המרכז לפנסיה,
ביטוח ואוריינות פיננסית
Pensions, Insurance and
Financial Literacy
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Financial Literacy – an Economist's Analysis

1. We economists believe in explanation and persuasion – people will understand and then the world will become better. I am not cynical. It goes back to our origin in the Enlightenment – reason will illuminate the dark parts of the society, ruled by Feudalism, Inquisition etc. The style of the Scottish Enlightenment was very clear, lucid.

2. To complement it, there comes consumer sovereignty, the belief that the consumer can make her own choices, and knows best what is good for her. This is our rationality – consistency and completion [the consumer can choose between any two situations, even with uncertainty included]. Our rationality does not imply that all we want to do it to consume more goods. Even a Buddhist monk can be a consistent rational individual – he just has other preferences.

3. The knowledge may help us in dealing with the large forces – government, monopolies, pension funds, the stock market, mortgage sellers. Our profession has a built-in mistrust of these forces, dating to Adam Smith's analysis of monopolies. We want the free market to decide the outcomes that will be efficient. Even though we know that in practice, this model is an abstraction that is rarely present in life.

4. Financial education and literacy fits well into this frame of mind. As the OECD explains, the fact that in DC pensions puts much more responsibility on the shoulders of the individual means that he will have to be educated in the secrets of Finance. If their money is in the stock market – let's explain to them about stocks and bonds and on the accumulation of interest over time [compounded interest].

5. I like the idealism of this approach, but having talked to many people on financial issues and pension reforms, I realize that it has severe limitations. [My friends the economists will typically say when they hear my specialization in pensions: I don't understand any of it.] Some of them were suggested in this conference. Limitations are due to many reasons – these issues are very quantitative, and the non-quantitative people are put off. The sociology of money managers is that they have the power, they like to intimidate the customers. [Insurance agents do it – we have a paper on this]. There are psychological hindrances that were mentioned in the lectures and discussions throughout this conference.

6. What then should be done? It is very important not to fail, because this knowledge in indeed essential. If people can learn the laws of traffic, they can learn the laws of financial traffic – how to drive safely, how not to get hurt or hurt your family, how to find your way.

Just trying to teach finance as in the college – or testing for it in the same way – may prove to be a failure. We must combine efforts of economist, psychologist, and education people to as to find the right way to approach the public, and to test its knowledge. It is very important to have a follow-up of the financial education to see what works and what does not.

<u>This is the part of our mission here at the PIF center. We think that it is important</u>.