

Global Assets Project

Accelerating Financial Capability among Youth Nudging New Thinking

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Executive Summary

This paper argues that common definitions of financial capability understate the role of psychological barriers to establishing sound financial behaviors, namely savings habits. Drawing on insights from psychology and behavioral economics, we explore these missing psychological variables in the standard financial capability equation and suggest mechanisms, or nudges, to overcome those barriers to accelerate financial capability among low-income youth. Our intended audience includes development practitioners and scholars focusing on global development, financial inclusion, and asset building. Very little work, to our knowledge, has been done on exploring the nexus between savings and habit formation. Though we acknowledge that the goals of financial capability vary and do not focus solely on forming savings habits, we believe it is an important outcome of financial capability. Additionally, while the proposed nudges have been administered, and in some cases tested, in the fields of public health, education, and financial services, they have not been extensively tested in the youth savings context. With that in mind, this paper is intended primarily to spur debate and provide ideas for further testing in the emerging field of youth savings.

Introduction

The importance of establishing good habits early in life is intuitively obvious. Good work habits, eating habits, and savings habits—like bad ones—often become second nature during adolescence and are maintained throughout adulthood. Less understood are psychological biases and their role in breaking old habits and establishing new ones. In the literature on financial capability, especially, the behavioral challenges to altering and establishing savings habits are too often understated or even, at times, neglected altogether. Specifically, discourse on the intent to save versus savings outcomes is rarely given proper emphasis.

“Financial capability” has become a catchphrase among many development practitioners, policy makers, and researchers concerned with youth development and their future financial wellbeing. For a person to become financially capable, under the standard definition, they require access to appropriate financial services combined with the ability, knowledge, skills, attitudes, and *behaviors* to make sound, personal financial decisions.¹ The underlying assumption is that financial education and access to financial services are ingredients that when combined, mutually reinforce sound financial decision-making, such as saving.

While this “access + education” approach may lead to advanced knowledge, skills, and attitudes, it underemphasizes the most challenging component: behaviors.

Is there a missing ingredient that could help overcome this last mile problem? We posit that nudges, or mechanisms that prejudice specific decisions, can prompt positive savings behavior and that the impact could be especially powerful for low-income youth

Evidence from cognitive science and behavioral economics suggests that intentions do not necessarily result in corresponding behavioral outcomes. There are various human biases and psychological barriers that can prevent an individual from engaging in positive behaviors, such as eating healthy, exercising, or saving regularly, even when they have the ability, desire, and opportunity to do so. Herein lies the last mile problem to establishing sound, financial behaviors: the challenge of linking *desire and ability* (through financial education) and *opportunity* (through access to financial services) to behavioral outcomes.

Is there a missing ingredient that could help overcome this last mile problem? We posit that nudges, or mechanisms that prejudice specific decisions, can *prompt* positive savings behavior and that the impact could be especially powerful for low-income youth. When delivered during a young person’s cognitive development, nudges may further counteract psychological biases to saving in a financial institution and accelerate financial capability into adulthood.

While saving in a financial institution is not the only outcome of financial capability, we argue that it is an important one. Saving regularly can allow individuals to build assets into adulthood, cushion against shocks to their livelihoods, smooth consumption, and provide them with a chance to invest in their future wellbeing. Therefore, this paper considers how to accelerate financial capability among low-income youth from a formal savings lens by 1) exploring the last mile problem to establishing financial behaviors; 2) examining lessons in behavior formation and how starting young can help counteract psychological barriers to saving in financial institutions later in life; 3) exploring biases that contribute to the last mile problem of behavior change ; 4) highlighting nudges from a range of fields and how they might promote positive savings habits among youth; 5) providing an overview of external challenges to nudging youth financial capability; and 6) concluding with additional ideas for research.

The Last Mile Problem to Behavior Change

The “last mile problem,” originally refers to the telecommunications challenge in extending out service to hard-to-reach populations. Applied to the context of development policy and behavioral change, the last mile problem can be defined as achieving certain behavioral outcomes, like establishing a savings habit, in cases where the capacity and desire to achieve that outcome already exist.

