FINANCIAL ILLITERACY

THE REAL COSTS OF FINANCIAL IGNORANCE

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Abstract:

In a world of relentless economic adversity and a complex global environment, financial illiteracy is the last thing you want. This article addresses the implications of the absence of meaningful financial education, both for society and for our daily individual decisions. At the same time, it provides an evaluation of the level of financial knowledge in Spain and the United States. Finally, it highlights the successful results of financial training courses and provides a key solution to combat the current deficit in financial literacy.

First of all, we need to define or formalise what financial education covers in order to understand what it involves to be a competent person in this area. In *Financial Education and Economic Development*, Hogarth encompasses three aspects to consider. First, having knowledge and training in the areas of cash and asset management, banking, investment, credit, insurance, and taxation. Second, understanding the basic concepts underlying money and asset performance, such as the time value of money in investments or the risk pooling in insurance. Finally, using this knowledge to plan, implement, and evaluate day-to-day decisions. Despite the possible complexity of financial education or the ingenuity of those who prefer to ignore it, "the importance of financial education is given weight by citing what can happen in its absence"[1].

Therefore, we will now present the results that reveal the extent of financial illiteracy in a large part of the population. We begin by reviewing the publication *Self-control, financial literacy and consumer over-indebtedness*. The models derived from the survey revealed that poor financial literacy and a lack of self-control are both directly associated with over-indebtedness. Self-control problems were even more crucial, as consumers rely more on high-cost credit and tend to be more exposed to financial crises. However, while teaching them to restrain these traits is difficult, what can be taught is good financial education[2].

If we now examine the *Everyday Wealth in America* report we notice, among others, the following findings: 75% of people consider money issues to be their biggest source of stress, whether it is the economy in general or personal finances, while only 1 in 3 people consider family problems to be a major stressor, to put it in perspective. If, rather than looking at our biggest stressors, we look at our greatest concerns, the results follow the same line, with inflation and a possible recession being the top two concerns in the US, surpassing the current political environment or global conflicts and crises. Half of couples say they have had a fight over money, and one in three people find it overwhelming to simply plan their finances or have made a financial decision based on their emotions that they later regretted. Are these outcomes not enough to make you decide to educate yourself on finances or go to a professional? Well, the same report states that 80% of individuals who have a financial advisor are less stressed thanks to their help, which translates into less anxiety and stress in general, even in the context of a difficult economic year[3].

To round off the topic, we bring up some final outcomes that are closely associated with a lack of financial literacy. First, "countries with lower economic and financial literacy have weaker national economies and were more vulnerable to the effects of the Great Recession of 2008". There exists a clear relationship between the GDP slowdown between 2007 and 2013 and adult financial literacy. In strongly educated countries, such as Denmark and the UK, the aggregate declines did not exceed 4 percent. Even in Germany, the GDP variation was actually positive. By contrast, Mediterranean countries such as Italy, Greece, and Spain, with financial knowledge scores below 50%, experienced GDP declines of more than 10%, more than twice as large as in well-educated countries. Financial literacy thus emerges as a vital issue whose consequences are particularly severe in the absence of it, especially hitting the poorest and most vulnerable classes the hardest[4].

On the other hand, the lack of financial education has not only distressed our past but also harms our future, the students. In the US, in 2018, two out of five individuals had student loans. What is shocking here is that half of students with loans regret choosing an expensive college over a cheaper one, while among students without loans, only one in ten regrets it. The cause? 51% say they were careless and didn't even calculate their monthly payments. The consequence? Besides the constant remorse of having taken that college instead of a cheaper one, half express great concern about being able to pay back their loans, and 42% have already missed at least one payment in the last year[5].

