Why financial literacy matters for development

Sarah Bel, UNCDF Better Than Cash Alliance, and James Eberlein, OECD Development Centre

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"Most of our problems are based on finances. Money is always an issue. I have to still provide for both my parents who are not working and make sure they are fed; I must pay their insurance policies because they no longer have the ability to pay them. I don't earn enough money to afford all of that."

These are the words of 35-year-old man from Lesotho, interviewed as part of the UNCDF Making Access Possible initiative. Low-income consumers must make complex financial decisions even more frequently than middle- or high-income consumers, given their smaller operating margins and their limited and irregular incomes. In Lesotho and Swaziland, many workers forfeit up to 40% of their income because of burdensome loan repayments. Indebtedness in the informal consumer market is often an indicator not only of poverty, but also of limited financial literacy.

Yet these problems are not limited to poor consumers or low-income countries. In response to the growing concerns about over-indebtedness, policymakers across the world are focusing on "predatory" lending, which takes advantage of financial illiteracy to push inappropriate loans to consumers who cannot repay them. Some common-sense reforms, like one implemented in France, now require lenders to include a disclaimer, such as "you are responsible for paying back a loan" and "verify your ability to repay the loan before borrowing". Additionally, all marketing material must include plain-language explanations of the long-term cost of loans (interest rate, total amount due and the final cost of the credit). South Africa's Broad-Based Black Economic Empowerment legislation has specific regulations around financial education and consumer empowerment. The purpose of these types of regulations is to improve financial capability and increase financial inclusion. But while such reforms have helped improve the protection of financial consumers, they address only part of the problem.

Many people, in developed and developing countries alike, know little about basic financial concepts and do not engage in savvy financial behaviour. An OECD working paper by Adele Atkinson and Flore-Anne Messy shows that in almost all of the 14 countries across four continents taking part in the study, at least half of the adult population failed to identify the impact of interest compounding on their savings, and revealed that fewer than one in five people would shop around when buying financial products. Unfortunately, the picture isn't any brighter when it comes to young consumers. The *Students and Money* report from the 2012 OECD PISA financial literacy assessment revealed that around one in seven students in the 13 OECD countries and economies taking part in the assessment are unable to make simple decisions about everyday spending, and only one in ten can solve complex financial tasks. This result is astonishing and requires prompt action to ensure that tomorrow's adults understand bank statements, the long-term costs of consumer credit and how insurance works, among other basic financial services and products. Indeed, improving the financial literacy of young people will help ensure that they can benefit from savings, retirement and health care coverage–much-needed safety nets in the absence of parents or social systems.

To help governments design and implement policies to increase financial skills, including among young people, the OECD and its International Network on Financial Education (INFE) developed High-Level Principles on National Strategies for Financial Education, which were endorsed by G20 leaders in 2012. They encourage countries to develop nationally co-ordinated frameworks for financial education policies and provide general guidance on the main elements of an efficient national financial education strategy, such as an effective mechanism to co-ordinate with civil society and the private sector.

Governments may involve financial service providers and other key stakeholders to build the financial capabilities of young people and adults through a variety of delivery channels. Rwanda's national strategy, for instance, underlines the importance of using not only schools to deliver financial education, but also other innovative channels to reach vulnerable, out-of-school youth. Umutanguha Finance, one of the ten institutions supported by the UNCDF initiative YouthStart, empowers teenagers to deliver financial education on issues such as savings to younger children. This peer-to-peer approach is particularly useful because young people tend to listen to their peers more than adults, and the participative approach helps foster youth as agents of change in their own communities.

Financial literacy programmes can play an important role in reducing economic inequalities as well as empowering citizens and decreasing information asymmetries between financial intermediaries and their customers. Public authorities have a responsibility to develop financial education policies and set up robust financial consumer protection frameworks to ensure that consumers are informed and understand the financial products available to them. Innovations such as electronic payments are tipping the economic scales in favour of those who have, for too long, been excluded from the system. But unless consumers are equipped to make sound decisions when using financial services, no amount of innovation will bridge the gap.

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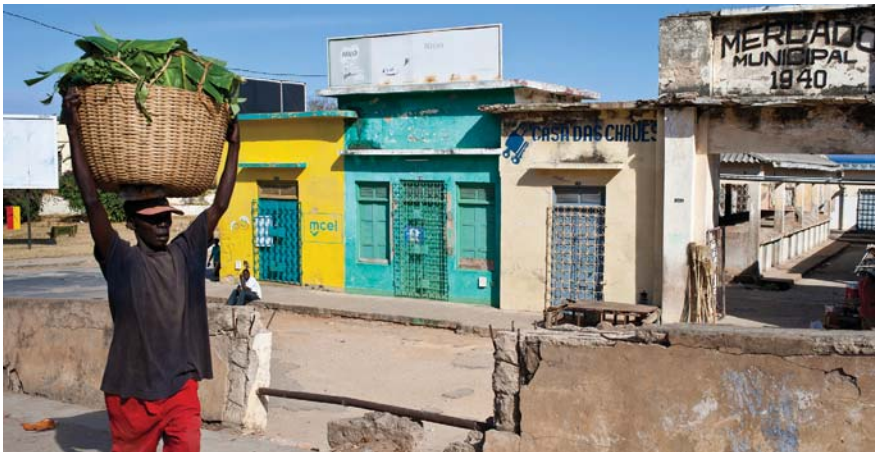
This *OECD Observer* Spotlight focuses on how access to financing can contribute to inclusive social and economic development. The articles are adapted from a series published on www.oecdinsights.org, which was prepared jointly by the OECD Development Centre and the United Nations Capital Development Fund (UNCDF).

Financing smallholder farmers: Growth potential

Kameshnee Naidoo, UNCDF



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Joacquim is a subsistence farmer from Etatara in Mozambique. At 46 years old, he is his family's sole breadwinner, responsible for supporting his wife and three orphaned grandchildren. He lives in a traditional house, which he is unable to use as collateral, and grows maize, sorghum, cassava and beans. They consume a lot of the produce themselves, and what is not consumed is sold. Joacquim earns US$300-500 per month depending on the season and his produce.

In the attempt to understand the real livelihoods of lower-income individuals and households in markets such as Mozambique, the lack of data and field-based insights are challenging. UNCDF's project focusing on financial services, Making Access Possible (MAP), for instance, seeks to place demand-side analysis at the centre of the research process to focus the minds of multiple stakeholders on the end consumer. Better provision of appropriate financial services is an ancillary tool to wider development goals of enabling more sustainable livelihoods for low-income populations.

Millions of smallholder farmers like Joacquim live in or close to poverty and rely on agriculture for their livelihoods. Agriculture is fundamental to poverty reduction, driving economic transformation and ensuring that growth includes the poor. Pathways out of poverty–whether through farming, employment, non-farm processing and trade, or migration–are all heavily reliant on agriculture. Moreover, improving agricultural productivity–while conserving and enhancing natural resources–is an essential requirement for farmers to increase global food supplies on a sustainable basis and enhance their livelihoods. Over the longer term, increasing agricultural productivity plays an even greater role in economic development by enabling economic transformation through a new green revolution.

For agriculture to work better and improve livelihoods, financial services need to work better in helping the poor to diversify their activity and become more resilient to periodic shocks and prevent them from falling into poverty traps. The rural economy requires a wide range of financial services and products, which no single type of financial institution is capable of efficiently providing. Microfinance, for example, can help to meet the short-term needs of farmers and other low-income residents and help to finance microbusinesses, though it is not as suitable for larger businesses to raise productivity.

As the OECD's *Multi-dimensional Review of Myanmar* shows, the rural sector is the