In India, for instance, as of March 2008, following a government mandate to open “no frills” accounts for the poor, 15.8 million accounts had been opened, with 155 districts labeled as having achieved total financial inclusion—100 percent.² In one study of such a district, however, 87 percent of these accounts lay dormant after twelve months.³ This is not a unique occurrence—dormant accounts reflect a serious gap between observed intentions (the customer opened the account and therefore intended to use it) and observed outcomes (the customer did not end up using the account). One observes a similar gap across a variety of contexts. For instance, insulin users intend to take their medication regularly, but still, nonadherence rates of roughly 20-45

percent in the United States result in thousands of cases of blindness and amputations, with general pharmaceutical nonadherence costing the United States economy up to an estimated \$100 billion each year.⁴

Much of the anti-poverty work performed in developing countries in regard to medication adherence and health prevention reveal this same disappointing gap between intents and outcomes, as well as a disparity between a focus on technological solutions and availability on the one hand, and encouraging the necessary behavioral change on the other. Professor Sendhil Mullainathan at Harvard University, in a 2009 TED talk, detailed this essential and damaging disparity, pointing out it does not make sense to invest so heavily in the technological solutions to problems in the developing world—all tested rigorously—while focusing so little, and with little or no rigorous testing, on achieving the corresponding behavioral change. Achieving behavioral change cannot merely be about access, in other words, or even access and information.

In the context of savings behavior, as implied above, the last mile problem is best illustrated in the high incidences of dormant accounts. In South Africa, four years after the government pushed for two million Msanzi accounts for low-income citizens, 42 percent of the accounts remained dormant.⁵ Importantly, dormant accounts do not merely occur out of lack of convenience, either. Take the case of M-PESA. In 2010, M-PESA partnered with Equity Bank to offer customers an interest-bearing savings account on their cell phone, M-KESHO. Any of M-PESA's over 20 thousand vendor locations would allow deposits into this account, and the take-up of the accounts has been impressive, almost half a million in the first three months. Again, the sign-up for the accounts signal intent to save, yet even in these cases where accounts and vendors are hugely convenient and accessible, over half of these accounts remained unused—only 176 thousand accounts had even been activated, meaning only 38 percent of those signing up for the M-KESHO accounts had followed through on their intent to use them.⁶

In everyone's day-to-day life, of course, there are disparities between intents and outcomes: one may sign up for a gym membership, but after two weeks, stop attending; one may pledge to quit smoking, but soon lapse back into the habit. For savings in the developing world, however, the disparity between intents to use savings accounts and savings outcomes can be considerably more harmful; it can mean the difference between alleviating poverty, and potentially escaping it altogether by building assets, smoothing consumption, and having a means to protect one's family from shocks or adverse events.

Behavior Formation: Why Starting Young Matters

According to renowned economist Amartya Sen, the deprivation of capabilities, or what a person is able to do or be, is at the core of persistent poverty.⁷ Advancing this notion into the realm of cognitive science, studies have suggested that capabilities, such as the ability to make sound financial decisions, can be encouraged by forming behaviors early in life, so that habits might become “automatic” and continue into adulthood.

As recent research from neuroscientists has repeatedly shown, childhood experiences play an influential role in setting the foundation for adult capabilities. As the brain evolves from childhood into adolescence, neural circuits are “plastic” and malleable. The continual and changing organization of the brain's circuitry allows experiences to shape behavioral patterns and skills into adulthood.⁸ Especially relevant is the capacity for “executive function,” housed mostly in the brain's prefrontal cortex, which is responsible for reflective thought and active decision making.

During executive function development, young people progress in their capacity to plan, understand the difference between present and future, delay gratification, and inhibit impulses

During executive function development, young people progress in their capacity to plan, understand the difference between present and future, delay gratification, and inhibit impulses.⁹ Therefore, as many financial education proponents advocate, actively shaping the financial knowledge, skills, attitudes, and behaviors of individuals at an early age can influence and impact their financial capability as adults, as well as generally improve their likelihood of saving. In a similar vein, advocates of

experiential learning and self-efficacy theories use the same argument to contend that children and youth should actually engage early on with formal financial institutions. The basic idea here is that children learn from experiences or observing their environment. Professor Sik Hung Ng at City University of Hong Kong showed that “children in Hong Kong tend to have better understandings of the banking system earlier in life than American children because of their particular experiences with banking.”¹⁰ Additionally, if youth are exposed to others who save, that experience or observation can shape perceptions and attitudes toward saving. As older children mature into adulthood, experience (or inexperience) with the banking system and financial concepts may determine if and how they engage in the financial system.

