Alan Greenspan: The importance of financial education and literacy

Remarks (via videoconference) by Mr Alan Greenspan, Chairman of the Board of Governors of the US Federal Reserve System, before the National Council on Economic Education, Chicago, 26 October 2001.

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I am pleased to address your conference today. Education is a critical issue for our country, and economic education is of particular concern to those of us at the Federal Reserve.

Throughout our economic history, we have seen significant adjustments to enable markets to respond to the demand for services. Structural changes in recent years have heightened competition, encouraging market efficiencies that continue to help drive down costs, and fostered the emergence of increasingly diverse and highly specialized organizations. These organizations - ranging from firms that offer their services through electronic delivery mechanisms to local partnerships that provide one-on-one counseling and financing arrangements - provide consumers increased access to a variety of credit and savings instruments.

For this ever-more complex financial system to function effectively, widespread dissemination of timely financial and other relevant information among educated market participants is essential. Informed judgments by consumers are required to foster the most efficient allocation of capital.

Constant change, of course, can be unsettling no matter how beneficial, and one challenge economic and financial educators face is overcoming consumer anxiety about the new products and choices they encounter. 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 associated educational challenges. For example, universities provide remote learning options to allow students to pursue continuing education via the Internet. Financial service consumers can use web-based calculators to create customized budgets, or to develop long-term savings strategies for retirement or a college education. In both scenarios, technological advances represent the opportunity for achieving efficiencies and exercising preferences. This promise can only be met, however, when the end-users know how to obtain pertinent information and how to capitalize on the available knowledge.

Education enabling individuals to overcome their reluctance or inability to take full advantage of technological advances and product innovation can be a means of increasing economic opportunity. As market forces continue to expand the range of financial services, consumers will have more choice and flexibility in how they manage their financial matters, and they will demand education about use of the new technologies to make informed decisions.

Indeed, surveys repeatedly demonstrate a strong link between education and the use of new financial technologies. For example, data from the Federal Reserve's periodic Survey of Consumer Finances (SCF) suggest that a higher level of education significantly increases the chances that a household will use an electronic banking product. In particular, in 1998, the typical user of an electronic source of information for savings or borrowing decisions had a college degree - a level of education currently achieved by only about one-third of U.S. households.

The most recent data from the survey reveal a good news-bad news picture of the financial status of households, providing evidence that we need to reach further to engage those who have not been able to participate fully. For example, while the median real net worth for all families increased 17-1/2 percent between 1995 and 1998, this trend did not hold true where the head of the household had a high-school level of education or less, family earnings were less than $25,000 annually, or the ethnicity of the respondent was non-white or Hispanic. That families with low-to-moderate incomes and minorities did not appear to fully benefit from the highly favorable economic developments of the mid-1990s is, of course, troubling, and the survey results warrant a closer look. In the details, we find that families with incomes below $25,000 did increase their direct or indirect holdings of stock, and more reported that they had a transactions account. However, they were less likely to hold nonfinancial assets - particularly homes, which constitute the bulk of the value of assets for those below the top quintile according to income.

At the same time, one encouraging finding from surveys conducted by the Bureau of the Census is the increasing homeownership rates for minorities. For example, the homeownership rate for blacks increased from 42.9 percent in 1995 to 48.6 percent through the second quarter of 2001. The homeownership rate for Hispanics also rose, from 42.0 percent in 1995 to 46.1 percent through the second quarter of 2001. This trend may be a sign of improved access to credit for minorities.

Other recent findings of the SCF include a rise in families' median level of debt burden, financial stress (defined as debt payments that represent more than 40 percent of income), and incidence of late payments on debt. The findings showed increases in each of these categories across all income and age groups, with the highest levels of financial stress among households headed by people 65 and older and earning less than $25,000 annually.

Obviously, falling into financial distress is not solely the result of lack of knowledge about finance. But in many cases such knowledge could avoid or ameliorate the negative consequences of uninformed decisions. Thus, in considering means by which to improve the financial status of families, education can play an important role. While data to measure the efficacy of financial education are not plentiful, the limited research available is encouraging. For example, a recent study by one of the nation's largest purchasers of home mortgages finds that homebuyers who obtain structured homeownership education have reduced rates of loan delinquency. Similarly, an evaluation conducted by the National Endowment for Financial Education on its high-school-based programs found that participation in financial-planning programs improved students' knowledge, behavior, and confidence with respect to personal finance, with nearly half of participants beginning to save more as a result of the program. Another study of the relationship between financial behavior and financial outcomes revealed that comprehension of the general principles of sound financial behavior, such as budgeting and saving, is actually more beneficial in producing successful financial results over time than specific and detailed information on financial transactions.

These findings underscore the importance of beginning the learning process as early as possible. Indeed, in many respects, improving basic financial education at the elementary and secondary school level can provide a foundation for financial literacy, helping younger people avoid poor financial decisions that can take years to overcome. In particular, competency in mathematics - both in numerical manipulation and in understanding its conceptual foundations - enhances a person's ability to handle the more ambiguous and qualitative relationships that dominate our day-to-day 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 can be instructive in where and how to look for information to evaluate decisions. Educational efforts to improve fundamental mathematic and problem-solving skills can foster knowledgeable consumers who can take full advantage of the sophisticated financial services offered in an ever-changing marketplace.

Many of you are involved in institutions that are working hard to enhance basic education about economics and finance, and it is a challenge the Federal Reserve takes seriously as well. Gary Stern, President of the Minneapolis Federal Reserve Bank, has been an inspiration in the Fed as well as within National Council on Economic Education. The economic educators of the Federal Reserve System have recently launched an interactive web site offering students, educators and the general public an introduction to the workings of the Fed and the nation's banking system. The goal is to offer consumers a clearer picture of how, for example, the Federal Reserve's decisions influence the economy and consequently impact their monetary choices.

The Federal Reserve also has a keen interest in encouraging and measuring the effectiveness of financial literacy programs. Last year, for example, we hosted a forum at the Federal Reserve Board in Washington on credit education that focused on identifying the most effective tools and techniques. More recently, we have asked for studies that evaluate the impact of such training initiatives in our call for papers for the Community Affairs Research Conference scheduled for the spring of 2003. Measurement of the quality and long-term success of these efforts will be particularly useful to the Federal Reserve System as we develop and distribute financial and economic literacy products through our Community Affairs and Public Affairs Offices. I hope our efforts in this regard will be of assistance to you as well.

In closing, let me reiterate that the pace of technological change and competitive pressures in the economy can only increase. These changes will affect both financial and nonfinancial institutions around the world. We cannot know the precise directions in which technological change will take us, but the role of banks and other providers of financial services will continue to be significantly affected by the same basic forces that guide the real economy. Building bridges between our educational institutions, the business sector, and community organizations will no doubt 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. Such efforts, and educators like you, will have a critical bearing on how well we meet the challenges of an increasingly knowledge-based global economy.