The importance of financial education for effective reforms

Overview

- Structural economic reforms – such as labor market and pension reforms – typically imply sacrifices today in exchange for benefits tomorrow. As such, they can be viewed as "social investments". The popular view, however, is that they represent a bitter medicine against an ill-defined disease. Politically, reforms are therefore difficult to realize because of the electorate's discontent.
- People won't necessarily vote out a politician that takes painful steps provided they understand their necessity. Indeed, if people understand the need for reforms, they do not see them as mere punishment ("austerity") and may not express their dissent at the polls.
- In a 2017 study[1] Elsa Fornero and Anna Lo Prete (University of Turin) took a dataset including information on parliamentary elections held between 1990 and 2010. The authors collected data on electoral outcomes, pension reforms, education, macroeconomic, demographic, and political factors in 21 OECD countries, namely: Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Netherlands, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, and United Kingdom.
- Fornero and Lo Prete considered whether the incumbent government introduced a "fundamental" (structural) pension reform. More specifically, they defined "major" a pension reform that satisfies both the following criteria:
  - introduces a structural change that - according to valuations of the international institutions (such as the OECD, the WB, or the IMF) – has an impact in terms of financial sustainability and/or income adequacy;
  - has a broad scope, that is, it affects the generality of workers and not only specific categories, including reforms which aim at greater integration of public and private pillars of retirement systems.

Research findings

The authors found that:

- The introduction of a "major" pension reform increases the probability of the head of the government to be re-elected by 15 percentage points for a country with the average level of financial literacy in the sample under analysis.
- These results do not hold when less specific indicators of education - such as school attainment - are used, suggesting that the knowledge of basic economic and financial concepts has distinctive features that help explaining government re-election probabilities in the aftermath of pension reforms. Financial literacy indicators seem to capture a specific dimension of human capital that is relevant to the association between re-election probabilities and major economic reforms of the pension system.
- Since pension reforms have a relevant economic content, the results are in line with the idea that their understanding requires some basic economic and financial knowledge (like the notions of accumulation, compound interest, debt, and risk diversification).

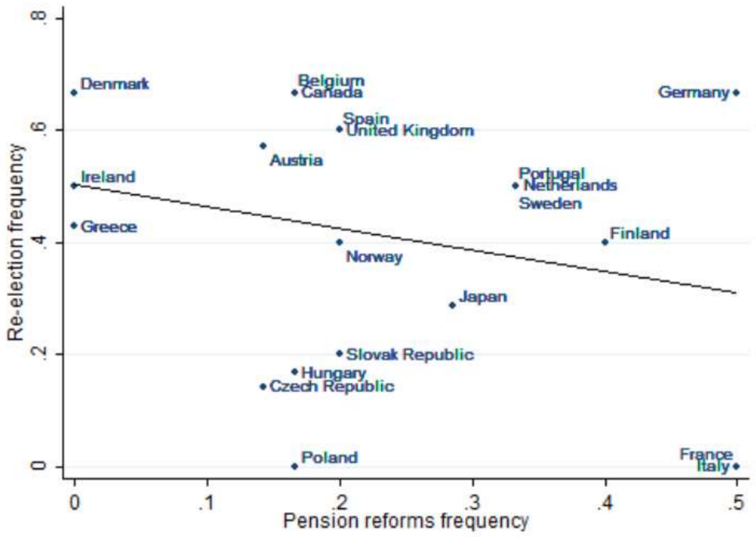
Policy implications

The study delivers an important policy implication: instead of trying to convince people that nothing will change for them with the implementation of the reform, financial education programs can be a tool to involve citizens in social change, make them less prone to populist solutions and make reforms more effective.

[1] "Voting in the Aftermath of a Pension Reform: The Role of Financial Literacy" by Elsa Fornero and Anna Lo Prete, CeRP WP 171/17; forthcoming on the *Journal of Pension Economics and Finance*.

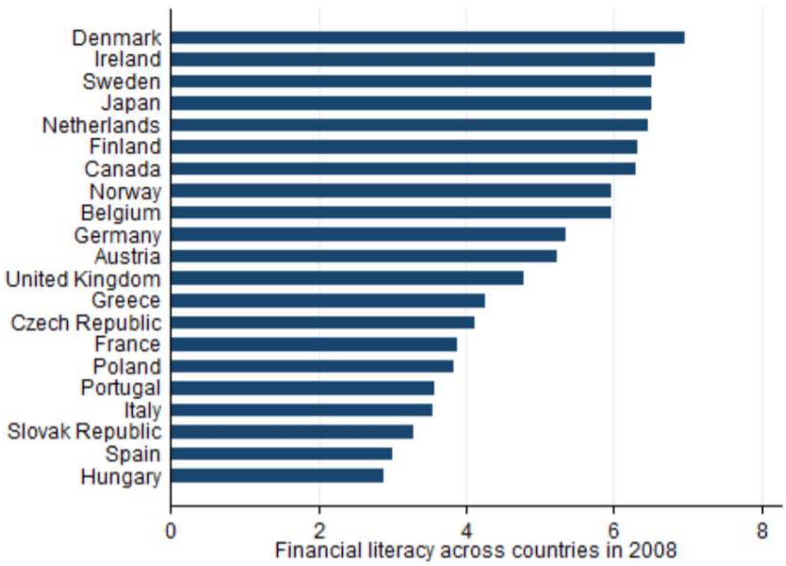
Future research might successfully extend the analysis, for instance, by collecting information on other reforms belonging to the same policy package of the pension reforms, or approved during the same legislature, such as changes in labour market regulation. And possibly use more direct indicators of economic and financial knowledge, like the PISA and other surveys providing cross-country analyses, as soon as they become available.

Figure 1. Pension reforms and re-election frequencies.



Notes: The panel plots the number of re-election events against the number of major pension reform episodes in each country, both weighted by the number of election events over the 1990–2010 period.

Figure 2. Level of financial literacy across countries in 2008.



Figures from Fornero and Lo Prete's paper.