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Making Business Sense

Potential benefits of implementing financial education

A Cebr report for Moneysavingexpert.com

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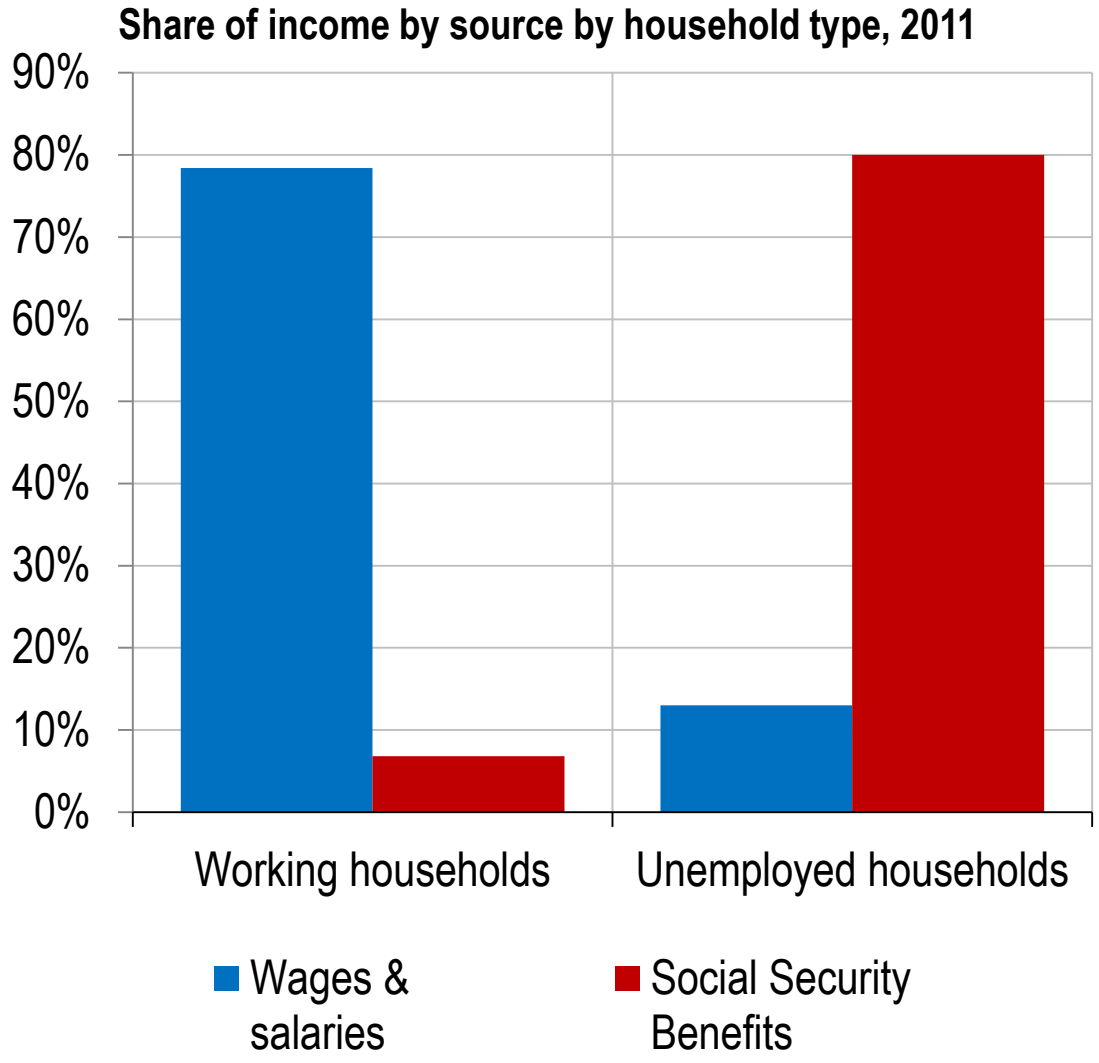
This report was produced by Centre for Economics and Business Research (Cebr) for Moneysavingexpert.com.

