Improving Financial Literacy at School: a Way to Ensure Retirement Well-being

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Abstract

According to OECD definition financial literacy is "a combination of knowledge and skills necessary to be aware of and effectively manage personal finances, make informed choice of financial services and their use, ultimately ensuring private financial stability and sustainability". Latvia has introduced notional defined contribution (NDC) multi-pillar pension scheme in which responsibility to ensure sufficient replacement income rate for retirement has shifted away from state to individual. The average literacy rate in Latvia was evaluated with 20,6 points out of 99 during first nationwide financial literacy survey in 2014. The research revealed that people have the worst knowledge about pension system and its related services. Many scholars have outlined that satisfactory results can only be achieved if financial literacy skills are being improved at school, because pupils have not developed particular behavioural patterns when dealing with various financial issues which are then difficult to change. At this point it is possible to reach out to almost every member of the ~~society.~~ This is an efficient way how to influence adult members of the society, because students tend to exchange the information and skills gained at school with their parents and closest relatives. Latvian pupils score slightly above the average result of all OECD countries when it comes to financial literacy. However Latvia has fewer students who have very good or excellent financial literacy skills. The curriculum is overloaded. Economics is an optional subject in high school, hence only 40% of pupils learn any basics of economics. In 2014 first financial literacy promotion strategy of Latvia was issued and it is a good chance to develop financial education of all age groups and enhance capacity of civic knowledge- based society.

1. Introduction

In the mid 90-ties a substantial pension system reform in Latvia was initiated to respond to the challenges caused by the gradually ageing society. Latvia is one of the first countries to introduce notional defined contribution (NDC) multi-pillar pension scheme. A knowledge-based welfare state demands enlightened individual's participation in the pension scheme. In practice it means that the future pension amount will depend not only on the contributions made, on effective pension fund administration and smooth functioning of financial market, but also from the decisions made by individual, e.g., by choosing an asset management company and a pension plan.

The OECD and the World Bank have emphasized the necessity to start financial learning as early as possible, preferably – already at school by including it in the mandatory school curricula [1;2]. Lewis Mandell says that at school it is possible to reach out to the widest possible auditorium, as the primary education in most countries is mandatory, hence pupils from various backgrounds, including the ones coming from social exclusion risk groups, can receive proper

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financial training which could benefit them in their future lives and help them to escape from the poverty circle [3]. Furthermore pupils have not developed particular behavioural patterns when dealing with financial services. Therefore by receiving adequate training, as research findings have confirmed, they will become more responsible consumers of financial services.

2. *Financial literacy in Latvia*

By the end of 2014 there were around 1,25 million members (62% of the total population) in the state funded pension scheme (2nd tier) [4]. Altogether the state funded pension scheme since 2001 has accumulated more than 2,1 billion euros (9% of the GDP of Latvia), which have been divided between seven asset management companies offering in total 20 pensions plans: 8 with active investment strategy, 4 with balanced and 8 with conservative investment strategy. Once a year every member of the scheme can change the asset management company and twice a year – move from one pension plan to another within the same asset management company [5]. Latvian pension system in 2014 has been ranked 9th most sustainable in the world and the most sustainable in CEE [6]. Yet, due to the fact, that the wealth accumulation has become individual's responsibility, questions regarding the security of the pension capital and the adequacy of pensions have appeared on agenda. One of reasons for concern are the inadequate level of financial literacy [7].

For the purpose ~~of this~~ paper a definition of financial literacy drafted by the OECD and applied by the Financial and Capital Market Commission of Latvia is used. According to it, financial literacy is "a combination of knowledge and skills necessary to be aware of and effectively manage personal finances, make informed choice of financial services and their use, ultimately ensuring private financial stability and sustainability. Financially educated people have knowledge of finances and economics and they are capable of using it for enhancement of their future wellbeing and financial growth, in order to achieve individual financial objectives" [8]. Furthermore a distinction between the financial literacy, which can be seen as a result, and the financial education, which can be perceived as an ongoing process to reach the state of financial literacy, should be made.

In 2014 first nationwide financial literacy survey in Latvia was conducted. The average literacy rate in Latvia was evaluated with 20,6 points out of 99. The research revealed that people have the worst knowledge about pension system and its related services. Alarming fact is that 75% of the respondents said that they highly doubt that their accumulated pension will meet their needs and expectations during retirement, yet 82% of the respondents do not make any other savings and will completely rely on their pension income. The system demands active involvement not only by choosing age and risk-tolerance relevant pension plan, but also regular follow-up of how the plan is doing and whether it is meeting the expectation of the consumer. However 75% of participants do not follow the results of their chosen pension plan [8]. Furthermore future pension forecasts are overly optimistic and are not based on actual income rate or pension calculation methodology [9]. As there is no guaranteed return rate, in order to discipline asset management companies, a performance based administration rate was introduced in 2015. Nevertheless the bank discretion level is still rather high, therefore highlighting need for more active involvement and control from the civil society.

