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Expanded Economic Education Is a Smart Investment

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Like many of my colleagues in the Federal Reserve System, I was a teacher before joining the Fed. My students arrived at college with varying levels of economic and financial knowledge. Some were those you might call "naturals." They looked at the world as an economist would, a place in which trade-offs are always present and costs and benefits must be weighed.

For other students, these concepts were less intuitive. But, hopefully, all of them left my classes with a greater appreciation of the power of economics to explain the world around them -- and a desire to continue to learn, both formally and informally.

Many students, however, will never take a college class in economics.

The numbers vary from year to year, but approximately 60 percent to 65 percent of high school graduates continue their studies at a college or university. And of those students, only about 40 percent enroll in even one college economics course. This is not to say that everyone should go to college or that all who do should major in economics.

The world would be a much poorer place (I mean that in both a financial and nonfinancial sense) without further generations of artists, engineers, and novelists enlightening our world. But as recent events in the credit markets demonstrate, economics affects everyone. I believe that an increased understanding of fundamental economic principles would help people in their own lives -- and improve the functioning of our economy and polity.

The historian Thomas Carlyle called economics "the dismal science." As you might guess, I beg to differ. Economics is not just about strictly pecuniary decisions, important as those may be. As I mentioned before, it can also provide a framework for evaluating a broad range of questions, including some of the most important public-policy issues of the day -- even though many of those issues might seem far removed from the realm of economics.

One of the key attributes of markets is that individuals who act in their rational self-interest will benefit not only themselves but also their fellow citizens. In doing so, they act as if they were being guided by an "invisible hand," as Adam Smith famously put it. We see this every day.

Consumers express their preferences for goods and services, and entrepreneurs satisfy their requests. Indeed, the two groups might hold quite differing social, political, or religious beliefs, but in the marketplace their interactions are harmonious and mutually beneficial. Little or no economic and financial education is needed to ensure that such day-to-day transactions take place. But in other areas, it seems that people could profit from greater awareness and understanding of the choices they face.

Consider the issue of retirement savings, for instance. Just a generation ago, many individuals relied on employer-provided defined-benefit packages, or pensions, to provide the bulk of their retirement income. Today, though, a relatively small share of companies provide such plans. Instead, they have shifted to defined-contribution programs, such as 401(k) plans, which place greater responsibility on workers to choose suitable investment options.

Such choices are not necessarily obvious or intuitive. Better economic and financial education would serve a very useful purpose here -- as well as in other areas of consumer finance, including questions surrounding homeownership. As an economist, I believe that people have strong incentives to weigh such decisions carefully. And if they are equipped with the relevant information, I am confident that they will, in general, make choices that are beneficial for them and their families.

When it comes to public-policy questions, though, the incentives are not as clear. Citizens may wish to support those policies that will lead to a healthy economy and society. But they have a much more immediate personal interest in understanding how refinancing their mortgage may benefit them than in, say, the best method to reform the health care system. Economic education can help them to better understand the trade-offs involved with such issues and to hold more informed views. In turn, they can use this increased knowledge to affect the way policy is made.

I would not necessarily argue that policymakers respond only to public opinion, but they certainly do listen to the views of their constituents. And if those constituents are economically knowledgeable, we can reasonably expect better policy decisions to emanate from Washington, state capitals, and local governments.

Events over the past year -- particularly the turmoil of the past month -- have sparked intense interest among many citizens in the economy. While not all of those events have been positive -- nor, in my opinion, have all the policy responses necessarily been wise -- it is possible they will lead to a discussion about the importance of economic and financial education. It's a discussion that I would welcome and believe could ultimately yield significant benefits.

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