Yet while intent, knowledge, and experience are all important components to the financial capability equation, they are not necessarily the best predictors of future behaviors. In fact, there is a dearth of research on whether those factors—even when combined with access to inclusive services—can lead to sound financial behaviors into adulthood. Theories of habit formation suggest that the strongest predictors of future behaviors can be, in many cases, past behaviors. For example, in one longitudinal study Dr. Vera Mikkila at the University of Helsinki, and her fellow researchers showed that “food behavior and concrete food choices are established already in childhood and adolescence and track into adulthood.”¹¹ Other studies have drawn similar conclusions in exercising patterns.

Lessons from neuroscience and cognitive science suggest therefore that the potential to form adult financial capabilities may be strengthened if the foundation for those capabilities is laid early in life, during the phase of executive function development. Still, psychological biases can stand in the way of establishing habits, such as saving, during this formative phase of brain development as well. Like adults, young people draw on experiences, observations and available mental cues to form decisions, which do not always lead to optimal choices.

Biases

The last mile problem to behavior change shows that human beings do not always make rational choices even when the corresponding intentions exist. As we have seen, a person may intend to save and understand the advantages of saving, but still fail to do so. This contradicts the neoclassical economic concept of people as “rational agents,” which asserts that people make rational choices in order to maximize their gains.¹² Clearly, the rational agent model overlooks psychological barriers or biases that prevent people from always making optimal decisions.

Guiding human thought processes and decisions are two systems: the automatic and the reflective. The automatic system is characterized by intuitive actions that are effortless, uncontrolled, and fast.¹³ The reflective system is associated with conscious thought, drawing on memory, rules, and representative examples to help form decisions.¹⁴ However, the mental shortcuts of the automatic system are flawed, resulting in psychological biases. Three psychological biases in particular stand in the way making rational savings choices: availability bias, status quo bias, and hyperbolic discounting.

Types of Biases

- **Availability Bias:** The tendency of human beings to make a decision based on the frequency of information or examples the mind imagines or retrieves.
- **Status Quo Bias:** The tendency for individuals to remain with their current situation because they are loss averse and the disadvantages of shifting their decision-making away from the “usual” appear to outweigh equivalent gains.
- **Hyperbolic Discounting:** The inclination of individuals toward “smaller-sooner” rewards over “larger-later” rewards.

Availability and status quo biases draw on current or past experiences and memories to help shape decisions. Psychologists have defined availability bias as the tendency, based on unrepresentative memories, to misidentify the likelihood or probability of an event occurring.¹⁵ Applied to the context of decision-making, availability bias is the tendency of people to make choices based on the frequency of information or examples the mind imagines or retrieves. As such, a person may choose to save under a mattress instead of a bank if, in their memory, examples of community members, friends, or family using their mattresses to save comes to mind more frequently than saving in a bank. Here the availability bias is the absence of memorable or retrievable information to cue a decision to deposit savings in a formal account.

Related, status quo bias, or the tendency for people to remain with their current situation,¹⁶ can arise because individuals are loss averse and the disadvantages of shifting their decision-making away from the “usual” appear to outweigh equivalent gains.¹⁷ Status quo bias can also persist due to lack of attention, inertia, and influences from social environments. (Richard Thaler and Cass Sunstein, authors of *Nudge*, term it “yeah, whatever” heuristic.¹⁸) In this instance, a person who saves their money under a mattress may see no reason to alter this status quo, especially if he or she is pre-disposed to distrusting a bank.

Furthermore, especially as the act of saving can require discipline in present consumption decisions, hyperbolic discounting is also a relevant bias. Psychologists have shown that individuals are biased toward “smaller-sooner” rewards over “larger-later” rewards.¹⁹ For low-income households in developing countries, hyperbolic discounting is complicated by uncertain future income flows and the unreliability of available savings mechanisms, thus making short-term consumption a more likely option to get immediate value from their money. The challenge, in part, is developing mechanisms to delay immediate gratification for future, larger-later rewards.

