

Financial Literacy and Retirement Planning in the United States

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**Annamaria Lusardi
and
Olivia S. Mitchell**

Changes in pensions

- 1. From Defined Benefit to Defined Contribution pensions**
- 2. Individuals are in charge of deciding how much to save for retirement**
- 3. Individuals are in charge of allocating their pension wealth**

Questions

- 1. Are Americans financially *literate*?**
- 2. Who knows the least?**
- 3. Does financial literacy matter?**

Study Methodology

National Financial Capability Study includes three linked surveys:

1. **National Survey**: Nationally-projectable telephone survey of 1,488 American adults
2. **State-by-State Survey**: Online survey of approximately 28,000 respondents (roughly 500 per state + DC)
3. **Military Survey**: Online survey of 800 military personnel and spouses

Objective

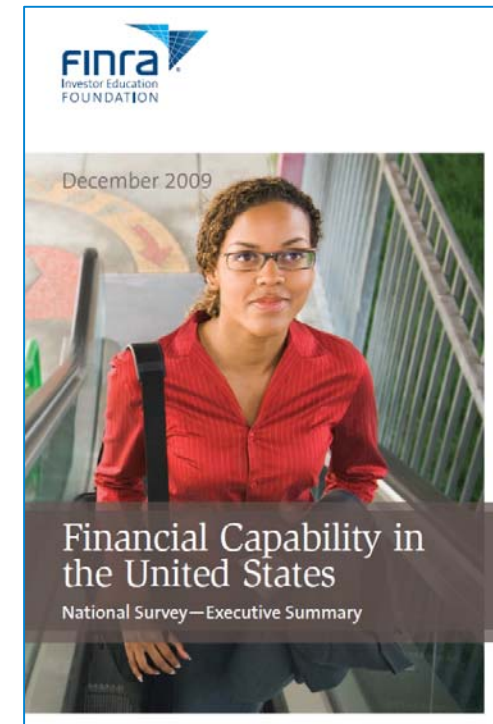
Establish a baseline measure of the ability of Americans to manage their money.

Multi-Disciplinary Team:

- Applied Research & Consulting LLC (ARC)
- FINRA Investor Education Foundation
- Office of Financial Education, U.S. Treasury Department
- Annamaria Lusardi
- Additional input from:
 - Craig Copeland, Employee Benefit Research Institute (EBRI)
 - American Institute of Certified Public Accountants (AICPA)
 - Bob Willis, Univ. of Michigan, past PI of U.S. Health and Retirement Study

Four Key Financial Capability Components

1. Making Ends Meet
2. Planning Ahead
3. Managing Financial Products
4. Financial Knowledge and Decision-Making



Measuring Financial Literacy

To test numeracy and understanding of interest rates, we asked:

“Suppose you had \$100 in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow?”

- i) more than \$102
- ii) exactly \$102
- iii) less than \$102
- iv) don't know (DK)
- v) Refuse to answer

Measuring Financial Literacy

To test understanding of inflation, we asked:

“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...”

- i) more than today
- ii) exactly the same as today
- iii) less than today
- iv) DK
- v) refuse

Measuring Financial Literacy

Finally, to test understanding of risk diversification, we asked:

“Do you think the following statement is true or false? Buying a single company stock usually provides a safer return than a stock mutual fund.”

- i) true
- ii) false
- iii) DK
- iv) refuse

How much do Americans know?

Distribution of Responses to Financial Literacy Questions (%)

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

NB: Only 30% correctly answer all 3 questions correctly; less than half (46%) got the first two questions right.

