Alan Greenspan: Financial education

Speech by Mr Alan Greenspan, Chairman of the Board of Governors of the US Federal Reserve System, at the JumpStart Coalition's Annual Meeting, Washington, DC, 3 April 2003.

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I am pleased to be here today to share with you my perspective on the importance of financial education. I commend the leadership of the JumpStart Coalition and the activities it has undertaken to support teachers working on the front-line of financial education.

Trends in consumer finances

As you are aware, today's financial world is highly complex when compared with that of a generation ago. An understanding of how to maintain a checking and savings account at a local financial institution may have been sufficient twenty-five years ago. Today's consumers, however, must be able to differentiate between a wide range of products, services, and providers of financial products to successfully manage their personal finances. Certainly, young adults have access to credit at a much earlier age than their parents did. Accordingly, they need a more comprehensive understanding of credit than was afforded to the previous generation--including the impact of compounding interest on debt balances and the implications of mismanaging credit accounts. In addition, as technological advances have contributed significantly to the dramatic changes within the financial services market, consumers more generally must be familiar with the role that computers play in the conduct of every traditional financial transaction, from withdrawing funds to gaining access to credit.

While the focus of your efforts is to provide youth with a solid foundation for understanding personal financial management, the benefits of that objective extend to a much broader audience. Data, both empirical and anecdotal, point to trends in consumer financial conditions that have caused concern among some consumer groups. For example, Federal Reserve statistics indicate that household debt outstanding increased more than 9 percent last year--the largest rate of increase since 1989. And while analyses suggest that, overall, this level of debt is being serviced adequately, reports of nonbusiness bankruptcy filings reaching record highs in 2002 reveal that many consumers are experiencing significant financial crises.

Regulators, lenders, community leaders, and consumer advocates continue to be concerned about abusive home mortgage lending practices. More recently, the emergence of certain deposit-linked products has also sparked debate among these parties. For example, one product marketed as protection against bounced checks has generated concerns among consumer groups ranging from the appropriateness of assessed fees to the possible unintended effect of reinforcing poor account-management practices on the part of consumers who do not properly monitor their accounts.

Trends in the financial services industry

Perhaps, some may judge such information as an indication that the combination of market forces and industry trends has had negative effects on consumers. On the contrary, many benefits have accrued to consumers of household and business credit as the result of the remarkable growth and technological developments that have occurred in financial services. Computer and telecommunications technologies have lowered the cost and broadened the scope of financial services. As a consequence, specialized lenders and new financial products tailored to meet very specific market needs have proliferated. At the same time, the development of credit-scoring tools and the securitization of loan pools hold the potential for opening doors to national credit markets for both consumers and businesses. Deregulation has created important structural changes in the financial services industry and has contributed significantly to creating a marketplace that is increasingly competitive and highly innovative as a result of the entry of new players or expansion of existing players.

Throughout our banking history, we have seen significant adjustments to existing policies to enable markets to respond to the demand for services. These structural changes have heightened competition, resulting in market efficiencies that continue to help drive down costs and foster the emergence of increasingly diverse and highly specialized organizations. These entities range from banks and brokerage firms that offer their services exclusively through electronically based delivery mechanisms to locally based public-private partnerships that provide counseling and financing arrangements to low- and moderate-income families. Corporations, for example, often allow employees to self-direct their investments in pension and other benefit plans, whereas employers dictated such decisions twenty years ago. The advent of on-line brokerage firms has enabled individual investors to directly conduct stock transactions.

The role of financial education

However beneficial, constant change, of course, can be unsettling, and one challenge we face is overcoming such anxieties. But just as the rapid adoption of new information technologies has expanded the scope and utility of our financial products, so, too, has it increased our means for addressing some of the challenges these changes pose. For example, just as universities provide remote learning options to allow students to pursue continuing education via the Internet, consumers can use software to create customized budgets to develop long-term savings strategies for retirement or for their children's college education. In both scenarios, technological advances represent the opportunity for achieving efficiencies and exercising preferences, but only when the end users possess the knowledge necessary to access pertinent information and to capitalize on it.

