



Director's Corner *John P. Laitner*

The Michigan Retirement Research Center website has been refreshed with the latest crop of working papers from the 2011 research projects. In the feature article for this issue, Olivia Mitchell uses evidence from the United States and abroad to address the topics of financial literacy and impatience and how they impact preparation for retirement. The Key Findings section highlights three recent working papers.

MRRC research scholars David Neumark and Joanne Song study the relation between the work environment and retirement behavior from a legal perspective. In states with the most comprehensive protections against age discrimination, the authors observe the greatest degree of response to financial inducements for longer careers. Economists frequently study tax and other financial factors affecting work incentives, but legal and social conditions merit close consideration as well.

Michael Hurd and Susann Rohwedder study responses of older Americans' consumption expenditures to the recent financial crisis. Households over 65 seem more insulated than those 50-65, who are more often still in the labor market. Big ticket items, dining out, and housing tend to be among the most sensitive expenditure categories.

John Karl Scholz and Ananth Seshadri develop a dynamic, life-cycle model of health, saving, and consumption behavior. Short-term changes in the availability and cost of medical care may sometimes appear to have small effects. However, the authors emphasize that promoting and sustaining good health is an investment process. ■

Inside this issue

Director's Corner 1
 Financial Literacy and Impatience 1
 Cartoon: How Much is a Latte Really Worth? 2
 Key Findings: 2011 MRRC Papers..... 3
 MRRC Researchers in the News..... 4

How Financial Literacy and Impatience Shape Retirement Wealth and Investment Behaviors

Dr. Mitchell discusses her MRRC-supported research with Justine Hastings

MRRC: Could you provide a brief overview of your working paper?

OSM: My research with Justine Hastings examines two competing explanations for why consumers have trouble with financial decisions. The first is that too many people fail to understand simple economic concepts such as compound interest, and



Olivia S. Mitchell is the International Foundation of Employee Benefit Plans Professor of Insurance and Risk Management and Executive Director of the Pension Research Council at the Wharton School, University of Pennsylvania.

financial illiteracy can partly explain why they do not save. The second is that impatience, or what we call present-bias, can help explain suboptimal financial decisions. For example, people

Financial Literacy and Impatience, continued

who persistently choose immediate gratification instead of taking advantage of larger long-term payoffs get into trouble on many fronts. Thus we show that both impatience and financial illiteracy are strong predictors of wealth and investment in health.

MRRC: Are people who are financially literate simply those who are more educated? Are you measuring something other than education level?

OSM: The people who are most likely to be impatient are often the least-educated, lowest-paid, and are older. Our analysis controls on educational attainment and still detects distinct and independent effects of impatience and financial literacy. So, no, it is not just education that matters. One must be financially savvy, make financial plans, and be able to execute the plans as well.

MRRC: What can be done to make financial decisions more user-friendly for individuals who may not be really savvy about money and investing?

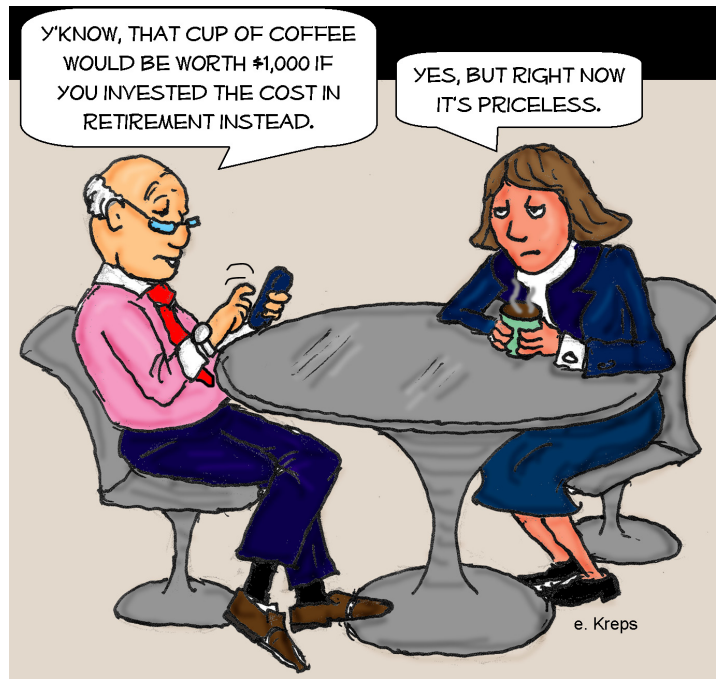
OSM: Our work shows that the way financial information is framed can help, particularly for the least savvy. For instance, showing workers the gains they could make if they saved in the lowest-cost pension fund is more powerful than showing them losses. Showing them how much more their account will be worth in dollars (or pesos, in Chile) has a greater impact than showing them expense charges in percentage points. At the same time, enhancing financial literacy and patience can have wider spillover effects, since we found that those who were most patient and efficacious in carrying out long-term plans not only had more retirement wealth but also were more likely to undertake health investments such as annual checkups, regular exercise, and so forth.

