Financial Literacy: Where Does Texas Rank?

by Camden Cornwell and Anthony Murphy

How well are Americans applying financial decision-making skills to their lives? Are Texans more or less financially literate compared with consumers from other states? Do educational mandates designed to improve financial understanding and capabilities result in better financial outcomes?

Financial literacy matters because households face increasingly complex economic decisions. Responsibility for retirement planning is falling more on individuals, financial instruments are more complex, student debt is rising and financial scams abound. While the level of financial literacy in Texas is relatively low, the Lone Star State has introduced a fairly rigorous mandate over the past decade to improve financial competence. Research suggests that this mandate is showing success, although there is still plenty of room for improvement.

Measuring Financial Literacy

Data from the 2012 Financial Regulatory Authority (FINRA) National Financial Capability Survey—the most recent available—reflect a relatively poor understanding of basic financial concepts in Texas and the nation. Financial literacy may be measured by the number of correct answers to five questions. Scores are computed as the total number of correctly answered questions on basic financial literacy concepts. The national average is 2.88, showing that most respondents comprehend concepts such as compound interest, inflation and mortgages, but many do not understand the importance of financial diversification and how bond prices respond to changes in interest rates (Table 1).

<table>
<thead>
<tr>
<th>Question/concept</th>
<th>Correct (%)</th>
<th>Incorrect (%)</th>
<th>Don’t know (%)</th>
<th>Refused (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compound interest</td>
<td>74.9</td>
<td>13.0</td>
<td>11.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Inflation</td>
<td>61.3</td>
<td>17.2</td>
<td>20.2</td>
<td>1.3</td>
</tr>
<tr>
<td>Bond prices</td>
<td>28.1</td>
<td>33.3</td>
<td>37.4</td>
<td>1.2</td>
</tr>
<tr>
<td>Mortgages</td>
<td>75.0</td>
<td>9.0</td>
<td>15.2</td>
<td>0.7</td>
</tr>
<tr>
<td>Diversification</td>
<td>48.5</td>
<td>8.7</td>
<td>42.0</td>
<td>0.9</td>
</tr>
</tbody>
</table>

NOTE: All figures expressed as percentage of total respondents using national weights.

Financial Literacy in Texas

Financial literacy in Texas appears to be relatively low. Texas ranks No. 44 out of 50 in the average number of correct answers to the five questions (Chart 1), with a score of 2.73 out of 5. State population differences—age, sex, race and education—account for most of the disparities in average scores. For example, Texas is one of the youngest states by median age. Younger households have less wealth and less experience dealing with finances and are less likely to plan for the future. Consequently, their financial literacy scores tend to be lower.
Education is also an important factor that influences financial literacy. Higher levels of education have positive effects on average financial literacy scores and many forms of financial behavior. Texas again ranks poorly compared with other states in the relative share of the population over age 25 with a high school education or higher.

**Financial Behavior and Outcomes**

Consistent with this result, the survey results show that financial behavior and outcomes in Texas often rank toward the bottom when compared with other states (Chart 2). More than 30 percent of Texas respondents had overdue medical bills, a rate 4 percentage points higher than the national average.
average, ranking the state 40th. The use of nonbank borrowing and financial services—which includes payday loans, auto title loans, pawnshops, check cashing and other forms of expensive financing—is 9 percentage points higher in Texas than the nation on average. More than 61 percent of Texans said they had not yet planned for retirement, a rate exceeded by only six other states.

The FINRA results show that other household financial conditions in Texas (cannot find $2,000 in case of emergency, no emergency or rainy-day fund and no bank account) are closer to, yet still higher than, the national average. One exception is household spending. About 56 percent of Texas respondents reported that they spend all or more than their income; still, Texas fared better in this category than all but 12 other states. It is uncertain, however, by how much spending exceeded income.

**Texas Financial Literacy Mandate**

“Good” financial outcomes are highly correlated with higher average levels of financial literacy, so it’s logical that improving financial literacy should result in better financial behaviors. Generally, the research literature does not find strong causal links between interventions aimed at improving financial literacy and better financial outcomes. However, recent results evaluating the effect of high school financial literacy mandates in a handful of states, including Texas, find notable improvements in credit outcomes for young adults exposed to carefully implemented, rigorous programs.

In 2004, Texas enacted an education mandate that required personal financial literacy courses for high school graduation. The courses were based on a standard curriculum embedded within the economics curriculum already required by Texas high schools.

The study tracked the credit behavior of young adults for four years after they graduated from high school between 2000 and 2009. The three cohorts affected by the mandate graduated in 2007, 2008 and 2009. Changes in the credit scores and delinquency rates of young Texas adults before and after the mandate were compared with the differences among young adults in New Mexico and similar states where no mandate was introduced. This approach was used to determine the “true” effect of the state financial literacy mandate, excluding, for example, the effects of changes in unemployment rates and other relevant factors.

Following implementation of the mandate, the credit scores of young Texans rose significantly and delinquency rates on credit rates fell significantly. Interestingly, the effects were much stronger and more significant with each subsequent cohort, evidence that teachers honed the efficacy of their financial literacy courses. Compared with New Mexico, young Texans who graduated from high school in 2009 averaged 32 points higher on their credit scores (an increase of 5 percentage points). Their 90-day delinquency rates on credit accounts—auto loans, credit cards, etc.—decreased by 6 percentage points, or one-third.

**Conclusions**

Financial literacy is relatively low in Texas, which is reflected in the financial behaviors and outcomes of Texans. However, evidence suggests that carefully implemented, rigorous financial literacy programs, as well as higher educational attainment, will help Texans improve their financial behaviors and their financial well-being.

*Cornwell is a research analyst and Murphy is a policy advisor and senior economist in the Research Department at the Federal Reserve Bank of Dallas.*

**NOTES**

5. In 2007, the Federal Reserve Bank of Dallas first published Building Wealth—a personal finance education resource that presents an overview of wealth-building strategies for consumers, community leaders, teachers and students. It is on the Texas State Board of Education’s list of approved materials for instruction on personal financial literacy.
Noteworthy Items

Federal Reserve Chair Janet L. Yellen gives a speech at the City Club of Cleveland entitled “Recent Developments and the Outlook for the Economy” (July 10, 2015)
Yellen presents on the conditions of the U.S. economy since the 2007–09 recession—particularly noting the Fed’s role in the process of achieving its dual mandate from Congress of achieving maximum employment and price stability.

Federal Reserve Chair Janet L. Yellen gives the semiannual monetary policy report to the U.S. Congress (July 15, 2015)
Yellen presents to Congress about the progress the Federal Reserve is making in the economy. Her report indicates further improvement toward the Federal Reserve’s objective of maximum employment and indicates that inflation is lower than the level the Federal Open Market Committee deems as aligned with the Congressional mandate of price stability.

The Federal Reserve Bank of Dallas announces the appointment of Robert Steven Kaplan as president and CEO of the Eleventh District. Kaplan was a professor at Harvard Business School and a previous vice chairman of Goldman Sachs Group Inc. He succeeds Richard W. Fisher, who retired from the Dallas Fed in March 2015.

Fischer indicates that even though the Federal Reserve is achieving its goals in terms of maximum employment, inflation is below where the Federal Open Market Committee wants it to be in order to sustain stable growth in the economy. He attributes this lower-than-targeted inflation to the recent drop in oil prices and other energy-related items.

Federal Reserve releases FOMC statement (Sept. 17, 2015)