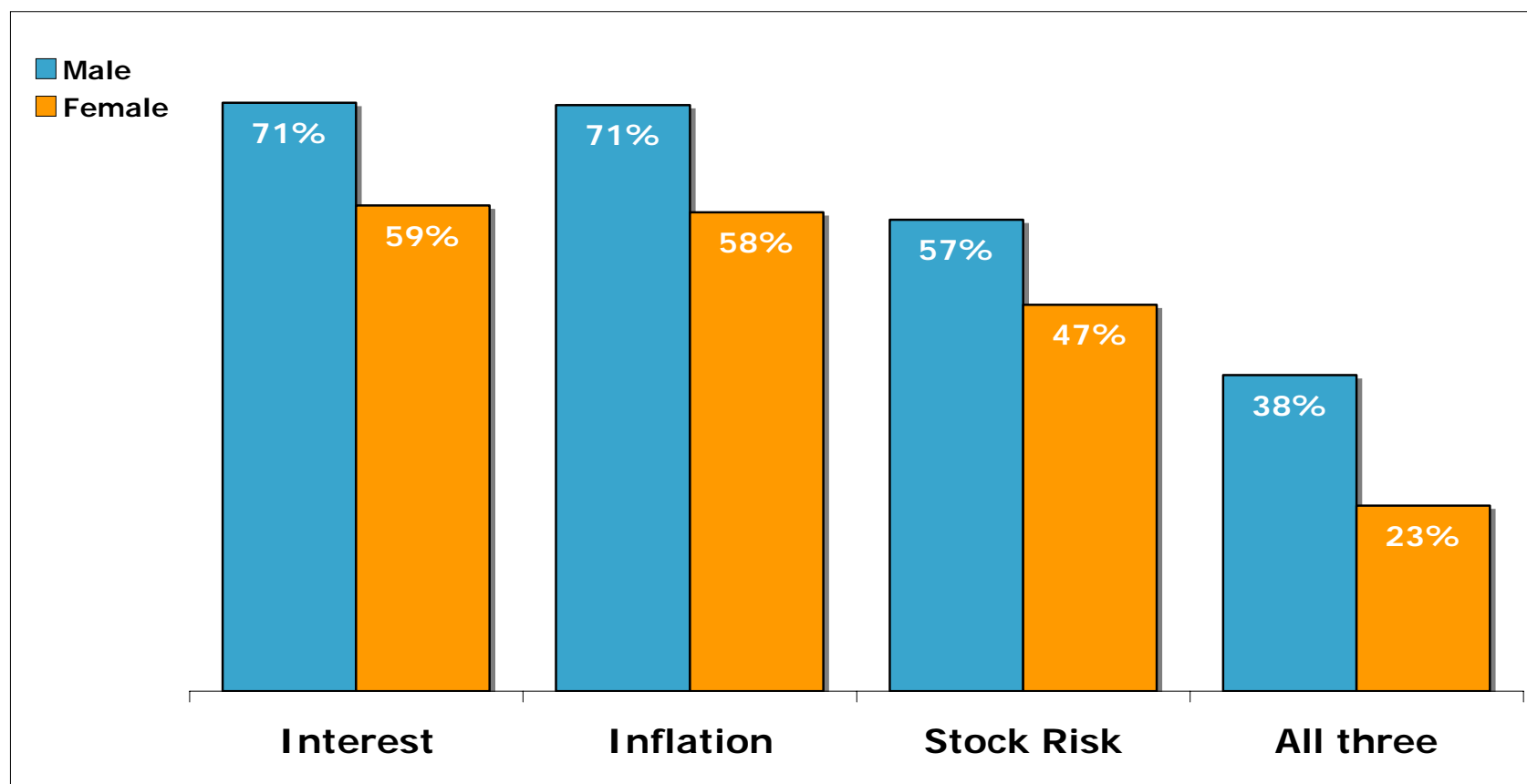
These questions have been asked in other countries

These questions have been added to surveys in:

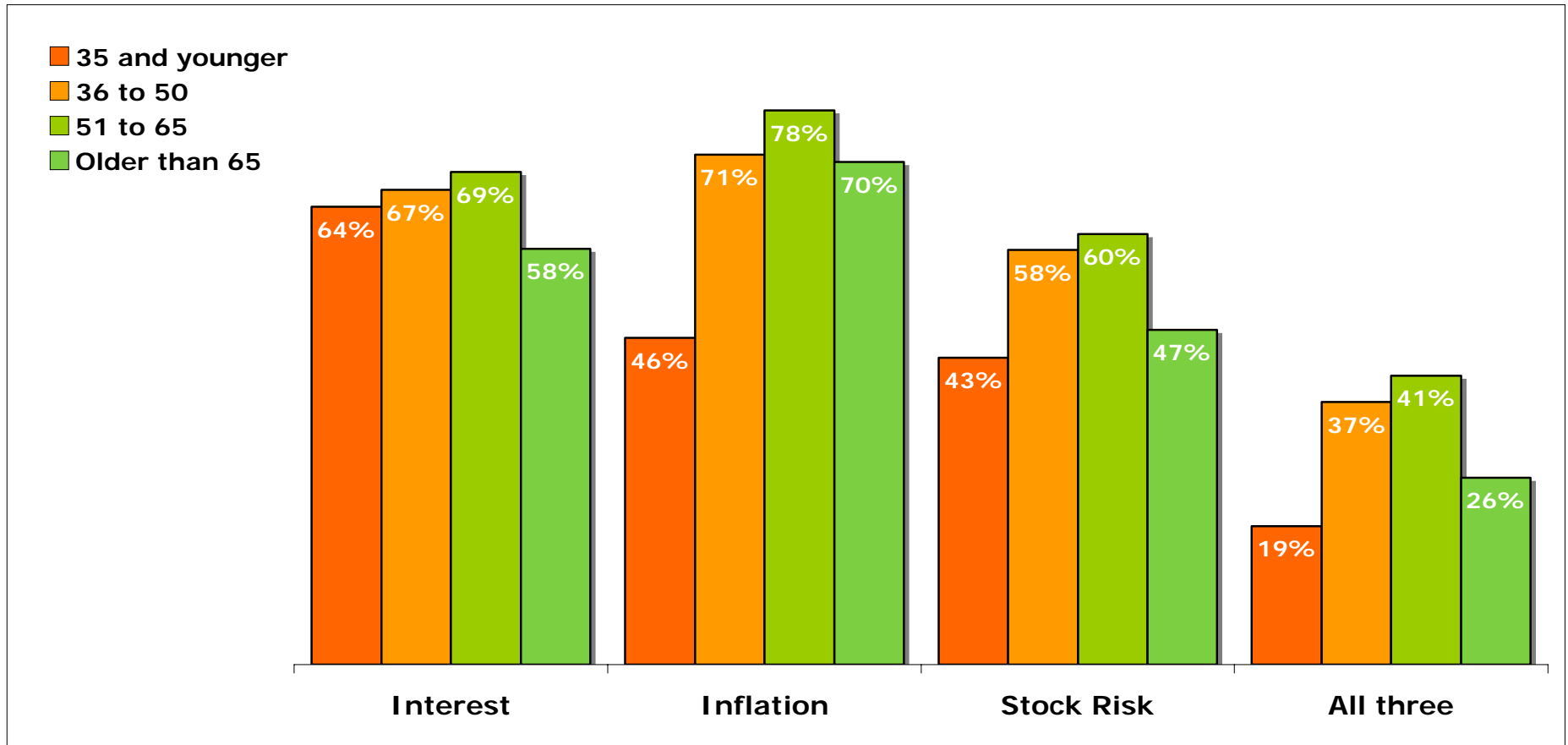
- ❖ Colombia
- ❖ Chile
- ❖ Mexico
- ❖ Indonesia
- ❖ China
- ❖ Sri Lanka



