Learning the Tricks
FINANCIAL ILLITERACY GETS AMERICANS IN HOCK. BUT IS THE

By Kimberly Palmer

Many Americans, talking about money is at least as uncomfortable as discussing sex. A recent Charles Schwab study found that most parents felt better prepared to give their teens advice on the "birds and the bees" than on investing. That taboo may explain why Americans are so inept when it comes to making some of the most important decisions of their lives.

Millions of Americans accumulate unmanageable debt, fail to save for a rainy day (and retirement), and make countless other poor financial choices that eventually leave them worse off. But before railing against consumer stupidity, consider this: It's not always their fault. Many of those bad decisions are caused or exacerbated by a lack of knowledge.

"There are probably millions ... of households who have gotten themselves into mortgage [debt] they never should have gotten themselves into. Most of them didn't understand what they were agreeing to," says Alan Blinder, economics professor at Princeton University and former Federal Reserve vice chairman.

The time for claiming ignorance as an excuse may be coming to an end. Alarmed by the fact that foreclosures are up 57 percent over last year, consumer credit card debt is increasing at an annual rate of 6 percent, and Americans' savings will replace less than 60 percent of their income on average after retirement, public- and private-sector groups have launched a flurry of programs aimed at promoting financial education. But some experts suggest that even such efforts could be fruitless because they might not change consumers' behavior. They say the focus should instead be on making the financial world easier to understand.

"It's naive to think that we could give high school students one financial course and then make them financially literate consumers," says Richard Thaler, economics professor at the University of Chicago's Graduate School of Business and coauthor of Nudge: Improving Decisions About Health, Wealth, and Happiness. "We can make a lot more progress by making the world more benign."

Part of the problem, educators say, is that the financial systems that consumers navigate have become so complex. Easy access to credit, self-directed retirement accounts, and complicated mortgage options all force Americans to make decisions they may not be prepared for. "We don't know any less than our grandparents—we just need to know a lot more now," says Dan Ianni, deputy assistant secretary at the Treasury Department and executive director of the President's Advisory Council on Financial Literacy, launched by the White House in January (box, Page 48).

For Genette Brooks, 30, the ease with which she could take out credit cards as
of Managing Money

BEST SOLUTION MORE SCHOOLING OR A SIMPLER SYSTEM?

A college student eventually put her $20,000 in debt. "I didn't know what I was getting into," says Brooks, who graduated with a degree in human resources management and lives in Buffalo. A big reason for the debt, she says, was that no one had ever taught her how credit cards work or how to use them. She says she didn't realize that a zero percent introductory rate could later balloon to 30 percent or that making only the minimum payments can lead to a rapid pileup of debt.

Flunking. Most Americans have extremely low levels of financial literacy, research suggests, despite its importance. The JumpStart Coalition for Personal Financial Literacy tests 12th graders every two years by asking them practical money questions. The students consistently record an average score of 50 to 55 percent, generally considered to be a failing grade (quiz, Page 46). Other research shows that about 3 in 4 workers don't know how much money they need to save for a comfortable retirement. Only about half of respondents in one study were able to correctly answer two simple questions about interest rates and inflation.

Such poor results matter, says Anamaria Lasardi, a professor of economics at Dartmouth College, because research also shows that people who understand basic financial principles are better at retirement planning, accumulating wealth, and avoiding debt. In fact, she found that people who develop financial plans accumulate from 10 to 15 percent more wealth than those who don't, even after taking into consideration income and education levels.

To encourage saving and planning, dozens of initiatives target kids as well as adults. The National Endowment for Financial Education, for example, distributes a curriculum for high school students that covers budgeting, debt, insurance, career choices, and other financial decisions, reaching more than 800,000 kids a year. "It's important to give them a base understanding," says Ted Beck, chief executive of NFTE and a member of the President's Advisory Council. Similarly, the National Council on Economic Education helps teachers incorporate financial instruction into other subjects, such as explaining taxation during a lesson on the Boston Tea Party. But most states do not require students to take personal finance courses.

Rep. Judy Biggert, an Illinois Republican who is ranking minority member of the House Subcommittee on Financial Institutions and Consumer Credit, applauds efforts to increase education and recommends against limiting the financial industry's ability to collect fees. "We just need more personal responsibility," she says. "It's sad that people don't take financial education as seriously as other things, because it determines whether they will be successful or lose money to fraud."

The banking industry, not surprisingly, agrees with her. "The real heart of the issue is financial literacy and the ability of consumers to make choices that work for them," says Ken Clayton,
the American Bankers Association’s managing director and senior vice president for card policy. If consumers knew more about credit and how it functions, they would use it in a more responsible way that worked for them, he says.

Lessons. Experts outside the finance industry are often more skeptical of the power of education, and with good reason: Research suggests that many of the lessons are not having their intended effect. "The very disappointing result...is that people exposed to financial education don't do any better," Tasardi says. One study followed up with graduates five years after they took a respected personal finance course; it found the course had an insignificant impact on their behavior.

