ST.GALLEN SYMPOSIUM

Global Essay Competition 2024

Title: The silent crisis of financial literacy: empowering though education

Essay:

Introduction

While the allure of wealth often sparks vivid fantasies, the practicalities of effectively managing and preserving wealth require a nuanced understanding of financial principles and strategies. In a world where the pursuit of affluence is often romanticized, the intricacies of prudent wealth management remain elusive to many. Newer financial instruments become more sophisticated albeit easier to access. Despite their complexity consumers are easily swooped without realizing the long-lasting consequences of their choices.

Can a society make collectively well-informed choices without empowering everyone with sufficient financial education? Of course, money is not the sole factor in the decision-making process for many situations, yet it frequently plays a crucial role. Financial education scarcity is a pressing issue that affects people across various socio-economic backgrounds in emerging markets and developed countries. Therefore, the following essay will elaborate on the significance of financial education and gather ideas on how to improve it at various levels of society.

The current state of financial literacy

The first problem with financial literacy begins with its definition and scope. Most simply, we would depict how competent a person is with personal money management. However, the financial landscape is a complex one. Financial proficiency encompasses more than just competence in money management and requires knowledge of financial instruments, regulations, taxation, economic principles, and market dynamics. The Organization for Economic Co-operation and Development (OECD) defines it as “a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.” (OECD, 2011, p. 3). Remund (2010) additionally distinguishes the ability to discuss financial principles, the capacity to make sound financial decisions, and confidence in effectively planning for future financial exigencies. The lack of consensus on the definition makes it harder to agree on a unified scale and developments in that nature are rather recent. The European Commission and the OECD's International Network on Financial Education only published the joint financial competence framework for adults in 2022, and for children and youth in 2023, despite starting the drafting in 2010 (European Commission, n.d.; OECD, 2012). In the United States, various independent bodies collect data on the topic, e.g. The Global Financial Literacy Excellence Center, and the Financial Industry Regulatory Authority (FINRA).

According to the European Commission statistics (2023), financial literacy follows natural distribution. 18% of EU citizens have a high level of financial literacy, 18% have a low level, and the remaining 64% is classified as a medium level.[1] The Netherlands, Sweden, Denmark, and Slovenia are the only Member States where more than 25% of people obtained a high score (European Commission, n.d.). Thus, the lack of knowledge leads to an imbalance among market participants and causes the market to be in disequilibrium. People are more vulnerable to being exposed to higher risks since they do not have the tools to mitigate them. As a consequence, the societal burden increases for everyone.

Beliefs collectively imposed on one another, especially about wealth, hold significant influence. Once enforced collectively, they wield the power to mold social structures, economic systems, and individual behaviors, thus contributing to the shaping of disparities and inequalities within a society. These beliefs can impact access to resources, opportunities, and social status, while also shaping attitudes towards success, work ethic, and the distribution of wealth. Since money is considered a personal matter, people do not openly discuss it.

56% of Americans admit feeling anxious about their finances (Lin et al., 2022). Stress related to money is mainly caused by a lack of savings to protect oneself from unexpected situations. Often, one salary is what separates someone from falling into financial trouble (OECD, 2020). Despite the discomfort, these individuals might have issues to improve their circumstances which can exacerbate wealth inequality. According to the OECD (2020), education can increase resilience and empower individuals. By resilience, they mean keeping control over money, long-term planning for financial goals, availability of savings for unexpected situations, and fraud awareness. A lack of financial education can leave individuals vulnerable to predatory financial practices and scams, further exacerbating their sense of scarcity.

[1] Measured by a survey of five questions. Scale: high score (4 or 5 correct answers), medium score (2 or 3 correct answers), low score (0 or 1 correct answer).

Inadequate education significantly heightens the risk of accumulating excessive debt. When consumer debt is spent on consumption rather than wealth-building, it has the potential to trigger a debt spiral, wherein individuals struggle to repay the principal amount. Human nature inclines individuals to avoid discomfort, leading many to initially overlook financial challenges. Delayed payments or skipping a single installment may not immediately yield tangible consequences. Only when these instances accumulate, does the impact become palpable, causing individuals to experience the repercussions of their financial choices.

Financial illiterates are not well prepared to plan for a long-term horizon, that is, their pension (Lusardi, 2019). It is worrisome, given that we are moving towards aging populations and governmental retirement alone might not be enough to retain the same standard of living. FINRA distinguished that 83% of high incomers have some kind of retirement account (401(k)/pension/IRA) versus 18% in the lowest income group. Statistics are also higher for respondents with a college degree. There are disparities in retirement account ownership among racial and ethnic groups, with Black/African American and Hispanic/Latino respondents being less likely to have one, while Asian/Pacific Islander respondents are more likely to possess one (Lin et al., 2022). Thus, targeted policies should be tailor-made for vulnerable groups to address their specific needs.

According to a WallStreetZen (2023) survey, 76% of Gen Z learns about personal finance from social media platforms like TikTok and YouTube.[2] On one hand, it is a good sign that younger generations seek financial information themselves. But on the other, we should consider that maybe we failed to equip them with appropriate resources in the first place. Since anybody can post financial content (as long as it is not financial advice that is reserved for certified financial advisors), it cannot be ruled out that it contains misinformation to some degree.

