NATIONAL CONSUMERS LEAGUE
LIFESMARTS COMPETITION AWARDS CEREMONY

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The Importance of Personal Financial Management

I'd just like to take a second to applaud the National Consumers League, my colleagues at the Federal Reserve Bank of Boston, and all of the other sponsors for making this event possible. I believe that it is vitally important to get young people involved in financial education as early and as often as possible, and I think the LifeSmarts competition is a great way to do that.

As was just mentioned, I am president and CEO of the Federal Reserve Bank of Chicago, or the Chicago Fed as we call it. Just to give you a little more background about what we do, the Chicago Fed is one of the twelve District Reserve Banks across the country that, together with the Board of Governors in Washington, D.C., serve as the nation's central bank. The Chicago Fed covers a region that includes most of five states: Illinois, Indiana, Iowa, Michigan, and Wisconsin. Our mission is to help support the soundness of the U.S. financial system and the economy's ability to achieve maximum sustainable growth.

We carry out our mission with three main activities. We're probably most well-known for conducting monetary policy—that is, we influence short-term interest rates to help control how much money and credit flows through the economy. But, in addition, we supervise and regulate banks to make sure they are safe and sound and comply with government rules and regulations. And we make sure the payments system works and we are involved in processing electronic transfer of funds and paper checks.

We also support our mission through a variety of other activities, including financial education —the topic I'd like to talk to you about today. Even if the overall economy is expanding at its maximum sustainable pace, all of our work is useless to the consumer if he or she does not make informed decisions about how to save and invest their money.

Consider this new fifty dollar bill. It doesn't come with a set of instructions. You have to learn how to earn it. How to save it. How to borrow it. How to invest it. And how to spend it wisely.

Regrettably, our society does not insist that its citizens receive the education that would be necessary for them to adequately manage their finances. Our schools require that graduates achieve a certain level of professional expertise before they send them out to our businesses and workplaces. However, they do not require them to be prepared to manage their personal finances.

The importance of bank accounts

Perhaps one of the most glaring examples of our financial illiteracy is the number of people who don't use basic banking services. It's estimated that 10 million American families lack accounts at financial institutions, and according to a recent survey, 22 percent of high school seniors do not have any bank account. Sometimes limited access to financial institutions is a factor. But, more often, it reflects educational and cultural issues.

Banks provide unmatched security for savings, market-rate loans and actually pay depositors to hold their money. And deposits are insured up to certain limits. People who chose to forgo a banking relationship not only are sacrificing these tangible benefits, but they're also missing out on important intangible benefits, such as building a formal credit history.

Using credit wisely

Consumers with questionable credit histories or nonexistent credit histories have borrowing needs just like everyone else. In fact, they often need short-term loans just to pay their monthly bills. Sadly, many of these individuals rely on a variety of short-term loans with burdensome repayment conditions. This is something a financially savvy person would avoid.

But, some consumer debt is generated by otherwise rational people with a fondness for plastic—credit cards. Most credit cards have double-digit interest rates, so that many households face hundreds of dollars in monthly interest payments alone. And there are millions of people with huge credit card balances who simply make a minimum payment. That is convenient, but it ensures that their debt will continue to grow and be more difficult to pay off.

Obviously, cardholders shoulder most of the blame. Too many of them either are careless with credit or simply unaware of the potential pitfalls. But, in recent years, more aggressive marketing by credit card issuers has exacerbated the problem.

Credit providers used to be much more cautious when it came to offering cards, especially to young people. When many of you were born, a 25-year old corporate manager earning $60,000 a year could not qualify for a credit card if he hadn't lived at the same address for at least two years.

Today, times have changed. Let me ask you all a question. By show of hands, how many of you have ever gotten a letter inviting you to apply for a credit card? How many of you actually have your own credit card?

In some cases there is nothing wrong with using a credit card for purchases. But unfortunately, as credit cards have become more readily available for young people, more twenty somethings than ever have found themselves in need of financial counseling. With better financial planning, self-restraint and reasonable debt consolidation loans, some consumers are able to wipe the slate clean. But, many cannot, leading to delinquent payments and bankruptcies that could threaten the health of lenders.

By contrast, individuals who can manage money, ultimately have more money to manage; as my father once told me, it is always easier to make money when you have money. Financial literacy promotes financial security, and secure families are more willing and able to increase their wealth and enhance their standard of living. Those who save and invest put themselves in a better position to handle major outlays, such as car purchases, home purchases, and college tuition. Incidentally, in a recent survey of high school seniors, only 17 percent knew that stocks should have the highest return over an extended period of time (18 years), compared to savings bonds and savings accounts.

Educating for financial literacy

Clearly, formal education is a key component of any effort to improve financial literacy. Today, most people acquire their financial knowledge haphazardly, by trial and error. Numerous surveys reveal that young people do not learn any principles of personal finance systematically from their parents. Instead, they pick up bits and pieces in school, from their families, from the media, and through their business dealings with financial services providers.

At the Federal Reserve, we promote financial education in the classroom in a variety of ways.

The Fed has greatly expanded its education outreach efforts by putting in place professional development programs for educators, organizing programs and competitions for students, and advising educational groups on program development.

We also frequently serve as a catalyst to bring together educational groups, community-based organizations and financial institutions. The goal is to encourage these groups to work together to share resources and expertise.

At the Chicago Fed, we have a variety of economic and consumer education efforts underway. They include programs to teach teachers how to educate students about the Fed, the economy and personal finance topics. We accomplish this through teacher workshops and through On Reserve, a teacher newsletter that goes to thousands of educators across the Midwest.

And, our Web site, ChicagoFed.org, offers a wealth of information about personal finance topics, including information on shopping for a mortgage or a credit card, banking safely via the Internet, and direct payment of bills.

Money Smart Week

Our biggest undertaking this year is our third annual Money Smart Week, May 10 through May 15. The goal is simple. Bring together a wide range of different public and private organizations to promote financial literacy in a week of concentrated activities. All of these organizations do good work in helping adults and children to manage their finances successfully. Money Smart Week just helps make everyone aware of these resources so people who need help know where to get it.

We have a number of notable people involved in this year's Money Smart week. Fed Chairman Alan Greenspan will give a speech to area high school students, Mayor Daley is scheduled to participate, as is Reverend Jesse Jackson, and hip hop mogul and entrepreneur Russell Simmons is taking part as well.

Conclusion

However, no matter how many Money Smart weeks we have and no matter how many financial education resources we produce, the drive to become financially literate must come from within consumers themselves. I commend all the students here for taking an interest in consumer issues early on in life.

But I'd like to leave you with one thought. During my lifetime, I've seen dramatic changes in the marketplace for personal financial services. New technologies and regulatory changes have allowed banks and other financial institutions to create many new, specialized savings accounts and loan products. I can almost guarantee that you will see many changes in your lifetimes as well.

So, remember that while taking part in the LifeSmarts competition and learning about consumer issues today is a step in the right direction, financial literacy is a journey that you will have to continue on for years to come.