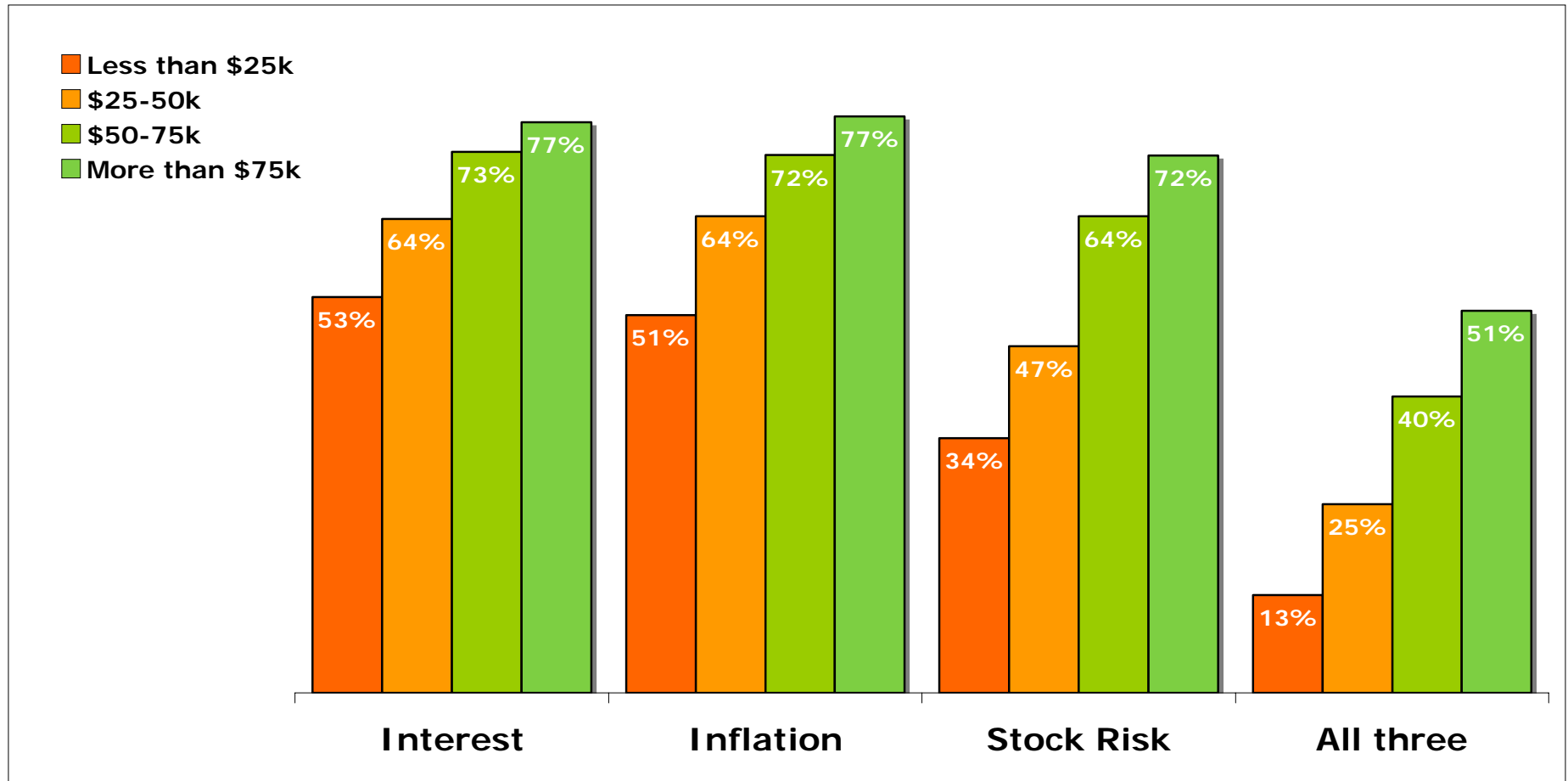
Differences in financial literacy by sex