Overcoming these three biases may require significant incentives or triggers to cue different mental constructions, experiences, and/or self-control. However, as psychological biases, exogenous barriers, and temptations to consume take effect, we argue that many low-income youth will need a push to *choose* to save regularly in a bank as well as to develop a habit that will persist. Nudges can help overcome the last mile problem to behavior change in the context of savings, we suggest, by helping create automatic behaviors earlier on in life.

Nudges

According to the rational agent model, low-income youth will choose to go to school to increase earning potential as adults; will eat nutritious food to lead healthy lives if it is available; and will save today to improve chances for financial stability in the future. Behavioral economists are increasingly uncovering the flaws in that logic, showing that in addition to many external

factors, intrinsic psychological biases can create inertia to rational choices. Nudges are mechanisms that can prompt specific decision-making and are especially useful in overcoming psychological biases. Governments, NGOs, and the private sector are experimenting with nudges in the fields of public health, education, and financial services. Specific nudges that may *prompt* positive savings behavior among low-income youth include: reminders, peer pressure, automated and default controls, and incentives. (See Table 1 for examples of nudges highlighted in this section.)

Reminders

Reminders can serve two important functions. First, they are a reference point bringing issues, such as saving, to one's immediate attention to overcome the "availability bias." The continual flag to save creates a mental construct that saving is important and relevant in one's financial decision-making process. Second, when paired with a pre-stated future goal, reminders help address the hyperbolic discounting challenge by alerting people to why they decided to delay present consumption in the first place. Framing reminders to include a goal can also facilitate mental accounting, which assumes that individuals, contrary to economic theory, do not view money as "fungible."²⁰ Moreover, mental accounting can help individuals control and regulate their spending by assigning funds for different purposes (i.e. a child's education or household expenses).

In a recent study, economists Dean Karlan, Margaret McConnell, Sendhil Mullainathan, and Jonathan Zinman, conducting experiments in the Philippines, Bolivia, and Peru, determined that bank reminders (via text messaging or paper statements) "increased the likelihood of reaching a savings goal by 3 percent and the total amount saved in the reminding bank by 6 percent."²¹ When referencing a client's pre-stated goal for saving or a particular future expenditure opportunity, like school fees, reminders were even more effective in increasing savings.

Where the technology or institutional infrastructure does not exist to text or mail reminders, there are other forms of related savings nudges. For instance, deposit collectors can serve as a continual reminder and pressure to save. As Karlan and colleagues Nava Ashraf and Wesley Yin maintain, "there is almost a moral imperative to deposit with a deposit collector, since he or she is there to collect the money on the individual's behalf."²² To incite youth savings, school-based deposit collection can fulfill this function for youth. For example, Bangko Kabayan in the Philippines and Government Savings Bank of Thailand use school-based volunteers such as teachers, parents, or community members to collect students' deposits.²³ While deposit collection of this kind includes its own set of risks, such as theft, it can also serve as a commitment mechanism to urge youth to save.

Commitments and Peer Pressure

Creating commitments and peer pressure around a particular action is a more overt nudge toward overcoming the status quo and hyperbolic discounting challenge.

A growing number of studies indicate that individual behavior is strongly shaped by peer effects and the social pressure exerted by fellow community members.²⁴ For example, studies from Mexico and Colombia showed that a conditional cash transfer program increased school attendance among low-income youth, but also prompted higher attendance rates among unqualified, slightly better off students, as Rachel Glennerster of MIT and professor Michael Kremer of Harvard University point out, "presumably because it's not much fun being out of school if all your playmates are there."²⁵

Already, youth savings initiatives are nudging youth by marketing savings as something youth should do if they want to be part

of the “club.” In the Philippines, Paglaum Multi-Purpose Cooperative (PMPC) offers accounts both for children under 13 years old (Youth Savers Club) and youth aged 13-18 (Power Teens Club).²⁶ Creating a similar type of social norm or status quo out of saving are schools in New Orleans, where students participating in a financial literacy program sponsored by Capital One called KidzBank are given their own non-interest-bearing savings account, as well as the chance to line-up before lunch period (with their peers) to make weekly deposits.²⁷

