

# Financial literacy as a leading regulator of consumption expenditure

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**Abstract** The concept of leadership has transformed over time, from a dictatorial management style to a leadership that is oriented towards serving and inspiring others to live a life with complete development of your skills no matter the field of choice, along with genre and economic status. Based on this perspective, everyone has the possibility to become a financial leader, assuming the implied challenges such as personal responsibility and not limited only to governmental influence, or schools, universities and other entities in charge to promote a healthy economy in each country. Unfortunately, throughout the world there is a lack of financial education and consciousness in this leader-financial aspect, especially in developing economies, which show rapid growth in debt rates, and at the same time levels of savings are decreasing and consumption expenditure has skyrocketed. Is in this scenario, the financial literacy takes relevance because once the people are aware of it, will be able to regulate their spending habits as the first step to become a self-leader economy.

## 1 Introduction

According with the report from S&P Global FinLit Survey (2014), only 1 in 3 adults around the world are financial literate (Klapper et al. 2015). It is important to know when it comes to the term financial literacy, the literature divided into two studied segments; first a conceptual definition that explains the concept(s) in a theoretical frame, and second, an operational definition who expresses how to relate these concepts to a particular field of study, in other words, converting them into a measurable criteria.

There are several conceptual definitions that reference the financial literacy as the knowledge of financial products, management of bank accounts, function of interest compound, risk diversification and other notions that allow consumers, investors and general people to make informed choices. (Miller et al. 2009; Emmons 2005; Lusardi 2008; Abdullah and Chong 2014; Hung et al. 2009; Huston 2019; Zait and Berteau 2015). Despite all the connotations proposed by different authors, organizations and entities concur there is not a unique consensus in the meaning of financial literacy. Nevertheless, Remund (2010) provides a framework of five key concepts based on his research that can be related to the general skills from a leader: a) basic knowledge: what differentiates a leader from others is the valuable information that produces extraordinary results. b) ability to communicate effectively: which entails the ideas offered by someone are delivered accurately. c) managing your self: it is not possible to lead others when we do not manage ourselves. d) make appropriate decisions according to the situation and the proposed vision. e) confidence in the future which is built based upon an adequate planning strategy.

Even though we embraced the conceptual definition from Remund (2010), it still lacks an operational definition per se, due that is not clear how to measure it. Until now, surveys and polls are the most common systems to measure financial literacy, especially for American researchers. However; some investigations use instruments designed to the purpose (Chen and Volpe 2002; Lusardi and Mitchell 2007).

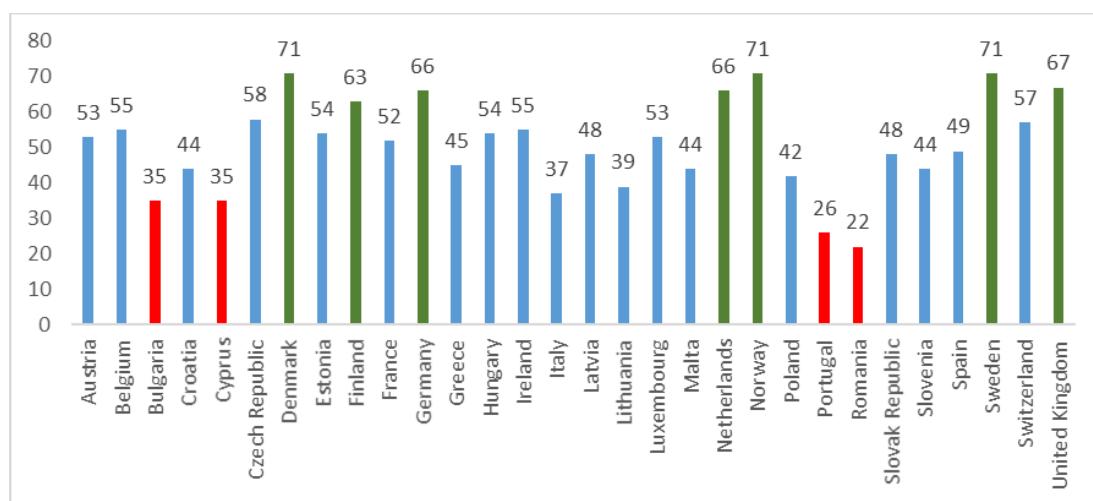
The intangibles can be described as the knowledge and skills that must be measured by the individual in some way in order to prove the efficiency of the concept models. Based upon the existing literature, there are four main categories, which fit into the operational definition: budget, saving, loans and investments. Despite the fact those operational variables are important, it is necessary to consider the consumption expenditure within the equation. “*Financial literacy can empower consumers to be better shoppers, allowing them to obtain goods and services at lower cost. This optimizes their household budgets, providing more opportunity to consume and save or invest*” (US Department of Treasury 2006). The lack of it disable people from making the right choices related with the consumption expenditure, which directly affects other aspects such as savings, excessive indebtedness and investment just to name a few. Finally, it becomes a problem for society when facing poverty, crime and disparity.

