The Need for Financial Literacy: a Key Element in a Sound Education Policy

"EVERYBODY wants it. Nobody understands it. Money is the great taboo. People just won't talk about it. And that is what leads you to subprime. Take the greed and the financial misrepresentation out of it, and the root of this crisis is massive levels of financial illiteracy."

John Bryant, Founder, Chairman and CEO, Operation HOPE[1]

"It is no great surprise to learn that the current financial crisis began with the sub-prime mortgages that were marketed primarily to those with less income, education, and presumably less financial literacy than those who were eligible for prime mortgages. Financial literacy clearly has ongoing macroeconomic ramifications."

Dr. Lewis Mandell, Author of the 2008 Financial Literacy Report and Professor Emeritus, State University of New York at Buffalo, School of Management, and Aspen Fellow

I. Standing at the cross-road - An Introduction to the Post-Financial Crisis World:

The subprime mortgage crisis of the last few years was a result of a set of events, centered round a rise "in subprime mortgage delinquencies and foreclosures, and the resulting decline of securities backed by said mortgages."[2] An over-saturated housing market, bad and defaulting loans, risky investments by investment houses and global banks, as well as weak banking and finance regulations and rising interest rates are just a few of the elements that led to this global crash of markets. The general feeling is that the ordinary consumer didn't stand a chance to save his or her life savings – whether they were invested into a concrete home or an abstract stock portfolio. Yet, maybe with more financial literacy and understanding of what constitutes market security as well as how monetary policy inter-connects with interest rates, one could argue that fewer consumers would have been pulled down the dark road of wealth destitution.

One of the main lessons learned through this financial meltdown, at least to the ordinary person on the street, is one of distrust of bigger finance houses as well as advice from financial experts. Any economist will tell you that there was no way to fully predict what could happen, though a few "outliers" spoke out during the height of the bubble. In his book "Boomerang", Michael Lewis, interviews these overlooked voices who warned of over investment and the end of a bubble. Could this crisis have been averted? We will never really know.

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[1] The Economist, "Getting it Right on the Money", Financial Literacy section, April 2008, http://www.economist.com/node/10958702

[2] Subprime Mortgage Crisis, Wikipedia http://en.wikipedia.org/wiki/Subprime_mortgage_crisis

What we do know is that we currently stand at a cross-road in the financial world. Where we go next in terms of government regulations, market ethics and consumer protection will shape the wealth of generations to come. The US Fed refers to this period as the "Post-Financial Crisis World", and even though it is tempting to fully blame big banks, loan providers, investment houses as well as "fat cats" and the government for our predicament, the ordinary consumer must also bear some responsibility for the individual, if not collective, financial failure. What this crisis has sparked is a realization in policy circles that financial literacy has become an even more important and nuanced skill, which if taught to more and more people, can only help in both the good and bad times.

Programs on financial literacy have been around since the start of this century, with such organizations as Junior Achievement, a non-profit organization that focuses on teaching children about money. But as the subprime mortgage crisis shows, teaching our youngsters about opening a bank account is not enough, in fact, many adults of various socio-educational levels need lessons as well. The very notion of what constitutes financial literacy has to be deepened as "money" and "finance" has become more complicated. We are in a new era, where the ordinary consumer, working alongside private and government initiatives can either continue in his/her financial ignorance or attempt to gain a better understanding of money and how it works. This is the very cross-roads we stand at today.

II. The New Financial Literacy: It's Not Your Mother and Father's Financial Literacy Anymore[3]

On January 29, 2010, The President's Advisory Council on Financial Capability (PACFC) was created by Executive Order 13530 and signed into existence by President Obama.[4] Its charter is to "advise the President on promoting and enhancing financial literacy and capability among American people".[5]

The PACFC, in its manual to local communities and tribal areas, identifies three broad areas for financial capability initiatives, namely:

1. Financial education and capability programs for youth;
2. Financial capability and access for low- to moderate-income families and the underserved; and
3. Financial capability in the workplace.

[3] A play on a title from a 2011 Fed paper on financial literacy.

[4] In January 2008, President Bush created the "Advisory Council on Financial Literacy", and some members from this committee overlap with the PACFC. Both Councils exist under the guidance of the US Treasury Department. http://annalusardi.blogspot.com/2008/01/newly-created-advisory-council-on.html

[5] PACFC, "Creating Financially Capable Communities", March 21012, http://www.treasury.gov/resource-center/financial-education/Documents/Local%20Guide%20-%20Creating%20Financially%20Capable%20Communities.pdf

The PACFC is made up of a mix of private and public sector leaders – including such luminaries as Carrie Schwab-Pomerantz, President, The Charles Schwab Foundation, John Bryant of Operation HOPE and Ted Beck, President and CEO, The National Endowment for Financial Education (NEFE) .