Executive summary

- The less financially literate a household is, the more likely it is to face financial misfortunes.
- Better financial education (FE) is likely to help consumers make retirement planning more effective, boost job prospects, avoid excessive debt, balance their books and make more prudent purchases.
- Implementing FE could decrease the cost of unemployment. The UK government subsidises unemployed households by some £6.0 billion a year, in the form of additional benefits on top of what the average working household receives. Better overall education could help reduce the risk of unemployment by some 40%; here we estimate that financial education specifically could reduce unemployment by 10%. This would help to lower the unemployment subsidy by £600 million a year.
- FE could also help decrease the cost of retirement to the taxpayer. The government spends roughly £6.2 billion a year subsidising the incomes of those that did not save adequately for retirement. We estimate that implementing FE would cut this cost by £1.8 billion a year.
- A lack of FE has helped consumers to accumulate excessive debts that they struggle to, or cannot, pay off. This excessive debt could have been used more productively elsewhere in the economy, e.g. by financing the investment plans of small and medium enterprises. The economic activity that this could have generated may have contributed some £720m a year to government tax revenues.
- Consumer detriment (a cost to the individual from dealing with a provider) in the professional and financial services industry is estimated at £1.2 billion a year. We estimate that implementing FE could help to reduce this figure by £244 million a year.
- The total benefits of implementing FE are estimated in this study at £3.4 billion a year.
- However, there are factors that could be the subject of further research that we have not included here. One additional example of a potential benefit of FE is helping to lessen the impact of scams and fraud. The social cost of child poverty, experienced through bankruptcy and a greater risk of unemployment, could also be studied. As such, the total impact of FE could well be greater than we have estimated in this report.

Large cost to government from financing long-term unemployed households

- There is a significant cost to public coffers from subsidising the incomes of long-term unemployed households, as explained below.
- Long-term unemployed households receive as much as 80% of their weekly income, or £178 a week, from social security benefits.
- This is significantly more than the average working household, which receives just 6.8%, or £63 a week from benefits.
- In addition, the average long-term unemployed household receives £93 a week in benefits and allowances to reduce rental costs. This compares to just £6 a week for the typical working household.
- With an estimated 570,000 households in long-term unemployment, the effective amount that the government subsidises these households is estimated at around £3.4 billion a year in benefits and £2.6 billion a year in housing subsidies.
- This makes a total cost of £6.0 billion a year to the government for subsidising those out of work for the long term.

