Financial Literacy and Financial Stability are two aspects of Efficient Economy

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Abstract

Financial Literacy enhances the ability to effectively monitoring of financial resources for developing the economic security of a person. Financial stability of economy is based on these terms and currently it is necessary for developing and developed country. Currently most of countries are adopting various programmes for financial education. India is having large population, growing economy with national focus on inclusive growth and an urgent requirement to develop a vibrant and stable financial system. The Reserve bank of India, which is the central bank, has been actively participating in the field of eradicating financial literacy and maintain financial stability in the country. RBI has developed various strategies and adopted programmes to develop a smooth process of financial literacy. The present study focus on some important aspects which are necessary for financial literacy to effective financial and economic stability. The study also discuss about the role of RBI for improving financial knowledge of individuals.

Keywords: Financial Literacy, Component of financial stability, RBI’s initiatives

Introduction
Financial literacy indicates awareness about financial products. The importance of financial literacy has improved in recent years due to the development of economic and financial market. India is ranked number two in the list of highest financial literacy countries in the world.

There are large numbers of stakeholders including the central and state governments, financial regulators, financial institutions, civil society, educationists and others are involved in spreading financial literacy. Financial literacy is considered an important adjunct for the promotion of financial inclusions and ultimately financial stability. In India the need for financial literacy is getting greater because of the low level of literacy and large section of population which remains out of the formal financial set up. The meaning of financial stability can be discussed as a condition in which the financial system is capable of withstanding shocks, thereby reducing the likelihood of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to profitable investment opportunities.

There are three parts of the financial system:

- **financial intermediaries**- Banks, insurance companies and other institutional investors that direct funds from those willing to invest or lend to those who want to borrow.

- **financial market**- where lenders and borrowers meet such as money market and capital market

- **financial market infrastructures** -through which money and financial assets flow between buyers and sellers such as payment systems and security settlement systems.

Following three key characteristics display a stable financial system:

- Efficiently and smoothly transfer of resources from savers to investors.
Assessment and management of financial risk

- Comfortably absorb financial and real economic surprises and shocks.

If any one or a combination of these characteristics is not being maintained, then it is likely that the financial system is moving in a direction of becoming less stable, and at some point might be instability. The safeguarding of financial stability requires identifying the main sources of risk and vulnerability such as inefficiencies in the allocation of financial resources from savers to investors and the mis-pricing or mismanagement of financial risks. This identification of risks and vulnerabilities is necessary because the monitoring of financial stability must be forward looking: inefficiencies in the allocation of capital or shortcomings in the pricing and management of risk can, if they lay the foundations for vulnerabilities, compromise future financial system stability and therefore economic stability.

The first decade of the twenty-first century has seen a universal recognition for spreading financial literacy among people. The concept of improving financial literacy is considered as a national project in maximum developing and developed countries. Most of the countries are adopting a unified and coordinated national strategy for financial education. Given the fact that India is having large population, a fast growing economy with national focus on inclusive growth and an urgent need to develop a vibrant and stable financial system, it is all the more necessary to quickly formulate and implement a national strategy. Reserve Bank of India has actively participated for developing financial literacy, maintain price stability and economic growth in the country.

**Literature Review**
There are several widely used definitions of financial literacy and financial stability exist, all of them generally imply the ability of individuals to obtain, understand and evaluate information required to make decisions to secure their financial future as best as possible. After analyzing a host of papers on the subject, Noctor, Stoney and Stradling (1992) introduced, conceptualized and defined the term financial literacy as “the ability to make informed judgments and to take effective decisions regarding the use and management of money”. Anthes (2004) stated that “personal financial literacy is the ability to read, analyze, manage and communicate about the personal financial conditions that affect material well being”. OECD(2005) defines financial education is “the process by which financial consumers/investors improve their understanding of financial products and concepts and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being.” Mark Taylor (2010). Identify the key determinants of Financial Literacy. Using panel data models, He fined the key determinants to financial literacy are age, health, household size and structure, housing tenure, and the employment status of the individual and other household members. Older men and women in full-time work with an employed spouse have the most financial capability although many of these characteristics have significant impacts on financial capability, but results suggest that age, and employment status has the largest impacts. Tullio Jappelli(2009), has done a comprehensive assessment of literacy across the world based on a survey of executives in 55 countries, in 1995-2008. The survey respondents are a selected group of managers and country-experts, Through descriptive analysis he shows that literacy varies quite substantially among countries, and the regression analysis shows that its level depends on educational achievement, social interactions (as proxies by the share of urban population), and
mandated savings in the form of social security contributions. *Huston (2010)* proposed that financial literacy must also include application of financial knowledge; the argument being that absent demonstrated ability to apply financial knowledge, an individual cannot be regarded as being financially literate.

