“Importance of Financial Literacy in the Global Economy”

Keynote Address by The Hon. Donald J. Johnston,
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Education about money, and how it works, must be incorporated into our basic education systems.

Why? I offer two simple explanations.

Individuals and households must have the tools to cope with the increasingly complex world of financial instruments. Understanding the financial world is crucial as people assume more responsibility for their own retirement security because public and private pensions face pressures that threaten their solvency.

As Alan Greenspan noted recently about financial education:

“*Today’s financial world is highly complex when compared with that of a generation ago. Forty years ago, a simple understanding of how to maintain a checking and savings account at local banks and savings institutions may have been sufficient. Now, consumers must be able to differentiate between a wide range of financial products and services, and providers of those products and services. Previous, less-indebted generations may not have needed a comprehensive understanding of such aspects of credit as the impact of compounding interest and the implications of mismanaging credit accounts.*

Financial education is important to both the security of individuals and the security of nations.

Enlightened societies today strive to ensure social cohesion as an integral part of economic progress. Interesting and well-paid jobs are central pillars of social cohesion, but so are savings and the building of capital to provide individuals with financial security, especially for their retirement.

That cohesion can be seriously undermined by major imbalances of wealth within nations. Major inequalities between elements of society, especially along ethnic or racial lines, can be a recipe for disaster. One way to avoid that catastrophic scenario is to ensure that everyone participates in wealth, both in its creation and distribution. Along with good employment prospects, financial education can play a key role in helping individuals and families build their assets.

Just as health education in primary and secondary schools helps children develop good life-long dietary and hygiene habits, good financial education can provide them with the skills and habits necessary to enable them to participate sensibly in financial markets. Moreover, well-informed financial consumers ultimately lead to better financial markets, where rogue products are forced from the market-place and confidence is raised.

Findings from various studies on the issue of financial education are both sobering and encouraging.

On a ***sobering*** note, financial literacy surveys indicate that many consumers lack adequate understanding of either their financial needs or the financial instruments and products available.

- In Japan, a survey found that 71% of respondents lack knowledge about equities and bonds; 57% lack knowledge about financial products in general; and 29% lack knowledge of insurance and pensions.

- A survey in the United States found that four out of ten American workers are not saving for retirement.

- And in Australia, a survey found that 37% of those with investments did not understand that investments can fluctuate in value. In the same survey, 67% of respondents indicated that they understood the concept of compound interest. Yet, when asked to solve a problem using this concept, only 28% demonstrated a good level of understanding.

On the other hand, the findings are ***encouraging*** in that they show that countries are increasingly aware of the importance of financial education. Many provide a variety of financial education programmes through websites, brochures and pamphlets, and media campaigns. A few are developing national strategies to coordinate and direct their financial education programmes. A word of caution: with so many programmes offered by both public and private providers it is increasingly important to avoid unnecessary duplication or gaps.

But there have been relatively few evaluations of financial education programmes to determine what has worked and what has not. This is due both to the high cost of programme evaluation and to the difficulty of assessing whether the main goals of financial education programmes – such as increasing consumer awareness and changing individual financial behaviour – have been fulfilled.

E***ncouragingly,*** the few financial education programmes which have been evaluated have been found to be reasonably effective.

- Research in the United States shows that workers increase their participation in 401(k) plans when employers offer financial education programmes, whether in the form of brochures or seminars.

- Mortgage counselling has been found to be effective in reducing the risk of mortgage delinquency.

- Consumers who attend one-on-one credit counselling sessions have lower debt and fewer delinquencies.

Of course, the effectiveness of financial education programmes is sometimes counteracted by powerful psychological or behavioural traits, such as inertia and lack of willpower. This has led some experts to argue for automatic enrolment in defined contribution plans. However, critics say automatic enrolment results in low contribution rates and conservative asset allocations. In the final analysis, most experts acknowledge that financial education does play an important role in providing advice and information to workers about their retirement plans.

OECD governments have published ***a set of principles and good practices for financial education and awareness***, based in large part on the findings of the study produced by the OECD's Financial Education Project.

- Governments and all concerned stakeholders should promote unbiased, fair and coordinated financial education;

- Financial education should start in primary school and should be an integral part of the good governance of financial institutions to encourage accountability and responsibility;

- Financial education should be clearly distinguished from commercial advertising and codes of conduct for the staff of financial institutions should be developed;

- Financial institutions should encourage clients to read and understand information, especially when related to long-term commitments or financial services with potentially significant financial consequences; small print should be discouraged;

- Financial education programmes should focus particularly on important life-planning aspects, such as basic savings, debt, insurance or pensions;

- Programmes should be oriented towards financial capacity building, targeted on specific groups and "personalised" where appropriate;

- Future retirees should be made aware of the need to assess the financial adequacy of their current public and private pensions schemes;

- Finally, we advocate that national campaigns, specific websites, free information services and warning systems on high-risk issues for financial consumers (such as fraud) should be promoted.

It is clear from the OECD study that we have much to do and learn about financial education programmes and how to improve them.

- Increase consumer awareness as to the necessity of financial education and how they can access it. ***Financial education is not just for investors***. It is just as important, if not more so, for the average family trying to balance its budget and save for the children's education and the parents' retirement.

- More needs to be learned about the financial education needs of consumers at various stages in their lives and how financial education programmes can be designed to best address these needs.

- More evaluations of programmes need to be conducted in order to find out which programmes succeed and why.

To conclude, financial education has a role to play in so many critical areas of every day life:

- Financing home ownership;
- Financing higher education;
- Financing retirement security;
- Making people more astute when saving and investing;
- Protecting individuals from those who prey upon the ignorance and greed of the unwary.

As in health, the state often becomes the protector of last resort, ensuring a minimum social security net for the poor. Financial education should reduce those numbers and the burden on the tax paying public.