FINANCIAL LITERACY AND BEHAVIORAL BIASES AMONG TRADITIONAL AGE COLLEGE STUDENTS

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ABSTRACT

Research and policy interest is increasingly focused on the links between financial literacy and household saving as a means of explaining why citizens under-save for retirement, make poor credit decisions, and experience other problems in the modern financial environment.

There are several reasons why studies may not have found strong links between financial education and financial behavior. Financial behavior may be difficult to change. In addition, financial education programs, which typically involve a “generic” short course adapted to the local environment, may not be relevant, informative, or interesting for the target population. Moreover, finding skilled and engaging educators may be difficult.

Due to the wide range and complexity of investment opportunities, several academics, politicians, and other advocates have expressed concern that low levels of financial literacy will harm individual retirement savings plans (Lusardi and Mitchell, 2007).

In this paper, we explore an alternative explanation for why people fail to make sound financial decisions. Using a comprehensive survey of college students, we find that behavioral biases and not financial literacy are the primary reason why savings and retirement planning processes are sub-optimal. We also find that young individuals appear to exhibit risk aversion levels that are inconsistent with their age and future earnings potential.

Our results shed new light on the practicality of financial literacy and educational program content. We believe that financial literacy programs will remain ineffective as long as they do not incorporate the necessary behavioral components as a means of trying to mitigate critical behavioral biases.