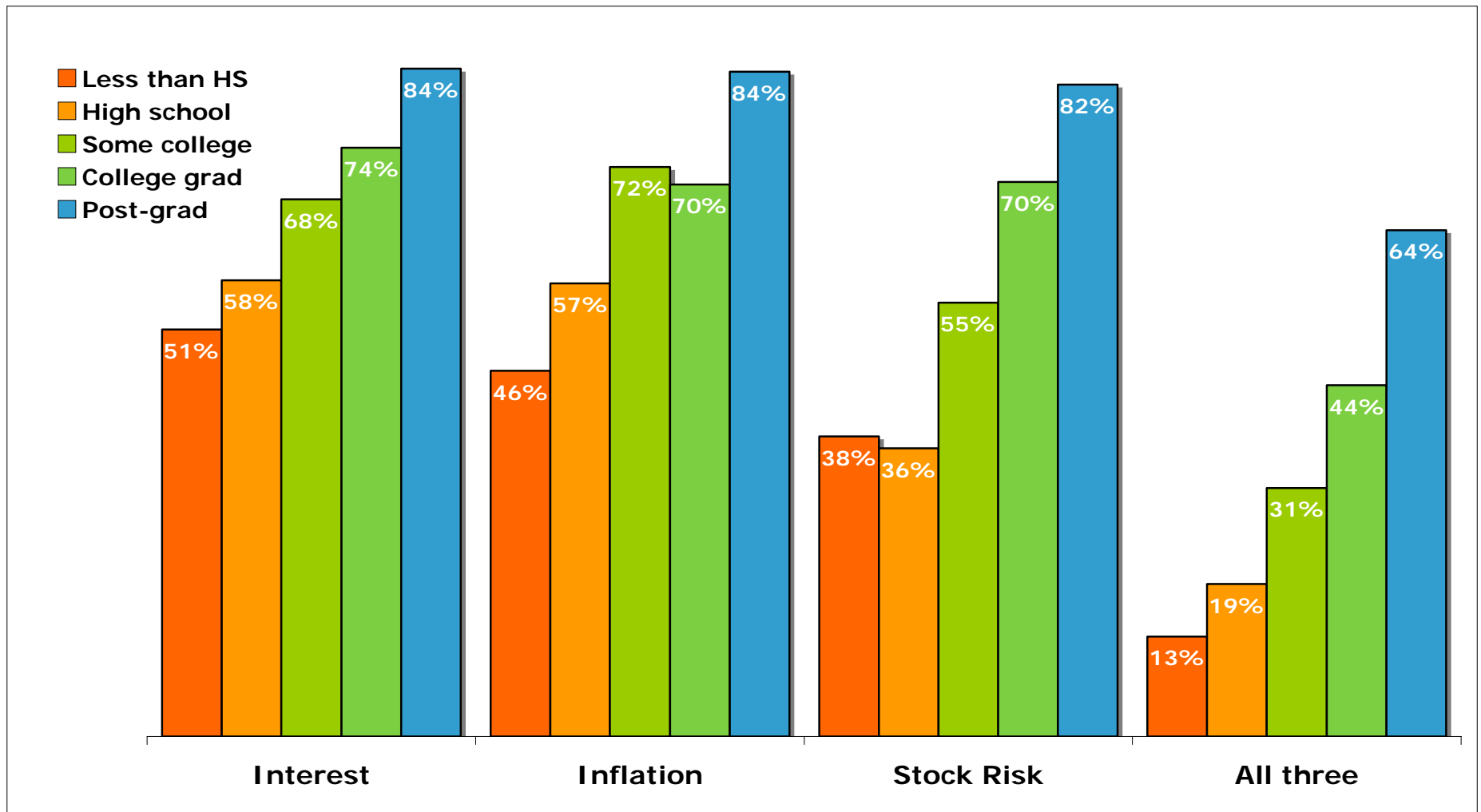
Differences in financial literacy by age



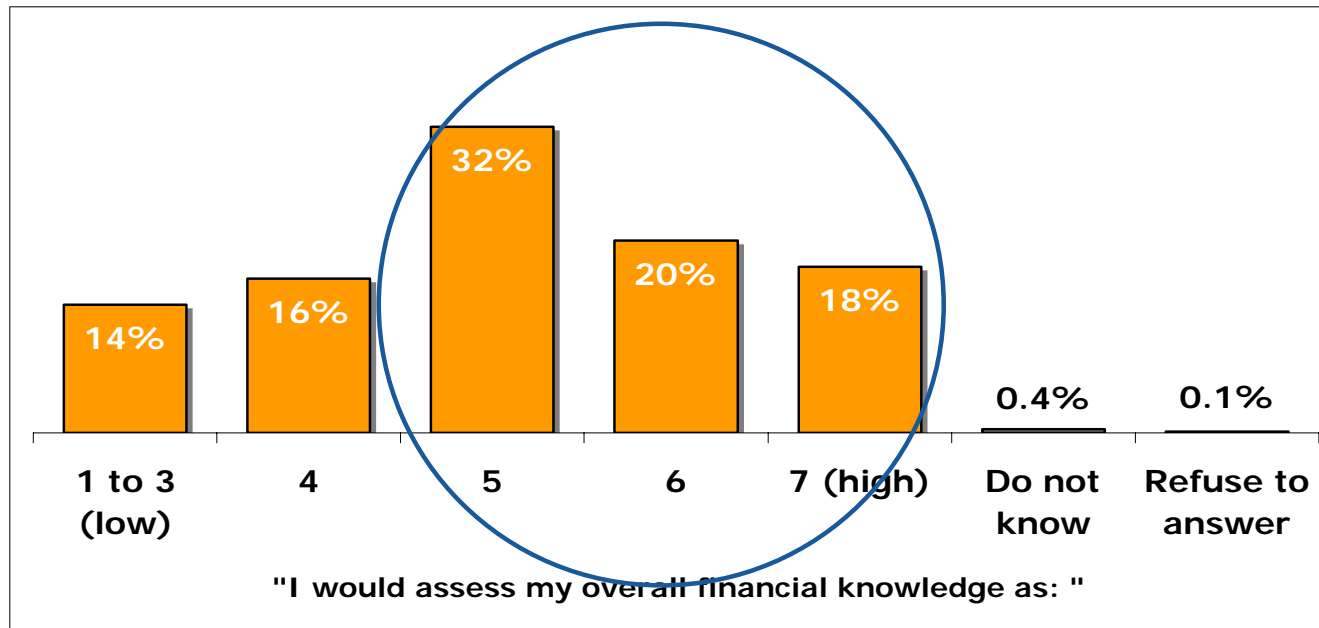
Difference in financial literacy by income