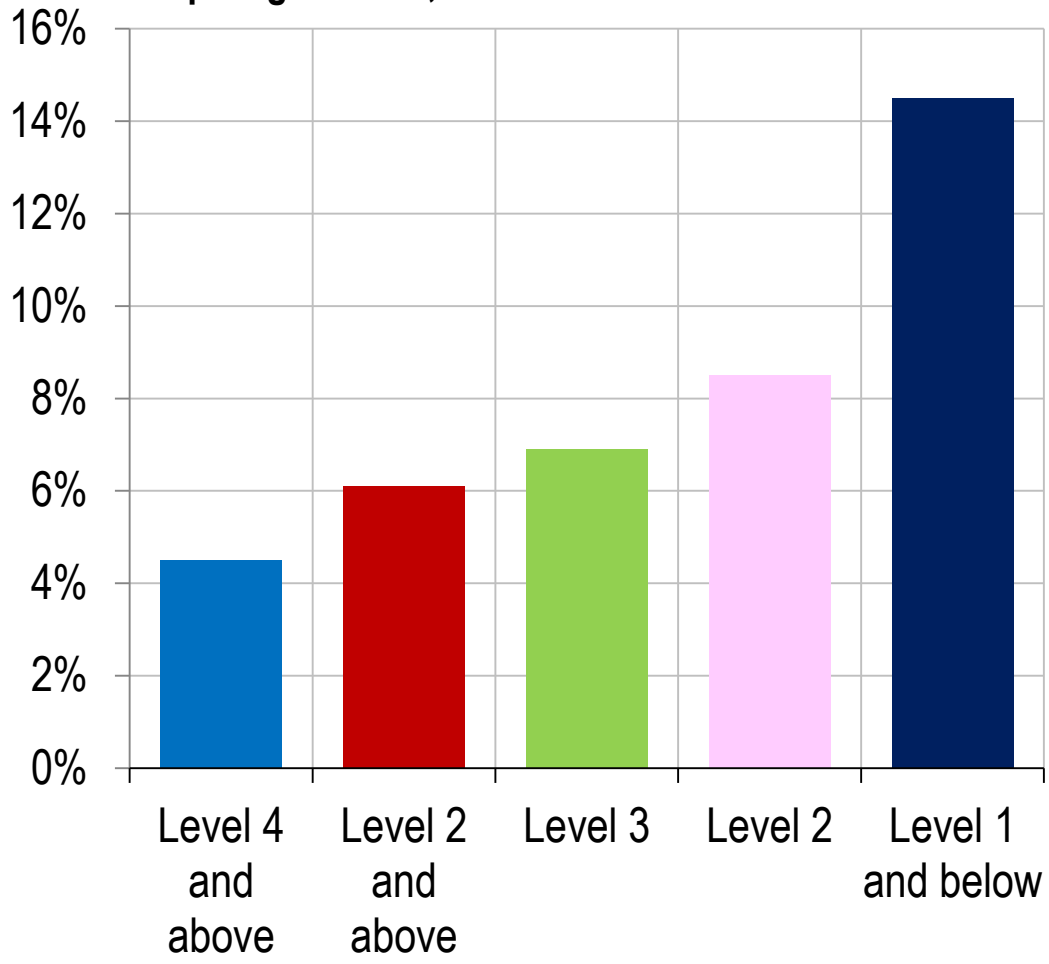


Source: ONS Family Spending Report 2012

Financial education could reduce unemployment subsidy by £1.2 billion

- There is evidence to suggest that better education and better financial education can help to reduce the risk of unemployment.
- According to the Department for Education, those with Level 2 educational qualifications (equivalent to good GCSE grades) experienced an unemployment rate some 40% below those with Level 1 or below qualifications (e.g. weak GCSE grades).
- An academic paper* suggests that roughly half the effect of schooling on labour force participation can be attributed to the sorts of numeracy and literacy skills that can be gained from financial education.
- This would give an estimate that instituting additional financial education in the national curriculum could help to reduce the cost government subsidies for long-term unemployment by as much as a 20%. As a conservative estimate, we suggest a 10% reduction.
- This 10% reduction in the number of long-term unemployed households could save the government some £600 million a year.