In an attempt to measure globally the financial literacy, in 2014 a survey was made by The S&P Global Finlit Survey in 140 economies assessing four main concepts: knowledge of interest rates, interest compounding, inflation and risk diversification. The results shows a disparity between the developed economies vs developing

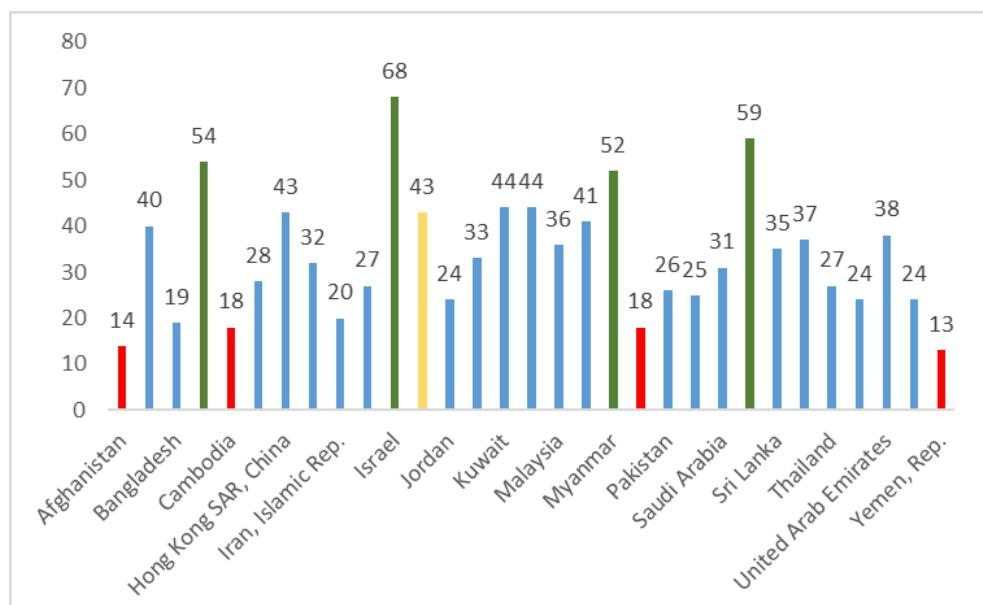
economies (OECD 2016). European countries as a Denmark, Norway and Sweden had the highest score of 71% in financial literacy (Figure 1). Meanwhile, the lowest percentage belongs to Asian economies which rate among 13% and 18%. This is the case of Yemen, Afghanistan, Nepal and Cambodia (Figure 2). The landscape for Latin American countries looks quite better, the media rate in developing countries is 30% (Figure 3). Nevertheless, those results in general show the opportunity to improve the economy in those countries by making people aware of the consumption expenditure. In fact, this action needs to get involved in a leadership role, where every single person assumes the responsibility of their finances.

Overall, it exists a worldwide ignorance of financial literacy. “*Knowledge is worthless without applied experience, and research has shown that experience forms the bridge between knowledge and aptitude*” (Hilgert and Hogarth 2002). Unfortunately, the experience most of the times comes without a clear consciousness, leading to all the economic problems that we are facing in most developing economies. The consumer behavior has not limit nowdays and it is important to understand the impact of it (Havlena and Holbrook 1986; Holbrook and Hirschman 1982). Hence it is critical to consider the behavior as an individual matter, based on the knowledge and skills that determine the process of decision – making (Block and Roering 1979)

