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Statement of
Alan Greenspan
Chairman
Board of Governors of the Federal Reserve System
before the
Committee on Banking, Housing, and Urban Affairs
United States Senate
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I am pleased to be here this morning to discuss the importance of improving financial literacy and learning for consumers.

Given the importance of accurate and timely information in the financial services industry, it is not surprising that this sector has benefited enormously from the innovative application of new technologies that have facilitated the development of a wide range of new financial providers and products. For consumers of household and business credit, computer and telecommunications technologies have lowered the cost and broadened the scope of financial services. As a consequence, we have seen a proliferation of specialized lenders and new financial products that are tailored to meet very specific market needs. At the same time, the development of credit-scoring tools and the securitization of loan pools holds the potential for opening doors to national credit markets for both consumers and businesses. In addition to technological advancement, deregulation has created important structural changes in the financial services industry and contributed significantly to creating a marketplace that is increasingly competitive and highly innovative as a result of the entry or expansion of new players.

Throughout our banking history, we have seen significant adjustments made to existing policies to enable markets to respond to the demand for services. These structural changes have heightened competition, resulting in market efficiencies that continue to help drive down costs and foster the emergence of increasingly diverse and highly specialized organizations. Through these entities, which range from banks and brokerage firms that offer their services exclusively through electronically based delivery mechanisms to locally based public-private partnerships that provide counseling and financing arrangements to facilitate access to mortgage credit for low- and moderate-

income families, consumers have increased access to a variety of credit and savings instruments. Corporations, for example, often allow employees to self-direct their investments in pension and other benefit plans, whereas employers dictated such decisions twenty years ago, and the advent of on-line brokerage firms has enabled individual investors to directly conduct stock transactions.

For an increasingly complex financial system to function effectively, widespread dissemination of timely financial and other relevant information among educated market participants is essential if they are to make the type of informed judgments that promote their own well-being and foster the most efficient allocation of capital.

However beneficial, constant change, of course, can be unsettling, and one challenge we face is overcoming such anxieties. But just as the rapid adoption of new information technologies has expanded the scope and utility of our financial products, so has it increased our means for addressing some of the challenges these changes pose. For example, just as universities provide remote learning options to allow students to pursue continuing education via the Internet, consumers can utilize software to create customized budgets to develop long-term savings strategies for retirement or their children's college education. In both scenarios, technological advances represent the opportunity for achieving efficiencies and exercising preferences, but only when the end users possess the knowledge of how to access pertinent information and how to capitalize on those choices.

As in the workplace, fostering education that will enable individuals to overcome their reluctance or inability to take full advantage of technological advances and product innovation in the financial sector can be a means of increasing economic opportunity. As

market forces continue to expand the range of providers of financial services, consumers will have more choice and flexibility in how they manage their financial matters. They will also need to accumulate the appropriate knowledge about how to use new technologies and how to make financial decisions in an informed manner.

Indeed, surveys repeatedly demonstrate a strong link between education and the use of new financial technologies. For example, data from the Federal Reserve's Survey of Consumer Finances (SCF) suggest that a higher level of education significantly increases the chances that a household will use an electronic banking product. In particular, in 1998, the typical user of an electronic source of information for savings or borrowing decisions had a college degree--a level of education currently achieved by only about one-third of U.S. households.

These most recent data from the SCF exhibit a mixed picture of the financial status of households, providing evidence that we need to reach out to those who have not been able to participate fully. For example, while the median real net worth for all families increased 17-1/2 percent between 1995 and 1998, this trend did not hold where the head of the household had a high-school level of education or less, family earnings were less than \$25,000 annually, or the ethnicity of the respondent was non-white or Hispanic. That families with low-to-moderate incomes and minorities did not appear to fully benefit from the highly favorable economic developments of the mid-1990s is, of course, troubling, and the data from the 2001 survey that will be available later this year will warrant a detailed look. Through 1998 we found that families with incomes below \$25,000 did increase their direct or indirect holdings of stock, and more reported that they had a transactions account. However, they were less likely to hold nonfinancial assets--

particularly homes, which constitute the bulk of the value of assets for those below the top quintile according to income. At the same time, one encouraging finding from the survey is that the homeownership rate among minorities rose from 44 percent to 47 percent between 1995 and 1998, and according to the Census surveys, the rate edged above 48 percent as of the fourth quarter of 2001. This trend may be a sign of improved access to credit for minorities.

Other findings of the SCF through 1998 include the rise in families' median level of debt burden, financial stress (defined as debt payments that represent more than 40 percent of income), and incidence of late debt repayment. The findings showed increases in each of these categories across all income and age groups, with the highest levels of financial stress among households headed by people 65 and older and earning less than \$25,000 annually. The recent evident rise in subprime loan delinquencies is of some concern in this regard.