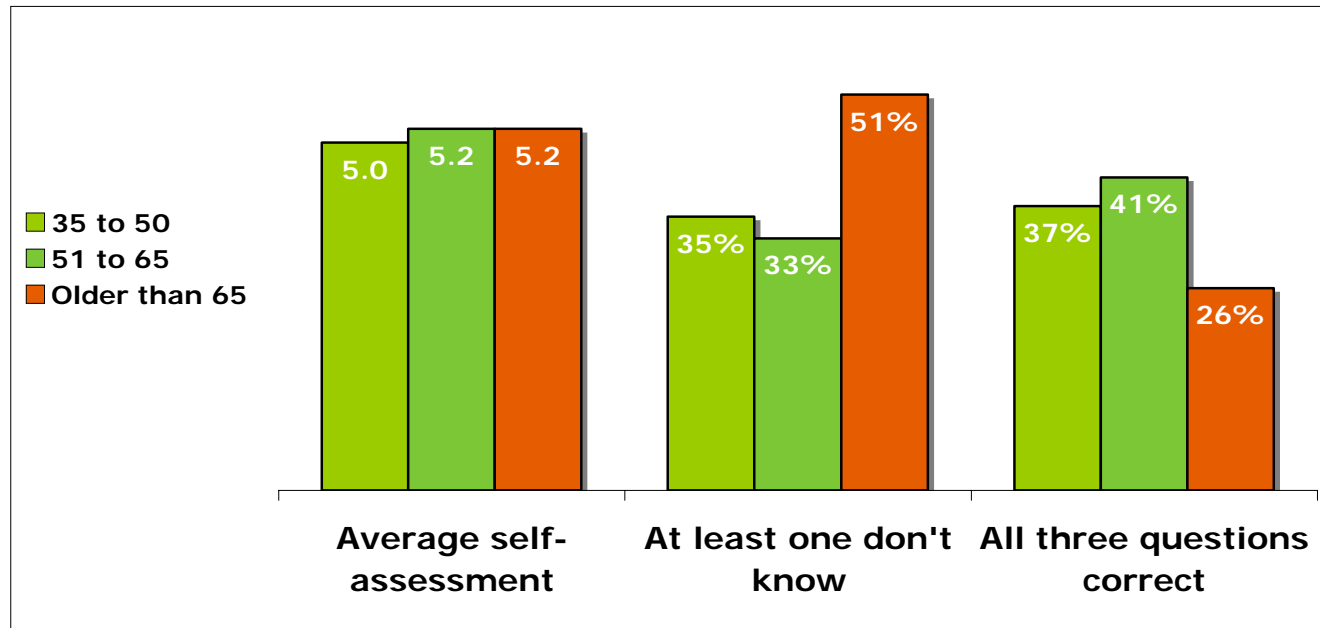
Difference in financial literacy by education



