

# Financial Literacy and Retirement Security: A Global Perspective



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## Our Research Agenda:



- How widespread is financial illiteracy?
- What are links between financial literacy & economic decisions/outcomes?
  - Especially retirement security.
- What are cost-effective policy options?

→ *Def:* Financial Literacy: Ability to understand and act on financial information.

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### 3 simple questions (“Big Three”, Lusardi/Mitchell)

Interest Rate: Let’s say you have \$100 in a saving account paying 2% interest/year. How much would you have in the account at the end of 5 years?

<\$102; =\$102; >\$102; DK; refuse

Inflation: Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, with the money in this account, would you be able to buy: > today, = today;

< today

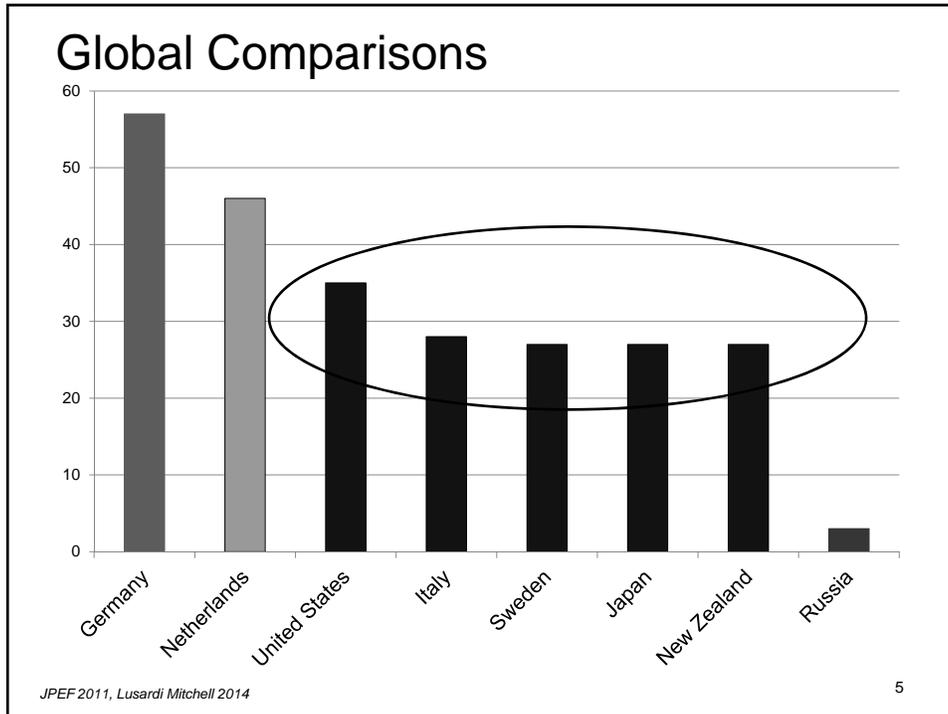
Risk Diversification: True or false? Buying a single company stock usually provides a safer return than a stock mutual fund.

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### How much do Americans know? (2009 FINRA)

	Correct	Incorrect	DK	Refuse
Interest rate	65%	21%	13%	1%
Inflation	64%	20%	14%	2%
Risk diversif.	52%	13%	34%	1%

→ Only 30% got all 3 questions right; < half (46%) got first two right.



### Links with Retirement Security:

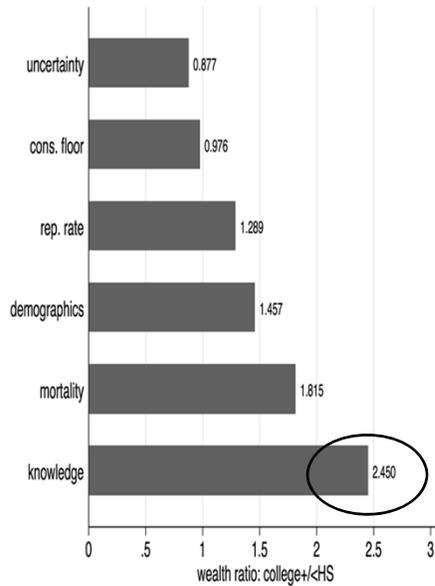
- Financially literate do better in retirement:
  - Many countries: More financially literate more likely to plan and save for retirement (*Lusardi/Mitchell JPEF 2011*)
  - Chile: Savvier more aware/sensitive to pension management fees (*Hastings/Mitchell 2011*)
  - US: Savvier earn higher risk-adjusted investment returns (*Clark/Lusardi/Mitchell JPEF 2015*)
  - US: Savvier more likely to value annuity vs lump sum consistently (*Brown/Kapteyn/Mitchell 2016*)