Along with such high-level advisory bodies, more and more public and private initiatives are being launched to end the " well-established fact" that "a substantial proportion of the general public in the English-speaking world is ignorant of finance," as noted by Niall Ferguson, an historian at Harvard University, in his book about the history of finance, "The Ascent of Money".[6]

One such program, Aflatoun, the brainchild of Jeroo Billimoria, a social entrepreneur who previously worked with street children in India, provides children with the building blocks of life, encouraging them to save their resources and start social and financial microenterprises. The program addresses children aged between six and 14, whom most educators have in the past considered too young to understand money. [7] Having begun with experiments in rural India, under the umbrella non-profit organization, Child Savings International, Ms. Billmoria very successfully piloted the Aflatoun program, focusing on microenterprises for children, in 11 countries, including Argentina, South Africa, Vietnam and Zimbabwe. Only recently, after suggestions from the Dutch central bank and the European Commission, has Ms Billimoria started to adapt Aflatoun for rich countries such as Britain, the Netherlands, and (in progress) the US. [8]

What Aflatoun and Child Savings International teach us is that a child is never too young to learn about finance – from opening a bank account (Junior Achievement), to micro-enterprise (Aflatoun) strategy. The US Federal Reserve Bank ("the Fed") has joined this initiative as well – and under various regional branches –started providing class room and online resources to aid teachers in educating K-12 students about economics and personal finance. [9]

In a paper on the Fed and monetary policy, entitled "It's Not your Mother and Father's Monetary Policy Anymore: The Federal Reserve and Financial Crisis Relief" written in 2011, Andrew Hill and William Wood[10] write that sweeping changes to the framework of monetary policy in this post-financial crisis world present a great challenge to teachers (high school and college level) and yet, more than ever, it is critical that this upcoming generation are taught monetary policy "in order to make them well-informed citizens participating knowledgeably in our economy". Hill and Wood emphasize that it is imperative that students learn and understand:

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[6] http://www.niallferguson.com/site/FERG/Templates/General.aspx?pageid=194&cc=GB

[7] Aflatoun in the OECD, http://www.oecd.org/dataoecd/20/58/40108882.pdf

[8] The Economist, "Getting it Right on the Money", Financial Literacy section, April 2008, http://www.economist.com/node/10958702

[9] The Federal Reserve Bank of Philadelphia's educational online program, http://www.philadelphiafed.org/education/teachers/

[10] Social Education Journal, National Council for the Social Studies, "It's Not your Mother and Father's Monetary Policy Anymore: The Federal Reserve and Financial Crisis Relief", Andrew T. Hill and William C. Wood, March-April 2011, http://www.philadelphiafed.org/education/teachers/resources/federal-reserve-and-financial-crisis-relief/hill-wood_social-education-2011.pdf

- How open market operations affect the size of the money supply;
- The availability of credit;
- The level of interest rates (and what these mean/their impacts); and
- The health of the economy

Through its regional branches, the Fed also offers courses professional development programs to K-12 teachers (at a nominal cost) on how to teach personal finance, via such topics as "Making Sense of Money and Banking".

Among the other initiatives out there, the introduction of United States Consumer Financial Protection Bureau (CFPB) in July 2011 is a huge step towards protecting and education the consumer. Founded as a result of the Dodd–Frank Wall Street Reform and Consumer Protection Act, both a result of the financial crisis, the bureau is tasked with the responsibility to "promote fairness and transparency for mortgages, credit cards, and other consumer financial products and services." [11]

Within the CFPB, the Office of Financial Empowerment, which is part of the Division of Consumer Education and Engagement, has a special focus on lower-income and economically vulnerable consumers – those who face barriers to accessing affordable financial products and services that meet their needs for credit, payments and transactions, and savings.[12] The Office's goals include:

- Research, identify, spotlight, and promote the development of promising and effective practices that empower consumers and positively influence their financial decision-making;
- Provide consumers with information and opportunities to improve their financial stability and build assets; and,
- Engage with the public on targeted consumer finance issues as they relate to the underserved.

In addition to the above noted government initiatives, organizations such as Jump$tart, a national coalition of organizations dedicated to improving the financial literacy of pre-kindergarten through college-age youth, provide advocacy, research, standards and educational resources towards this goal.[13] The Coalition, founded in 1995, also includes a network of 49 affiliated state coalitions that operate on a local level to promote financial literacy.[14] The Coalition also maintains the most comprehensive online clearinghouse of financial educational resources for educators, parents, and Pre-K through college students currently available in the US. Along with the Clearinghouse, the Coalition publishes and updates regularly a guide to what they see as the national standards in K-12 personal finance education. These standards often form the basis for what good personal finance courses in schools cover.