Unemployment rate by highest qualification held, People aged 19-64, 2011

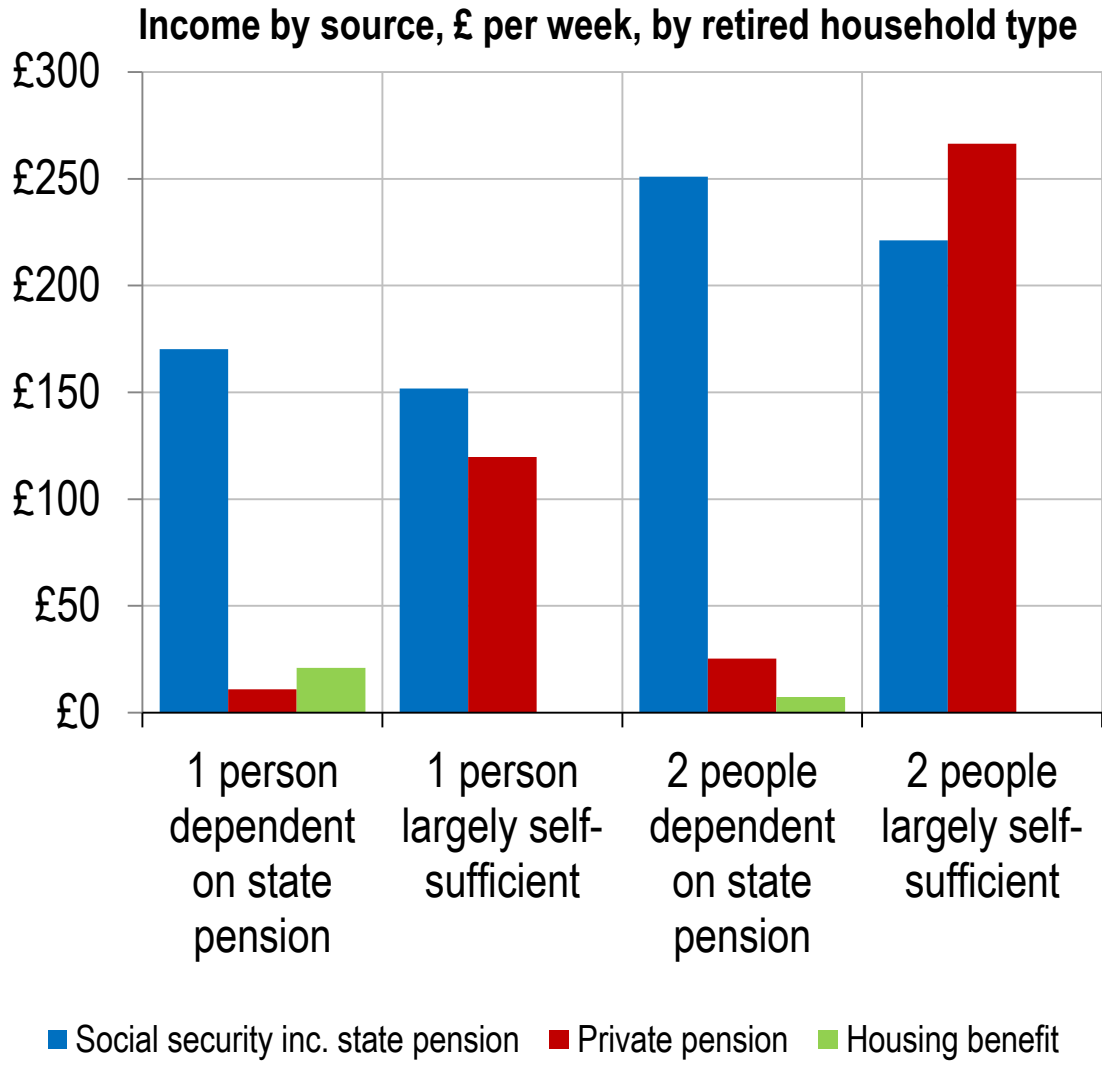


* Chiswick, Lee and Miller (2003)

Source: Department for Education

More than a million retired households didn't save adequately for retirement

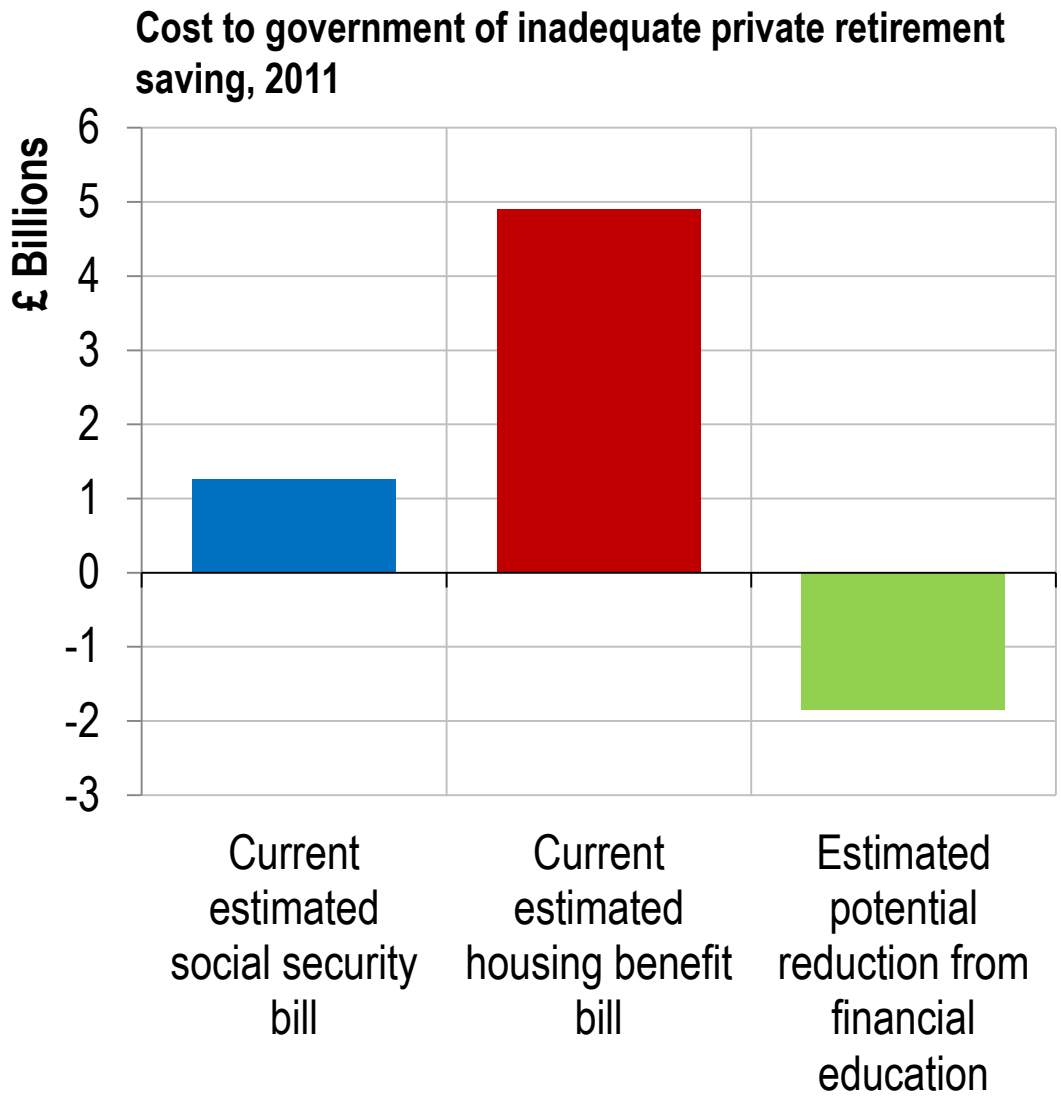
- A further cost to the government comes from subsidising the incomes of those that didn't save adequately for retirement, estimated at £6.2 billion a year. This estimate is explained below.
- In 2011 there were 1.1 million retired households that were largely dependent on state benefits (i.e. for more than 75%) for their weekly income.
- 1- and 2-person retired households dependent on state pensions received £170 and £251 a week in state pensions and benefits in 2011, compared to £152 and £221 for more self-sufficient households. Across the 1.1 million households this amounts to some £1.3 million a year in additional benefits.
- In addition, 1- and 2- person retired households dependent on state pension on average received £100 and £59 a week in housing subsidies , compared to nothing for more self-sufficient households that own their own home. Across retired households dependent on state pension this amounts to an annual subsidy of £4.9 billion.