In considering means to improve the financial status of families, education can play a critical role by equipping consumers with the knowledge required to make wise decisions when choosing among the myriad of financial products and providers. This is especially the case for populations that have traditionally been underserved by our financial system. In particular, financial literacy education may help to prevent vulnerable consumers from becoming entangled in financially devastating credit arrangements. In the quest to stem the occurrence of abusive, and at times illegal, lending practices, regulators, consumer advocates, and policymakers all agree that consumer education is essential to combating predatory lending. An informed borrower is simply less vulnerable to fraud and abuse. Financial literacy can empower consumers

to be better shoppers, allowing them to obtain goods and services at lower cost. This effectively increases their household budgets, providing more opportunity to consume and save or invest. In addition, comprehensive education can help provide individuals with the financial knowledge necessary to create household budgets, initiate savings plans, manage debt, and make strategic investment decisions for their retirement or their children's education. Having these basic financial planning skills can help families to meet their near-term obligations and to maximize their longer-term financial well-being.

While data to measure the efficacy of financial education are not plentiful, the limited research is encouraging. For example, a recent study by Freddie Mac, one of the nation's largest purchasers of home mortgages, finds that homebuyers who obtain structured homeownership education have reduced rates of loan delinquency. Similarly, an evaluation conducted by the National Endowment for Financial Education on its high-school-based programs found that participation in financial-planning programs improved students' knowledge, behavior, and confidence with respect to personal finance, with nearly half of participants beginning to save more as a result of the program. Another Freddie Mac study of the relationship between financial behavior and financial outcomes revealed that comprehension of the general principles of sound financial behavior, such as budgeting and saving, is actually more beneficial in producing successful financial results over time than specific and detailed information on financial transactions.

These findings underscore the importance of beginning the learning process as early as possible. Indeed, in many respects, improving basic financial education at the elementary and secondary school level is essential to providing a foundation for financial literacy that can help prevent younger people from making poor financial decisions that

can take years to overcome. In particular, it has been my experience that competency in mathematics--both in numerical manipulation and in understanding its conceptual foundations--enhances a person's ability to handle the more ambiguous and qualitative relationships that dominate our day-to-day financial decisionmaking. For example, through an understanding of compounding interest, one can appreciate the cumulative benefit of routine saving. Similarly, learning how to conduct research in a library or on the Internet helps one find information to evaluate decisions. Focusing on improving fundamental mathematic and problem-solving skills can develop knowledgeable consumers who can take full advantage of the sophisticated financial services offered in an ever-changing marketplace.

As I noted earlier, we have seen the marketplace respond to an increased demand for conceptual job skills by increasing the range of educational options available to individuals. We are also beginning to see similar efforts to provide consumers with information and training that will improve their knowledge about financial matters throughout their lives. For example, the U.S. military, in response to surveys that revealed that nearly one-third of enlisted service members reported moderate-to-severe difficulty in paying bills, has mandated that all incoming enlisted personnel receive financial education.

Some school systems have introduced financial-management classes as part of their high-school curricula and many employers are taking up the challenge as well. At the Federal Reserve Board, for example, interest in financial education prompted an employee committee to host a seminar on financial-planning strategies, and our Consumer and Community Affairs staff recently hosted several well-attended educational

programs for Federal Reserve employees, providing information on qualifying for a mortgage and managing debt. In fact, in conjunction with National Consumers' Week, today an additional employee seminar on budgeting is underway

Despite the existence and proliferation of numerous training programs offered by a wide variety of public, private, and nonprofit organizations, evaluation of the efficacy of such programs has just recently begun. A study commissioned and published by the Fannie Mae Foundation recommended that financial education programs equip consumers of all ages and across all socioeconomic groups with the ability to know when they need information, where they can find it, and how to apply it.

The Federal Reserve also has a keen interest in measuring the effectiveness of financial literacy programs. For example, we hosted a forum highlighting best practices in credit education focusing on effective tools and techniques and identifying programmatic challenges and issues. More recently, we have included studies that evaluate the impact of such training initiatives in our call for papers for the Community Affairs Research Conference scheduled for the spring of 2003. Additionally, our Community Affairs and Public Information Offices have embarked on a national initiative to highlight the importance of financial literacy and heighten the visibility of economic education programs. Quantitative study of the quality and long-term success of education and training will be of particular interest to the Federal Reserve System, as we develop and distribute a wide variety of financial and economic literacy products.

Both individually and through long-standing partnerships with a variety of local, regional, and national organizations, each of the twelve Federal Reserve Banks and the Board provide extensive information on these topics to a wide range of audiences,

including school-age children, low- and moderate-income families, and minority and immigrant populations. The scope of these activities ranges from the sponsorship of competitions on economic principles for high-school students and workshops on homeownership and wealth-building strategies to the development of computer-based tools for understanding mortgage borrowing and creating household budgets and savings plans. The economic educators of the Federal Reserve System launched an interactive web site offering students, educators, and the general public an introduction to the workings of the Fed and the nation's banking system. The goal is to offer consumers a clearer picture of, for example, how the Federal Reserve's decisions influence the economy and consequently affect their monetary choices.

In closing, let me simply reiterate that the pace of technological change and competitive pressures can only increase. These changes are affecting both financial and nonfinancial institutions around the world. We cannot know the precise directions in which technological change will take us, but as in recent years, the role of banks and other providers of financial services will surely be significantly affected by the same basic forces that guide the real economy. Building bridges between community organizations, our educational institutions, and private business will be an essential aspect of our efforts to increase familiarity with new technological and financial tools that are fundamental to improving individual economic well-being. And the success of such efforts will have a significant bearing on how well prepared we are to meet the challenges of an increasingly knowledge-based economy.