Investing used to be perceived as something reserved only for the rich and elite. However, internet access and the smartphone boom made it more accessible to the masses. Yet, 56% of Gen Z did not start to invest because they did not know where to start (WallStreetZen, 2023). It should be considered worrisome since it limits their potential in wealth building. The issue with seeking help from financial advisors is that many individuals may be unsure whom to turn to, which would intensify their feeling of being lost.

[2] People born between 1997 and 2012 are considered Gen Z.

Call for action

In the pursuit of advancing financial literacy, we find ourselves confronted with a pervasive conundrum. It is incumbent upon policymakers, educators, and stakeholders alike to unravel this challenge. Initially, we should acknowledge the problem, raise awareness, and pledge it to society since navigating the financial landscape has become a key life skill. Therefore, we need to redesign our policies to simplify language in policy documents, utilizing plain and understandable terms to enhance comprehension for individuals with varying levels of financial literacy. Legislators need to demand sharp transparency. It will help to simplify to some extent the financial products since the final price, total costs, and benefits will be known upfront before the executive process will be carried out (Willis, 2008). In turn, comparison will become easier. However, legislators must require fees standardization. Else firms might follow supermarkets' path which employ manipulative pricing practices by inconsistently displacing product prices, alternating between price per half a kilo, per kilo, and 100 grams.

Lawmakers can influence the market through taxation. By adjusting tax rates, they can stimulate demand for particular financial instruments, operating under the assumption that people make rational choices. That is not always the case since one size does not fit all. It is important to keep in mind that personal finance is personal after all.

Regulators should prevent usury and set realistic maximal interest rates. In addition, implement mechanisms that prevent quasi-banks from "hiding" additional interest in the form of various fees. The US complicates the matter even more since their usury laws vary between states. Some of them do not set maximal rates for different types of loans, and interest rate depends on the location of the bank, not the borrower (Heath, 2023).

To empower the ones in need, we have to reduce the costs of acquiring financial literacy. According to research (Abramovitch et al., 1991; Lusardi et al., 2010; LeBaron et al., 2018), parental modeling and teaching are important channels, so it is best to begin early to develop skills and confidence. Lusardi et al. (2010) identified that individuals whose mothers had attained a high level of education or whose families possessed stocks or retirement savings demonstrated greater financial literacy. These findings imply that the knowledge gaps of parents should be addressed as well. Parents also need to be aware that they should educate their children about finances. LeBaron et al. (2018) discovered that Millennials wished their parents would discuss finances in front of their children.[3] Fostering open communication would allow one to grasp the practical aspects of managing finances. However, since not all parents are knowledgeable, financial education should be included in high school curriculums. In turn, less privileged children would be given an opportunity to advance their skills. Yet, school educational programs tend to be deemed unsuccessful. According to Lusardi (2019), four components are essential for ensuring effectiveness, namely, adeptly recognizing the requirements of its target audience, focusing on at-risk groups, establishing clear goals, and punctilious assessment criteria. McCormick (2009) stresses that students need to be taught why financial literacy is important to make it successful. Gen Z turns to social media because of convenience and accessibility (69% of respondents), while 42% find content engaging and visually appealing (WallStreetZen, 2023). Clearly, there is a demand for financial content. Perhaps we should evaluate how to tailor and deliver it in a successful way to appeal to younger generations. On the other hand, people learn and retain most knowledge through practice. By collaborating with financial institutions to organize competitions students would be given an incentive to perform well, while they could use and exercise their skills.

Artificial Intelligence (AI) development has the potential to lower the cost of financial education, and in turn, make it more accessible. AI can provide real-time feedback and allows for personalized learning regardless of time zone and location. Its flexibility confirms its versatility, meaning that it can be adapted to different levels of literacy (Osetskyi et al., 2020).

Lusardi (2019) suggests educating adults in workplaces. Yet, I have difficulties envisioning it as employers might oppose the idea en masse. OECD (2022) listed examples of such initiatives in 14 countries across the globe,[4] with the Netherlands pioneering in a matter. Nevertheless, a shared characteristic among these workplaces is their affiliation with financial institutions, including banks, the Ministry of Finance, consumer protection organizations, and pension funds. The list includes two governmental institutions, which might be a good starting point for a rollout. It should be desirable to include employee's financial know-how as part of the corporate social responsibility.

Lastly, when it comes to evaluating financial literacy, we should not rely on self-evaluation to minimize bias. Especially in the context of assessing perceived improvement after completing

[3] People born between 1981 and 1996 are considered Millennials.
[4] These countries are Australia, Canada, Czech Republic, Hong Kong (China), Italy, Ireland, India, Mexico, New Zealand, Netherlands, Peru, Russia, Thailand, and the United Kingdom

classes/workshops since they might improve self-confidence without translating into literacy gains (Willis, 2008).

Conclusion

Financial literacy scarcity is a silent crisis. For generations, financial education was absent in school curriculums, despite everyone managing money in their adulthood. The lack of preparation led modern society to be baffled by debt. People keep it to themselves since money is seen as a private matter or even taboo in some circles. We need to acknowledge that financial literacy is a critical life skill in the current economic landscape, and it is our duty to empower future generations to set them up for success. It is not something that can be resolved quickly. If not tackled, it will have detrimental effects on society's well-being. That is why we should strive for more in the context of financial education. There are possible solutions that can be implemented at various levels of society – individual, family, and regulatory. Addressing financial literacy scarcity has the potential to bring a long-term positive change, empowering individuals to make informed financial decisions and break free from cycles of poverty.

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