Fostering education that will enable individuals to overcome their reluctance or inability to take full advantage of technological advances and product innovation in the financial sector can increase economic opportunity. As market forces continue to expand the range of providers of financial services, consumers will have more choice and flexibility in how they manage their personal finances. They will also need to learn ways to use new technologies and to make wise financial decisions.

In considering means to improve the financial status of families, education can play a critical role by equipping consumers with the knowledge required to choose from among the myriad of financial products and providers. Financial education is especially critical for populations that have traditionally been underserved by our financial system. In particular, financial education may help to prevent vulnerable consumers from becoming entangled in financially devastating credit arrangements. Regulators, consumer advocates, and policymakers all agree that consumer education is essential in the quest to stem the occurrence of abusive, and at times illegal, lending practices. An informed borrower is simply less vulnerable to fraud and abuse. Financial education can empower consumers to be better shoppers, allowing them to obtain goods and services at lower cost. This process effectively increases consumers' real purchasing power, and provides more opportunity for them to consume, save, or invest. In addition, financial education can help provide individuals with the knowledge necessary to create household budgets, initiate savings plans, manage debt, and make strategic investment decisions for their retirement or for their children's education. Having these basic financial planning skills can help families to meet their near-term obligations and to maximize their longer-term financial well-being.

The importance of basic financial skills underscores the need to begin the learning process as early as possible. Indeed, improving basic financial education at the elementary and secondary school level will provide a foundation of financial literacy that can help prevent younger people from making poor decisions that can take years to overcome. In particular, it has been my experience that competency in mathematics--both in numerical manipulation and in understanding the conceptual foundations--enhances a person's ability to handle the more ambiguous and qualitative relationships that dominate our day-to-day financial decisionmaking. For example, through an understanding of compounding interest, one can appreciate the cumulative benefit of routine saving. Similarly, learning how to conduct research in a library or on the Internet helps one find information to enhance decision-making. Focusing on improving fundamental mathematical and problem-solving skills can develop knowledgeable consumers who can take full advantage of the sophisticated financial services offered in an ever-changing marketplace.

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In the long run, better basic education at home and at the elementary and secondary school level will provide the foundation for a lifetime of learning. We must also be alert to the need to improve the skills and earning power of those who appear to be falling behind. Strategies must be developed to overcome the education deficiencies that all too many of our young people have. Just as the marketplace has responded to an increased demand for conceptual job skills by increasing the range of education options available to individuals, efforts to provide consumers with information and training about financial matters throughout their lives must also be expanded.

The Federal Reserve has a keen interest in measuring the effectiveness of financial education programs. For example, we hosted a forum on best practices in credit education, which focused on effective educational tools and techniques and identified programmatic challenges and issues. In response to a call for papers, studies evaluating the impact of such training initiatives were presented at our Community Affairs Research Conference held last week. In addition, we have recently engaged in collaborative efforts with the Department of Defense and with several Native American tribal education councils to develop programs to assess their individual financial education efforts. Quantitative study of the quality and long-term success of education and training will be of particular interest to the Federal Reserve System as we develop and distribute a wide variety of financial and economic literacy products.

Building bridges between community organizations, our educational institutions, and private businesses will be an essential aspect of our efforts to increase familiarity with new technological and financial tools that are fundamental to improving individual economic well-being. And the success of such efforts will bear significantly on how well prepared our society is to meet the challenges of an increasingly knowledge-based economy.

The advent of new technologies and other market innovations will certainly bring new challenges and new possibilities for our businesses, our workers, and our educational system. These changes are affecting both financial and nonfinancial institutions around the world. Although we cannot know the precise directions in which these changes will take us, we can reasonably expect that the pace of technological developments and competitive pressures will increase. As in the past, our economic institutions and our workforce will strive to adjust. We must recognize, however, that adjustment is not automatic, and expanded linkages between business and education should be encouraged at all levels of our education system.

In closing, let us remember that all shifts in the structure of the economy naturally create frictions and human stress, at least temporarily. However, if we are able to boost our investment in people, ideas, and processes, as well as in machines, the economy can readily adapt to change and support ever-rising standards of living for all Americans.