MRRC: Could you tell us a little about the data you used?

OSM: This project used the Chilean Social Protection

Survey (Encuesta de Protección Social), a nationally representative longitudinal survey modeled on the Health and Retirement Study in the US, with input from three University of Pennsylvania researchers in collaboration with the University of Chile in Santiago. For this special study, we offered respondents a gift card to fill out a questionnaire, which would be activated for about US\$8 if it were completed immediately; if the respondent preferred to do it later and mail it in the envelope provided,

the gift card would be activated with a higher amount. Respondents who delayed received a 20–60% return if they actually returned the questionnaire within four weeks. The experiment permits us to identify three different types of respondents: the impatient who took the lower gift-card amount immediately, the efficacious deferrers who chose the later amount and returned the survey for the higher amount, and the inefficacious deferrers who opted for the later higher amount but then failed to send in the questionnaire so as to activate their cards.



How much is a latte really worth?

MRRC: What can this study tell us that we didn't know before?

OSM: Society is increasingly moving to more “individual responsibility” with the growth of personal pension accounts, vouchers for education, choice over health care, and such. At the same time, employers and the government are less likely to take on responsibility for our choices. We have shown that additional guidance and financial literacy training can go a long way in helping people make sensible decisions and execute them in good time.

MRRC: Are there ways to teach patience and financial literacy? Is it worthwhile?

OSM: Impatience has been linked in a range of studies to be associated with children's disciplinary problems, eating disorders, and other problematic behavior. Conversely, children who can defer gratification tend to be more successful in school and in life afterwards. There are ‘tricks’ that people can use to teach youngsters the

ability to defer gratification, which include helping them to devise strategies for waiting – thinking of things to do while waiting, finding something to distract, and so forth. There is also research suggesting that peers have a potentially powerful effect – if your friends all save and invest, you are more likely to do so too. Our other research has shown that there are strong causal links leading from financial literacy to retirement planning and wealth accumulation. Moreover, high school students who live in states where financial literacy was mandated and the school systems devoted resources are also more likely as young adults to plan and save more, suggesting that financial literacy can be enhanced.

MRRC: You and your research partners have conducted a few studies regarding pensions and retirement savings plans in Chile. How can the experience in Chile inform US retirement policy?

OSM: Our results should interest policymakers seeking to determine how to better shape the environment in which individuals undertake saving and investment choices. For instance, we show that it may be useful to facilitate decision-making, particularly among the less-educated, and to help people commit to and carry out long-term financial decisions. As households are expected to exert more control over their retirement accounts and other assets, this raises concerns about whether consumers can make optimal investment and saving decisions. Further, the development of ever more complex financial products probably makes it difficult for consumers to understand them and use them sensibly. What we have shown is that participant awareness of higher net-return funds can be greatly enhanced when information on fees is simplified in terms of likely gains from selecting higher net return funds.

MRRC: What are your next steps in this line of research?

OSM: The impact of fund fee framing is largest for the least financially literate and the lowest-educated groups. By contrast, choices made by the financially well-informed tend to be less responsive to the way in which information is presented, since those individuals tend to better understand the financial concepts necessary to translate annual percentage rates into costs and benefits. In the future, a field test of such policies would be the next step to level the playing field across socioeconomic groups and enable participants to commit to take actions now for greater gains later. ■

Key Findings: 2011 MRRC Papers

Do Stronger Age Discrimination Laws Make Social Security Reforms More Effective?

by David Neumark and Joanne Song
(WP 2011-249)

- ▶ In states with stronger protections against age discrimination in the labor market, older individuals were more responsive to increases in the Social Security Full Retirement Age (FRA).
- ▶ Where state laws applied to small firms not covered by the Age Discrimination in Employment Act (ADEA), employment increased more at ages that were initially beyond but subsequently lower than the FRA — i.e., for those older individuals “caught” by increases in the FRA.
- ▶ Where the state laws provided stronger remedies (harsher penalties), the response to the increase in the FRA was stronger for both employment and claiming Social Security benefits.
- ▶ We also find some evidence that these impacts of state age discrimination laws were stronger when, under state law, attorneys’ fees are recoverable.