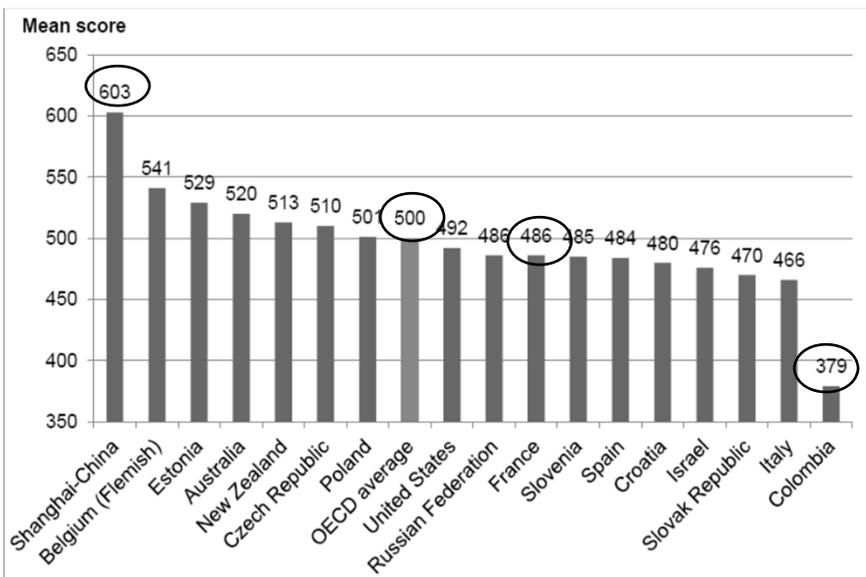
## Linking Financial Knowledge & Wealth Inequality

- Traditional models can't explain:
  - Wealth heterogeneity;
  - Low equity share;
  - Retirement wealth dispersion.
- They don't model financial literacy endogenously!
- We show Fin Knowledge explains ~ 1/3 of wealth inequality at retirement.

Lusardi/Michaud/Mitchell JPE forthcoming.

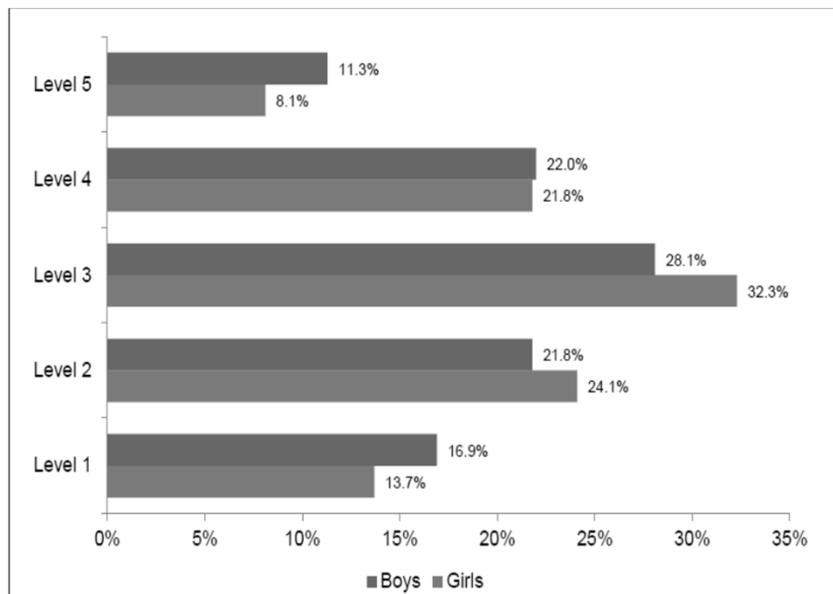


## Next Gen? Av FinLit Student Scores by Country (OECD/PISA)



Source: OECD. (2014). *PISA 2012 Results: Students and Money (Volume VI): Financial Literacy Skills for the 21st Century*.

## Student FinLit Diff's by Sex: Generally M>F



Source: OECD. (2014). *PISA 2012 Results: Students and Money (Volume VI): Financial Literacy Skills for the 21st Century*.

## Policy implications:

### What works?

1. Financial education needed in schools: Prepare new generations for new economic landscape.
2. Financial education in workplace: Prepare workforce for new pension & health realities.

→But beware: Financial literacy is endogenous.

- The more literate earn more & are wealthier than less literate;
- So be careful of self selection and reverse causality!



## Conclusions:

- Financial literacy drives planning, saving, pension wealth, and annuitization.
  - ✓ Heterogeneity: Women, low-paid, least educated most vulnerable.
  - ✓ So one-size-fits-all likely to be ineffective.
- Financial literacy drives wealth inequality.
- Program evaluation just getting off the ground.



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*Thank you!*

*For more information:*

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