_Ben Bernanke (2011)_ highlighted the need for continual updating of financial literacy across all age groups because of the dynamic nature of financial products and services as well as the changing needs and circumstances of individuals with time. He observed that exposing young people to financial concepts is particularly important as they are vulnerable to the temptations of taking excessive debt. *Jason West (2012)* show that the actions of individuals who are financially literate do not necessarily mean they will demonstrate good financial behaviour. In order to improve the financial behaviour of consumers, two critical areas need to be addressed.

_Puneet Bhushan & Yajulu Medury (2013)* suggest that overall financial literacy level of individuals are not very high. Financial literacy level gets affected by gender, education, income, nature of employment and place of work.

**Objective of Research**

This research project has the following research goals:

1. Identify the impact of financial literacy among individuals and their macro economic advantage for economy.

2. Determine whether financial education helps low- and moderate-income individuals achieve sustained behavioural and psychological changes enabling them to improve their financial stability.
3. Discuss the role of Reserve bank of India for developing financial literacy and impact of initiatives taken by RBI.

4. Examine the necessity of financial education to improve the economic stability in country.

**Research Methodology**

This article provides a brief overview of the field of financial education and explores some of the challenges and potential solutions for moving the field forward.

This study is based on Indian conditions. Moreover volatile condition of economy and new horizon of hopes makes this study really significant. In India financial literacy has assumed greater significance in recent years due to the complexity of financial markets. For the purpose of the study data has been collected various sources and mainly secondary data has examined for preparation of conclusions, findings and recommendations. The design of research study is exploratory. Data is collected from various sources such as magazines, journals, research papers; newspapers etc. different websites are also being studied to collect the required data.

**Assessment of Financial Literacy**

In recent years, developed and emerging countries and economies have become increasingly concerned about the level of financial literacy of their citizens. While still few in number, innovative efforts are under way to help microfinance clients and people improve management of
their assets by building knowledge of key financial concepts and developing skills to make informed financial decisions. Financial literacy is aim to improve knowledge and skills in budgeting, savings, debt management, use of bank services, and financial negotiations. Financial literacy can be defined as knowledge of financial concepts and the skills and attitudes to translate this knowledge into behaviours that result in good financial outcomes.

The need for financial education is especially salient in light of the current economic situation. Families struggling to high rate of inflation and reductions in household income need to be able to draw on financial skills such as budgeting, saving, and credit and debt management. In particular, many low- and moderate-income (LMI) families that were already stretched thin before face even greater financial challenges. These households suffer greater income losses (as a proportion of total income) during high rate of inflation in economy and experience slower economic recovery relative to higher-income households. Many of these families lack the basic knowledge and resources required to save and invest, build wealth, and avoid excessive debt; at the same time, many remain outside of the financial mainstream and lack access to important financial products and services.

Financial education plays a vital role in equipping all individuals with the knowledge, skills, and opportunities they need to get back on solid financial ground. Financial education can broadly be defined as providing the familiarity with and understanding of financial market products, especially, rewards and risks, in order to make informed choices. Viewed from this standpoint, financial education primarily relates to personal financial education to enable individuals to take effective actions to improve overall wellbeing and avoid distress in matters that are financial. Financial literacy is expected to impart the wherewithal to make ordinary individuals into informed and questioning users of financial services. It is not just about markets and investments, but also
about saving pattern, budgeting, financial planning, basics terms of banking and most importantly, about being “Financially Smart”.

