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Financial literacy and financial behavior: Evidence from the emerging Asian middle class

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ABSTRACT

This paper analyses financial literacy and financial behavior of middle class people living an urban Asian economy. Other than most papers on financial literacy that focus on people in developed countries, we surveyed people living Bangkok. Using standard financial literacy questions, we find that financial literacy levels are largely comparable to industrialized countries, but understanding of more advanced financial concepts is lower. Similarly, savings accounts are held by most people, but more sophisticated products are a lot less common. We further show, in line with the literature, that higher financial literacy leads to improved financial decision making.

1. Introduction

Good financial decision making is becoming increasingly important; the reasons behind this is a higher availability of more complex products and the heightened need to save for one's retirement. Whereas this is true for almost all people, these decisions are of particular importance for the middle classes in emerging economies, such as those in Asia. These economies are characterized by rapid growth, heavy structural changes and the emergence of a larger middle class (e.g. Kharas, 2010; Ravallion, 2010). Increasing incomes allow higher savings, and the number of ever more sophisticated financial products is constantly rising in these markets. Furthermore, longevity in combination with declining birth rates and an increase in social individualization increases the need for retirement planning. These changes have been most rapid in urban areas in many emerging markets, where at the same time a vast choice of sophisticated financial products is available to consumers. In order to address these challenges adequately and to use sophisticated products rationally, individuals need to have a certain financial understanding (Campbell, 2006). Hence, financial literacy is important for individuals to be able to tackle these challenges and it is therefore of particular importance for the middle class in emerging economies.

In this paper, we study the financial behavior and financial literacy of the urban middle class in Asia. The middle class has often been neglected in empirical studies, as papers on financial literacy have either looked at populations in industrialized countries (Lusardi and Mitchell, 2014) or focused on the poor living in developing countries (Xu and Zia, 2013). This is despite the important role that the middle class plays for growth and development (Ravallion, 2010; Banerjee and Duflo, 2008). One reason why the middle class in emerging markets has been argued as important for growth is that it has larger savings than the poor (Chun et al., 2017), mostly because the middle class tends to have stable employment (Banerjee and Duflo, 2008). In this light, it is particularly important to study financial literacy and financial decision making of the middle class. Good financial decisions making by the middle class in emerging economies may have more far reaching consequences than financial decision making by the poor. Furthermore, policies

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that target the urban middle class would have to be very different to policies designed to target the poor parts of the population in emerging markets.

To study this population group, we fielded a survey in Bangkok, Thailand, collecting information of over 500 middle class people. This survey was designed especially to study the financial behavior and financial literacy in emerging Asia. Bangkok provides a good platform for this. Firstly, Thailand belongs to the group of emerging economies where a sizable middle class with significant financial needs and wealth has emerged, meeting the global middle class definition of Kharas (2010).[1] This group is largely concentrated in the Bangkok area, where 23% of the Thai population lives, but which produces 44% of total GDP. Secondly, the financial sector grew quickly and the economy expanded significantly, meaning that the middle class had to adjust quickly to new financial products. Thirdly, the pension system in Thailand is small and undeveloped, implying that members of the middle class working in the private sector need to save for their retirement, without state support. Although sophisticated financial products are easily available to everyone in Bangkok, the question is whether they have sufficient financial literacy to take advantage of them.

Our sample is relatively homogenous with respect to age, income and education, making it well suited for studying non-socio-demographic factors such as financial literacy and their effects on financial behavior. To test the degree of financial literacy, we use standard items (Lusardi and Mitchell, 2007) and find that basic financial knowledge for middle class people in Bangkok is at the same level as that found in representative studies in developed countries. However, the results also indicate that our respondents struggle with more advanced financial knowledge, as only 24% can answer the standard stock market diversification question correctly. The relationships between socio-demographic variables and financial literacy are mostly those that are common in the literature: wealthier people with higher incomes are more financially literate and more educated people have higher financial literacy. Similarly, we find that younger people do better on all financial literacy questions. However, one results that is very unusual to the literature is that women do perform just as well as men on all questions. In most financial literacy studies, it is found that women have lower financial literacy than men (Lusardi and Mitchell, 2014, Grohmann et al., 2016).

We collect information on a large number of financial products and find that basic financial products are very wide spread in the Bangkok middle class. Everyone has a savings account and 34% of respondents have a credit card. At the same time, use of sophisticated financial products such as stocks and bonds is low (9% and 11% respectively), whereas bank accounts and deposits are the most common financial assets.

We further show that financial literacy explains a wide range of these savings as well as some borrowing decisions and so we demonstrate that financially literate individuals make better use of advanced financial products. However, the relationship between financial literacy and financial behavior suffers from potential endogeneity caused by potential measurement error or unobserved variable bias. Furthermore, reverse causality is also a potential problem; it is conceivable that holding advanced financial products such as stocks may provide some kind of financial literacy training. In order to address these problems, we use an instrumental variable approach. We collect several variables that refer to respondents' childhood. These variables have been used before by Grohmann et al. (2015) to study the childhood roots of financial literacy. They are particularly suited as instruments as they are correlated with financial literacy, but uncorrelated with financial decisions in adulthood. The analyses with instrumental variables confirm our earlier findings.

Our main contribution to the literature is showing the beneficial causal impact of financial literacy for a new sample representing the emerging middle class in Asia. As additional aspects, we consider a broader set of savings and borrowings decisions than typically covered in other studies on financial literacy. Furthermore, as we are using financial literacy questions that have been used in a large number of countries, we can easily compare our results to those from industrialized countries. We can further show that the results are robust, using instrumental variables regression.

The link between financial literacy and financial behavior has been looked at in a number of other studies. The literature of financial literacy first developed to study the link between financial literacy and retirement planning (Ameriks et al., 2003, Lusardi and Mitchell, 2007, Bucher-Koenen and Lusardi, 2015, Van Rooij et al., 2011b). Apart from better retirement planning, financially literate individuals are more likely to invest in stocks (Christiansen et al., 2008; Van Rooij et al., 2011a) and have more diverse portfolios (Guiso and Jappelli, 2008; Abreu and Mendes, 2010). Regarding borrowing decisions, financially literate people have lower cost debt and are more likely to be aware of their optimal debt level (Lusardi and Tufano, 2015; Stango and Zinman, 2009). They have less high-cost consumer credit (Disney and Gathergood, 2013) and fewer problems with repaying credit card debt (Gathergood, 2012).

Financial literacy is also an important topic for developing countries: we refer to Xu and Zia (2013) for a review of the literature. Levels of financial literacy in emerging markets are lower than in industrialized countries (Hastings and Tejeda-Ashton, 2008; Cole et al., 2011; Klapper and Panos, 2011; Beckmann, 2013), especially in rural areas. At the same time, studies in developing countries confirm that better financial literacy is positively related to retirement planning (Klapper and Panos, 2011), to greater participation in financial markets, to greater use of formal sources of borrowing (Klapper et al., 2013), to higher voluntary savings (Landerretche and Martinez, 2013) and to better diversification (Beckmann, 2013).

A more recent strand of the literature focuses on the effect of financial literacy trainings on financial decision making. Many of these studies are based on randomized control trails, studying poor people in developing countries. Results of these studies show that the effect of financial literacy training is small (Fernandes et al., 2014), but training is more effective in improving savings behaviors than borrowing behaviors (Kaiser and Menkhoff, 2017).

The evidence on financial literacy is limited to population-wide studies or poorer areas in developing countries. Within a single

[1] Precisely: average household income per person between $10 and $100 per day in purchasing power parity terms, measured in 2005 US dollars.