Source: ONS Family Spending Report 2012, Cebr analysis

Better education on retirement planning could reduce government costs by almost £2 billion a year

- Financial education from a relatively early age could help to reduce this cost.
- A paper from the National Bureau of Economic Research (NBER) looked into the role of financial literacy on savings behaviour with some worrying findings for retirees.
- For instance, the paper found that only 18% of workers knew the correct age at which they would receive a pension.
- The study discovered that upon attendance of seminars designed to provide information to assist in the retirement planning process, 30% of attendees reported changes in retirement savings goals.
- If then we assume that adding financial education to the national curriculum would have as much as a 30% success rate in convincing students to save enough for retirement, then financial education could help to reduce the government's cost from subsidising those with inadequate retirement savings by some £1.8 billion a year.

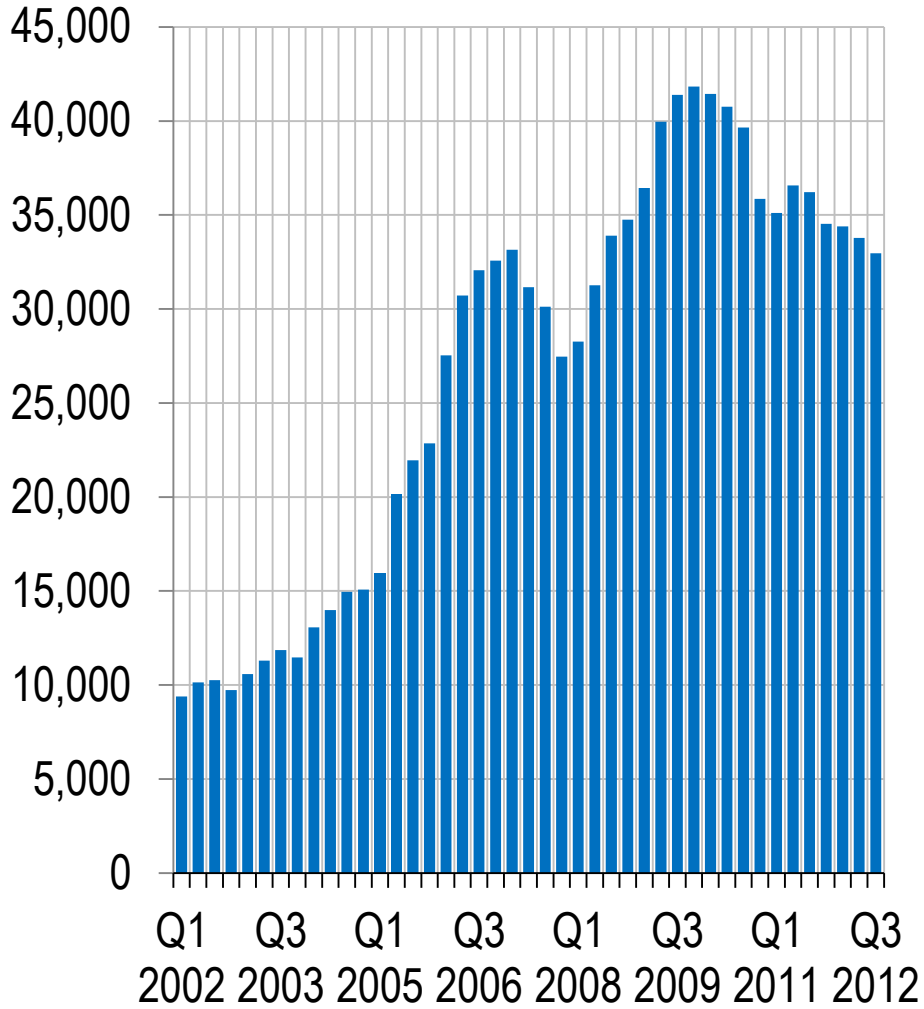


Source: Cebr analysis

More than 142,000 personal insolvencies a year as UK economic conditions remain tough