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[11] My Bank, CFPB launch, http://www.mybanktracker.com/bank-news/2011/02/07/consumer-financial-protection-bureau-website-launched-open-suggestions/

[12] Consumer Financial Protection Bureau Blog, "Empowering America's Consumers", Cliff Rosenthal, Assistant Director, Office of Financial Empowerment, May 18. 2012, http://www.consumerfinance.gov/blog/empowering-americas-consumers/

[13] http://www.jumpstart.org/

[14] Wikipedia, Jump$smart Coalition for Personal Financial Literacy, http://en.wikipedia.org/wiki/Jump$tart_Coalition_for_Personal_Financial_Literacy

III. And Yet, Continuing Poor Results - A divided Policy Approach:

As we can see, today, hundreds of organizations throughout the US– both private and public initiatives - have started to promote financial literacy, members of Congress introduce bills supporting financial literacy, many states have passed initiatives to teach students personal finance, and serious scholarly work is being published.

While these initiatives are exemplary – unfortunately, these tools, and other public and well as private initiatives are accessed by only a minority of US consumers (adults and high school students). Personal finance is still considered a private endeavor and until actual school curriculums, focusing on teaching practical finance strategy and monetary policy are implemented on a national level, only a drop in the bucket are getting educated.

Additionally, the Council for Economic Education, in its most recent "Survey of the States" found that while the financial literacy movement is spreading in schools across the globe, it is faltering in US schools. In fact, since 2009, three fewer states require schools to test in the area of economics and one fewer state requires schools to offer a personal finance course (number of states have fallen from 15 in 2009 to 14 in 2012). [15] According to a 2010 study by the National Endowment for Financial Education, by downplaying the importance of financial literacy, states are missing out on the chance to better equip high-schoolers to succeed as adults.[16]

In a 2008 financial literacy survey, posed by researchers at the State University of New York, Buffalo, barely half of a sample of high-school pupils aged 17 to 18 gave correct answers to a set of questions about personal finance and economics posed.

- Less than one-quarter knew that income tax could be levied on interest earned in a savings account.
- Three-fifths did not know the difference between a company pension, Social Security and a 401(k) savings account. [17]

Additionally, in another 2008 survey, nearly one-third of American (adult) credit-card holders said they had no idea what the interest rate on their credit card was.[18]

[15] TIME Magazine, Moneyland, "A Step Backwards in Spreading Financial Literacy", March 27, 2012, http://moneyland.time.com/2012/03/27/in-a-bad-economy-dont-teach-kids-economics/

[16] Huffington Post, Money, "Despite Really Nasty Financial Crisis, Teaching Kids about Money Not a Priority", March 2012, http://www.huffingtonpost.com/2012/03/28/financial-literacy-high-school_n_1384946.html

[17] Financial Literacy: Improving Education Results of the 2008 National Jump$tart Survey Washington, D.C.: Jumpstart Coalition, 2008, http://www.jumpstart.org/assets/files/2008SurveyBook.pdf

[18] The Economist, "Getting it Right on the Money", Financial Literacy section, April 2008, http://www.economist.com/node/10958702

Even more interestingly, the financial literacy survey of high school students – from 2000 onwards to the latest in 2008, showed that white high school aged students achieved the highest performance with a mean score of 52.5 percent, followed by Asian-Americans with a mean score of 47.2 percent and Hispanic-Americans with a means score of 45.1. Native Americans fared least well with a score of 37.7 percent and African Americans did somewhat better with a mean score of 41.3 percent.

Perhaps most importantly, no racial group, including whites, had more than about a third of students passing the exam. The problem then appears to be national, rather than strictly one of race or poverty.[19]

As Dr. Lewis Mandell, author of the financial literacy surveys, Professor Emeritus, State University of New York at Buffalo, School of Management, Aspen Fellow and coalition partner of Jumpstart writes in the 2008 financial literacy report:

> "We have long noted with dismay that students who take a high school course in personal finance tend to do no better on our exam than those who do not. This finding has been a great disappointment to consumer educators and to those who support efforts to make courses in personal finance a requirement for high school graduation, and it points to the need for better materials and teacher training."[20]

Yet, somewhat contrary to Jump$start and Dr. Mandell's findings, after surveying nearly 16,000 college students, researchers at the Council for Economic Education concluded that students from states that required a financial education class were "*more likely to display positive financial behaviors*."[21]

These two sets of findings, namely that:

(1) **High school aged students attending a personal finance class do not necessarily learn that much about financial literacy overall to the general public (there is some difference, but not as much as expected); and yet,**
(2) **High school aged students who've attended a personal finance class DO show better financial behaviors;**

appear to show a discrepancy – and have divided the financial literacy community on how to move forward.

