Leverage the crisis for building financial literacy

Written by CKG Nair | MS Sahoo | **Updated: Mar 20 2010, 02:41am hrs**

The world has recently witnessed the leveraged power of the financial markets. But a vast majority of us stood aside in amazement and witnessed the spectacular show without understanding what was happening around us. While the causes and the consequences of the crisis are still being debated amongst the elite financial pundits and economists, it is sufficiently clear that the crisis was the creation of greater information asymmetryheightened opaqueness and the consequently reduced literacy levels. More and more complex products with hidden risk actually made even the conventionally literate illiterate. It was not a tragedy of the commons but that of the elite, who failed to visualise the destructive power of their own innovations. Not surprisingly, the focus is on financial literacy as the key to sustainable financial stability.

The financial crisis has thrown up new challenges. One challenge is how to communicate during the crisis to the stakeholders, a vast majority of whom are not financially literate. They dont understand the ins and outs of how their bank meets the capital adequacy ratios, Basel norms, prudential standards and yet their cheques are dishonourednot because of insufficient funds in their accounts but because of insufficient funds with the bank itself. Can we effectively talk to them when they are queuing to run on a bank What can the authorities do, particularly when the media is hyperactive, projecting the gloom Will complex jargon capsuled into a few minutes of exhortation help These are all practical questions facing policymakers and regulators alike.

The conventional definitions of financial literacy and capabilities got derailed in this crisis. How literate should be to undertake KYP (know your products and participants) is a more complex question now. The masters themselves have got drowned in the murky waters under the weight of their own innovations. So, what can the just literates do How much of literacy is adequate With every passing day, financial engineers churn out new designs in market structure, products and processes. By the time we understand new designs and their implications, still newer designs with much higher risks appear in the marketmaking our knowledge obsolete all the time. The frontier of financial literacy, therefore, keeps moving further away as more and more complex products emerge on the scene.

Emerging economies trying to expand the contours of their financial markets have an additional reason to worry. They also have the policy objective of financial inclusion to address. If the financial market becomes the victim of crisis more often, would greater financial inclusion lead to sharper depressions While poverty is a factor that inhibits the spread of financial literacy, there is no evidence that those who are not poor are financially literate. Educational status and income levels seem to have positive correlation with the level of financial illiteracy. The higher the education or income level, the higher is the level of sophistication of the financial markets and the level of financial illiteracy. This is why financial illiteracy is every nations concernfrom Albania to the US. This is why countries are setting up national agencies and framing laws to promote systems and standards to build capabilities for the entire population, for living in a world of inclusive finance and surviving it. Given the unifying power of financial markets, regulators and governments across the world are now working to make financial literacy a concerted initiative.

Yet another dimension of the crisis was the failure to distinguish between financial promotion campaigns and financial awareness campaignsbetween marketing efforts and literacy efforts. Marketing of products, ranging from credit cards to complex structured products, was often passed on as financial literacy campaigns. These are often efforts aimed at enrolling more and more people into the financial market by maintaining a deafening silence on its flip side. Here, the dream merchants even got the NGOs and social organisations involved. These marketing-led drives and the consequent information gaps have promoted regulators like the Financial Services Authority of the UK to come out with what they call neutral financial literacy drives in their money made clear campaign. Such campaigns pitch fork no sales, no jargon, only facts efforts in promoting financial literacy and building financial capabilities.

When it comes to imparting financial literacy in schools, policymakers in many countries complain that they cannot overload children with more and more study material. The syllabus is already back-breaking; how to add more The answer is an Irish reply. If we can teach trigonometry to teens, why not money Financial literacy is an infrastructure. Like any infrastructure, it is the baby of many agencies and private costs exceed private benefits. Coupled with the complex world of markets and products and also a variety of niche market segments, one agency cant make a dent by itself. This calls for public private partnerships to promote financial literacy and co-operation among domestic and overseas agencies.

In the run up to the early days of financial literacy drives, many agencies used the comic book approach. But is this sufficient in a fast-changing world of finance that could go into a tailspin in a flash of a second The reality is that we need to accelerate the pace of financial literacy efforts. Here again, as in the case of so many other policy tools, what works in one context may not work in another, adding to the complexities of the endeavour. But whether we can come out with tailor-made solutions for every context or not, the trajectory of financial literacy needs to be fast-tracked. There is no better opportunity than a crisis itself to chalk out such a strategy for the nation. This is something that we can leverage manifold without having to worry about over-leveraging.

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