- The years up to the financial crisis saw significant increases in consumer debt, with many finding themselves struggling to make repayments.
- Indeed, the number of individuals facing bankruptcy or entering individual voluntary agreements (where alternative payment options are agreed with the lender) rose significantly during the 2008-09 recession to a peak of 42,000 in Q4 2009.
- This figure has remained high recently, at 142,000 in 2011 as a whole, as unemployment stands at elevated rates and earnings growth remains weak. We can define the debt held by these individuals as being an 'excessive' or a 'bad' debt.
- We estimate the average debt held by those falling behind with payments or filing for bankruptcy at almost £100,000 in 2011. One fifth of this (£20,000) is unsecured debt while almost £80,000 is left to pay on a mortgage.
- Our estimate for the total level of excessive or bad debt is £14.2 billion in 2011, i.e. almost £100,000 for each of the 142,000 individuals filing for bankruptcy.

Total UK personal insolvencies including bankruptcy and individual voluntary agreement

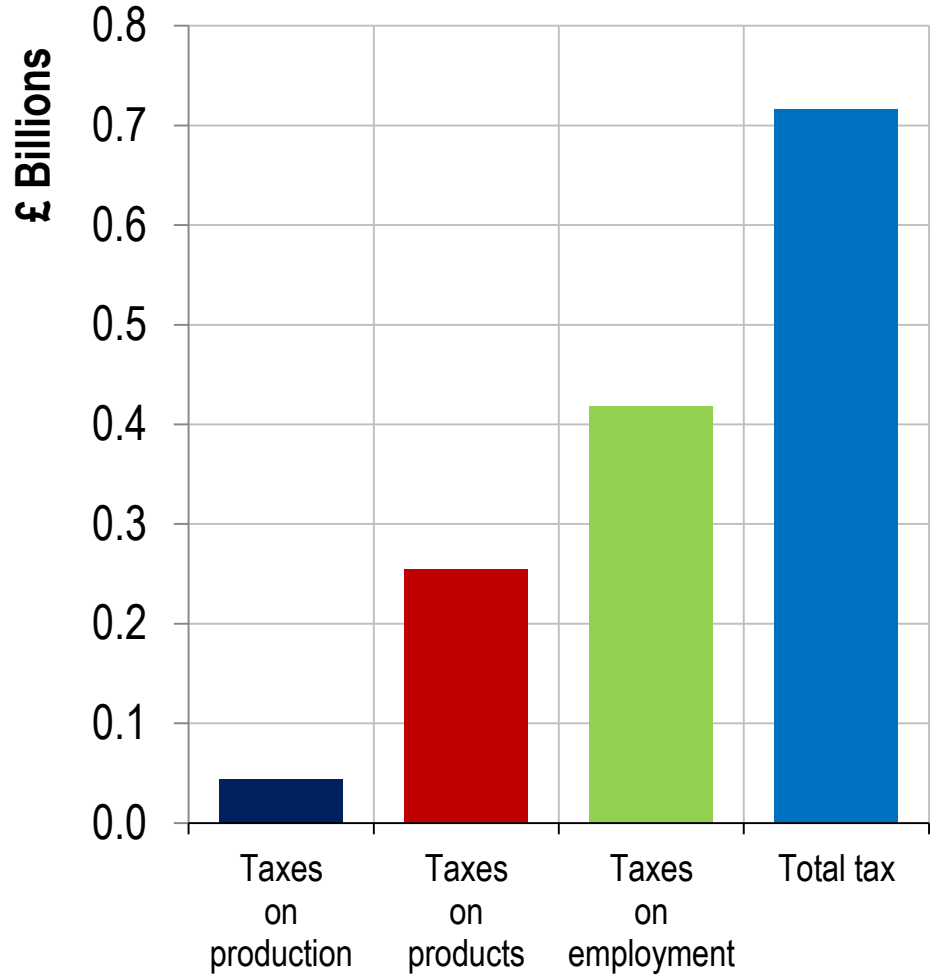


Source: UK Insolvency Service, Cebr analysis

Bad debts could be put to better use – government could be missing out on tax income from better investments