Furthermore, in developing countries, rotating savings and credit associations (ROSCAs) are an informal mechanism to create social and individual commitments to saving. As professor Mary Kay Gugerty at the University of Washington showed, “saving requires self-discipline and ROSCAs provide a collective mechanism for individual self-control in the presence of time-inconsistent preferences [or when hyperbolic discounting occurs].”²⁸ An idea applicable to the youth context, in Uganda, DFID, Innovations for Poverty Action, and FINCA Uganda have funded a Project to provide a financial education curriculum and group savings accounts through youth clubs organized by Straight Talk Foundation.²⁹ Several NGOs are doing similar work, such as BRAC’s Employment and Livelihoods for Adolescents program, which reaches about 430 thousand low-income, adolescent girls through its savings services.³⁰

More formal commitment products are also worthy of note here. As Yale University’s Gharad Bryan, Dean Karlan, and Scott Nelson defined them in April of 2010, “a commitment device is any arrangement entered into by an individual with the aim of helping fulfill a plan for future behavior that would otherwise be difficult due to intra-personal conflict stemming, for example, from a lack of self control.” One particularly striking example of a savings commitment device are SEED accounts (Save, Earn, Enjoy Deposits) designed by Ashraf, Karlan, and Yin.³¹ Two commitment devices were offered to existing customers of a bank in the Philippines: customers could either set an amount below which they would not be able to access their funds; or customers could set a date before which they could not access their funds. The actual funds were kept in a lock box with the customer, with the bank holding the key, so the barrier was actually quite weak. Nevertheless, after one year, average savings balances had increased by 81 percent for clients who signed up for the accounts relative to those in the control group. In 2003, Nathalie Gons, Ashraf, Karlan, and Yin detailed various other commitment savings products in the developing world, many of which provide relevant clues to developing such products among youth populations.³²

Of course for youth in very low-income contexts, undue pressure to save can also create negative spillover effects; youth may feel badly if they are unable to save at the level of their peers or this might even lead them to more desperate actions to save. Therefore, program implementers should balance the use of individual or group commitment mechanisms with sensitivity to young peoples’ economic situations.

Automatic and Default Settings

Nudges that attempt to address individuals’ tendency to remain with the status quo employ automated and default options to make decisions easy and ‘sticky.’ One example of this technique includes changing the default option from opt-in to opt-out.

For instance, early HIV diagnosis, treatment, and care can improve mortality outcomes and reduce transmission rates.³³ In Botswana, due to the high prevalence of HIV among pregnant women, the government offers free services for the prevention of mother-to-child transmission. However, between 1999 and 2003, uptake of anti-retroviral treatment was low, prompting the President of Botswana to institute opt-out, provider-initiated routine testing in medical settings.³⁴ Soon after the opt-out testing began, Dr. Agnesa Moses of the University of North Carolina, and fellow researchers found that “the percentage of HIV-

infected women delivering in the regional hospital who knew their HIV status increased from 47 percent to 78 percent and the percentage receiving medical interventions increased from 29 percent to 56 percent.”³⁵

Similar opt-out, automated mechanisms are applied to account settings to increase savings outcomes and overcome hyperbolic discounting challenges. For example, automated deductions from paychecks into a 401K (retirement accounts) allow individuals to stop the transfer at any time, but the status quo bias often prevails and the recipients, like the women in Botswana, continue with the desired actions for long-term future gains.

In November 2010, the Bayelsa State Government in Nigeria launched its Child Development Account (Savings, Training and Rewarding Savers, or CDA STARS) as the first child savings policy pilot in a developing country. Designed by Columbia University and the Global Assets Project at the New America Foundation, with technical support from the World Bank, the policy design automatically opens a savings account (seeded with a lump sum of money) for 1 thousand junior secondary students from public schools throughout the state. Rather than selecting the students and allowing them to opt-in, the opt-out mechanism and automating account opening is meant to nudge youth to use or access the account, without overburdening them with the process of signing up. Once the account is opened and youth have access to it, their deposits will be matched 2:1 to incentivize continued use of the account.³⁶

