THE FINANCIAL PAGE

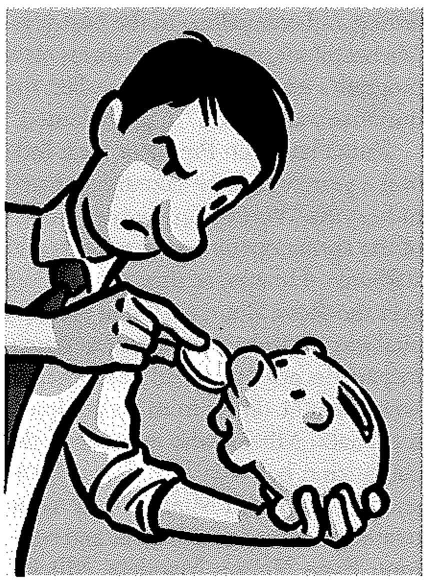
GREATER FOOLS

Halfway through his Presidency, George W. Bush called on the country to build "an ownership society." He trumpeted the soaring rate of U.S. homeownership, and extolled the virtues of giving individuals more control over their own financial lives. It was a comforting vision, but, as we now know, behind it was a bleak reality—bad subprime loans, mountains of credit-card debt, and shrinking pensions—reflecting a simple fact: when it comes to financial matters, many Americans have been left without a clue.

The depth of our financial ignorance is startling. In recent years, Annamaria Lusardi, an economist at Dartmouth and the head of the Financial Literacy Center, has conducted extensive studies of what Americans know about finance. It's depressing work. Almost half of those surveyed couldn't answer two questions about inflation and interest rates correctly, and slightly more sophisticated topics baffle a majority of people. Many people don't know the terms of their mortgage or the interest rate they're paying. And, at a time when we're borrowing more than ever, most Americans can't explain what compound interest is.

Financial illiteracy isn't new, but the consequences have become more severe, because people now have to take so much responsibility for their financial lives. Pensions have been replaced with 401(k)s; many workers have to buy their own health insurance; and so on. The financial marketplace, meanwhile, has become a dizzying emporium of choice and easy credit. The decisions are more numerous and complex than ever before. As Lusardi puts it, "It's like we've opened a faucet, and told people they can draw as much water as they want, and it's up to them to decide when they've had enough. But we haven't given people the tools to decide how much is too much."

Unsurprisingly, the less people know, the more they run into trouble. Gary Rivlin's blistering new examination of the subprime economy, "Broke, U.S.A.," is full of stories of financially ignorant people bamboozled into making bad decisions—refinancing out of low-interest mortgages, say, or buying overpriced credit insurance—by a consumer finance industry adept at creating confusing products. Such stories are backed up by the numbers. A study by economists at the Atlanta Fed found that thirty per cent of people in the lowest quartile of financial literacy thought they had a fixed-rate mortgage when in fact they had an adjustable-rate one. A study of subprime borrowers in the Northeast found that, of the people who scored in the bottom quartile on a very basic test of calculation skills, a full twenty per cent had been foreclosed on, compared with just five per cent of those in the top quartile.



CHRISTOPH NIEMANN

What can be done? One solution is regulation: the financial-reform bill now before Congress will create a consumer financial-protection agency that should help curb the finance industry's most predatory excesses. Another solution is to tinker with "choice architecture"—doing things like enrolling people in 401(k)s automatically—in order to "nudge" them toward better decisions. Both of these strategies are necessary, but they're not enough on their own, because financially illiterate consumers are always going to be easy victims. We also urgently need proper financial education.

This seems obvious, but it's surprisingly controversial. Some suggest that financial illiteracy is an example of what economists call "rational ignorance"—inattention that is justified because the costs of paying attention outweigh the benefits. But few decisions affect us more directly than the ones we make about our money. Critics also argue that financial education may make people overconfident, and therefore more likely to make bad decisions. In fact, the reverse is true: the less people know, the more overconfident in their abilities they tend to be. In a German study, eighty per cent of those surveyed described themselves as confident in their answers on a questionnaire, yet only forty-two per cent got even half the questions right. This is known as the Dunning-Kruger effect: people who don't know much tend not to recognize their ignorance, and so fail to seek better information. No wonder, then, that the least knowledgeable people in the Atlanta Fed study were also the least likely to do research before getting a mortgage. By contrast, well-informed people are more likely to ask others for help. If financial education taught people only how little they actually know, it would accomplish quite a lot.

