Financial literacy: A prelude to livelihood security

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Abstract

Achieving sustainable long term economic growth is a policy concern. In this context, financial inclusion has emerged as an important topic all across the globe. Being an inseparable part of this, financial literacy refers to a person's ability to understand and use financial concepts. In the developing economy like India the role of financial literacy is very crucial where; indebtedness is a major problem that results in farmers' suicide. So, whether increasing the financial literacy is helping the rural people in general and farmers in particular to move towards owing a secured livelihood is a policy question. This paper answers how livelihood security is the resultant of financial literacy in two propositions.

Key words: Financial literacy, livelihood security, indebtedness, economic growth.

Financial inclusion has emerged as an important area of concern all across the globe for sustainable long term economic growth (Amidzic, Massara & Mialou, 2014). Financial inclusion is defined "*as the process of ensuring access to financial services and timely & adequate credit where needed by vulnerable groups such as the weaker sections and low income groups at an affordable cost*".[1] Financial inclusion aims at drawing the "unbanked" population into the formal financial system so that they will be having the opportunity to access financial services ranging from savings, payments, and transfers to credit and insurance (Hannig & Jansen, 2010). So, financial exclusion (opposite of financial inclusion) is the process which prevents certain social groups and individuals from gaining access to the formal financial system (Leyshon & Thrift, 1995). In a broader sense, financial inclusion can be defined as a state of economy where individuals or firms are not deprived from the basic financial services.

Financial literacy is an inseparable part of financial inclusion. Financial literacy refers to a person's ability to understand and make use of financial concepts (Servon & Kaestner, 2008). Another definition of financial literacy is the ability of individuals to assimilate and process financial information to make informed personal financial decisions (Hilgert &Hogarth, 2002; VanRooij, Lusardi & Alessie, 2012; Lusardi & Mitchell, 2008; Cole & Shastry, 2009). So, financial literacy can be conceptualised as having two dimensions- (a) personal financial knowledge and (b) application of personal finance.

In the Indian context, besides high transaction cost of providing financial services to low-income households, low financial literacy has slowed down the adoption of new financial products as well as the demand for basic financial services (Gine, Townsend & Vickery, 2007,2008; Cole et al., 2009; Gine & Yang, 2009). It implies that, financial exclusion in India is due to low financial literacy. Again in India, financial literacy is

[1] Rangarajan, C. (2008), "Report of the Committee on Financial Inclusion", National Bank for Agriculture and Rural Development (NABARD), Mumbai, January.

significant in the context of constant rural indebtedness resulting in farmer suicides (Government of India, 2007). That's why, role of financial literacy is important. So, an economy should try to boost rate of financial literacy. Because, increased consumer financial literacy enhances wealth (Behrman, Mitchell, Soo and Bravo, 2010; VanRooji, Lusardi and Alessie, 2012). When wealth is accumulated, individual's preference move towards better opportunity in health, water, sanitation, adequate consumption of goods and services, which speaks about their well-being. Thus, welfare (wellbeing) of an individual (an economy in aggregate) takes place on account of financial literacy.

What is livelihood and livelihood security?

Livelihoods are the ways in which people satisfy their needs, or gain a living (chambers & Conway, 1991). Livelihoods can be made up of a range of on-farm and off-farm activities. Thus, livelihood constitutes several possible sources of entitlements in simple sense. Livelihoods should generate sufficient earnings to avoid poverty, and preferably, increase the well-being of an individual. Well-being of a person means and includes adequate consumption of goods and services, having a good health condition, social status, achievement, and security (Chambers, 1995). Frankenberger (1996) also defined livelihood security as the family or community's ability to maintain and improve its assets, income and social well-being. Apart from these, Chambers and Conway (1991) identified secured ownership on resources and income-generating activities including reserves and assets those are having a capacity to offset risk, and meet contingencies as the elements of possessing a secured livelihood.

Financial literacy and livelihood security of rural people in India

For the achievement of high level financial inclusion resulting in better economic growth, financial literacy has a great importance. Because, increased level of financial literacy results in increased level of savings; and this saving constitutes the basis for capital formation (Rao, 1980). But, does this financial literacy affect the livelihood security of rural people is a policy concern. So, the connection between financial literacy and livelihood security is discussed through the following arguments.