Incentives

Traditionally incentives are considered part of the rational-agent model of decision-making. However, behavioral economists also consider incentives as nudges that can be used to overcome biases that lead to irrational thinking. After Thaler and Sunstein published *Nudge*, a companion blog (not affiliated with Sunstein) was created. One blog post edited by John Balz addresses the misconception economists might have on incentives, stating that “since people are not good at investing a little bit now to get a lot later, behavioral economics steps in to try and jump start these investments through small financial incentives.”³⁷

Even *in-kind* incentives or prizes can have a surprisingly large impact on behavior. An evaluation in Kenya found that providing a free school uniform could increase attendance of young children by 6.4 percentage points.³⁸ In the case of youth savings initiatives, there are several ways that banks can and are using in-kind incentives to nudge youth towards attaining their savings goal. For example, in the Philippines, Cantilan Bank gives the 4 thousand members of its Student Savers Clubs small prizes, such as pencils and crayons. When students reach a balance of \$11, the prizes become larger.³⁹ However, program, product, or policy implementers should keep in mind that awarding high savers can also lead to low-income youth engaging in undesirable activities to increase their deposits.

Financial incentives that can prompt youth savings include offering interest-bearing accounts, providing seeded accounts (with a lump sum), matching deposits, and providing cash transfers. Notably, conditional cash transfers (CCTs) have been used as an anti-poverty social policy tool to spur certain behavioral improvements in health, education, and job training through economic assistance. World Bank research in Malawi and Tanzania, for example, showed that cash transfers could prevent HIV and sexually transmitted diseases. In Malawi, 3,796 never-married girls and their parents were given \$15 each month if the girls attended school regularly. After 18 months from the program’s inception, data showed that HIV infection rates among girls who received the cash transfer were lowered by 60 percent (compared with the group that did not receive the transfer).⁴⁰

Recently, savings-linked conditional cash transfers (CCTs)⁴¹ have been proposed as a potential social policy tool to nudge a particular behavior, such as school attendance, while providing direct cash transfers into a savings account. Mexico’s savings-linked CCT, *Jovenes con Oportunidades* program consists of savings accounts for youth to incentivize continued education. An account is opened in a child’s last year of middle school, and “points” are deposited in the account for each year of high school that the student completes. As New America Foundation’s Jamie Zimmerman and Fundación Capital’s Yves Moury reported, “upon graduation, typically at age 18, the points are converted into approximately USD 336 cash, which the youth can then withdraw or leave in his/her savings account at Bansefi, the program’s affiliated financial institution.”⁴² The student can also use the Bansefi account for making and withdrawing deposits, with the cash payout associated with their “points” not available until the account holder graduates.

Table 1: Examples of Nudges⁴³

Nudge	Bias Addressed	Example
Reminder	Availability	Researchers conducting experiments in the Philippines, Bolivia, and Peru determined that bank reminders (via text messaging or paper statements) increased the likelihood of reaching a savings goal by 3 percent and the total amount saved in the reminding bank by 6 percent
Reminder/ Commitment and Peer Pressure	Availability/ Status Quo	Bangko Kabayan in the Philippines and GSB Thailand use school-based volunteers such as teachers, parents or community members to collect students’ deposits
Commitment and Peer Pressure	Status Quo	Students in the Capital One program called KidzBank are given their own non-interest-bearing savings account, as well as the opportunity to line-up before lunch period [with their peers] to make weekly deposits
Commitment and Peer Pressure	Status Quo	In the Philippines, Paglaum Multi-Purpose Cooperative (PMPC) offers accounts both for children under 13 years old (Youth Savers Club) and youth aged 13-18 (Power Teens Club)
Commitment and Peer Pressure	Status Quo	In Uganda, DFID, Innovations for Poverty Action, and FINCA Uganda have funded a project to provide a financial education curriculum ¹ and group savings accounts through youth clubs organized by Straight Talk Foundation
Automation and/or Default Settings	Status Quo	Automated deductions from paychecks into a 401K (retirement account)
Automation and/or Default Settings	Status Quo/ Hyperbolic Discounting	Bayelsa State Government in Nigeria launched its Child Development Account, Savings, Training and Rewarding Savers (CDA STARS), as the first child savings policy pilot in a developing country. 1 thousand junior students are provided with automatically opened and seeded savings accounts, with deposits matched 2:1 to encourage use of the account
Incentives	Hyperbolic Discounting	Cantilan Bank in the Philippines gives the 4 thousand members of its Student Savers Clubs small prizes, such as pencils and crayons. When students reach a balance of USD 11, the prizes become larger
Incentives	Hyperbolic Discounting	In Mexico’s savings-linked CCT, <i>Jovenes con Oportunidades</i> program, an account is opened in a child’s last year of middle school, and “points” are deposited in the account for each year of high school that the student completes. Upon graduation, typically at age 18, the points are converted into approximately USD 336 cash, which the youth can then withdraw or leave in a BANSEFI savings account, the affiliated financial institution

