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"Public vs. Private Commitments: The effect of labels and classification of mental accounts on the behavior of low-income savers in Colombia"*

Luz Magdalena Salas

As part of the Todas Cuentan initiative, a project financed by the International Development Research Centre (IDRC) of Canada and implemented by the University of Chile's Economics Department, along with the Instituto de Estudios Peruanos and the Fundación Capital, and supported by the Ford Foundation and IDRC of Canada, an evaluation of Local Savings and Loan Groups in Colombia was proposed. The purpose of the evaluation, carried out by Luz Magdalena Salas with support from IED Iniciativas Empresariales de Desarrollo Microfinanzas and Corporación Vital, is to determine the effect of various innovative savings incentive strategies on participants' savings and investment decisions, to provide input for policies to promote saving.

* The complete document is available at the Capital Project: <www.proyectocapital.org>.

Summary

This project involves the design and implementation of a randomized controlled trial (RCT) to study whether innovative savings incentive strategies applied to the Local Savings and Loan Groups (*Grupos de Ahorro y Crédito Local,* GACL) result in changes in savings and investment decisions and other behaviors of poor people who participate in UNIDOS, Colombia's largest anti-poverty initiative.

Participants create a fund, periodically contributing their savings to it and using it to request loans. This methodology encourages saving and lending, but does not set a specific savings goal. Based on behavioral economics hypotheses, the RCT explores how, by explicitly (publicly) or implicitly (privately) setting specific savings goals,

people can meet pre-set commitments, increase savings and use financial services more effectively, this increasing their income and improving their standard of living. Each savings goal defines a mental account for each person. This goal serves as a commitment for addressing problems of self-control associated with intertemporal decision-making.

The RCT randomly assigned 136 new GACLs to two treatment groups and one control group. From July to November 2011, base line information was gathered from 664 GACL members and 142 non-savers. An intervention was carried out to remind participants of their savings commitments. After liquidating the fund, a follow-up survey was carried out to measure possible changes in the behavior of the people who participated in the interventions. The project uses recent theoretical lessons and applies rigorous experimental strategies in the field to test the theory and improve the impact of large-scale social programs in poor countries. The RCT contributes to the study of how different *mental accounting* strategies affect people's decisions and expands knowledge in the area of behavioral economics and microfinance.

Motivation and rationale

Recent studies show that poor households use informal financial services to level out consumption, start up businesses or productive activities, acquire durable goods, and finance events and celebrations. Collins and other authors (2009) found that a relatively large proportion of the income of poor households in Bangladesh, India and South Africa flowed through financial products. Poor households use various informal savings products (deposit collectors, physical assets), but they are inadequate. Saving through the purchase of animals or durable goods can be very risky, because they could die or deteriorate, resulting in the loss of the savings. The real return is also frequently negative. In the case of deposits, the interest is usually zero, and in some cases, the beneficiaries pay fees or premiums to safeguard their deposits (Ashraf et al, 2006). In other cases, people seek loans so they can make their deposits in savings accounts or savings groups with set payment amounts.[1]

Informal financial contracting is common in developing countries, where the supply of financial products is limited. Poor households save small amounts of money in cash, which are costly for formal providers to collect; this makes the use of financial products inefficient in this sector and limits people's ability to manage and accumulate assets. Even if they were offered bank accounts or other formal financial products, it would be very expensive for them to deposit their savings. Bank branches are usually located far from their homes or workplaces, particularly in rural areas, where transportation costs are often greater than the amount to be deposited. High transaction and follow-up costs, compared to transaction size, have led to a reduction of both supply of and demand for formal financial services and have made access to them very expensive (Karlan and Morduch, 2009; Dupas and Robinson, 2010).

