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NEWSLETTER



# The case for financial literacy education

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Financial literacy education does not have a great reputation. It's a huge industry, spawning all sorts of books, web channels, TV shows and even social media accounts — but past studies have concluded that, for the most part, financial literacy education is kind of a waste of time.

For example, a much cited paper published in the journal *Management Science* found that almost everyone who took a financial literacy class forgot what they learned within 20 months, and that financial literacy has a "negligible" impact on future behavior. A trio of academics at Harvard Business School, Wellesley College and the Federal Reserve Bank of Chicago, produced a working paper that showed that mandated Finlit classes given to high schoolers made no difference to the students' ability to handle their finances. And the list goes on.

The name that comes up again and again in these papers and reports on financial literacy is Annamaria Lusardi. She is a professor of economics and accountancy at the George Washington University School of Business. She's also the founder and academic director of the Global Financial Literacy Excellence Center at GWU. She and Olivia Mitchell, a professor at the University of Pennsylvania's Wharton School of Business, published a paper in 2013 that amounted to a study of studies about financial literacy, and it was quite critical of the way financial literacy programs are taught. This study of studies has been widely quoted ever since.



## **New Hope For Financial Dullards**

Ten years later, Lusardi and Mitchell are out with a new paper, similarly titled, but much more upbeat. "The Importance of Financial Literacy: Opening A New Field," picks up where their 2013 study of studies left off, and it draws on the two women's experience teaching personal finance.

The first thing they establish is that the level of financial literacy, globally, is just as woeful as it was when they released their seminal paper ten years ago. To establish this, they conducted a survey that asked participants three questions, which focus on interest rates, inflation and risk diversification.

"These are simple questions," Lusardi says, "Yet they test for basic and fundamental knowledge at the basis of most economic decisions. In addition, answering these questions does not require difficult calculations, as we do not test for knowledge of mathematics but rather for an understanding of how interest rates and inflation work. The questions also test knowledge of the language of finance."

How did respondents do? Let's just say there is room for improvement. (You can test your own knowledge by checking out the paper).

"Only 43% of the respondents (in the US) are able to answer all of the questions correctly," Lusardi says, adding that the level of financial illiteracy is particularly acute amongst women. "Only 29% of women answer all three questions correctly, versus 48% of men," she says, adding that this gender difference is strikingly stable across the 140 countries that they ran the test in.

"We also see ... that women are much more likely than men to respond that they do not know/refuse to answer at least one financial literacy question," she says. Such gender differences are likely to be the result of lack of self-confidence, in addition to lack of knowledge."

Young people are also more likely to be disadvantaged in this area, Lusardi and Mitchell found, as are people of color. "The young display very low financial literacy, with only one-third being able to answer all three questions correctly. Half of Whites could correctly answer all three questions, versus only 26% of Blacks and 22% of Hispanics."

This is a problem, Lusardi says, not just because it means that many people are ill equipped to handle an increasingly complicated and complex financial landscape that can impact their earnings and long-term wealth. There are obvious social implications to the fact that white males appear to have a significant edge on the rest of the population in this area. And if that isn't enough, Lusardi says, it's also a problem for the economy.

"On average, Americans spend seven hours per week dealing with personal finance issues, three of which are at work. People with low financial literacy spend double that amount," she says. The impact on productivity of people spending most of an entire working day on their personal finances whilst at work is considerable, she goes on. Add in the consequences of mismanagement of assets, investments, mortgages and other debt, and there is a significant potential effect on the economy.

Lusardi says this idea, that the damage wrought by a lack of financial literacy might extend beyond the individual — to companies and even to the economy has not escaped the notice of governments.

"Influential policymakers and central bankers, including former Fed Chairman, Ben Bernanke, have ... spoken to the critical importance of financial literacy," the paper says. "Additionally, the European Commission has recently acknowledged the importance of financial literacy as a key step for a capital markets union. Some governments have ... implemented financial literacy training in high schools. Several years ago, the Council for Economic Education (CEE 2013) established National Standards for Financial Literacy, detailing what should be covered in personal finance courses in school."

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## Fixing The Flaws

A decade ago, Lusardi and Mitchell were somewhat critical of the financial literacy courses offered by companies and schools. The programs were generally not effective, they said, not because the concept of personal finance education was flawed per se, but because the various programs were generally not well resourced, and often poorly conceived.

"Most of these (courses) in the US were unfunded," Lusardi says. "There was no curriculum. There were no materials, and teachers were hardly trained. So the gym teacher was teaching financial literacy, or anybody they could find. This is, of course, not going to work. It wouldn't work for any topic. If you have a course in French and the teacher doesn't speak good French, (students) are probably not going to learn good French either."

Moreover, the classes, whether taught in schools or in corporate offices, tended to provide one-shot, one-size-fits-all instructions, with little or no follow-up. Lusardi says that was a recipe for failure. But those organizations that have recognized the need for financial literacy programs, and that have persisted in developing them, have made progress, she says.

"Many programs have moved beyond very short interventions, such as a single retirement seminar or sending employees to a benefits fair, to more robust programs," Lusardi says. "Financial literacy has now become an official field of study in the economics profession. Many initiatives at national levels have been launched, and more than 80 countries have set up national committees entrusted with the design and implementation of national strategies for financial literacy."

Lusardi says it's particularly important to teach and consolidate principles of good personal finance as early as possible, which means starting at home — where children are likely to model good financial habits — and in school. To that end, the Programme for International Student Assessment in 2012 added financial literacy to the set of topics that 15-year-old students need to know to be able to participate in modern society and be successful in the labor market.

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Lusardi says that in the decade since she and Mitchell released their 2013 report, their experience teaching financial literacy has proved that these programs, properly taught, can work.

"Our research shows that much can be done to help people make savvier financial decisions," she says, noting that a successful course will help people grasp key fundamental financial concepts, particularly financial risk and risk management. It will help them understand the workings of specific financial instruments and contracts, such as student loans, mortgages, credit cards, investments, and annuities. It will also make them aware of their rights and obligations in the financial marketplace.

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Most importantly of all, of course, it will attract and retain the students' interest, which isn't always easy in the dry world of finance.

"I teach very differently now because of my research," Lusardi says. "I say, what do you think this course is about? And as you can imagine, most of the students think it's about investing in the stock market. That's what personal finance is associated with. And I tell them, 'No, this is a happiness project. We talk about all of the decisions that are fundamental and important in your life. And I want to teach you to make them well, because if you do, you are going to be happy.'"