Economic Education & Financial Literacy

The time has come to revisit economic education and financial literacy efforts and to arm people with the deeper thinking skills they need for assessing new and unexpected situations.

Economic education and financial literacy have long had a place on the list of things deemed to be good for us, right up there with healthy eating and regular exercise.[1] But let's be honest. Most of us aren't going to give up bacon and climb on a treadmill unless we experience a health crisis, nor are we likely to get serious about studying economics and learning the fine points of consumer credit unless we perceive an immediate and compelling need.

Survey after survey reveals that most Americans don't know as much as they should about basic economic concepts and the essentials of managing money, yet financial literacy and economic education initiatives often fail to get much beyond the talking stage.[2] Tight budgets and time constraints have kept them from making their way into the educational mainstream.

Simpler Times

Beyond those obvious barriers is something most people have been reluctant to acknowledge publicly: In the past, formal training in financial literacy and economic principles wasn't really necessary. During the second half of the 20th century, conditions were such that most Americans were able to survive, and even thrive, despite minimal knowledge of economics and little or no training to manage their finances. Economic and financial choices were fewer and less complex.

Take the example of applying for a home mortgage. In 1960, or even 1990, the application process may have been scary for the first-time buyer, but it was fairly straightforward, defined by tradition and government regulation. Buyers had to come up with a substantial down payment—often 20 percent—and their monthly payments couldn't exceed a certain percentage of income. Lenders even held to the quaint practice of verifying a borrower's income and employment status. Anyone who didn't have the down payment or didn't meet the income requirements didn't get a loan. It was that simple.

In some ways it was also easier for a young person to avoid falling into the consumer debt trap. Banks were less willing to put credit cards in the hands of 20-year-olds, and education loans were small enough to repay within a reasonable amount of time, before the next generation went off to college. Informal social taboos against spending, borrowing, or consuming to excess provided an extra layer of restraint. "Don't charge Christmas!" was a widely accepted maxim of financial folk wisdom. And every family had at least one member who had lived through the Great Depression and whose mission in life was to remind everyone within earshot that good times don't last forever.

Today's Reality

But the realities of the 21st century global economy are far different from those of mid-20th century America. Somewhere along the way, jobs became less secure, financial dealings became more complicated, and Americans decided that the economy works best when government "gets out of the way" and allows markets to function with minimal regulation. We also chose, in ever increasing numbers, to slip the bonds of caution, self-discipline, and self-denial. The old ethic of "Use it up, wear it out, make it do, or do without!" gave way to "Shop 'til you drop!"

As a result, there are now fewer safeguards and restraints to protect us from ourselves and others. Ours has become a self-service world, in which the phrase "Buyer, beware!" has taken on renewed significance.

True, the recent financial crisis has prompted lenders to tighten their standards, but there's no telling how long their caution will last. And, yes, Congress responded to the crisis by creating the Consumer Financial Protection Bureau, but it remains to be seen how much actual power and influence the CFPB will be able to exercise.

In any case, the ability to make sound financial decisions and the capacity to understand basic economic concepts have become essential survival skills. Educators, parents, and politicians largely agree on the need to help more people acquire those skills. But beyond that, consensus is more difficult to achieve.

Financial literacy proponents want to focus on helping people learn to make financial choices that will lead to using money wisely and building wealth. They also emphasize skills and training to help consumers avoid the pitfalls of the marketplace. But they don't always agree on what to teach or how best to teach it, nor do they all agree on how much government regulation, if any, is needed to protect consumers.

Proponents of economic education have their own internal differences. One camp favors the straightforward teaching of basic economic concepts. Another promotes the virtues of entrepreneurship. Others would use economic education to advance a specific agenda: free trade is good (or bad), government regulations are good (or bad), higher taxes, lower taxes—you name it, and they're for it … or against it.

Which approach is best? Perhaps that question is best set aside for now.

Alfred Marshall Revisited

Rather than spending an inordinate amount of time and energy debating an issue that has no simple solution, we might do better to adopt the view of Alfred Marshall, who

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At the Boston Fed's Economic Adventure, visitors gain access to economic education, financial capability, and skills for evaluating information. Photograph: Heidi Furse

saw economics as the study of humankind "in the ordinary business of life." Marshall fell out of favor during the mid-20th century, but his words are well suited to serve as a peg on which to hang the many hats worn by economic and financial educators.

The best chance for delivering effective economic and financial education may lie in helping people to make the connections between economics and the ordinary business of life—connections that include the ability to make sound financial decisions, build wealth, safely navigate the hazards of the marketplace, *and* evaluate the increasingly complex policy decisions we face as citizens.

But in an age of increased time pressures and scarce resources, how and where do we proceed?

In some ways, financial literacy might seem to be an easier sell and a better fit for these turbulent times. The need is immediate and apparent. Anyone who ventures into the marketplace—the young, the middle-aged, the elderly—ought to know as much as possible about managing money and using credit wisely.

But is that enough? Isn't there more to economic life than "getting and spending"?

If people are taught only to shop wisely and manage money sensibly, when all is said and done, they will be little more than smart, financially comfortable *consumers*. Whereas if they also learn to use economics as a framework for analyzing the world around them, they will be smart, financially comfortable *citizens*.

If, for example, someone tells them that protectionism is the answer to their uncertainties over globalization, they will be able to assess the true cost of propping up an industry that may be outmoded or inefficient. Or when times get tough, and someone comes along promising simple solutions that will return them to a golden age that never was, they will be equipped to pose the appropriate questions with a certain degree of skepticism.

Of course, there are limits to what economic and financial education can accomplish. The ultimate goal is not to turn everyone into a trained economist or a certified financial planner, but rather to provide citizens with a basis for making their own assessments.

In broad terms, if financial literacy and economic education efforts are successful, they will enable citizens to:

1. Evaluate the true cost of something, whether it's a consumer product, a financial instrument, or a government policy.
2. See the connections between actions and outcomes.
3. Spot a snake-oil salesman who is peddling a "fabulous deal" that's too good to be true … or a seemingly simple solution to a complex societal problem.

We face difficult economic and financial choices that require a greater level of sophistication on the part of our citizens. A basic grasp of economics and personal finance will not only improve our ability to function in the marketplace and build wealth for the future, it will also help us to sensibly engage—as voters, taxpayers, and consumers—with the big issues of our time.

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Endnotes

[1] Financial literacy focuses mainly on the knowledge and concepts each of us ought to know in order to manage money effectively and build wealth—things such as the mechanics of compound interest, the basics of investing, the prudent use of credit. Economic literacy deals more with how all of us function in the marketplace, or as Alfred Marshall described it, "in the ordinary business of life." Perhaps the most fundamental economic principle deals with scarcity and choice—the fact that limited or finite resources influence the choices we makes as individuals and as a society. In recent years, yet another term—"financial capability"—has entered the mix. It refers to a person's ability to effectively use the knowledge and concepts associated with financial literacy.

[2] The following surveys are just three among many that indicate most Americans don't know as much as they should about basic economic concepts and the essentials of managing money: *Financial Capability in the United States,* FINRA Investor Education Foundation, 2009, http://www.finrafoundation.org/resources/research/p120478; *The Financial Literacy of Young American Adults*, The Jump$tart Coalition for Personal Financial Literacy, 2008, http://www.jumpstart.org/survey.html; and *What American Teens & Adults Know About Economics*, The Council for Economic Education, 2005, http://www.councilforeconed.org/cel/results.php.