Until now, we have reviewed the definition of financial literacy and confirmed the worrying and disturbing implications we witness in its absence, affecting everything from students or couples to entire countries. Nevertheless, is there really that much of a lack of financial skills and education? To answer this question with certainty, we rely on *The National Financial Capability Study*, which measures financial literacy levels in the US once every three years. Participants are asked to answer six questions about basic economic and financial concepts. In 2018, while only 7% got all six questions right, only 40% got at least four questions correct. Even more worrying is the fact that this percentage has been declining for each of the four editions since 2009. Hence, we can state that the levels of education are not only poor but have constantly worsened over the last ten years. Other important conclusions to be drawn are that age, income status, and level of education are positively correlated with better financial literacy; on the other hand, there are major gender differences, with higher scores for males[5].

All in all, we can now confirm the inherent problems of financial illiteracy, and we have confirmed the existence of real shortages in financial culture. So, what is the key? Starting from the bottom, from the education system. In the *Informe sobre la educación económico-financiera en las aulas españolas*, the strengths of the UK and Dutch education systems are analysed in depth so that we can draw inspiration from and follow their main points. Following a detailed comparative study of their school curricula and the Spanish one, it highlights some areas for improvement and recommendations: continuity and coherence of the content, greater involvement of academic experts, the incorporation of more didactic and interactive methods, hands-on and cooperative projects, the integration of experiences in the labour market, and incentives for lifelong learning for teachers, among other aspects. And this is only the first step in a long-term but rewarding investment in education, as evidenced by the UK's and the Netherlands' superior scores in financial literacy. Certainly, these results can be attributed to their pioneering implementation of finance lessons in their education systems as early as 2006. However, they have also had the support of their respective governments through national strategies and funding programmes, a critical driver of their success, which, in contrast, leaves a lot to be desired in Spain[4].

However, while an improvement in the education system would guarantee long-term results, as is the case in Spain's neighbouring countries, this would only target current students, excluding the adult population. Yet, it is also feasible to implement financial academic programs aimed at adults, the effects of which have already been substantiated by numerous research studies. The "First-Time Homebuyers" educational program in Georgia provided low- and middle-income families with information on budgeting and financial aspects of housing. In addition, pre- and post-course tests were conducted to assess and compare their behaviour. The study validated the effectiveness of the program by showing an increase in effective budgeting habits. It also revealed an improvement in consumer knowledge, regardless of the gender, race, age, education level, or income category of the participants[6].

These academic programs often assume that increased information and knowledge lead to changes in financial practices and behaviours. And they assume correctly. Studies in 2002 and 2003 confirmed that the greater a consumer's financial knowledge, the greater the likelihood of adopting favourable financial management attitudes and using more financial products and services[7]. Moreover, these behaviours embraced interesting practices such as increased involvement in cash-flow management, credit management, saving, and investment activities[8].

Finally, we will examine the results of offering financial courses in the workplace and their impact on the company's employees. Moving to the point, workshop participants reported greater satisfaction with their ability to save money and felt more confident saving for a comfortable retirement, demonstrating a higher propensity to do so. Three out of four participants said they had made better financial decisions since attending the workshops, and 70% said they had changed their investment strategy by diversifying appropriately. More than half concurred, literally, that their financial situation had improved because of the lessons. In short, the study provided evidence of the effectiveness of financial training in the workplace, as it contributes to improving the financial well-being of employees[9].

In conclusion, we emphasise the urgent call to address the problem of financial illiteracy and its negative consequences. Lack of financial knowledge and skills leads to over-indebtedness, lack of self-control, financial stress, and impulsive decision-making based on emotions. On top of this, financial literacy levels are insufficient and have worsened in recent years. To face this situation, it is essential to improve financial training throughout the education system, implement academic courses for adults, and offer financial training in the workplace. The good news? Three out of five Spaniards say that their concerns about inflation and interest rates are motivating them to improve their knowledge[10]. And currently, surrounded by online courses, academic articles, and free educational videos, there are no excuses for the lack of financial literacy. Furthermore, it has been found that in states where financial education is already common, it is no more likely that financial education courses will be enforced. This supports the view that mandates arise from political activism rather than from widespread interest or concern among the population[11]. Consequently, this drive to improve our financial literacy must come as much from each one of us as it does from state governments.

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