Necessity of Financial Literacy

Financial literacy is a very complex concept and it is very difficult to understand the impact of financial literacy on society. In fact, as a part of society, we are yet to fully recognise the need and potential of financial literacy. The nature of financial illiteracy and its manifestations may vary, but it gets reflected in the everyday financial choices that many of us make. The lack of basic knowledge about financial instruments and their risk-return framework is one common instance of financial illiteracy that is widely observed. Retail investors are greedy to get higher return at very short time and most of them do not calculate the associated risk of financial product. Thus, appreciation of various aspects of financial literacy and how it impacts our lives holds the key to prudent financial planning and welfare maximisation, both- at the individual level and for the society as a whole.

Financial Inclusion and Consumer Protection focuses on financial literacy which is necessary for ensuring financial stability. Financial literacy has significant relevance for financial inclusion and consumer protection. Without financial literacy, we cannot expect to make major headway in either financial inclusion or consumer protection.

There are two essential element of financial inclusion, one of access and the other of awareness. The acceptance of these two elements varies country to country. For developed countries with widespread financial infrastructure, the access to financial products/services is not a matter of
concern. It is more of a financial literacy issue in that market players/consumers are required to be educated about the features of the available financial products/services, including their risks and returns. In developing countries like India, however, the access to products itself is lacking. Therefore, here, both the elements, i.e. access and awareness need to be emphasized, with improving access assuming greater priority.

Financial Stability refers to develop such a policy which has a primary objective to avoidance of financial crisis. It emphasises to build a strong financial system which has ability to fight with different economic threats. The recent global financial crisis is a glaring example of how lack of financial literacy can impact financial stability. The genesis of the crisis was in the sale of inappropriate mortgage products to sub-prime borrowers, who did not understand the nature of product. The crisis was also fanned by the creation of sophisticated financial products by seemingly expert market participants, without understanding the underlying risks involved. Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System, remarked “In light of the problems that have arisen in the subprime mortgage market, we are reminded of how critically important it is for individuals to become financially literate at an early age so that they are better prepared to make decisions and navigate an increasingly complex financial marketplace”.

Financial literacy involves imparting knowledge about the risk and return of financial products to the users and providers of these products. It is this knowledge that helps in containing risks and maintaining stability in the financial system. Consumer protection and financial literacy are interrelated. Financial literacy is an essential pre-requisite for ensuring consumer protection. Financial education greatly helps the consumers to find suitable information from available wide information and helpful to narrow this information divide.
Financial Literacy and Target People

Financial literacy target each class of people except that who are worked as financial professionals. Actually there is very thin line between financial literacy and illiteracy and it very difficult to choose a financial literate person. So, it should be compulsory for everyone associated with the financial system needs to be financially literate. This includes all users of financial services, be it the financially excluded resource-poor, the lower and middle income groups or the high net worth individuals; the providers of services; and even the policy makers and the regulators. For the resource-poor population, which operates at the margin, vulnerability can be acute due to constant financial pressures. Cash management of household can be daunting under difficult circumstances, with few resources to fall back upon. Financial literacy efforts, in case of such population groups, essentially, involves educating them about the benefits of being part of the formal financial system and managing short term volatility in incomes and meeting unexpected emergencies without getting trapped in unnecessary debt. For the middle and lower-middle income groups that are participating in financial markets as either savers or borrowers or both, i.e. the financially included, financial literacy efforts should aim at enhancing their knowledge about the market and new products/services. For instance, there is a large section of our population that has a bank account but refrains from participating in the capital market on account of lack of knowledge. Financial literacy, in such cases, would focus on creating awareness about the way the capital market functions and also about the fact that the equity market provides relatively higher returns as compared to other investments, over a longer time horizon. Similarly for high net worth individuals, better knowledge about the financial markets, new and innovative products and instruments is important as it helps them in making better use of the available avenues in the financial markets. This knowledge is also useful for fetching greater returns from their investments.
in the market and to avail credit at relatively cheaper rates. However, whether saving or investing, the basic lesson that “higher return implies higher risks” should not be lost sight of. While the need for financial literacy for the users of financial products/ services is a well accepted fact. Financial literacy for the providers of financial services would involve understanding the risks involved in their businesses and in the products that they offer to their customers. As market players, they need to understand risks inherent in complex financial products and choose wisely while committing funds. For service providers, financial literacy also involves understanding the needs of existing and potential customers and creating products and services suited to those needs. Financial literacy is also relevant for opinion makers and policy makers. Literacy is a must to gauge the needs of the population and financial institutions; to understand the risks inherent in products and markets; and to create a policy environment conducive to attainment of the national goals. Only such an approach would ensure that physical and financial resources are put to their optimum use to generate higher economic growth, while minimizing the financial stability risks.

