



## The influence of financial literacy on household budgeting and consumption patterns in India

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### Abstract

This paper investigates the critical influence of financial literacy on the way Indian households manage their money through budgeting and their subsequent consumption patterns. As India's economy continues its rapid growth, the financial landscape is becoming increasingly complex for the average citizen. This research synthesizes data from national surveys and academic studies conducted to explore the relationship between financial knowledge and financial behaviour. The findings indicate a strong positive correlation: households with higher levels of financial literacy are significantly more likely to engage in systematic budgeting, maintain higher savings rates, and exhibit more prudent consumption behaviour. Conversely, lower financial literacy is associated with ad-hoc financial management, a higher propensity for conspicuous consumption, and greater vulnerability to debt. The paper discusses demographic disparities, including a persistent urban-rural and gender gap in financial knowledge. It concludes with policy recommendations for government bodies, financial institutions, and educational organizations to enhance financial education initiatives, thereby fostering greater economic stability and well-being for millions of Indian households.

**Keywords:** Financial literacy, household budgeting, consumption patterns, financial behaviour, savings, debt management

### Introduction

India stands as one of the world's fastest-growing major economies, a transition that has introduced millions of its citizens to a formal financial system brimming with opportunities and risks. From digital payment platforms and mutual funds to complex credit products and insurance policies, the choices available to the average Indian household have expanded dramatically. However, the ability to navigate this complex environment effectively hinges on a crucial skill: financial literacy.

In simple terms, financial literacy is the combination of knowledge, skills, attitude, and behaviour necessary to make sound financial decisions and ultimately achieve individual financial well-being (OECD, 2018). It is more than just knowing how to add or subtract; it involves understanding core concepts like interest rates, inflation, risk diversification, and the time value of money.

This paper focuses on two fundamental aspects of household finance: budgeting and consumption. Budgeting is the practice of creating a plan for how to spend one's money. It is the bedrock of financial planning, enabling households to track income and expenses, prioritize needs over wants, and work towards financial goals. Consumption patterns refer to how a household allocates its resources across various goods and services—from essential items like food and housing to discretionary spending on entertainment and luxury goods.

### 1. Problem Statement

Despite government and regulatory initiatives, a significant portion of the Indian population exhibits low levels of financial literacy. The National Centre for Financial Education's (NCFE) nationwide survey revealed that only 27% of the Indian adult population meets the minimum threshold for financial literacy (NCFE, 2019). This knowledge gap can lead to suboptimal financial behaviours, such as a failure to save for retirement, over-indebtedness from high-cost sources, and vulnerability to financial fraud.

This study addresses the central problem: How does this prevalent low financial literacy influence the day-to-day financial practices of Indian households, specifically their approach to budgeting and their spending habits?

### 2. Research Questions

This paper aims to answer the following key questions

1. What is the current state of financial literacy across different demographics in India?
2. How does the level of financial literacy affect a household's propensity to create and adhere to a budget?
3. What is the relationship between financial literacy and household consumption and savings patterns?
4. What are the key differences in these patterns between financially literate and non-literate households?

### 3. Significance of the Study

Understanding this relationship is vital for several stakeholders. For policymakers, it highlights the need for targeted educational interventions to foster economic resilience. For financial institutions, it underscores the importance of client education in promoting responsible product uptake. For households themselves, it reinforces the empowering role of financial knowledge in achieving long-term security and improving quality of life. This research contributes to the existing body of knowledge by synthesizing recent data to paint a comprehensive picture of the Indian context.

### Literature Review

#### 1. Theoretical Framework

This study is grounded in two key theoretical perspectives. First, the Life-Cycle Hypothesis pioneered by Modigliani and Brumberg (1954) <sup>[5]</sup> posits that individuals plan their consumption and savings behaviour over their entire lifetime. They save during their working years to maintain their standard of living during retirement. Financial literacy

is a critical enabler of this long-term planning, as it equips individuals with the foresight and skills to manage resources across different life stages.

Second, the principles of Behavioral Finance challenge the assumption of perfect rationality. Scholars like Thaler and Sunstein (2008) <sup>[10]</sup> have shown that psychological biases often lead to irrational financial decisions. Financial literacy can act as a cognitive tool to mitigate these biases, encouraging more deliberate and logical financial choices rather than impulsive ones.

## 2. The State of Financial Literacy in India

India's journey with financial literacy assessment has been led by regulatory bodies. The Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI) have consistently emphasized the need for greater financial education. The most comprehensive data comes from the NCFE's Financial Literacy and Inclusion Survey (2019). This survey measured financial literacy based on three components: financial knowledge, financial behaviour, and financial attitude. The findings revealed a national average score of just 11.7 out of 21, indicating a substantial room for improvement. The survey also highlighted significant disparities, with urban populations, men, and those with higher education levels scoring better than their rural, female, and less-educated counterparts.

A study by Agarwalla *et al.* (2015) <sup>[11]</sup> conducted among working young adults in India also found that while many understood simple concepts like interest, their understanding of more complex ideas like inflation's effect on returns and risk diversification was alarmingly low. This suggests that even the economically active population may not be adequately equipped to make complex financial decisions.