- A lack of financial education helped contribute to this unsustainable build-up of debt and subsequent bankruptcies.
- We estimate that a third of these bankruptcies could have been avoided; of those that attended a financial instruction seminar, 33% reported that such a course would've helped to avoid filing for bankruptcy.
- This means that roughly £4.7 billion of the £14.2 estimated bad debts could have been prevented through the implementation of financial education.
- These bad debts, a deadweight loss to society, could have been put to more productive use elsewhere in the economy.
- A more productive use for these bad debts could have been closing the "funding gap" that small and medium sized enterprises (SMEs) are experiencing. SMEs are currently the fastest-growing business area of the UK, seeing 2.9% turnover growth in 2012 compared to 2.3% for large firms.
- If the £4.7 billion of avoidable bad debt had been loaned to SMEs, we estimate that the Exchequer could have received **an additional £716 million in tax revenue**.

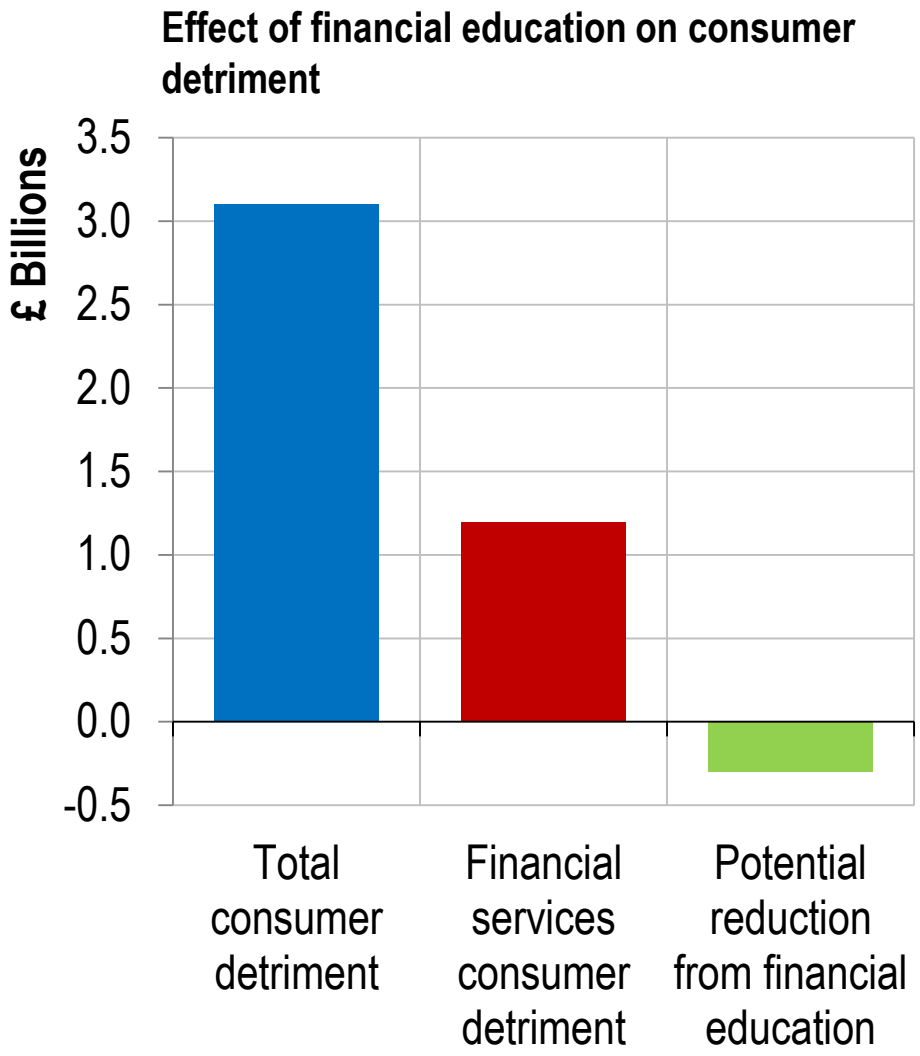
Potential loss to government from foregone tax revenues due to inefficiently allocated loans, 2011



Source: Cebr analysis

Consumer detriment creates a welfare loss to society; this could be reduced by financial education

