

## Financial literacy

“True or false? Buying a company stock usually provides a safer return than a stock mutual fund.” This question and others are asked to people age 18 and older in the Rand American Life Panel. In response to the aforementioned question, respondents can choose “true,” “false,” or “don’t know.” Only 71.4 percent of people answered “false,” the correct answer, and 24.5 percent indicated they did not know. In the article “How Ordinary Consumers Make Complex Economic Decisions: Financial Literacy and Retirement Readiness,” (*NBER Working Paper Series*, National Bureau of Economic Research, September 2009) Annamaria Lusardi and Olivia S. Mitchell discuss results from the Rand American Life Panel and other studies that have measured financial literacy in the United States.

The Rand American Life Panel poses basic questions to test whether or not respondents have at least a general sense of a number of financial concepts, and it also asks how much respondents have thought about retirement. There are simpler questions that ask about concepts such as compound interest and inflation, and more difficult questions that test whether respondents have a basic sense of concepts such as the stock market, mutual funds, bonds, volatility, and risk diversification. Although almost every question had a correct-response rate of more than 50 percent, less than half of respondents answered all of the five easier questions correctly and only 16.5 percent of respondents answered all eight of the more difficult questions correctly. Lusardi and Mitchell report that men, people 50 or older, and people with a college degree displayed higher levels of financial literacy and were more

likely to think about retirement than women, people younger than 50, and people without a college degree, respectively.

There are also questions that ask people to rate their understanding of economics, to report how much economics they have learned in school, and to indicate whether or not their workplaces have offered financial education programs. On the whole, people who rated their own knowledge of economics highly, those who had taken economics in school, and those who had been offered financial education programs in the workplace all were more likely to score better on the financial literacy questions. Through the use of a multivariate analysis linking retirement planning to financial literacy, the authors determine that, even after controlling for a number of socioeconomic factors, people who attained higher scores on the questions testing financial literacy were more likely to have given serious thought to retirement.

## Measuring potential economic growth

How much do economists know about measuring potential economic output? That question is the theme of the July/August 2009 issue of the *Federal Reserve Bank of St. Louis Review*, in which seven papers presented at the Bank’s 2008 policy conference are published. Measuring potential economic output—defined as the maximum sustainable level of output—is integral to maximizing employment while keeping prices stable. To make rational decisions, policymakers need to know the difference between actual and potential output (the “output gap”) and they need to understand how and why the

actual rate of inflation often differs from the targeted rate.

Each of the articles in the July/August Review deals with some aspect of potential output growth and its measurement. The first two papers are highly theoretical: one addresses neoclassical growth models and argues that a two-sector model is preferable because technological shocks have different effects on investment goods and consumption goods; the second theoretical paper embeds a production function—which specifies total output for all combinations of inputs—within a dynamic stochastic general equilibrium model and argues that policymakers need models which enable them to compare flexible price concepts based on the production function approach with those based on the real business cycle approach.

Two of the papers deal with the effects of using “real-time” data in measuring potential output: one analyzes the role the output gap has played in Canadian monetary policy, particularly in relation to projections used by Canada’s central bank; the second employs a state-space model to estimate the “true” unobserved measure of total output in the United States. Two of the papers use an empirical approach to measure potential output: one stresses that potential is less a “technological ceiling” than it is a measure of the maximum sustainable output; the other looks at the role of labor force trends in measuring potential output, particularly life expectancy, household net worth, and the unemployment rate. Finally, one of the papers examines the issue of measuring potential output in China, a rapidly developing country, compared with measuring potential output in the United States and the European Union. □