The question posed then is how is it possible for students who have taken a personal finance course to know so little about actual financial theories and facts, and yet overall, show some improvement in their financial behavior (in relation to their cohorts who have not had such classes)?

One answer is that across the US, most personal finance or financial literacy classes in schools are often thought in the abstract to students who have no practical concept of being responsible for their own

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[19] Financial Literacy: Improving Education Results of the 2008 National Jump$tart Survey Washington, D.C.: Jumpstart Coalition, 2008, http://www.jumpstart.org/assets/files/2008SurveyBook.pdf

[20] Ibid
[21] Ibid

finances. As we discuss in the next section, when classes have been thought using practical financial applications, **the results are very different.**

In addition, classes often target students **only** in their senior year of high school – sometimes too late – when notions of spending and saving have already been developed and fossilized. A mixture of middle and high school classes are needed – starting young and continuing through to graduation, along with a mixture of theory and practical application.

The financial literacy world in the US is unsure how to proceed. Some, like Dr. Mandell, would prefer scarce resources be spent on financial education programs aimed at mainly adults and in support of regulations that dictate things like clearer mortgage documents and credit card statements. This is largely what the Consumer Financial Protection Bureau is all about.[22] As Dr. Lewis Mandell in the 2008 Financial Literacy Report, succinctly states,

> "Since standard of living is a multiplicative function of both financial resources (income and wealth) and the ability to use those resources efficiently (financial literacy), we find it increasingly disturbing that those with less income and education are saddled with the additional disadvantage of not possessing the ability to spend what they have efficiently. "[23]

But this is not the preferred approach in the 25 other countries that the OECD lists as having or developing a formal national strategy for financial literacy. Some, like Australia and Singapore, have well rounded programs designed to reach both adults at work or in the community as well as kids in school.

Annamaria Lusard, an economics professor at George Washington University School of Business, writes in the Council of Economic Education Report, "Just as it was not possible to live in an industrialized society without print literacy—the ability to read and write—so it is not possible to live in today's world without being financially literate. To fully participate in society today, financial literacy is critical."[24]

IV. Conclusion: Policy Suggestions

While the US Financial Literacy community seems divided on how much impact personal finance courses impact the long-term behavior of school age students, various test cases across the globe show that when tied to practical applications (such as setting up microfinance operations, internships with business, earning and investing money at an early age), financial lessons significantly and positively affect the future financial behavior of young subjects.

[22] TIME Magazine, Moneyland, "A Step Backwards in Spreading Financial Literacy", March 27, 2012, http://moneyland.time.com/2012/03/27/in-a-bad-economy-dont-teach-kids-economics/

[23] Financial Literacy: Improving Education Results of the 2008 National Jump$tart Survey Washington, D.C.: Jumpstart Coalition, 2008, http://www.jumpstart.org/assets/files/2008SurveyBook.pdf

[24] Huffington Post, Money, "Despite Really Nasty Financial Crisis, Teaching Kids About Money Not A Priority", March 2012, http://www.huffingtonpost.com/2012/03/28/financial-literacy-high-school_n_1384946.html

The key seems to be to start financial literacy at a young age, versus after behavioral patterns have been learned (by parental example etc.) and set. Basically, students who only started learning about personal finance in their last year of high school did worse on financial literacy tests than those who started learning as early as freshman and sophomore year, and even as early as middle school.

This should not discredit personal finance lessons in the senior year of high school; instead these classes should go along with a curriculum begun at an earlier age, and at this senior level, be tailored to have "real life impacts" on students.

The Latino Educational Fund feels that it is important to think of personal finance courses as part of the core curriculum of school academics, to be taught from a young age, until graduation, with each level being more and more nuanced and detailed, ending with high school seniors having a more applied approach, especially as they leave either into the workforce or to college – facing housing, car and student loans. Additionally, while taking a broad range approach, students themselves will see how the financial world, and financial tools as well as stock markets, and the economy change and grow over time. The aim of personal finance courses should be to instill in the students a life-long learning of finances and constant upkeep of their financial literacy levels.