Management of financial products is also difficult for these people, because they generally lack the will to reconcile decisions about the present and the future. Time-bound decisions require

1. A common practice in Spandana IMF, which provides financial services to women in poor neighborhoods in India. Banerjee and Duflo (2011), pp. 196-197.

costly immediate actions that people postpone, with sub-optimal results.[2] This is the case with saving. People know that the cost of reducing the consumption of unnecessary goods now leads to future benefits. The cost associated with decreased immediate consumption, however, is often higher than the value placed on the future savings benefit. This is particularly true for people with limited or unstable incomes, who disproportionately spend a larger share of their income on the consumption of unnecessary goods and for whom saving is more difficult.[3]

This reveals a potential demand for products that promote saving (commitment products) for clients with inconsistent preferences over time,[4] which are especially designed to increase poor people's access to the financial market. Financial expansion will help these people increase saving and investment in productive activities, gain access to new income-producing opportunities and generally improve their quality of life.[5]

Some field experiences suggest that including simple, low-cost products to promote saving as part of existing financial services can have significant impacts. Some indicate that people find the creation of mental accounts a valuable and practical way of constraining their own behavior (Thaler, 1980; Mullainathan, 2006; Thaler and Sunstein, 2009). Relative changes in the way people frame their savings decisions can also have a significant impact on the rate of saving (Bertrand et al, 2005, 2006; Karlan et al, 2009, 2011; Dupas and Robinson, 2010). People save more when they save for a stated purpose (Thaler and Benartzi, 2004; Kast and Pomeranz, 2009; Bryan and Karlan, 2010).

The proposed experimental design studies whether classifying or labeling mental accounts by defining the purpose of saving in a social context results in higher savings rates and greater compliance with those goals, compared to doing so individually (or privately). The public commitment creates implicit agreements that can affect and even change the behavior of some members of the group (Fehr and Gächter, 1999, 2000; Fehr and Fischbacher, 2002; Carpenter et al, 2010).

In Colombia, it was recently found that less than 4 percent of poor women save through financial entities. They do save, however: 72 percent save temporarily, as they use those funds to "cover everyday expenses." Only 39 percent of the women save for the medium and long term.[6] Programs such as GACL are part of a strategy for including people in the financial system and promoting saving in the country. In 2010, the government carried out a pilot with 6,873 participants. The total amount of money accumulated was about US$440,000, or an average of US$64 per person.

This underscores the importance of thinking about and designing new alternatives for promoting saving that lower implementation costs

2. Basu (2009) explains how different types of people with inconsistent intertemporal preferences can "renegotiate" with themselves to reach a different equilibrium.

3. Banerjee and Mullainathan (2010), and Karlan (2010) discuss this and its implications for accessing products that promote savings. Likewise, Banerjee and Duflo (2011) show that people claim to expend a big portion of their savings in these type of assets.

4. Bryan and others (2010).

5. Dupas and Robinson (2010) found that access to savings accounts led to greater productive investment and higher incomes among women with microenterprises in Kenya.

6. Preliminary impact report. *Mujeres Ahorradoras, Familias en Acción.*

and improve the terms and use of services that are currently offered. Innovation in these products makes it possible to increase the vulnerable population's inclusion in the financial system, thus providing more effective, lower-cost income-generation and asset-accumulation strategies for combating poverty.

Overall objective

Evaluate the impact of innovative commitment-savings products on the ability to manage and accumulate assets among poor people participating in Local Savings and Loan Groups (*Grupos de Ahorro y Crédito Local,* GACL) in Colombia, using Randomized Controlled Trial (RCT) methodology.

Specific objectives

1. Evaluate the role played by *mental accounting* in people's decisions about consumption, saving and productive investment, to determine whether motivating GACL participants to set goals and plan savings affects their ability to manage and accumulate saved funds.
2. Evaluate how implementation of different *mental accounting* strategies has heterogeneous effects on people's behavior, particularly whether implicit (private) vs. explicit (public) classification of savings commitments affects compliance with goals set at the beginning of the saving cycle and whether this indicates the most efficient use of financial instruments among the poor and extremely poor population.
3. Determine the impact of low-cost products for motivating and promoting saving on the economic security and welfare of people who are poor and vulnerable by improving their ability to handle unexpected shocks in income, consumption, etc.
4. Analyze strategies for linking GACL participants with the formal financial system, such as opening bank accounts or other forms of inclusion in the formal financial system, to help improve their situation and enable them to overcome poverty in the future.

Hypothesis

1. The average savings rate in the public and private treatment groups is greater than in the control group.
2. People in the private treatment group will show greater compliance with their savings goals than those in the control group.
3. In a context of cooperation, savers in the public treatment group are more likely to meet their savings goal and stick to their plan than those in the control or private treatment groups.
4. Conditioned to savings and investment goals, people in the public treatment group will more often comply with the initially established commitments than those in the other experimental groups and will save more.