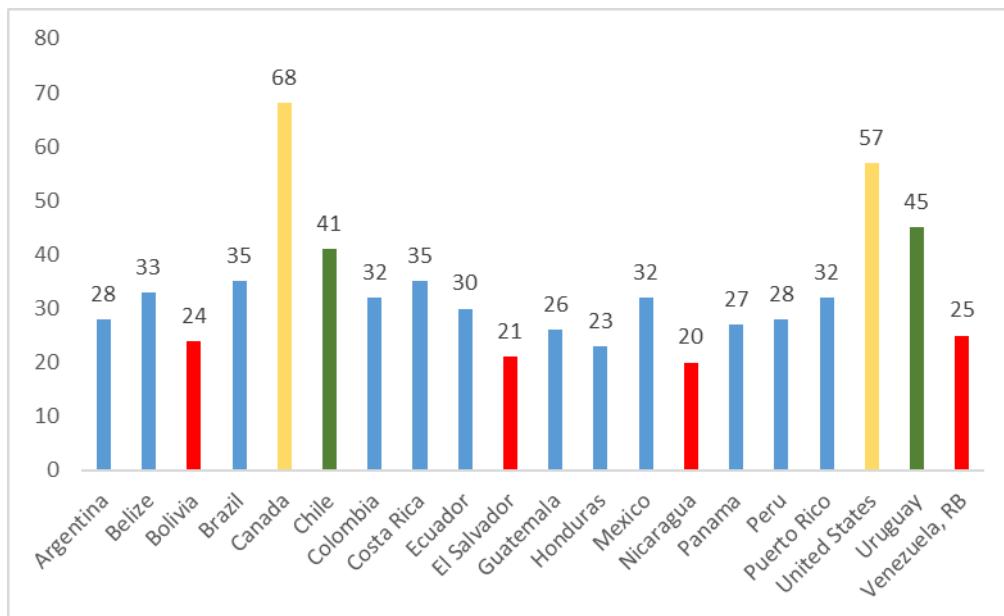
The purpose of this paper is to determine the impact of financial literacy against the consumption expenditure in different economies and how it affects the abilities of people for making accurate financial decisions that lead to healthy economy habits, encouraging savings and investment over indebtedness. Based on that new scenario, people are able to show a leadership in their own economy.



**Fig. 1.** Financial literacy 2014: developed economies in Europe  
Source: S&P Global FinLit Survey data (2014)



**Fig. 2.** Financial literacy 2014: developed economies in Middle East and Asia  
Source: S&P Global FinLit Survey data (2014)



**Fig. 3.** Financial literacy 2014: developing and developed economies in Americas  
Source: S&P Global FinLit Survey data (2014)

## 2 Methodology

There exists numerous factors which affects the consumption expenditure of the population around the world. These are sociodemographic , economic, environmental and educational influences among others. Even though the analysis can have more variables, this study takes the financial literacy as starting point.

Based on the data from OECD (2019) about the final consumption expenditure of residence households on the territory and abroad, available in local currency of each country. Seven countries were analyzed centered on the financial literacy results mentioned in the FinLit Survey, taking the three highest percentages in Europe (Denmark, Norway and Sweden, 71%) in contrast to three Latin American countries (Colombia 32%, Chile 41% and México 32%). During the initial research it became clear the total population in those countries had a similarity with at least other examined country excepting Colombia and México. Thus, it was decided to include Spain (49%) in order to have different variables. The studied facts were considered for the period 2015-2017 converting local currency to dollar, using the exchange rate as of December 31<sup>st</sup> 2017.

The components of the consumption expenditure analyzed were broken down as it follows: food and non-alcoholic beverages; alcoholic beverages, tobacco and narcotics; clothing and footwear; housing, water, electricity, gas and other fuels; furnishings, households equipment and routine; health; transport; communications; recreation and culture; education; restaurants and hotels; miscellaneous goods and services. The expenditure approach according with the literature calculates GDP by evaluating the total of all final good and services purchased in an specific economy. So with this information it was undertaken some calculations feasible with the data to determine the percentage of expenditure regarding GDP. In fact, this comparison shows the tendency of the consumer over time, expenditure preferences and the influence of financial literacy in the consumption spending.

## 3 Results

In general, if one looks at the percentages for each of the three years (2015-2017), the interesting thing to point out is that the influence of financial literacy makes the population awareness about the consumption expenditure; Denmark, Norway and Sweden have the lowest proportions (39%-46%) regarding the GDP (expenditure approach), meanwhile Colombia, Chile and Mexico exceed those values (63% -68%) (OECD 2019).

The calculations here bring to light a number of aspects: for european countries the highest spending is related with housing's rentals, maintenance, water supply, electricity, gas and other fuels, as a second major expenditure transportation followed by food and non-alcoholic beverages. In the case of Latin American countries, which have lower percentages of financial literacy, the tendency is to cover food and non- alcoholic beverages OECD (2019) first and then housing, transportation, miscellaneous goods and services.

