collins and Collin O'Rourke studied the evaluative literature of 41 different financial education programs and identified four major methodological issues: selection bias, measurement issues, longitudinal design and a general lack of theory.[66] Without going into the details of these problems, the existence of these biases reveals serious flaws within our current measurement system. Currently, we are unsure of the success of many programs because of these biases and the lack of a common and effective evaluative measurement procedure. Further research is necessary as to determine proper evaluative measurements for financial education programs. A general consensus for an evaluative method must be developed that can be used on a large scale. Once this method is determined, programs can be better evaluated, which will hopefully lead to changes in the unsuccessful programs.

Conclusion

High levels of poverty have plagued the American nation for far too long and are showing no signs of ceasing. While there are many factors that contribute to poverty, one that is relatively easy to eliminate is financial illiteracy. Financial illiteracy not only can cause individual poverty, but it can contribute to large-scale economic decline, which affects many

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[65] Lyons, Are We Making the Grade?, 210-211.

[66] Collins, Michael, and Collin M. O'Rourke. "Financial Education and Counseling—Still Holding Promise." *Journal of Consumer Affairs* 44.3 (2010): 492. Web.

individuals. Poor financial decision-making and lack of financial knowledge is attributed as one of the contributing causes of the recession in the early 2000s. When taught effectively, financial education can increase financial literacy and therefore increase financial well-being among the poor. Government policies and regulations can work with financial education programs to decrease exploitation and increase financial literacy.

Financial education can be beneficial and necessary at many points in an individual's life, but the most important time to prevent future financial problems is for school age children. Financial education should be mandated at both elementary and high school levels, and research finds that it is very important to start as young as possible. The younger the children are, the more likely they are to not have formed any preconceived views of money management. The way in which financial education is taught must vary with age in order for the educator to make a proper connection with the learner. Adults often need financial education as well. Low-income individuals are often exploited by lending institutions and are victims of misinformation. Many different life situations can cause individuals to be forced into debt and poor money management. Effective financial education can help individuals prevent these situations or get out of them before further damage occurs.

While many low-income individuals think financial literacy is important in theory, they often do not have time or motivation to attend financial education classes. This is where incentive based programs can play a role in attracting participants. While I discussed a few programs, program options are seemingly endless. A problem with programs like IDA programs is that they can leave out the poorest of the poor. That does not mean there is no room for other programs that can target this demographic. Often times, the biggest issue is funding for these programs. Since poverty reduction is a very important goal for our country, there is room for many potential funders. The government can and should play a larger role in funding programs. The government can work together with nonprofit organizations, community organizations and private university programs towards gaining the funding and resources to make financial education available and attractive to low-income individuals all over the country.

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On my honor, I have neither given nor received any unacknowledged aid on this paper.

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