Such findings have led lawmakers and experts to argue that it is the financial industry, not American consumers, that needs improvement. "The issue is not financial literacy. It is the byzantine structure that the companies have set up, and we need to focus on that," said Rep. Keith Ellison, a Minnesota Democrat, at an April hearing on credit card reform.

Princeton’s Blinder suggests structural changes, such as creating laws to penalize the mortgage industry for selling products to people for whom they don’t make sense, just as stockbrokers are now under suitability standards. He adds that banks could be required to keep a certain percentage of the mortgages they originate on their own books instead of selling them to third parties, so they would have an incentive to screen borrowers more carefully.

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Are You Financially Smarter Than a 12th Grader?

Every two years, the Jump$tart Coalition for Personal Financial Literacy tests 12th graders' practical money knowledge. The average score usually hovers around 52 percent. You can test yourself on these sample questions from the 2006 survey.

Matt and Eric are young men. Each has a good credit history. They work at the same company and make approximately the same salary. Matt has borrowed $6,000 to take a foreign vacation. Eric has borrowed $6,000 to buy a car. Who is likely to pay the lowest finance charge?

Matt will pay less because people who travel overseas are better risks.

They will both pay the same because they have almost identical financial backgrounds.

Eric will pay less because the car is collateral for the loan.

Many savings programs are protected by the federal government against loss. Which of the following is not?

A bond issued by one of the 50 states
A U.S. Treasury bond
A savings bond
A certificate of deposit at the bank

Which of the following statements is true?

Your bad loan payment record with one bank will not be considered if you apply to another bank for a loan.

If you missed a payment more than two years ago, it cannot be considered in a loan decision.

Banks and other lenders share the credit histories of their borrowers with each other and are likely to know of any loan payments that you have missed.

People have so many loans it is very unlikely that one bank will know your history with another bank.

Doug must borrow $12,000 to complete his college education. Which of the following would NOT be likely to reduce the finance charge rate?

If his parents took out an additional mortgage on their house for the loan.

If the loan was insured by the federal government.

If he went to a state college rather than a private college.

If his parents cosigned the loan.

If you had a savings account at a bank, which of the following would be correct concerning the interest that you would earn on this account?

Sales tax may be charged on the interest that you earn.

You cannot earn interest until you pass your 18th birthday.

Earnings from savings account interest may not be taxed.

Income tax may be charged on the interest if your income is high enough.

Kelly and Pete just had a baby. They received money as baby gifts and want to put it away for the baby's education. Which of the following tends to have the highest growth over periods of time as long as 18 years?

A U.S. government savings bond
A checking account
A savings account
Stocks
In their book *Nudge*, Thaler and law Prof. Cass Sunstein suggest designing financial and other programs to help guide people toward smart choices without limiting their options. They call their approach "libertarian paternalism." Thaler and Sunstein recommend automatic enrollment in retirement savings plans, which research shows increases and speeds participation in workplace programs. And they advocate allowing consumers to sign up to save more money each time they get a raise, which boosts savings rates. Just by using the term "minimum payment," the authors say, credit card companies suggest that it is an "appropriate" amount to pay, even though it's usually just a fraction of the total bill and paying it maximizes interest payments. Their solution? Companies should allow automatic payment of the full amount due.

Limits. Susan Wones, 46, of Denver, seemed to be asking for a version of this libertarian paternalism when she testified on behalf of consumers at a recent hearing on Rep. Carolyn Maloney's legislation to create a cardholder's "bill of rights." Wones expressed frustration that her card company, Chase, had approved her purchases even after she went over her credit limit, triggering a fee and an interest rate hike. She had assumed charges would be denied as soon as she reached her $2,000 limit. (Chase says that most customers appreciate the ability to go over their credit limit but that consumers can request to have such charges denied.)

Thaler says that credit card companies, for example, could apply his and Sunstein's approach by asking consumers whether they want to exceed their credit limit (for a penalty) or if they would prefer the charges be denied. "Then people would be aware of what they were getting into," he says.

In the meantime, pending any structural changes, there is some evidence that certain types of financial education work. Programs that are interactive and repetitive, and focus on big-picture concepts, such as goal-setting, get the best results. The lessons from an interactive stock market game, where students buy and sell stocks with $100,000 of virtual cash, appear to stay with students, for example.

Elizabeth Coit, executive director of Networks Financial Institute at Indiana State University, says that teaching the basic ideas of goal-setting and delaying gratification at a young age and then constantly reinforcing those messages can pay off over time. "If you wait to introduce financial management and responsibility until the teenage years or beyond, then you're fighting what is now already entrenched, impulsive behavior," she says.

Financial educator Tischelle George says many kids would benefit from just learning the basics. When George went to college, she quickly ran up credit card debt after signing up for a card in exchange for a free T-shirt. No one had explained to her that she should pay off the balance each month to avoid interest and fees or that taking out a cash advance was expensive. "I was just doing all the wrong things," she says. "I wished someone had taught me about this."

