The current level and impact of financial literacy

By Scott Todd

27 Jan 2016

Financial literacy has never been more important, but is a dearth of financial education responsible for the spiralling growth of household debt?

©Wavebreak Media Ltd via 123RF

Today, the majority of consumers will experience some sort financial difficulty that causes a significant impact on their everyday lives. The huge number of financial products currently on the market and the ease with which these products can be accessed is having an adverse effect on some consumers. Many simply do not have the necessary levels of financial literacy to be able to use these products in a responsible way.

Why is financial literacy so important?

Financial literacy can be defined as the ability to understand how money works in the world. This includes how to manage it, how to invest, and how to donate it to help others.

Financial decisions are becoming increasingly complex. Given the sheer number of spending, saving, borrowing and investing options that are available to consumers, the ability to make decisions with confidence is critical to their financial well being.

There are hundreds of credit cards, mortgage providers, savings accounts and investment options out there all trying to get your business. While the number of options has grown, the costs of living have continued to rise, meaning that a retirement fund or nest egg that would have once been generous is now barely enough. The onus, more than ever, is now on us as individuals to manage our finances effectively and make our own provisions for later life.

The growth of household debt

Household debt, which is defined as the total amount of money all adults living in a household owe financial institutions, including consumer debt and mortgage loans, is on the rise. This is truly a global problem, although some countries seem to be doing a better job of managing their finances than others.

According to the latest household debt data from the Organisation for Economic Cooperation and Development (OECD), Hungarian household debt is just 54 per cent of net disposable income. At the other end of the scale is Denmark, with an average household debt of 313 per cent of disposable income.

The current lack of financial literacy

Is a lack of financial literacy contributing to the spiraling levels of household debt? A recent survey of 18,000 South African loan customers found that 77 per cent of these 18,000 respondents did not look at the interest rates or fees on credit applications; while only 32 per cent said they saved money on a monthly basis.

The inability to save is one of the leading causes of debt problems. By failing to save every month, consumers have little or no room in their budget to pay for unexpected costs and emergency payments, so, when the car breaks down, nothing is left in the kitty to get it back on the road. To fund this expense, people then turn to short-term debt solutions, in many cases without properly considering the cost of this debt.

What's the solution?

A key to combating this problem is to increase the level of financially education from a young age. Once we understand the basics, we can then be more responsible in our approach to credit provision. At the very least, borrowers should always think carefully about the interest rates attached to a particular source of debt, and have an exit plan in place to repay the debt before they take out a loan.

ABOUT THE AUTHOR

Scott Todd is an Irish born financial blogger and digital marketing enthusiast. He runs a financial blog and has a vast breadth of experience in the financial language and culture of both hemispheres with a particular interest in South Africa.