Content of Financial Literacy

It is very necessary to discuss some important content of financial literacy which play a major role to develop sound financial stability in country. Following are the major areas of financial literacy:

Transaction of Money

This area includes the awareness of the different forms and purposes of money and handling simple monetary transactions such as everyday payments, spending, value for money, bank cards, cheques, bank accounts and currencies. Following task can come under it:

- Awareness regarding different forms and purposes of money:
- Recognition of bank notes and coins;
• Understand the amount money is used to exchange goods and services;
• Identify different ways to pay for items, in person or via the Internet;
• Recognise that there are various ways of receiving money from other people and transferring money between people or organisations;
• Understand that money can be borrowed or lent, and the reasons for paying or receiving interest.
• Use of cash, cards and other payment methods to purchase items;
• Use of ATM machines to withdraw cash or to get an account balance;
• Checking transactions listed on a bank statement and note any irregularities.

Risk and Return Analysis

Risk and return is a key area of financial literacy, incorporating the ability to identify ways of managing, balancing and covering risks and an understanding of the potential for financial gains or losses across a range of financial contexts. There are two types of risk of particular importance in this domain. The first relates to financial losses that an individual cannot bear, such as those caused by catastrophic or repeated costs. The second is the risk inherent in financial products, such as credit agreements with variable interest rates, or investment products.

Following area come under it:

• Recognition of certain financial products (including insurance) and processes (such as saving) used to manage and offset various risks (depending on different needs and circumstances)
• Applying knowledge of the ways to manage risk including the benefits of diversification and the dangers of default on payment of bills and credit agreements to decisions about:
  • limiting the risk to personal capital
• various types of investment and savings vehicles, including formal financial products and insurance products, where relevant; and

• various forms of credit, including informal and formal credit, unsecured and secured, rotating and fixed term, and those with fixed or variable interest rates

• Knowing about and managing risks and rewards associated with life events, the economy and other external factors, such as the potential impact of:

  • theft or loss of personal items, job loss, birth or adoption of a child, deteriorating health;

  • fluctuations in interest rates and exchange rates; and other market changes.

• Knowing about the risks and rewards associated with substitutes for financial products; in particular such as saving in cash, or buying property, livestock or gold; and borrowing from informal lenders.

**Financial landscape**

This content area covers knowing the rights and responsibilities of consumers in the financial marketplace and within the general financial environment, and the main implications of financial contracts. Information resources and legal regulation are also topics relevant to this content area. In its broadest sense, financial landscape also incorporates an understanding of the consequences of changes in economic conditions and public policies, such as changes in interest rates, inflation, and taxation or welfare benefits. Tasks associated with this content area include:

Knowledge of rights and responsibilities, and ability to apply it:

• understand that buyers and sellers have rights, such as being able to apply for redress;

• understand that buyers and sellers have responsibilities
• consumers/investors giving accurate information when applying for financial products;
• providers disclosing all material facts
• consumers/investors being aware of the implications of one of the parties not doing so.
• Recognise the importance of the legal documentation provided when purchasing financial products or services and the importance of understanding the content.