This behaviour shows a tendency for immediate pleasure rather than a future gratification. In fact this kind of thinking cause people to make hasty financial decisions, leading to excessive indebtedness. According to a report by the Institute of International Finance (IIF 2019), the global debt at the end of the third quarter of 2018 amounted to US 244 trillion, the equivalent a three times the size of the global economy. (Global debt Monitor

2019). This data is made up of the existing debt in households US 46.1 trillion; non-financial corporations, US 72.9 trillion; government, US 65.2 trillion; financial sector, US 60 trillion. Despite the fact that exists assorted components of debt, only households represents the 19% which give us a large field of action to work. When people get conscious of the economical problems that surround them, they are able to make better choices in order to regulate the spending habits.

In the field of health, Colombia and Chile triple the percentage of the three european countries mentioned with the highest index of financial literacy. It is understood that in those countries the health system is covered by the government and works properly for most of the population. However, is interesting to recognize, that in emerging economies have to pay much more for something that is really precarious. For example, Colombia has the highest coverage in health in Latin American countries, surpassing 95% of its population (Dinero 2018). Though, according with a survey from Interamerican Development Bank the 70% of affiliates are dissatisfied with the service. Around the 30% of the people have access to a primary attention that is reflected in a major concurrence in the emergency services. The cost of medicine is not affordable, corruption has affected the quality of the health. Although is necessary the intervention of the government to improve the system, there is a part that involves the individual in different ways, leading himself to a healthy habits that improve the quality of live, which finally converts into fewer interventions in the health system.

Other interesting thing to point out is the percentage of the education expenditure for Colombia and Chile that fluctuates between 2.5% - 2.9% meanwhile Denmark, Norway and Sweden do not exceed 0.4%. Despite having a high cost to those south american countries, the general results in financial literacy are poor. It is clear that an improvement in the education system is required starting in primary school to university. Also the access to a programs of financial literacy for the people who not have the economic possibilities.

In Europe, public authorities have the responsibility to develop the national strategy for financial education through different mechanisms. In some cases, it only falls on an institution such as Sweden (Swedish Financial Supervisory Authority). For other countries, case of Denmark the Money and Pension Panel is responsible also for develop financial education. It should be noted that a large part of the strategies for financial education in Europe are completely aligned with the same national objective, which focuses not only on the strengthening of knowledge but also on the responsible promotion of financial behavior and the resilience capacity. This last aspect is striking, since western culture any type of financial failure becomes an object of humiliation and, consequently, the loss of opportunities for growth in this area.

Another field that is considerably higher than European countries is clothing and footwear. South American countries double the percentage reflecting around 4% for the studied periods. Which is interesting because not all the countries are limited by the seasons. This is the case of Colombia due to its proximity to Ecuador, so the temperatures are almost the same during the year. Then, we could emphasize that the acquisition of clothing and footware is more a trend rather than a necessity. Chile is affected by seasons and the portion of the GDP in this field is 3.7% still high compared with Europe under the same conditions.

Regarding the consumption expenditure in restaurants and hotels Spain is at the top of the list, having 10% followed by Colombia with 7.8% regarding the analized GDP. In fact is the second and fourth level in importance for these countries respectively. Which is interesting because it denotes that people's priorities are centered not only in the basics for living but also in the pleasure of the food rather than recreation and culture.

## 4 Conclusions

Financial literacy is a fast growing challenge as developing countries experience an increased access to financial services. Access to these services has become more available as technological, and geographical constraints are reduced. Cell phone infrastructure, urbanization, and a globalized market allow that even poor, rural populations can easily access a bank account from a mobile phone or computer. Increasing financial literacy in developing countries is a public good and a potential function of foreign assistance in partnership with financial service companies, government agencies and financial regulators.

At the same time, the creation of programs can play a critical role in reducing economic inequalities and reducing information discrepancies between financial intermediaries and their customers. Governments have a responsibility to develop financial education policies and create sustainable financial consumer protection systems to ensure that consumers are well informed so they can understand the vast array of products available to them. But unless consumers are trained to make smart decisions when using financial services, the gap will always be present. However, it is here where personal leadership takes an important role, people are able to regulate their consumption expenditure as a first step to become financially free, to then start making accurate economic decisions.

In the specific case of Latin America, it is imperative to incorporate strong user experience and educational components into the development and distribution of financial products to increase financial literacy, together with building websites and other services that break down fees and interest rates to help people understand their options. This will allow to take full advantage of existing distribution channels and points of sales with the

intention to create a Big Data Framework that would utilize that information in order to learn more about purchasing and transaction habits, as well as to provide further education on how to utilize these new alternatives.

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