The range of nudges presented in this section are a few examples of how those involved in the inclusive financial services field can begin addressing the intrinsic barriers to save, particularly for youth. Still, the significant external challenges inhibit the potential use of nudges to accelerate the pace of financial capability among low-income youth.

External Challenges to Nudging Youth Financial Capability

By helping to overcome the psychological biases embedded in the last mile problem, we argue that nudges can serve as a powerful multiplier in the traditional “access plus education” financial capability equation. Still, without access to savings products, the nudge to save in a bank is ineffectual. This section acknowledges the regulatory, institutional, and product design challenges that can prevent youth from access to and effective use of financial products. It also highlights efforts that policy makers and stakeholders involved in the youth-inclusive financial services field are making to overcome some of those barriers.

Regulatory Challenges

At a regulatory level, there are two primary barriers that inhibit youth from owning and operating savings accounts. First, most countries restrict account openings and account control to youth until they are legal adults. Age restrictions prevent youth from engaging in the act of formal saving. Second, *Know Your Customer (KYC)* provisions are identity requirements that, at minimum, governments require banks to adhere to as part of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) policies. Although intended as a protective mechanism, KYC provisions can also serve as a significant barrier for low-income households, including youth, to open bank accounts. In the United Nations Development Programme’s 2008 report, “Making the Law Work for Everyone,” it is estimated that roughly 70 percent of children in the world’s least developed countries do not have birth certificates or registration documents.⁴⁴

However, governments are taking steps to overcome the identity challenge, in a few cases using biometric technology to uniquely identify a person (i.e. via iris scans, fingerprinting, or DNA recognition) to facilitate financial inclusion, especially among low-income populations. In India a national biometric identification program called Aadhaar (meaning support or foundation) has been initiated to provide its 500 million unregistered peoples with a unique ID, which would be sufficient to open an account and meet KYC provisions.⁴⁵ Already, the government is considering Aadhaar to support welfare schemes as well, such as cash transfers. For example, Santosh Mehrotra, head of the Development Policy Division for the Government of India’s Planning Commission, recently put forth a proposal to create a savings-linked conditional cash transfer program for low-income youth. Central to this proposal is the biometric program, which would facilitate automatic account openings.⁴⁶

Physical Access Challenges

Physical access remains a significant barrier to financial inclusion. Since the delivery of financial services is still dependent, in large part, on the traditional “bricks and mortar” establishment of bank branches, infrastructure limitations contribute to the overwhelming majority of unbanked, low-income populations in developing countries. Access is an even greater challenge for low-income youth who cannot easily mobilize and travel long distances to a financial institution.

Mobile phone technology and agent banking models show potential in overcoming these access challenges. While there is limited data on mobile phone penetration in low-income youth markets, a recent CGAP Focus Note, “Scenarios for Branchless Banking,” cited that there are “more than 4 billion mobile subscriptions globally, with 80 percent of new connections in emerging markets and mostly by lower income consumers.”⁴⁷ The previously mentioned M-KESHO accounts are but one of many promising examples in the potential scope of mobile-banking. Furthermore, banking correspondents and retail banking models can reach remote populations. Agents can range from grocery stores, pharmacies, mobile operating stores, post offices, and even schools. In Sri Lanka, Hatton National Bank trains students to manage Student Banking Units, or school-based branches, in over 200 banking centers throughout the country.⁴⁸

Yet, mobile and branchless banking are not panaceas for access, especially since considerable infrastructure and regulatory hurdles exist to advancing both channels. Critics also express concern with non-banking agents managing cash flows and the possibility of identity and/or credit theft that may arise from mobile phone transactions.