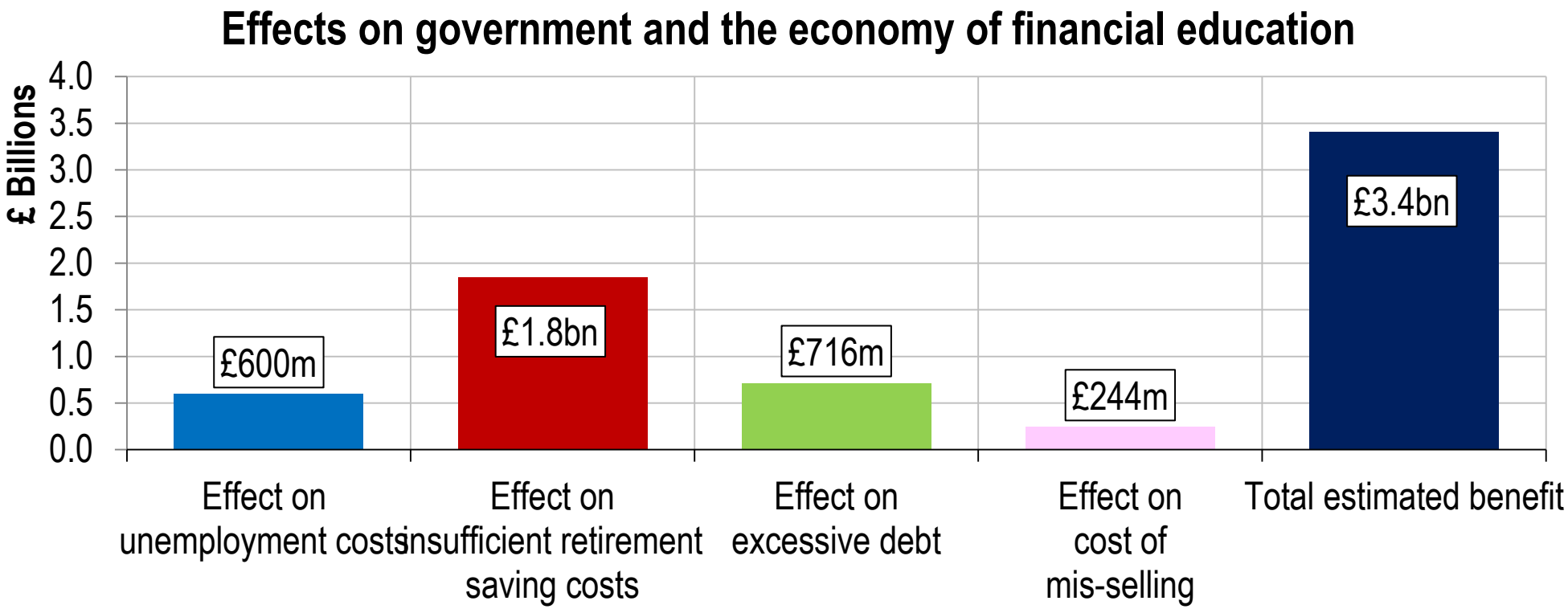
- The total value of consumer detriment in the economy is estimated by Consumer Focus at £3.1 billion in 2012. This is to the individual of the cost of dealing with a trader that provides an unsatisfactory service and includes issues such as mis-selling.
- Of this headline figure, £1.2 billion is estimated for the financial and professional services sector – the highest of any other sector.
- Financial education is likely to play a significant role in reducing the level of consumer detriment from the financial and professional services sectors.
- In line with our research on the other potential effects of financial education, we assume a relatively conservative 20% success ratio of financial education on the incidence of consumer detriment.
- The result of this is that financial education could reduce consumer detriment, a welfare loss to society, by as much as £244 million a year.
- This compares to the Office for Fair Trading's annual budget for consumer enforcement of £9 million.



Source: Cebr analysis, Consumer Focus

Government and economy could gain significantly from effective financial education

- Aggregating the different effects on welfare and government finances shows that financial education is likely to have a significant positive effect.
- The benefits from reduced social security payments from the unemployed and pensioners, as well as the effect on debt and mis-selling, sum to a total positive impact of £3.4 billion a year.



Source: Cebr analysis

Areas for further study

- In this report we have considered the impact on the government and the economy of implementing financial education through four channels:
  - Reducing the risk of unemployment
  - Helping consumers to plan more effectively for retirement
  - Reducing the risk and cost of bankruptcy
  - Helping to minimise the effects of consumer detriment, e.g. through mis-selling

- We have estimated a total impact for these channels. However, there are also likely to be further ways that financial education could have positive impacts that could be considered in future studies.

- This could include:
  - Reducing the risk that consumers fall victim to scams and fraudulent activity
  - Reducing the cost that child poverty has on the government and the economy, through reducing the risk of unemployment and bankruptcy.

- As such, the total impact of implementing financial education could well be higher than is estimated in this report.

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