The government's new consumer-protection agency has the authority to "review and streamline" financial literacy programs, but that's not enough. We really need something more like a financial equivalent of drivers' ed. There's evidence that just improving basic calculation skills and inculcating a few key concepts could make a significant difference. One study of the few states that have mandated financial education in schools found that it had a surprisingly large impact on savings rates. And the Center for American Progress has found that, across the country, education and counselling by nonprofit organizations, like the Massachusetts Affordable Housing Alliance, have helped low-income families buy and hold onto homes, even during the housing bubble. The point isn't to turn the average American into Warren Buffett but to help people avoid disasters and day-to-day choices that eat away at their bank accounts. The difference between knowing a little about your finances and knowing nothing can amount to hundreds of thousands of dollars over a lifetime. And, as the past ten years have shown us, the cost to society can be far greater than that.

—*James Surowiecki*

MONEY U Because Financial Literacy Keeps Young Adults on Top of Their Game.

Financial Literacy Facts

WEBSITES

People in the 18 to 24 age bracket spend nearly 30% of their monthly income just on debt repayment - double the percentage spent in 1992 (10% of net income is a recommended amount for debt obligation).

The State of Financial Literacy in America

65.1% of Americans consider themselves "very" or "highly" knowledgeable when it comes to personal finance. However a majority of Americans (52%) do not regularly review their credit report each year. 23% of Americans have never reviewed their credit report.

Jump$tart: Making the Case for Financial Literacy, 2007

Of the 5,775 high school seniors who took the Jump$tart personal finance test in 2006, 62% received failing scores.

The State of Financial Literacy in America

Nearly two-thirds (63%) of Americans acknowledge they don't save enough, and more than a third say that they often (11%) or sometimes (25%) spend more than they can afford. More than one-in-three (36%) Americans also say that they have at some point in their lives felt their financial situation was out of control.

Jump$tart: Making the Case for Financial Literacy, 2007

The average 21-year-old in the U.S. will spend more than 2.2 million in their lifetime.

The State of Financial Literacy in America

Only 14% of American adults mentioned their company's 401(k) plan when asked about ways they save.

Jump$tart: Making the Case for Financial Literacy, 2007

In 2004 the credit card industry took in $43 billion in fee income, up from $39 billion in 2002, according to R.K. Hammer Investment Bankers. Fees accounted for 35% of industry income last year, up from 18% six years ago.

USA Today

Students entering college are offered an average of eight credit cards during their first week of school.

The State of Financial Literacy in America

More than 40% of American households have less than $1,000 in liquid, non-retirement savings accounts according to Census Bureau data, leaving them incredibly vulnerable financially.

How to Survive Seven Big Budget Busters

DOWNLOADS
Research has shown that as little as 10 hours of personal financial education positively affects students spending and savings habits.

Making the Case for Financial Literacy [DOC]

In 1999, approximately 461,000 Americans under age 35 sought protection from creditors through declaring bankruptcy, according to Harvard Law School professor and researcher Elizabeth Warren. This figure was up from 380,000 in 1991.

USA Today Collegiate Case Study: Money Matters for College Students [PDF]

Children's spending has roughly doubled every ten years for the past three decades, and tripled in the 1990s.

Making the Case for Financial Literacy [DOC]

More than 1 in 5 youths ages 12 to 19 have their own credit cards or have access to parents' credit cards, and 14% have debit cards.

Making the Case for Financial Literacy [DOC]

83% of college students have at least one credit card, and undergrads carry an average of three cards. But it's not like teens enroll in college with plastic in their pockets. Actually, 55 percent of students acquire their first credit card during their freshman year. On average, credit card companies extend credit lines between $500 and $3000 to college students.

Making the Case for Financial Literacy [DOC]

Startling Facts

- 20% of employees are unable to carry out normal work activities three days per week due to financial concerns (http://www.remtech.biz/FactsAndStats.htm).

- The personal saving rate went negative for the first time ever in 1998. Americans are spending $100.20 for every $100.00 they bring home (http://www.remtech.biz/FactsAndStats.htm).

- 2 out of 3 households will probably not be able to accomplish one of their major life goals because they did not plan for the future (http://www.remtech.biz/FactsAndStats.htm).

- In the United States, the most affluent 1% of the population holds more wealth than the entire bottom 90% combined, according to U.S. Federal Reserve research (*The Futurist*, July-August 2005).

- There are all kinds of ways to describe today's 30-year-olds. But what may really come to distinguish them is that they could be the most indebted generation in modern history (*BusinessWeek*, November 14, 2005).

- The most-honored captains of industry – Fortune 500 CEOs – routinely make more in a morning than their average employees earn in a year (*The Futurist*, July-August 2005).

- It costs the average American family over $200,000 to raise a child to 18 (*US Department of Agriculture*; http://www.remtech.biz/FactsAndStats.htm).

- In the 2004, U.S. presidential election campaign, President George W. Bush made no apologies for his tax cuts that, in 2004 alone, meant an extra $170,000 for average taxpayers in the nation's most affluent 1% (*The Futurist*, July-August 2005).

- Approximately 57% of all divorces are due to arguments over money (http://www.remtech.biz/FactsAndStats.htm).