The Effects of the Financial Crisis on Actual and Anticipated Consumption

by Michael Hurd and Susann Rohwedder
(WP 2011-255)

- ▶ Among 50-65 year olds, household-level spending declines attributable to the recession ranged between 3.5 percent and 7.0 percent.
- ▶ For those over the age of 65, the spending declines were smaller, about 2.4%.
- ▶ In both age groups, stock owners experienced larger spending declines than those not owning stocks.
- ▶ The declines were concentrated in big ticket items (-7.3 percentage points), dining out (-15.9 percentage points), and housing (-8.5 percentage points).
- ▶ Older households (age 66+) showed greater spending declines in food eaten at home, clothing, and household supplies and services than those age 50-65. However, the older age group increased donations and gifts, unlike the younger age group (+12% vs. -2.0%), possibly because of the need to help support younger family members.

MRRRC Researchers in the News

On December 2, 2011, Insurancenewsnet.com cited Nicole Maestas, Kathleen J. Mullen, and Alexander Strand's research on disability in the article, *House Ways and Means Subcommittee on Social Security Hearing*.

The Chicago Tribune cited Alan L. Gustman, Thomas L. Steinmeier and Nahid Tabatabai in the article, *Study spots distortion of Social Security goal* on November 11, 2011.

Olivia Mitchell, Gary R. Mottola, Stephen P. Utkus and Takeshi Yamaguchi were cited in the October 21, 2011, issue of **Forbes**, in the article, *What Women Can Teach Us About Money*.

2011 Key Findings, *continued*

The Influence of Public Policy on Health, Wealth and Mortality by John Karl Scholz and Ananth Seshadri (WP 2011-252)

- We develop a dynamic model of household behavior that blends a model of health capital and production to better understand the links between health, wealth and aging.
- The model we develop matches quite closely the joint distribution of medical expenditures and wealth over time observed in data.
- When Medicare is eliminated in our simulation, poor households experience a drop in income by more than their richer counterparts, which leads to a cutback in medical spending, resulting in higher mortality at both age 60 and at age 75.
- While most models assume that households will respond to an absence of social insurance in old age by engaging in precautionary saving, our model shows that poor households largely run down their health capital in response to an absent or withdrawn safety net.
- Short-run changes in survival probabilities, even to very large policies affecting the elderly, appear to be small because health capital is largely determined by the time an individual reaches retirement. Long-run changes can be substantial, however. With fewer lifetime resources households will both consume less and die earlier.

MRRRC Newsletter Online

Read our newsletter online at:
www.mrrc.isr.umich.edu?id=264.

Sign up to receive our newsletter by email at:
www.mrrc.isr.umich.edu?id=252.



Michigan Retirement Research Center
Institute for Social Research
University of Michigan
426 Thompson Street, Room 3026
Ann Arbor, MI 48104-2321

Director: John P. Laitner
Associate Directors: Daniel Silverman
and Dmitriy Stolyarov
Associate Director for External Relations:
Ruth Shamraj
Administrative Manager: Becky Bahlibi

Phone: (734) 615-0422
Fax: (734) 615-2180
E-mail: mrrc@isr.umich.edu
Web: <http://www.mrrc.isr.umich.edu>

The Michigan Retirement Research Center is supported by a cooperative agreement with the Social Security Administration.

Regents of the University of Michigan
Julia Donovan Darlow, Ann Arbor
Laurence B. Deitch, Bingham Farms
Denise Ilitch, Bingham Farms
Olivia P. Maynard, Goodrich
Andrea Fischer Newman, Ann Arbor
Andrew C. Richner, Grosse Pointe Park
S. Martin Taylor, Grosse Pointe Farms
Katherine E. White, Ann Arbor
Mary Sue Coleman, Ex Officio