Her own experience led her to develop a financial literacy program, Mind Your Money, in which she teaches preteens and teenagers at Brooklyn,

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**Your Short Course on Key Money Lessons**

Dozens of financial education programs aim to teach adults and kids how to make smart money decisions. Here are their top lessons:

**Set Goals.** Deciding what you want, whether it's an early retirement or a new car every two years, helps you prioritize spending. It's the focus of the first lesson from the National Endowment for Financial Education's curriculum for high school students, which encourages distinguishing between needs and wants.

**Make a Budget.** NEFE's curriculum also encourages students to consider where their money goes and whether it's aligned with broader goals. Students consider their expenses and categorize them as fixed, variable, or periodic and weigh whether they need to be adjusted.

**Save Early.** The Treasury Department's Money Math curriculum emphasizes the value of compound interest by showing how quickly money grows when it earns a 5 or 10 percent return year after year.

**Create an Emergency Fund.** Devika Kamboh, a financial planner and volunteer teacher for the nonprofit Dress for Success's money management workshops, tells her students to build an emergency fund with six to 12 months' worth of savings. "That's so you don't have to make decisions under stress or accept a low-paying job that you hate," she says.

**Be a Savvy Shopper.** The America Saves campaign tells consumers to wait 24 hours before buying pricey items to avoid impulse buys that they will later regret.

**Manage Debt.** The ability to borrow money to buy a home or a car depends on being creditworthy, a concept explained in materials distributed by the American Bankers Association's Education Foundation. The foundation shows students how to compare interest rates and fees to pick the best credit card for them and to avoid borrowing money that will be difficult to repay.

**Avoid Hidden Fees.** The Federal Trade Commission warns that credit card interest rates often go up after low introductory rates and that conveniences such as cash advances, balance transfers, and telephone payments often carry fees. -K.P.

A list of financial literacy resources, with links to useful websites, is at www.usnews.com/fllitresources
N.Y., public libraries. The basic concepts she covers include how to choose a bank with low or no fees, how to write a check, and how credit and debit cards differ. 

Teens. Research shows that young adults who are financially literate tend to be the children of college graduates. That suggests that parents play an important role in teaching their kids about money, Luardi says. The Schwab survey also found that many parents shy away from discussing personal finance with their teens, often because they falsely believe the teens aren't interested in learning about it. In fact, 60 percent of teenage respondents cited learning about money management as a top priority.

Programs aimed at adults have also shown signs of success: America Saves, a national savings campaign, found that 3 out of 4 participants in a Cleveland-based program put a savings plan into effect and made progress toward their goal after the card companies on her behalf and helped her develop a plan to pay off outstanding balances, now down to $11,000. Says Brooks, “It took me getting into debt to figure out what it was all about.”

‘We’ve Got to Make Smart Sexy Again’

Bush adviser says rampant ignorance breeds financial victims

John Hope Bryant has dedicated his life to promoting financial literacy and ending poverty. As founder of the nonprofit Operation Hope, he works on bringing minority and poor communities into the mainstream by promoting private-sector investment in inner cities and financial education for individuals. He was recently appointed vice chairman of the President’s Advisory Council on Financial Literacy. U.S. News spoke with Bryant about why financial literacy matters and what can be done to promote it. Excerpts:

Why is financial literacy important?

The big-picture answer is this subprime mortgage crisis. People got paid shock. I’m not talking about poor people. We’re talking about people who make six-figure incomes who asked the wrong questions. They asked, “What was the payment?” not “What was the interest rate?”

This crisis that we're dealing with — yes, there's fraud; yes, there's greed; yes, there's misrepresentation and investor speculation. But at the heart of this, people were victimized far easier because they allowed themselves to be victims. Because they were financially illiterate. Because they could not defend themselves and their families from financial predators.

So you think financial literacy plays a big role in the choices people make.

The dropout rate in high schools across the country is about 30 percent for all students, but among inner-city kids it's 50 to 70 percent. That is an economic death sentence. It's also a financial handicap for American competitiveness.

I believe one reason they're dropping out of school is they don't believe education is relevant to their future. One of the easiest ways to make it relevant is to show kids how to get rich legally. That's financial literacy. It's a literacy issue. We're the largest economy in the world, but no one is teaching our children about checking or savings accounts or budgeting. It's a sin. We live in a democracy rooted in capitalism, yet we're not teaching our children the language of money. We've got to make smart sexy again.

How can that be done?

The president is making financial literacy a policy of the federal government. That's the first major step. Then, we've got to work to integrate financial literacy in schools at the earliest age possible and into the workplace.

The No. 1 cause for black and brown people jumping out of college is money. The No. 1 reason adults divorce is money. What people get into arguments about is primarily money based. What depresses and discourages people and lowers productivity is them worrying about money. Money is the one thing that everyone obsesses over and nobody understands. It's the last tabula. When was the last time you talked to a girlfriend and said, “Girl, my credit score is 500.” They're ashamed to admit they don't understand. So for kids, we've got to make smart sexy again, and for adults, we've got to remove the shame from talking about money. —K.P.