Title: The Perception-Reality Gap in Financial Literacy: Evidence from the Most Literate State in India

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<AT>The Perception-Reality Gap in Financial Literacy: Evidence from the Most Literate State in India

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<ABS-HEAD>Abstract

<ABS-P>This study measures the level of financial literacy and evaluates the impact of demographic and socio-economic attributes on financial literacy among the educated young adults in Kerala, the most literate state in India, during the year 2015. The study also analyses the perception-reality gap in financial literacy and the attitude of young adults towards financial education. Primary data collected using a structured questionnaire from 736 young adults is used in this study. Statistical techniques such as analysis of variance and chi-square test are employed to analyse the data. The findings reveal that the financial literacy in Kerala is low, with an average young adult answering only 44% of the questions correctly. The study finds that gender, marital status, age, religion, education, the discipline of study, occupation, work experience, income, and parents' education and their occupation influence financial literacy. It is also observed that respondents tend to overrate their financial literacy by around 50%, indicating their over-confidence in the knowledge of matters related to personal finance. However, a majority of the respondents (89%) expressed the need for financial education for young adults. This study, hence calls for initiatives to improve financial literacy among young adults in Kerala and for further research in this direction.

<ABS-P>**JEL Classification**: D14; G02

<KWD>Keywords: financial literacy; financial behaviour; self-reported financial literacy; Kerala; India

<H1>1. Introduction

Financial literacy refers to the capability of individuals and households to effectively manage their personal finance. The present era marks phenomena such as increasing life expectancy, rising costs of living, the complexity of financial products, contributory pension plans, and growth of financial markets. These developments make the knowledge of financial matters necessary to secure one's financial future. However, research from around the world reveal low levels of financial literacy among individuals (Chen and Volpe, 1998; Beal and Delpachitra, 2003; Lusardi and Mitchell, 2007; Mandell, 2008; Atkinson and Messy, 2012), despite evidence of the positive correlation between financial literacy and economic behaviour of people (Lusardi and Mitchell, 2005; Gerardi et al., 2010; Van Rooij et al., 2011; Bruhn et al., 2013; Lusardi and Tufano, 2015). This lapse in financial literacy concerns policymakers in various countries (Van Rooij et al., 2011).

United Nations Report (2012) identifies 'financial illiteracy' as one of the primary bottlenecks of achieving financial inclusion and development across the world. According to the UNSGSA Report<xps:span class="xps_endnote">1</xps:span>, two billion adults are not included in the formal financial system. These people tend to rely heavily on expensive and often unreliable informal channels of money-lenders, pawnbrokers and savings clubs for their financial needs and thus deprive themselves of the access to a wide range of financial services available in the organised sector. Therefore, from a micro and macro perspective, it is important to educate the financially excluded about the benefits of being part of the mainstream. Governments around the world and international organisations like United