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How Economically Literate Are You?

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How much do Americans know about economics? Recent surveys point out that the answer to this question is “not nearly enough.” Results have illustrated gaps in understanding of even the most basic of economics principles. The lack of understanding isn’t limited to the general public; even current and former economics students have done poorly answering questions that check their general knowledge.

In 1999, Harris Interactive (then known as Louis Harris & Associates, Inc.) conducted The Standards in Economics Survey on behalf of the National Council on Economic Education (NCEE). The survey was designed to evaluate adult and student understanding of basic economics as outlined in the Voluntary National Content Standards in Economics, developed and published by NCEE in 1997.

In 2005, at the request of NCEE, Harris Interactive conducted a follow-up study to examine adult and student current understanding, and how this has changed since 1999. The 2005 survey also included an additional set of questions focused on personal finance.

Nine out of ten adults and students surveyed believe it is important for all people in the United States to have a good understanding of economics. Virtually all adults believe economics should be included in high school education, though only half of high school students say they have ever been taught economics in school (Harris, 2005). The Michigan MEAP test now includes a section on economics. Evidence of the increased interest in economics can be seen on U.S. college campuses. The Wall Street Journal reports that the number of bachelor degrees awarded in economics at 272 colleges and universities around the U.S. in the 2003–2004 academic year was 16,141, up nearly 40% from five years earlier (WSJ, July 5, 2005).

The increased interest in economics may be as simple as a cyclical return to the discipline away from other areas such as sociology, which saw growth in the early 1990s. Students may be realizing that a background in a quantitative field like economics can dramatically increase job prospects. The popularity of a recent book, Freakonomics, by University of Chicago economist Steven Levitt, shows that economics can be applied to a wide range of issues which can generate interests in many students to explore economics to greater depths.

Results of the 2005 Harris survey found that despite the interest in and general belief in the value of economics, most adults and students have not mastered the basic economic concepts. Adults and students were given a 24-question quiz. The quiz covered the 20 economic content standards developed by NCEE, plus additional concepts related to personal finance. Based on this quiz, adults got a grade of 70 (C) and students a grade of 53 (F). Six in ten high school students and more than one-quarter of adults got a failing grade on the economics quiz. One-third of adults and only one in eleven high school students got an A or B grade. (Harris, 2005).

The quiz covered the essential principles of economics including topics such as scarcity of resources, allocation of goods and services, the roles of competition and money, and specialization and trade. Considering the continual globalization of the U.S. economy, the last two topics are of increasing importance.

The quiz results revealed that both adults and students could use improvement in the area of personal finance. Adults who are college graduates earn about 70% more annually (on average) than adults who are only high school graduates. Most respondents underestimated the importance of a college degree on earnings. This is certainly information that colleges and high school counselors should make a point of disseminating. Half of adults and even fewer students did not know that keeping savings as cash has the greatest risk of losing value due to inflation.

The results of the survey also revealed differences in knowledge across gender, race, and education. Fewer adult women (average quiz score 63) than adult men (average score 78) show a good understanding of economics. Adult Whites had a higher score (72) than Blacks (61) or Hispanics (64). Adult college graduates had a higher score (82) compared to adults with some college (72) and adults with a high school degree or less (61). These results carry over to students. Male students had an average score of 56 compared to female students’ score of 49. The average scores for White, Black and Hispanic students were 55, 45, and 50 respectively.

The good news is the results of the 2005 survey do show improvement over the 1999 results, yet there is still a long way to go. Anne Krueger, the First Deputy Managing Director of the International Monetary Fund, delivering the keynote address at the 2005 annual conference of the National Council on Economic Education focused on the importance of economic education:

“… The more the population at large understands about economic issues, the more sensible and informed will be the discussion about economic policy issues affecting the national economy and the better will be the policy decisions that are taken. Fewer than half of the students—according to the
requires that people are willing to pay an amount that at least the realization that the efficient allocation of these resources have health insurance. What is the cost? Economics requires cost for a doctor office visit or a prescription because they have been. This will result in an overall lower standard of living. benefit from the productive capital that otherwise could have reduced for many. The true cost will be borne by those having the war? In reality there is no bill, and taxes were actually of the war's cost to date. How might this impact the support Imagine receiving an annual bill of $1,200.00 for your share the surface this is a noble pursuit. There is an understandable desire to want to help people and respond rapidly. At the same time, economics provides us with an analytical framework to consider an undertaking of this magnitude. Economics considers the allocation of scarce resources. Consider the intensity of the rebuilding efforts being discussed by the various governmental agencies. Ramping up building efforts to this level in a short period of time may not be feasible. There will likely be enormous pressures on the supplies of raw materials pushing up prices. The search for sufficient numbers of skilled workers will drive up wages for these workers. It is highly unlikely that this much construction can happen in that short a period of time. Construction activity intensified in this way is likely to lead to shortages. An unintended consequence is that a lot of the funds allocated for this work will not go for more houses, buildings, roads, etc., but for rising costs. However much we want to help in the days following national disasters, we have to remember that there are capacity constraints. Resources are scarce. This is something many people do not understand or want to consider. What are called for are realistic and achievable goals.

We can apply the same framework to the war in Iraq or the proposed manned space missions to Mars. Perhaps it is the lack of understanding of budget deficits that has many people believing we are somehow escaping the cost of these programs. The cost would be obvious if people were billed for them. Imagine receiving an annual bill of $1,200.00 for your share of the war's cost to date. How might this impact the support for the war? In reality there is no bill, and taxes were actually reduced for many. The true cost will be borne by those having to pay higher rates of interest in the future and not having the benefit from the productive capital that otherwise could have been. This will result in an overall lower standard of living. Along the same lines, many people believe that there isn't a cost for a doctor office visit or a prescription because they have health insurance. What is the cost? Economics requires that consideration be given to the scarcity of resources and the realization that the efficient allocation of these resources requires that people are willing to pay an amount that at least equals the cost of providing the resource. You can certainly question how many people would have visited the doctor or requested the prescription if they had to pay the full price. If the answer is fewer, then too many resources are being misallocated toward health care. So the cost is the other goods and services we could have had, the proverbial no free lunch often referred to by economists.

Economic illiteracy can also be seen in many ideas that people generally believe to be true but don't hold up to sound economic reasoning. Thinking again of natural disasters, how many times do we hear that “at least one positive from the devastation is that the economies in these areas will be stimulated.” NO! As Henry Hazlett, author of Economics in One Easy Lesson put it, “…if you carry this thought to its logical conclusion, one could theoretically put the economy through the roof by hiring millions of people to dig holes and then fill them up again!” Here we see the lack of understanding of Gross Domestic Product (GDP). While it is true that GDP may rise from all of the rebuilding, GDP does not measure the loss of buildings, roads, and houses caused by the devastation. Overall we are worse off. Using the same flawed reasoning, the people of Paris, France should be heartened by the realization of the many new jobs that will be created repairing the damage from the recent riots.

One of the authors asked the students in an economics principles class about the attractiveness of an investment that offered a 15–20% return on funds invested. Many responded favorably suggesting this was a very attractive offer. Yet when it was suggested that if they had credit card debt they could pay off their balances and save 15–20% in interest, they reacted with a bit of disgust, as if they had been tricked. It seems that many couldn’t grasp the basic concept that interest not paid is the same as interest earned. In the same reasoning, if someone is given a ticket to the Superbowl, it will cost them the same to go to the game as someone who paid for their ticket. In either case the decision is the same, go to the game or have the thousands of dollars that Superbowl tickets could be sold for.

Consider Matt Leinart, the Heismann winning quarterback for the National Champion USC Trojans, who could also receive the award for paying the highest tuition of any college student in the country. Assuming that he could sign for what Eli Manning did two years prior, he is paying close to five million dollars for his one class this fall semester (ballroom dancing!). One has to hope he is getting close to five million dollars of fun playing this year for USC!

As economics teachers can tell you, it is hard teaching students about trade-offs. Many young people have the good fortune of growing up without budget constraints (their parents face these), and opportunity cost is not clear to them. But as we often are fond of telling our students, just because something is difficult to do, that is not a valid excuse for not doing it. In this case, it is especially true since economic illiteracy isn't just an inconvenience, it can be quite dangerous.