

What you don't know can hurt you

InsiderQ&A



Lusardi

Annamaria Lusardi, an economics professor at Dartmouth College, says Americans know too little about finances. Financial literacy is particularly important now, as workers are expected to take more control over their retirement savings. She's found that financially literate people are more likely to plan for retirement, and people with retirement plans end up with more than double the wealth of those without plans.

Just how bad is financial literacy in this country?

People lack not just advanced financial but also basic financial knowledge. One of the things we've found is that people lack numeracy (numerical literacy).

Do you mean they can't add?

I would say it is really the lack of

grasping calculations, like interest compounding, for example, or percentages and an understanding of statistics. ... When people are told, 'Your diagnosis is a 1 in 10 chance that you will get better' or '1 in 20,' many people think 1 in 20 is bigger because 20 is bigger.

You're pushing for a new style of education, like how the "food pyramid" is taught in schools to encourage good nutrition.

I like very much this idea of a food pyramid. In the same way that we tell people that broccoli is good for them, we can tell them that to diversify risk (by spreading investments across different stocks, bonds and other assets) is good for them. (We can tell them to) exploit the power of interest compounding, which means it is important to start to save when young.

It is important to be careful when borrowing at very high interest rates, because debt can grow so fast.

It's easy to feel confused with all these retirement calculators, personal-finance books and such.

We live in a world where there is so much information; we see that people have difficulty processing this information. I think they do want to rely on sources that they know are good. But if people are not financially literate, they might have difficulties in distinguishing between good and bad sources of advice.

Think of all the books that are out there. Are they good or bad? Who checks on them, really? I have to admit, I haven't read any of them. But I think it would be useful for someone with a rigorous background to check on them.

Who should mete out these seals of approval?

I think the government would really be the best to provide that stamp of quality, that seal of approval. They have the interest to make sure people are making good decisions.

You say employer-sponsored financial education programs aren't always effective.

Often, it's one retirement seminar or one hour of financial education. If you give me an hour of physics, I'm not going to go home and fix my car.

What should change?

These programs need to be targeted to different groups (by gender or age). My assumption is that people are really smart. But it's lack of knowledge: You need to empower people with very simple programs.

It sounds expensive.

Think of the consequences of so many people making mistakes and having to be bailed out, and potentially an increase in taxes or regulation.

How should it happen?

The best way is probably at the employer. As employers have a gym so that workers can have physical fitness, the firm can also provide a financial adviser for financial fitness.

The other thing is we have to find a way to coordinate and best leverage all of these scarce resources. I'm really afraid that people who do this will just add another Web page of information. We don't need that. A lot of these things should be centralized, and the Treasury Department could really (act as a hub of information).