Along with the finding about when classes are to be introduced, making the lessons concrete (and practical) versus purely abstract and only class-based learning, seems to make the biggest difference. Students who did the best on financial literacy tests were those who in some way learned through example or through direct experience to play the stock market game. The obvious conclusion is that financial literacy is best taught if interactive and relevant.

The results of the TD Bank survey of 2,160 consumers in 2010 showed that those most confident in their ability to make wise financial decisions began learning about financial responsibility at a younger age than those who are less confident. [25]

Longitudinal studies show that financial literacy is influenced mainly by parents. Those youngsters who are financially literate are more likely to have college-educated parents (in particular, college-educated mothers) and to have parents who had stocks and retirement savings when these young adults were growing up (when they were 12 to 17 years old).[26]

The Latino Educational Fund through its work on financial literacy, suggests a number of possible steps forward to ensure that our nation's young, especially minority students, from low-income households, and those where the primary language is something other than English, learn the fundamentals of credit, loans and bankruptcy so as to avoid becoming a generation of financially challenged adults (as well as being of more help to the adults present in their lives, many of whom depend on their children to interpret financial documents, bank interactions and general finance matters).

[25] Plan Advisor, "Financial Literacy Should start at Young Age" August 2010, http://www.planadviser.com/Financial_Literacy_should_start_at_a_young_age,_survey_finds.aspx

[26] Financial Literacy Amongst the Young, Anamaria Lusardi, George Washington School of Business, http://annalusardi.blogspot.com/2010/07/financial-literacy-among-young.html

1. In the short-term continue to concentrate on seniors in high school, providing them with real world personal finance issues, that include:

    a. Internships with financial advisory firms (so that students experience investing in stock markets and how to manage money etc. – especially important for those whose parents do not invest in the stock market); this could even be a potential requirement for graduation (comparable to community service requirements);

    b. Setting up of "hypothetical money market stock portfolios", such as through Yahoo finance ("Playing the Stock Market Game"). This way, teaching is removed from purely text book and classroom based learning;

    c. To encourage groups of students in schools to set up microfinance/microenterprises. While we see such projects more readily take place developing nations, rather than say, in developed nations, there isn't any reason they cannot be applied to the US (see Aflatoun's example and its spread to Europe). These projects can be supported through private and public financial grants/initiatives, awarded for the best ideas, devised and run by the students – such as healthy snacks delivery during exam time, car wash services, website and programming services etc. Loans would be made through the grants for start-up costs with low-interest payments scheduled according to a business plan set up by the student groups and approved by the grantees. A teacher-coordinator would ensure that students meet and learn to manage their loan payments and focus on profit and loss, as well as learn what constitutes a successful business enterprise; and

    d. The commencement of school banks or loan boards within the school where students either are elected to a board or seats within student council. These loan boards or positions would have the elected students review applications to distribute a small portion of school funding to athletic programs, clubs etc., on a loan basis with interest that is repaid by the programs activities. The money earned would be recycled to these programs year after year from the repayments (plus interest). In this way students would receive hand-on experience on how loans and loan programs work (from the stand point of banks/loaning agencies).

2. In the long-term, the Latino Educational Fund is also considering other ideas such as:

    a. Starting personal finance and financial literacy courses at a younger age, potentially even in middle school; and

    b. Encourage students to set up such stock portfolios as early as freshman year of high school and follow the market through more than one semester, and possibly start each student, via an "account" with $100 from an LEF investment fund.

The National Financial Educators Council suggests exactly the above in its 10 points guide on education young people on personal finances – encouraging parents to take their children on visits to financial advisors, as well as to encourage them to start businesses that don't encourage great financial investment. Of course, these are great tips for parents who have such resources (financial advisors, start-up money) at their fingertips. For students who don't have such advantages, private and public initiatives – led through state schools – are the only way to move ahead.[27]

If we truly wish to educate our young, especially those from families with less income and education, then we must implement financial literacy courses that are practical, relevant to today's world, and interactive, and do so at a much younger age than is the current norm. In addition, we must make such curriculums widespread and accessible by the many and not just the lucky few. We must, in other words, provide not your mother or father's financial literacy and do it soon.

Author: Latino Educational Fund

The Latino Educational Fund's mission is to provide young people with the resources necessary to obtain advance education and the financial knowledge to strive for a better life. The LEF focuses on providing services in four key areas:

1) Scholarships for students in need;
2) Career development and direct industry mentoring for young people;
3) Financial literacy to communities; and
4) Public policy initiatives and research reports for various industries.

[27] The National Financial Educators Council, Teaching Children about Money – 10 point Guide, http://www.financialeducatorscouncil.org/teach-children-about-money.html