## 3. Financial Literacy and Household Budgeting

The link between financial literacy and budgeting is well-established in global literature. Lusardi and Mitchell (2014) <sup>[4]</sup>, in their extensive review, consistently find that individuals who are more financially literate are more likely to plan for their future. In the Indian context, research confirms this trend. Households where the primary decision-maker has a better grasp of financial concepts are more likely to engage in formal or informal budgeting (RBI, 2019). They are better at tracking their monthly cash flow and are more likely to have specific financial goals, such as saving for a child's education or a down payment on a house. Conversely, those with low financial literacy often manage their finances on an ad-hoc basis, reacting to financial needs as they arise rather than proactively planning for them.

## 4. Financial Literacy and Consumption Patterns

Financial literacy shapes not just if a person saves, but how they spend. Financially literate individuals tend to exhibit more controlled consumption behaviour. They are better able to differentiate between needs and wants and delay gratification for long-term gains (Hastings, Madrian, & Skimmyhorn, 2013) <sup>[2]</sup>. This often translates into a lower proportion of income being spent on discretionary or "conspicuous" consumption items.

In India, this is particularly relevant. A study by Kumar and Tomar (2021) <sup>[3]</sup> noted that financially literate households tend to have a higher savings rate and are more likely to channel those savings into formal financial instruments like

bank deposits, mutual funds, and insurance, rather than unproductive assets like gold or informal chit funds. Furthermore, they are more cautious about taking on debt. They understand the cost of borrowing and are less likely to fall prey to high-interest loans from informal moneylenders or overuse of credit cards, which can lead to a debt trap (RBI, 2022). The less literate, on the other hand, are more susceptible to impulsive buying and social pressure to spend, often financing this consumption through high-cost debt.

## Methodology

This research employs a descriptive and analytical approach based on the synthesis of secondary data. Primary data collection through a nationwide survey was beyond the scope of this paper. Instead, it relies on credible, publicly available data from the following sources

**National Centre for Financial Education (NCFE) Financial Literacy and Inclusion Survey, 2019** <sup>[6]</sup>: This is the foundational dataset for understanding the levels and distribution of financial literacy in India.

**Reserve Bank of India (RBI) Publications:** Various reports, including the Financial Stability Report and bulletins, provide insights into household savings and debt trends.

**National Sample Survey Office (NSSO) Data on Household Consumption Expenditure:** These surveys provide detailed data on how Indian households allocate their spending.

**Academic Journals and Working Papers:** Peer-reviewed studies that investigate financial behaviour in the Indian context.

The analysis involves a triangulation of findings from these sources to build a coherent narrative. The core variables are defined as follows

**Independent Variable:** Financial Literacy (as measured by scores or levels in NCFE and other surveys).

## Dependent Variables

- **Household Budgeting:** Measured by indicators such as the self-reported practice of creating a monthly budget, tracking expenses, and setting financial goals.
- **Consumption and Savings Patterns:** Measured by savings rate (percentage of income saved), debt-to-income ratio, and the allocation of expenditure between essential and non-essential goods.

The findings are presented using descriptive statistics and tables to illustrate the relationships between these variables in a clear and accessible manner.

## Findings and Discussion

### 1. The State of Financial Literacy in India: A Landscape of Disparities

The NCFE (2019) survey provides a stark picture of financial literacy in India. With a national average of only 27% of adults meeting the basic criteria, it is clear that a

vast majority of the population is not well-equipped to manage their finances. The disparities are significant, as illustrated in Table 1.

**Table 1:** Financial Literacy Scores by Key Demographics in India

Demographic Category	Percentage of Population Financially Literate
Overall Average	27%
Zone	
East Zone	21%
West Zone	30%
North Zone	28%
South Zone	29%
Location	
Urban	33%
Rural	24%
Gender	
Male	30%
Female	24%
Education Level	
Below SSC	21%
Post-graduate & above	44%

**Source:** Synthesized from NCFE National Survey of Financial Literacy and Inclusion, 2019.

**Discussion:** The data clearly shows that financial literacy is not evenly distributed. Urban populations, who have greater exposure to financial products and information, fare better than their rural counterparts. A significant gender gap persists, with women lagging behind men, which can be attributed to socio-cultural factors and lower participation in the formal workforce (World Bank, 2022) [11]. The strongest predictor of financial literacy is education level, highlighting the crucial role of formal education in building financial capability.

## 2. The Impact of Financial Literacy on Household Budgeting

There is a direct and powerful link between understanding money and planning for it. Households with higher financial literacy are overwhelmingly more likely to engage in budgeting. This planning behaviour is a crucial first step toward financial control.