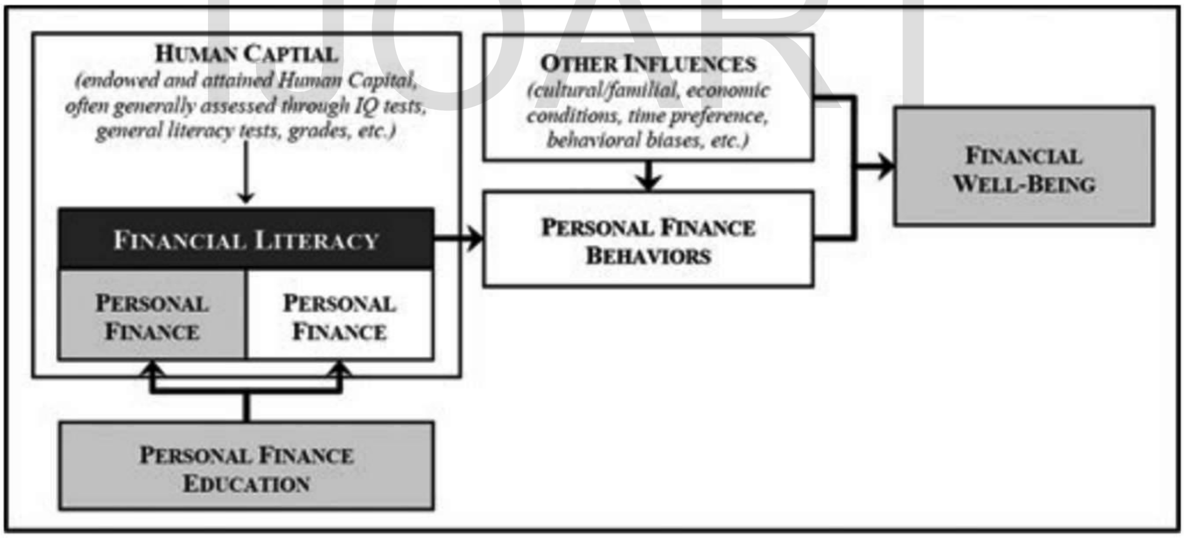
Argument I (Financial literacy, wealth accumulation and livelihood security)

Wealth of an individual refers to the value of assets regardless of their marketability (Pender, Marre & Reeder, 2012). Arrow et al. (2010) defined comprehensive wealth as "the social worth of an economy's entire productive base," which "consists of the entire range of factors that determine intergenerational well-being." So, wealth can be defined as the stock of all assets that can contribute to the well being. Thus, increasing wealth implies increasing well-being.

In the context of financial literacy and wealth accumulation, recent studies of Behrman, Mitchell, Soo and Bravo (2010) and VanRooji, Lusardi and Alessie (2012), reveal that, financial literacy has a positive impact on wealth accumulation. For creation of wealth saving is required. Rao (1980) also identifies that, saving constitutes the basis for capital formation. Saving is an investment. Because, the definition of investment says that, it is the sacrifice of present consumption for the sake of future benefits. So, when a person goes for saving he/she sacrifices his/her present fund and tries to secure his/her future. So, now we can say that, rate of investment increases as rate of savings of people increases. One important aspect here is investment. So it is imperative that why investment is given so priority in this context. The reason is that, from the literatures (Volpe,Chen &Pavlicko, 1996; Volve, Kotel & Chen, 2002; Dwyer,Gilkeson & List, 2002 ; Angrew & Szykman, 2004) it is found that, researchers have taken investment as one indicator of financial literacy. That also silently but surely speaks that, more financial literacy results in more investment in the form of savings and creates wealth form them. Thus in a nut shell it can be said that, through savings individuals move towards the **ownership of secured assets** by the help of which they can offset **their risks** or contingencies. That implies this ownership of secured assets having a capacity to offset risk, provide individuals a secured livelihood.

Argument II (Human capital, financial wellbeing and livelihood security)

In the present context, creation of wealth refers to creation of capital. With the expanded concept of capital, economists have accepted human capital besides physical goods and financial assets. Human capital as defined by Becker (1962), as the resources like education, skills and health embedded in the people. Financial literacy of a person is influenced by the attained human capital (Huston, 2010). So, financial literacy is a component of human capital. The relationship among financial literacy, knowledge, education, behaviour and well being is explained in the following figure.



(Huston, 2010)

The figure explains that, financial knowledge of an individual affects the personal finance behaviours. In the context of financial knowledge, financial education and financial behaviour, literature on financial literacy reflects two central themes (Edmiston & Gillett-Fisher, 2006). First, a positive association between financial knowledge and financial behaviour. That means, a good financial behaviour is positively associated with high level of financial knowledge (Chen & Volpe, 1998; Hilgert & Hogarth, 2003; Perry & Morris, 2005). Secondly, financial knowledge and behaviour are positively influenced by financial education (Maki, 2001; Lusardi, 2003). Thus, this changed financial behaviour due to financial knowledge and education helps individuals in making good decisions which enhances their financial well-being. As per recent definition of Consumer Financial Protection Bureau(2015), financial well-being entails having control over one’s finances day-to-day and month-to-month , having the capacity to absorb financial shocks, being on track to meet financial goals, and having the financial freedom to make choices that allow one to enjoy life (Drever et al., 2015). So, the concept of financial well being surpasses the concept of traditional financial literacy and financial capabilities. Thus, this is also leading towards a secured livelihood as the definition of livelihood talks about mitigating financial risks through the assets.

Conclusion

The above analysis makes it almost indubitable to conclude that financial education and financial behaviour are prelude to financial security. As in the macro level, financial policies are amicably shaped by precocious specialists, so in the micro level, the individual is to adopt and execute financial policies based on authentic information. Only affluence of assets without proper means of investment can lead to non-optimum output.

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