The case for better financial education

Michael and James Bartholomeusz
July 2017

Functional markets rely on well-educated consumers. This is especially true for the financial sector, from which consumers purchase some of their most important products and services. While sound financial education is always desirable, a range of current factors make this a particularly important time to ensure consumers are equipped for the coming years.

Firstly, following a dip after 2008, consumer debt levels are rising once again. As real wages stagnate – declining by 0.2% annually according to the Office for National Statistics – consumers are borrowing more to maintain their living standards. The Trades Union Congress predicts that unsecured household debt will surpass its pre-crisis level later this year; standing at £13,300 when Northern Rock collapsed in 2007, it is likely to be £13,900 by the end of 2017 and £15,000 by 2020.[1]

In this context there is a heightened risk of consumers making poor and ultimately damaging financial decisions. While the regulator, the Financial Conduct Authority, is primarily resourced to make "downstream" interventions to ameliorate any lender misconduct, excellent work is being done by debt charities such as StepChange to help consumers make better decisions. Given the extent of rising debt levels, there is a case for instigating this sort of programme in an integrated, national way.

Secondly, there are signs that the era of ultra-low interest rates may be drawing to a close. From generally above 5% in the decades leading up to the global financial crisis, the Bank of England cut the bank rate successively to a low of 0.5% from March 2009, and then to 0.25% from August 2016 shortly after the EU referendum.[2] These measures were an attempt to boost economic activity and to protect borrowers – especially those with mortgages – in a period of economic uncertainty. Nevertheless, whatever the benefits, business and consumer behaviour has become accustomed to cheap money.

In his June 2017 Mansion House speech, the Bank's governor Mark Carney noted that "some removal of monetary stimulus is likely to become necessary" and indicated that the Bank will consider raising the bank rate in the coming months.[3] This comes at a time when inflation is at 2.7%, its highest level since April 2012, and has been on a steady upward trend since the last trough of 0.2% in September/October 2015.[4] The combination of higher prices, stagnant real wages and higher costs of servicing debt will be potentially disastrous for consumers if not handled carefully.

Thirdly, the government's liberalisation of pension restrictions has created a new set of risks. Since April 2015, all over-55s have been able to withdraw their defined-contribution pensions without purchasing an annuity. While this might be a justifiable response to increasing retirement ages, severing the link between pensions and retirement income has the effect reducing the pension to just another easy-access savings product. With a market of newly cash-rich consumers to be exploited, there is a risk that poor short-term decisions will leave more people dependent on the state in later life. It is also worth noting that recent political announcements have cast doubt on the future of retirement-age benefits such as the triple-lock state pension and universal winter fuel payments.[5]

Set against the background of economic uncertainty created by Brexit, the combination of these factors suggest there is an ever greater need for greater financial education. Surprisingly, this does not currently play a significant part in the school curriculum for personal, social and health education (PSHE) and is only available in a piecemeal way for the adult population via initiatives like the Money Advice Service. This must change. Assuming no major economic policy changes are forthcoming, we must do what we can to equip consumers to navigate the turbulence ahead.

[1] https://www.tuc.org.uk/economic-issues/economic-analysis/britain-needs-pay-rise/household-debt-will-reach-record-high-first
[2] http://www.bankofengland.co.uk/boeapps/iadb/Repo.asp
[3] http://www.bbc.co.uk/news/business-40427865
[4] https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/l55o/mm23
[5] http://www.bbc.co.uk/news/business-39960309