Product Design Challenges

Lastly, beyond legal and physical access to an account, the savings product itself must be designed to meet the demands and needs of low-income youth. Professor Margaret Sherraden at the University of Missouri in St. Louis indicated that financial inclusion entails “affordable, financially attractive, easy to use, secure and reliable”⁴⁹ savings products. These concepts apply to youth in several ways. For example, required fees for opening an account may make the product financially unattractive. Additionally, complex account features with several rules, restrictions, or fine print may overburden or turn a young person away from the product.

Professor Margaret Sherraden at the University of Missouri in St. Louis indicated that financial inclusion entails “affordable, financially attractive, easy to use, secure and reliable” savings products.

In order to develop and deliver youth savings products that are accessible and effective, rigorous market research is needed to understand the needs and wants of target demographics. Research can help inform effective delivery channels (i.e. school-based, agent banking, or mobile-banking provisions), appropriate product design (i.e. whether to include withdrawal restrictions, incentives, or conditions), and effective marketing strategies. Of course, from the financial institution’s perspective, this process must also be undertaken keeping in mind the commercial constraints and financial viability of products created, delivered and marketed.

Further Research

Further research and experimentation on nudges aimed at increasing savings behaviors among low-income youth is a necessary step to employing them effectively. As such, research should focus on understanding: 1) in greater detail, the psychological barriers and behaviors related to saving among low-income youth; 2) factors that make nudges most impactful in changing or creating behaviors; and 3) the impacts of nudges in increasing youth savings behaviors and long-term social and economic outcomes.

First, although this paper described a set of intrinsic biases to making optimal savings decisions, it is by no means comprehensive or exhaustive in explaining youth behaviors. Questions related to the behavioral context in which nudges are applied include:

- When (or around what age) are habitual behaviors, such as saving, most malleable?
- Are psychological biases related to savings behaviors more pronounced among low-income populations, specifically youth, as some recent research by neuroscientists might suggest?
- How might behaviors and biases vary by youth demographics (i.e. age group, gender, geographic location, and in vs. out of school youth)?

Second, drawing on experiments in various fields, we hypothesize that the nudges presented in this paper will impact savings behaviors among low-income youth. However, further research and experimentation is needed to determine which nudges could be most appropriate and most impactful for youth of various demographics, cultural contexts, and family backgrounds. Experiments should therefore consider the following questions:

- What type(s) of nudges should be delivered?
- When, and with what timing and frequency, should nudges be delivered?
- Through what channels or delivery mechanisms should nudges be offered?
- How will the design of nudges vary by youth demographic?

Third, understanding the impact nudges can have in increasing savings behaviors among youth and their potential to achieve long-term, socio-economic impacts will require:

- Significant baseline research into the current savings habits among youth tracked into adulthood; and
- Longitudinal studies considering relevant socio-economic variables that may be correlated with savings behaviors.

Conclusion

If human capabilities are formed early in life, during a time when behaviors are malleable, then prompting savings behavior—*particularly earlier in life*—could be critically important in counteracting the psychological biases that notoriously inhibit positive financial behaviors. Already, a growing body of evidence from public health, education, and financial services shows that nudges can transform intent into action, overcoming the last mile problem. We posit that nudges, such as reminders, commitments and peer pressure, automated and default controls, and incentives could be used to accelerate the pace of financial capability among low-income youth. By prompting the habit early in life, nudges can help make saving a automatic-system process rather than an effortful, reflective process, further helping individuals resist the temptation to spend and making them good money managers as adults. Such financial capability could presumably lead to greater financial stability and opportunity into adulthood.

Of course, barriers to financial inclusion can prevent the impact of nudges from reaching fruition, indicating a need for policy makers and practitioners in the youth-inclusive financial services space to continue addressing those key challenges. At the same time, researchers should begin rigorously experimenting with nudges in youth savings, tailoring them to local contexts, and testing their impacts on savings habit formation in low-income youth.

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