Knowledge and understanding of the financial environment, including:
• Identifying which providers are trustworthy, and which products and services are protected through regulation or consumer protection laws;
• Identifying whom to ask for advice when choosing financial products, and where to go for help in relation to financial matters
• Awareness of financial crimes such as identity theft and scams, and knowledge of how to take appropriate precautions.

Knowledge and understanding of the impact of financial decisions including on others:
• understand that individuals have choices in spending and saving and each action can have consequences for the individual and for society;
• Recognise how personal financial habits, actions and decisions impact at individual, community, national and international level.

**Financial Literacy and RBI Initiative**

Financial literacy will no longer be a mere moral obligation for state-run banks. If a new government proposal goes through, it will become the official responsibility of industry stakeholders, including regulators. The attempt is to build, for the first time, a formal structure to
implement financial literacy linking sectoral regulators developed by RBI. The Reserve Bank of India (RBI) released new guidelines for financial literacy and credit counselling centres after a study showed most of the existing centres were “actually working as institutions of sponsor banks”. RBI said a nationwide survey of 30 centres in 16 states showed informational material provided by these centres generally pertained to various products of sponsor banks. “Even though 53 per cent of the FLCCs (financial literacy and credit counselling centres) are run by separate trusts/societies formed for the purpose, these are actually working as institutions of sponsor banks due to their dependence for funding and administrative support,” RBI said in a release. “Thus, FLCCs are not in a position to maintain arms-length distance from sponsor banks as envisaged in the model scheme.” RBI found all such centres were located in urban and semi-urban areas and not in rural areas, where most of the financially excluded population resides. Awareness of such centres is low, RBI said, adding they serve mostly walk-in clients and have very few outdoor campaigns. RBI said lead banks of various districts of the country would be told to set up financial literacy centres in each lead district manager’s office. The banks will be given a deadline to set up these centres. This is expected to add more than 630 centres across the country. RBI said banks should consider setting up need-based financial literacy centres in more locations. The rural branches of all scheduled commercial banks will be expected to promote financial literacy. To standardise the information disseminated via such centres, RBI is preparing uniform training and educational modules that would be distributed to all banks. Banks can translate the material into different languages, with focus on explaining basic banking products such as savings-cum-overdraft account. Financial centres would be expected to maintain full record of the people served. The onus of monitoring these centres would be on the banks and the state-level bankers’
committees concerned. Within 20 days of the end of a quarter, the state-level bankers’ committees will have to submit a quarterly report on the functioning of these centres to RBI’s regional offices. Above are some new guidelines issued by RBI to develop sound financial education practices in India. RBI has a strong hope with the help of financial literacy, they can increase the small savings of household as well as small investor would convince for long term investments.

**Conclusion**

The ability of consumers to make informed financial decisions is critical to developing sound personal finance, which contributes to efficient allocation of financial resources and financial stability. Greater financial literacy can also be an important component to efforts to increase saving rates and lending to the poorest and most vulnerable consumers. Lower Financial literacy is linked to lower household savings, as well as higher reported over-indebtedness. For instance, individuals with lower levels of debt literacy transact in higher-cost manners (interest rates, fees, etc.) and report that their debt loads are excessive or that they are unable to judge whether their debt is appropriate. In addition to greater susceptibility to fraud and abuse, the lack of financial literacy might lead to borrower behaviour that increases financial fragility (i.e. greater loan losses). Informed consumers also exercise innovation-enhancing demand on the financial sector and play an important monitoring role in the market that can help improve transparency and honesty in financial institutions. Furthermore, financial illiteracy appears to be particularly severe for key demographic groups: women; less educated; low income; ethnic minorities; and older respondents. Financial literacy substantially increases the demand for banking services, but only among those with low initial levels of financial literacy and low levels of education. Financial literacy appears to also be linked to economic and social development. Recently most of the
developing countries launched various programmes to effective financial education and definitely, it would be helpful for sound financial and economic stability in the organisation.

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