Halfway through his Presidency, George W. Bush called on the country to build “an ownership society.” He trumpeted the soaring rate of U.S. homeownership, and extolled the virtues of giving individuals more control over their own financial lives. It was a comforting vision, but, as we now know, behind it was a bleak reality—bad subprime loans, mountains of credit-card debt, and shrinking pensions—reflecting a simple fact: when it comes to financial matters, many Americans have been left without a clue.

The depth of our financial ignorance is startling. In recent years, Annamaria Lusardi, an economist at Dartmouth and the head of the Financial Literacy Center, has conducted extensive studies of what Americans know about finance. It’s depressing work. Almost half of those surveyed couldn’t answer two questions about inflation and interest rates correctly, and slightly more sophisticated topics baffle a majority of people. Many people don’t know the terms of their mortgage or the interest rate they’re paying. And, at a time when we’re borrowing more than ever, most Americans can’t explain what compound interest is.

Financial illiteracy isn’t new, but the consequences have become more severe, because people now have to take so much responsibility for their financial lives. Pensions have been replaced with 401(k)s; many workers have to buy their own health insurance; and so on. The financial marketplace, meanwhile, has become a dizzying emporium of choice and easy credit. The decisions are more numerous and complex than ever before. As Lusardi puts it, “It’s like we’ve opened a faucet, and told people they can draw as much water as they want, and it’s up to them to decide when they’ve had enough. But we haven’t given people the tools to decide how much is too much.”

Unsurprisingly, the less people know, the more they run into trouble. Gary Rivlin’s blistering new examination of the subprime economy, “Broke, U.S.A.,” is full of stories of financially ignorant people bamboozled into making bad decisions—refinancing out of low-interest mortgages, say, or buying overpriced credit insurance—by a consumer finance industry adept at creating confusing products. Such stories are backed up by the numbers. A study by economists at the Atlanta Fed found that thirty per cent of people in the lowest quartile of financial literacy thought they had a fixed-rate mortgage when in fact they had an adjustable-rate one. A study of subprime borrowers in the Northeast found that, of the people who scored in the bottom quartile on a very basic test of calculation skills, a full twenty per cent had been foreclosed on, compared with just five per cent of those in the top quartile.

What can be done? One solution is regulation: the financial-reform bill now before Congress will create a consumer

financial-protection agency that should help curb the finance industry’s most predatory excesses. Another solution is to tinker with “choice architecture”—doing things like enrolling people in 401(k)s automatically—in order to “nudge” them toward better decisions. Both of these strategies are necessary, but they’re not enough on their own, because financially illiterate consumers are always going to be easy victims. We also urgently need proper financial education.

This seems obvious, but it’s surprisingly controversial. Some suggest that financial illiteracy is an example of what economists call “rational ignorance”—inattention that is justified because the costs of paying attention outweigh the benefits. But few decisions affect us more directly than the ones we make about our money. Critics also argue that financial education may make people overconfident, and therefore more likely to make bad decisions. In fact, the reverse is true: the less people know, the more overconfident in their abilities they tend to be. In a German study, eighty per cent of those surveyed described themselves as confident in their answers on a questionnaire, yet only forty-two per cent got even half the questions right. This is known as the Dunning-Kruger effect: people who don’t know much tend not to recognize their ignorance, and so fail to seek better information. No wonder, then, that the least knowledgeable people in the Atlanta Fed study were also the least likely to do research before getting a mortgage. By contrast, well-informed people are more likely to ask others for help. If financial education taught people only how little they actually know, it would accomplish quite a lot.

The government’s new consumer-protection agency has the authority to “review and streamline” financial literacy programs, but that’s not enough. We really need something more like a financial equivalent of drivers’ ed. There’s evidence that just improving basic calculation skills and inculcating a few key concepts could make a significant difference. One study of the few states that have mandated financial education in schools found that it had a surprisingly large impact on savings rates. And the Center for American Progress has found that, across the country, education and counselling by nonprofit organizations, like the Massachusetts Affordable Housing Alliance, have helped low-income families buy and hold onto homes, even during the housing bubble. The point isn’t to turn the average American into Warren Buffett but to help people avoid disasters and day-to-day choices that eat away at their bank accounts. The difference between knowing a little about your finances and knowing nothing can amount to hundreds of thousands of dollars over a lifetime. And, as the past ten years have shown us, the cost to society can be far greater than that. ♦

To get more of The New Yorker’s signature mix of politics, culture and the arts: Subscribe now