3. *Retirement planning at school?*

"Developing financial literacy skills and knowledge is critical now that individuals are becoming increasingly responsible at an ever earlier age for financial risks affecting their future", said the Secretary-General of the OECD during the opening of the first OECD PISA international assessment of financial literacy of 15 year-olds in 18 countries. It confirmed the fact that young people lack even basic financial literacy skills. Although Latvian pupils score slightly above the average result of all OECD countries (501, compared to 500 in OECD countries), Latvia has less students who have very good or excellent financial literacy skills (15%, compared to 21% in OECD countries). Also the nationwide financial literacy index confirmed that young people aged 18-24 among all age groups have the worst knowledge about pensions [10].

In Latvia currently "Economics" is an optional subject at high school, which has been chosen by less than half (40%) of the pupils. In secondary school personal financial planning aspects are only scarcely touched upon, as economics are being taught as a part of the Social Sciences, where pupils also have to cover three other topics: ethics, health education and civics. Teachers lack time to discuss personal budgeting and other finance related aspects [11]. In a nationwide survey it was concluded that 73% of the population believe that the financial knowledge gained at school is insufficient [8]. Students who get minimum knowledge during the middle school and quit their studies immediately after (high-school education in Latvia is not mandatory) or do not choose this subject in high school, come into contact with financial services poorly prepared, therefore increasing the likelihood, that they will make ill-considered decisions when, e.g., applying for a mortgage or choosing an asset management company with an appropriate pension plan. Furthermore, in a research carried out in Latvia by the SEB Bank Group in 2009 it was outlined that both parents and their children think that language and math classes are the most important subjects in the school curricula, yet only 10% of parents and 6% of students said that Economics is the most important subject. These results can be explained twofold: firstly, pupils do not fully understand the practical use of the knowledge gained in this subject and the methods applied to teach this subject do not meet the needs and expectations of the students; secondly, as most of the parents did not have this subject at school, it has created a bias that it is not necessary or useful in an adulthood, as they have managed to carry out their everyday financial activities without applying any specific skills [12].

4. *A way forward to improve financial literacy skills*

The first National financial literacy strategy for the period from 2014 to 2020 was drawn up in 2014 and it stressed the essential importance of adequate understanding of basic financial and economic issues at the level of service consumers, emphasizing the need for financially literate society as a cornerstone to ensure long-term financial stability of the country [8].

This was the first time when need for improvement of financial literacy was explicitly mentioned in any policy planning document. Furthermore, it expressed need to start training already at school, by including "Economics" in the list of mandatory subjects at high school. Although discussions of this necessity have been ongoing for quite a while, making it a mandatory subject is only the first step towards a more financially literate society. Besides that, it is of great importance to change the subject curricula [13], which currently is overloaded with issues irrelevant or distantly relevant to everyday financial activities. Not only it leaves little or no time to cover topics such as personal budgeting or pension planning, current curricula hinders possibility to include hands-on activities, e.g., simulation games, excursions etc. The main reason for that is the fact that the final exam in "Economics", which can be passed on voluntary basis by the end of high school, is prepared centrally in Riga and based on the topics covered in the state-approved curricula. Teachers, therefore, are forced to strictly follow the programme, leaving no or very little time for any additional activities, which would be more interesting and rewarding for pupils. A possible solution for this problem would be to allow each school, where this subject is being taught, to make their own exam. This would give greater flexibility for teachers to tailor the programme on their own, foreseeing also time for more interactive learning methods. Furthermore, as private asset management, which have exclusive rights to administer pension savings, receive significant revenues from the pension plan administration, special courses for teachers, in cooperation with the Ministry of Education and Science, but financed by the private asset management companies, should also be organized to ensure that teachers are properly prepared and have access to up-to-date information and learning materials.

Although first steps forward a more financially literate society have been made by issuing the first National financial literacy strategy and by bringing the question of "Economics" being taught as a mandatory subject back into the agenda, very few practical steps have been made so far. And even then, if significant changes in the education system will take place, raising financial literacy is a time-consuming process, which will bring results in an unknown time in the future. However, the questions of how to protect consumers from unexpected turbulences in the financial markets which could negatively affect their pension savings and how to ensure that the retirement income will meet the needs of the future pensioners remain unanswered. One of the possible alternative solutions would be to implement life-cycle investment strategy as a default pension plan to safeguard people from unexpected financial turbulences and ensure that those with low financial literacy skills would multiply their savings effectively until sufficient financial literacy skills have been achieved.

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Conference Proceedings

The Future of Education

Edited by Pixel

5th Conference Edition
Florence, Italy
11-12 June 2015

libreriauniversitaria.it
edizioni

ISBN: 978-88-6292-620-1
ISSN: 2384-9509
Prima edizione: maggio 2015

Il nostro indirizzo internet è:
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