- The American Savings Education Council's 2004 report, Saving and Retirement in America, states that among all workers, 45 percent have less than $25,000 in savings and investments (aside from equity in primary residences). In the age group 25-34, 64 percent have less than $25k in savings; in the age group 35-44, 48 percent have less than $25k; in the age group 45-54, 30 percent have less than $25k. According to a 2002 survey by the Consumer Federation of America, 25 percent of U.S. households have net assets of less than $10,000 (http://www.mdmproofing.com/iym/hfstats.shtml).

- America is the richest country in the world, yet, ironically, we have the highest percentage of people living paycheck to paycheck. A recent study from ACNielsen revealed that about one in every four Americans say they don't have any spare cash ("Escape the Credit Card Trap," Kiplinger, 10/6/2005).

- In 1943, America's very richest, according to U.S. Internal Revenue Service statistics, paid 78% of their total incomes in federal income tax. In 2003, by contrast, they paid a mere 17.5% of their total incomes in federal tax (*The Futurist*, July-August 2005).

- The U.S. federal minimum wage currently stands at $5.15 an hour or $10,712 over the course of a year. A couple, with each spouse earning minimum wage, earns twice that, or $21,424. In 2003, the incomes of the richest 1% of U.S. citizens averaged $1.082 million for the year. In 2003, the middle 20% of income earners averaged $36,000 per household, less than twice the income for a minimum-wage worker (*The Futurist*, July-August 2005).

- Compared to average weekly filings of 30,000 to 35,000 during the month of October in recent years, Lundquist Consulting, Inc. (Burlingame, CA) reported over 205,000 filings for the week that ended on October 15. However, even that leap in filing volume didn't capture all of the activity in bankruptcy courts the last few days before the October 17th implementation. According to Fitch Ratings, "[f]ilings made on the weekend, as well as a large backlog, were processed in the week ended Oct. 21, which clocked in with 315,017 filings (http://www.spotlightonfinance.org/2005/November/forecast-story3.htm).

- From 1992-2000, disposable personal income rose 47%, but personal spending increased 61% (http://www.remtech.biz/FactsAndStats.htm).

College Tuition

- College students make up 10 to 15% of those seeking money-management help (http://www.remtech.biz/FactsAndStats.htm).
- The cost of higher education, however, has increased so dramatically in the past decade and a half – up by 63% at public schools and 47% at private – which more students borrow tens of thousands of dollars to attend, ensuring that many of them are paying off those loans well into their 40s. The median debt-to-income ratio now is about 8%. But fully one-quarter of graduates are paying more than 12% of their income, a level many financial experts regard as worryingly high (*BusinessWeek,* November 14, 2005).

- The price of public colleges, where about 80% of all students are enrolled, increased 28% in the past fives years alone, far more than in any five-year period since 1975. At private colleges, the total cost increased by 17% (*BusinessWeek,* November 14, 2005).

- The average college student who takes out student loans graduates with a debt burden of $20,000 (http://www.remtech.biz/FactsAndStats.htm).

- Since 2000 real earnings for college grads, age 25 to 34, have fallen almost 10% (*BusinessWeek,* November 14, 2005).

- Almost two-thirds of students have to borrow money to get through school; as many as one-quarter may be accumulating credit-card debt to help pay for tuition. The median debt for college graduates in 2004 was $15,162, an increase of 66.5 percent since 1993. That may not seem like a crippling sum, but plenty of individuals owe much more. Back in 1993, only 4.2 percent of graduates had loans exceeding $25,000. A decade later, 17 percent did *(BusinessWeek,* November 14, 2005).

Retirement

- Americans' number one fear is running out of money during retirement (*USA Today Survey*; http://www.remtech.biz/FactsAndStats.htm).

- More than half of us are not putting aside enough to maintain anything like our present standard of living upon retirement. By the year 2010, 78 million Americans will be 65 or older. One in three has no retirement savings (*Senator Paul Sarbanes, Maryland, Chairman of the Senate Banking, Housing and Urban Affairs Committee;* (http://www.remtech.biz/FactsAndStats.htm).

- Women are twice as likely as men during retirement to receive income below the poverty level *("A Financial Warmup", U.S. Department of Labor).*

- 55% of American workers have no idea how much they will need to save to make their retirement dreams a reality (http://www.remtech.biz/FactsAndStats.htm).

- The average personal savings rate is now less than 2% of income, and the average household has a net worth of just $264,000 at retirement, not including home equity (Money, December 2004, pg. 94; http://www.mdmproofing.com/iym/hfstats.shtml).

- The average American will spend 18 years in their retirement phase. By 2050, they will spend greater than 30 years in their retirement phase (http://www.remtech.biz/FactsAndStats.htm).

- Less than 1/2 of American workers have attempted to calculate how much they need to save for retirement (http://www.remtech.biz/FactsAndStats.htm).

