COMMENTS ON RELEASE OF
THE NATION'S REPORT CARD™: ECONOMICS 2006

GARY H. STERN, PRESIDENT
Federal Reserve Bank of Minneapolis

Washington, DC
August 8, 2007

I am pleased to join you this morning for release of the first Nation's Report Card™ on economics for at least three reasons. First, I clearly think that economic knowledge, and hence economics education, are very important. Although I am speaking only for myself today and not for the Federal Reserve System, it seems clear to me that economic policy-making becomes easier and more effective the better the general public understands economics, and I will return to this theme shortly.

Second, like many economists, I think that incentives, and thus accountability, matter. For that reason, I welcome the decision of the National Assessment Governing Board to extend their program of educational assessment to include economics. Assessment programs can be costly, for the assessors and the assessed alike. By drawing on its broad experience in educational assessment, the National Assessment can minimize these costs, so that they are outweighed by the benefits of enhanced incentives and accountability.

Finally, and especially, I am pleased to see that our nation's economics report card is perhaps a bit better than I would have guessed. As a member and former chair of the board of directors of the National Council on Economic Education, I certainly see plenty of room for improvement, and I think this assessment can help guide our efforts toward more effective education in economics. As a result, I hope to see even better results, and smaller disparities among students of different backgrounds, in the next economics report card in 2012.

But as an economic policy maker, I am encouraged that even now a large majority of American high school seniors have at least a basic understanding of economic principles, and that over 40 percent have reached the *Proficient* achievement level set by the Governing Board. That's a good base to build on and a credit to the teachers, parents, and others who guide our nation's youth and need our support to achieve even better results.

I'd like to draw on my experience as a Federal Reserve Bank president to expand a bit on how the public's understanding of economic principles contributes to good policy-making. As I have discussed at greater length elsewhere (*Top of the Ninth*, June 2006), enduring economic progress and prosperity depend on public institutions' ability to commit to policies that are optimal over the long haul, across the temporary ups and downs of the business cycle. In a democracy, such policy commitments can only be sustained with broad public support, and public support for good policies depends, in turn, on voters' competence in basic economic reasoning.

Tangible evidence of the connection between good policies and public understanding can be found in our experience with monetary policy during and after the 1970s. Over a decade before today's high school seniors were born, the U.S. economy experienced a period of sustained high inflation. From 1973 to 1981, consumer prices rose by about 9 percent per year, on average. These high inflation rates distorted economic decisions, hindered growth, pushed interest rates to record levels, and weakened our financial system. Adding to the problem was the widespread view that high inflation was here to stay, a "fact of life" to be accepted and adjusted to. Today we know that this view was too pessimistic.

Under Paul Volcker, the Federal Reserve made a commitment to get inflation down and keep it down. Chairman Volcker kept that commitment, and it has been unambiguously extended by his successors, Alan Greenspan and Ben Bernanke.

Although the Federal Reserve's firm commitment to a policy of long-term low inflation was essential in this process, support from the public was critical as well. This was especially so during Chairman Volcker's tenure, when the shift to a consistent anti-inflationary policy entailed painful adjustments for many consumers and businesses. Chairman Volcker's public statements helped guide the public to a consensus that inflation hurts economic growth and thereby, over time, most citizens.

Inflation has now been reasonably well contained for roughly two decades or so, and the consensus in favor of price stability has been sustained. One reason, I think, is that under Chairman Greenspan, the Federal Reserve took a series of steps to communicate more clearly with the public, including financial market participants, about its objectives and its policies. Chairman Bernanke has embraced and extended that effort. As a result, the public continues to understand the long-term benefits of low inflation and thus to support the Federal Reserve's pursuit of this objective as one important element of our dual mandate. I think this is an excellent example of the value of economic knowledge.

The public was educated about inflation at a high price, amidst the economic dislocations of the 1970s and early 1980s. I prefer that economic education be pursued more benignly, in the classroom and the press, and more proactively, before rather than after it is needed. So I regret to note that today we are again witnessing some painful and belated learning, by policy-makers and consumers alike, in our consumer financial markets.

As you are probably well aware, consumers today have access to a wide array of borrowing and savings options. In itself, variety is good, because it expands choice and opportunity. However, variety also fosters complexity, which challenges both consumers in their decision-making and financial regulators in their writing and enforcement of rules.

This is not the time to go into the details of how the Federal Reserve and the other financial regulators are responding, but I would like to use some simple economics to make a connection between financial regulation and economic education. In short, I view consumer regulation and consumer education as substitutes. If consumers are more educated and able to make good decisions on their own, regulations can be narrower and more focused on clearly abusive practices such as deceit and fraud.

This is valuable, because as the scope of regulation widens, so does the cost. I'm not just referring to enforcement costs, which are high enough. More significant, in my view, are the extra compliance burdens that broad regulations impose on legitimate transactions and the opportunities forgone when legitimate potential transactions are prevented outright.

Don't get me wrong. In some cases it is necessary and appropriate that we bear these costs in order to prevent even greater abuses elsewhere. However, regulation involves a trade-off between preventing harm to some and allowing innovation, gains from trade, and free choice for others. At any given time, we write regulations as best we can to balance that trade-off. Over time, however, we hope that better economic education will soften the trade-off and allow us to rely more on the informed decision-making of consumers and less on formal restrictions.

In closing, I hope my remarks help to highlight the importance of economic education and of The Nations Report Card on economics. I and many other Federal Reserve staff are actively involved in supporting economic education. We know that clear communication about public policy and an economically well-educated public are crucial in sustaining good monetary and regulatory policies and, in turn, a prosperous economy. Accordingly, we value the economics report card as a solid benchmark for measuring progress toward the complementary goals of better education, better policy, and economic growth.

Thank you.