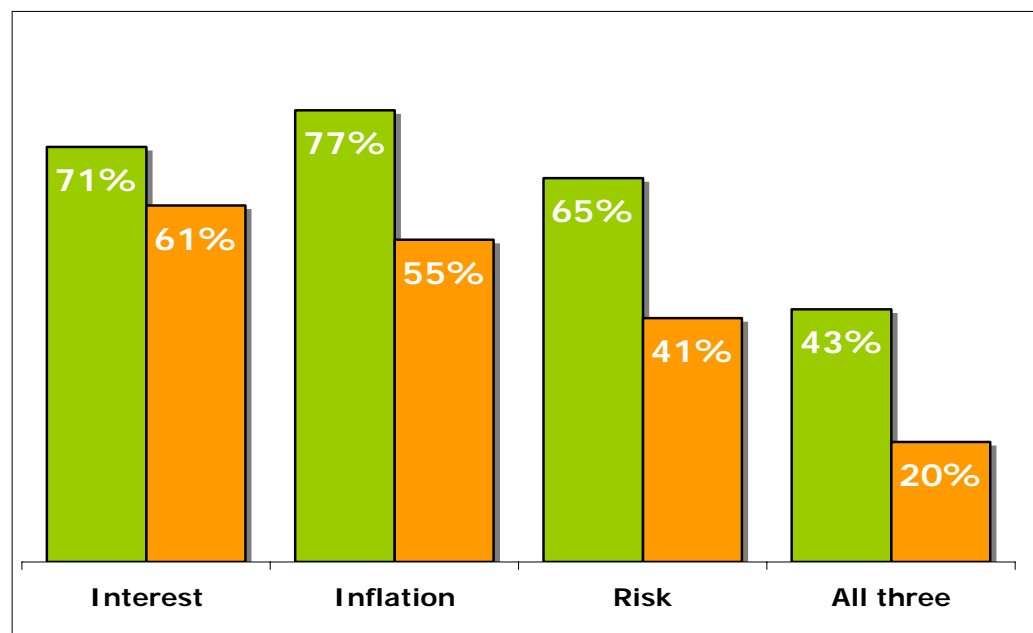
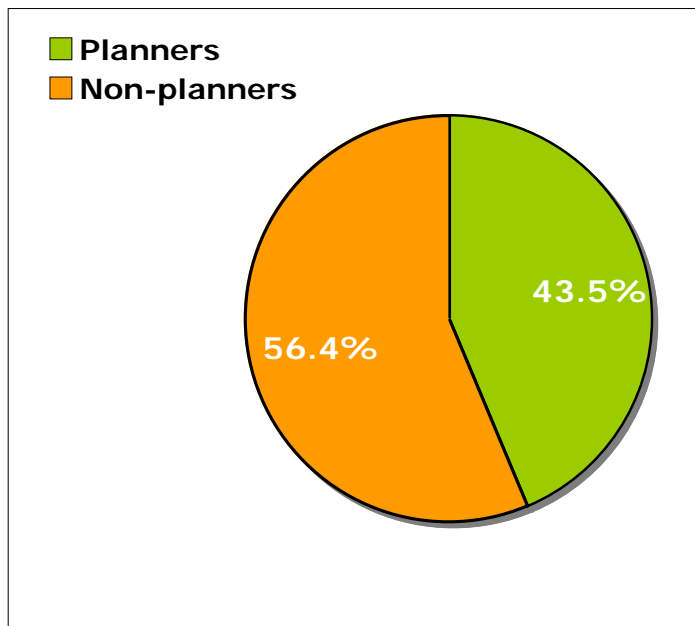
Self-reported financial literacy



Self-reported literacy and age



Retirement planning and literacy



Empirical work

Dependent variable: Retirement planning

	OLS	IV	OLS	IV
All three correct	0.099*** (0.031)	0.954 (0.702)	-	-
Number correct	-	-	.054*** (0.015)	0.234* (0.141)
High school	-0.016 (0.045)	-0.028 (0.059)	-0.013 (0.045)	-0.006 (0.048)
Some college	0.050 (0.048)	-0.046 (0.100)	0.043 (0.048)	-0.019 (0.070)
College	0.151*** (0.053)	-0.008 (0.147)	0.148*** (0.053)	0.076 (0.079)
Post-graduate	0.166** (0.065)	-0.126 (0.253)	0.163** (0.064)	0.041 (0.012)
Income Shock	0.076*** (0.029)	0.119* (0.050)	0.071** (0.029)	0.071** (0.030)
N	1,145	1,145	1,145	1,145

Note: Dummies included for age, gender, race, education, income, marital status, number of children and employment status.

*** p<0.01, ** p<0.05, * p<0.10

First-stage regressions

First stage regression		
Instrument:	All three correct	Number correct
Years since mandate	-0.0031* (0.0016)	-0.0125*** (0.0034)
N	1,145	1,145

Note: Dummies included for age, gender, race, education, income, marital status, number of children and employment status.

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$

Concluding remarks

- 1. Very low levels of financial literacy**
- 2. Large differences in financial literacy across demographic groups**
- 3. Financial literacy is linked to retirement planning: those who are more literate are more likely to plan**