Study design and implementation

A random experiment has been designed to test a simple theoretical prediction about the behavior of people who participate in savings groups in Colombia. Specifically, it compares changes in people's behavior as a result of creating a mental account to define a specific purpose for savings, and determines whether this intensifies when the situation has a social component.

The expansion of the GACL program in Colombia is used to test this hypothesis. In this program, poor families form savings funds in which their members meet frequently to deposit their savings in a safety deposit box that they safeguard themselves. The fund, called the "bank," grows with the purchase of shares by its members, who also request small, short-term loans at much lower costs than those they generally acquire in the informal sector.

New GACLs were randomly assigned to two treatment groups and one control group in three regions of the country: North (Bolívar), Pacific (Chocó) and Central (Cundi-Boyacá). The control group received only the standard GACL methodology. The random assignment followed basic lottery parameters and spot randomizing was used to assign GACL groups a treatment when they were formed in each of the three regions. For example, if five new GACLs formed in Bolívar in a week, the treatment to be received by each group (public, private or control) was determined by lottery. The treatment was maintained throughout the experiment, per agreement with the organizations implementing the program.

The unit of randomization is the savings group (GACL) and the unit of analysis is the individual, so although the intervention takes place at the group level, effects are measured at the individual level.

The fieldwork consists of three phases. The first phase consisted of the base line and interventions in the treatments and took place during the second half of 2012. Once the new GACLs were formed, five members of each were selected for the base line, to compare the savers' initial situation with the impact of the intervention. The new GACLs were then assigned to each experimental group, and the *public* treatment and *private* treatment interventions were implemented, with the individuals explicitly or implicitly defining their mental accounts and making a public (group) or private (individual) commitment to meet that goal.

In the *private treatment*, the participants received an additional module, besides the GACL methodology, in which the importance of saving and the difficulty of committing to a savings plan were discussed and emphasized. The role of *mental accounts* and their importance in meeting pre-defined commitments was also discussed. Finally, each member defined a purpose and established a personal biweekly savings plan.

The *public treatment* included a module that was similar, but motivated savers to define a commitment not only for themselves, but with the other members of the group, to explore whether group or public commitments have a different impact on people's behavior.

The second phase of the project consisted of follow-up. The treatment groups were visited to remind the participants of the commitments or goals established in the initial intervention. That phase was carried out before the liquidation of each GACL's first savings cycle. Once a GACL was liquidated and the saved funds were distributed, a follow-up survey was done to verify the use of the savings, access to loans, changes in consumption trends in households, and other variables to measure impacts after the intervention.

The third phase will be analysis. Impacts will be estimated and the proposed hypothesis evaluated using the base-line and follow-up information. Administrative data from the entity operating the program will also be used to gather information about savings, loans and sanctions for each person at each GACL meeting. That data will be used to corroborate and complement information in the household surveys.

The quantitative analysis will be supplemented with qualitative information through focus groups for more in-depth analysis of some of the results of the quantitative analysis. The goal is to understand the GACL participants' perception of the role played by the definition of savings goals and their impact on individuals' behavior; their participation in community activities; and the role of defining individual versus group goals. In other words, it will investigate their perception of possible changes in their behavior as a result of announcing their savings goals and plans publicly (to other members of the group, most of whom are relatives or neighbors).

Their opinions of the use of other financial instruments available to them will also be examined, along with the importance of their involvement in the formal financial system through the opening of bank accounts that stimulate saving, but which also promote the use of other financial services in the future. The study will assess how they believe saving will contribute to their households' economic security and how access to savings and other financial instruments will enable them to make productive investments and give them greater access to education, better job opportunities, better housing, etc., to improve their quality of life and combat poverty.

Contribution to policy implementation

The RCT results will provide valuable information for managers of the "Local Savings and Loan Groups," the UNIDOS Network and policy makers involved in the design and implementation of commitment-savings products. Greater availability of and access to these and other financial products contribute to increased saving, access to credit and better financial education among poor households. Without access to financial services, poor households cannot accumulate assets or handle unexpected shocks and will be unable to generate income to overcome poverty in the future.

Luz Magdalena Salas,
City University of New York, Fedesarrollo

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