- Social Security only covers 40% of the retirement expenses for the average American (http://www.remtech.biz/FactsAndStats.htm).

Financial Literacy

- Only 5% of investors believe they know everything they need to know to make good investment decisions (http://www.remtech.biz/FactsAndStats.htm).

- The likelihood on being on welfare is inversely proportional to financial literacy levels (http://www.remtech.biz/FactsAndStats.htm).

- Only 32% of American parents talk to their children regularly about personal finance (http://www.remtech.biz/FactsAndStats.htm).

- In 1999, 66% of high school seniors taking a basic economic literacy test failed. The results were worse in 2000 and 2001 (http://www.remtech.biz/FactsAndStats.htm).

- 43% of adults at the lowest level of financial literacy live in poverty, compared to only 4% of those at the highest level of financial literacy (http://www.remtech.biz/FactsAndStats.htm).

- More than one-third (36.1 percent) of Americans report that they do not use a budget to manage their family's expenses (http://www.remtech.biz/FactsAndStats.htm).

- September 6, 2005 - Despite the fact that 65.1 percent of Americans consider themselves "very" or "highly" knowledgeable when it comes to personal finance, many fall short in a number of key areas according to the results of a new survey by consumer advocacy group Consumer Action and leading financial services provider Capital One: (http://www.consumer-action.org/English/PressReleases/2005_09_06_PR.php).

- Sixty-two percent of Americans report that they are saving and/or investing. However, more than 40 percent of all Americans save less than 5 percent of their annual household income. Sixteen percent save between 5 and 10 percent. Only nine percent save more than 20 percent of their annual income (Jean Chatzky, You Don't Have to Be Rich, 2003; http://www.mdmproofing.com/iym/hfstats.shtml).

- Younger Americans are more inclined to use a budget compared to older Americans. Nearly 80 percent (79.7) of 18-19 year olds use a budget, compared to only 46.6 percent of Americans aged 70+ (plus) (http://www.consumer-action.org/English/PressReleases/2005_09_06_PR.php).

(The survey polled 1002 men and women nationwide ranging in age from 18 to older than 70. It gauged respondents' knowledge of the basics of personal finance such as budgeting, saving habits, credit principles, and basic personal finance responsibilities).

Credit

- Capital One and Consumer Action find the majority of Americans lack basic understanding of credit scores and the fundamentals of personal finance (http://www.consumer-action.org/English/PressReleases/2005_09_06_PR.php).

- The average American household with at least one credit card carried a balance of $7942 in 2000 (http://www.remtech.biz/FactsAndStats.htm).

- Older Americans have a poorer understanding of credit scores compared to younger Americans. Only 13.6 percent of 70+ Americans correctly identified 700 as a "good" score. By comparison, more than 43 percent of Americans in their thirties were able to correctly identify 700 as a good credit score (http://www.consumer-action.org/English/PressReleases/2005_09_06_PR.php).

- Approximately 60 percent of Americans revolve balances. The average revolving balance, among individuals with at least one credit card, is now $3,815. Households in the $75,000-to-$100,000 income bracket carry the heaviest debt loads, shouldering nearly $8,000 per person (CardTrak, April 2004).

- Approximately 35 million Americans pay only the required minimum — as low as 2 percent — of their balance each month (http://www.pbs.org/wgbh/pages/frontline/shows/credit/eight/).

- The average credit-card debt in among 25-to-34-year-olds was $52,000 in 2004, 98% higher than in1992 (*BusinessWeek,* November 14, 2005).

- Last year 76% of college students had credit cards and their average debt was $2,169 (*BusinessWeek,* November 14, 2005).

- The average credit-card debt among 25-to-34-year-olds was $5,200 in 2004, 98 percent higher than in 1992 (*BusinessWeek,* November 14, 2005).

- A majority of Americans surveyed either did not know (31.7 percent) or responded incorrectly (35.1 percent) when asked to define a good credit score (700) (http://www.remtech.biz/FactsAndStats.htm).

- Fifty-four (54) percent of those surveyed wrongly stated that age is a factor considered in determining credit scores (http://www.remtech.biz/FactsAndStats.htm).

- A majority of Americans (52 percent) do not regularly review their credit report each year. Twenty-three percent of Americans have never reviewed their credit report (http://www.remtech.biz/FactsAndStats.htm).

- More than 7 million Americans already have second jobs, according to the Bureau of Labor Statistics. Nearly three out of every 10 people who hold more than one job say they do so to meet household expenses or pay off debt (Chatzky, J.; September 2004; Weapons of mass debt destruction. Money, p. 57).

- According to CNN, the average credit card debt per household reached a record $9,312 in 2004. That's an increase of 116 percent over the past 10 years (CNN/Money, October 12, 2005).