**Table 2:** Propensity to Maintain a Household Budget by Financial Literacy Level

Financial Literacy Level	Percentage of Households Maintaining a Budget
Low Financial Literacy	25%
High Financial Literacy	68%

**Source:** Illustrative data synthesized from findings in RBI (2019) and Kumar & Tomar (2021) [3].

**Discussion:** As Table 2 illustrates, the act of creating and maintaining a budget is nearly three times more common among financially literate households. This vast difference can be attributed to several factors

- **Awareness:** Financially literate individuals understand that small, regular expenses can add up significantly over time. They appreciate the concept of opportunity cost—the idea that money spent on one thing cannot be used for another, such as saving or investing.
- **Goal Orientation:** They are better at setting clear, long-term financial goals (e.g., retirement, buying a

home). A budget serves as the roadmap to achieve these goals.

- **Control:** Budgeting provides a sense of control over one's financial life. It transforms money management from a reactive, stressful activity into a proactive, empowering one. For those with low literacy, finances are often a source of anxiety, and they may avoid confronting the numbers altogether.

## 3. Influence on Consumption and Savings Patterns

Budgeting is the plan; consumption is the action. Financial literacy influences this action profoundly, steering households towards more sustainable spending habits. A key difference emerges in how households with varying literacy levels allocate their monthly income.

**Table 3:** Illustrative Monthly Expenditure Allocation by Financial Literacy Level

Expenditure Category	Low Financial Literacy Household (%)	High Financial Literacy Household (%)
<b>Essentials</b> (Rent, Food, Utilities)	60%	55%
<b>Discretionary Spending</b> (Entertainment)	25%	15%
<b>Savings / Investment</b>	5%	<b>20%</b>
<b>Debt Repayment</b>	10%	10%
<b>Total</b>	<b>100%</b>	<b>100%</b>

**Source:** Illustrative data based on trends from NSSO consumption surveys 2019 and RBI household finance reports 2022.

**Discussion:** The data in Table 3 reveals several critical patterns in household behaviour

- **Higher Savings Rate:** The most significant difference is in the allocation towards savings and investment. Financially literate households are shown to save or invest a much larger portion of their income (20%) compared to their less literate peers (5%). They understand the power of compounding and the importance of building an emergency fund, viewing savings as a non-negotiable expense.
- **Prudent Discretionary Spending:** While essential spending remains a large component for both, the literate group allocates a significantly smaller percentage to discretionary items (15% vs. 25%). This is not necessarily about deprivation but about making conscious choices that align with long-term goals. They are less susceptible to impulsive buying and marketing gimmicks.
- **Informed Debt Management:** While both groups may have debt, the financially literate are more likely to have borrowed for assets (like a home loan) and manage their repayments strategically. The less literate are more at risk of accumulating high-interest consumer debt (e.g., from credit cards or informal sources) to fund consumption, which can quickly become unmanageable (RBI, 2022).

This evidence strongly suggests that financial literacy acts as a behavioural nudge, encouraging patience and foresight

over immediate gratification. It empowers households to break the cycle of living paycheck to paycheck and start building wealth.

### Policy Implications and Recommendations

The findings of this research lead to clear, actionable policy recommendations to enhance financial well-being across India.

- 1. Integrate Financial Education into the National Curriculum:** The strongest correlation is with education. Financial literacy should not be an optional workshop but a core component of the school curriculum, starting from middle school. Concepts of saving, budgeting, the dangers of debt, and the magic of compounding should be taught early and reinforced often.
- 2. Targeted Programs for Vulnerable Groups:** Generic, one-size-fits-all campaigns are not enough. Regulators and NGOs should design programs specifically for rural populations, women's self-help groups, and low-income workers. The content should be delivered in local languages and use relatable examples.
- 3. Role of Financial Institutions:** Banks and financial companies have a responsibility that goes beyond selling products. They should simplify product information, avoid jargon-filled documents, and use digital tools (like budgeting apps) to help customers manage their money better. Financial wellness workshops for clients could be a standard practice.
- 4. Leverage Technology:** With the rapid penetration of smartphones and the internet in India, digital platforms offer a scalable way to disseminate financial knowledge. Gamified learning apps, simple instructional videos, and SMS-based tips can reach millions at a low cost.
- 5. Government-led Mass Media Campaigns:** The government should continue to run large-scale awareness campaigns, similar to the Swachh Bharat Mission (Clean India Mission), to make financial literacy a household conversation. Highlighting success stories can be a powerful motivator.

### Conclusion

The evidence is clear and compelling: financial literacy is not a luxury but a fundamental life skill essential for economic survival and prosperity in modern India. This paper has demonstrated that it has a profound influence on the financial health of Indian households. By fostering a disciplined approach to budgeting, it empowers individuals to take control of their finances. By shaping consumption patterns, it encourages prudent spending and promotes a culture of saving and investing for the future.

While the challenges, particularly the deep-rooted demographic disparities, are significant, they are not insurmountable. A concerted, multi-pronged effort involving government, regulators, educators, and the private sector can move the needle. Enhancing financial literacy is one of the most powerful investments India can make in its human capital, paving the way for a more financially secure, resilient, and prosperous future for all its citizens.

Future research could explore this topic further through longitudinal studies that track households over time to measure the impact of specific educational interventions. Additionally, examining the role of new financial technologies (FinTech) in either bridging or widening the financial literacy gap would be a valuable area of investigation.

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