

# Financial Literacy and Planning: Implications for Retirement Wellbeing

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# Overview of Remarks

- Interpreting the results
- Financial literacy, retirement planning and wealth accumulation
- Characterizing the household's intertemporal optimization problem
- Some implications

## Table 1. Financial Literacy Patterns

*(HRS 2004, Planning Module - preliminary, unweighted data)*

### Panel A: Distribution of Responses to Financial Literacy Questions

	<i>Responses</i>		
	<i>Correct</i>	<i>Incorrect</i>	<i>DK</i>
Compound Interest	67.1%	22.2%	9.4%
Inflation	75.2%	13.4%	9.9%
Stock Risk	52.3%	13.2%	33.7%

# Compound Interest Question

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 let the money to grow?

- More than \$102
- Exactly \$102
- Less than \$102

# Risk Diversification Question

Do you think that the following statement is true or false?

“Buying a single company stock usually provides a safer return than a stock mutual fund.”

**Panel B. Proportion of Planners in the Full Sample**

<i>Question</i>	<i>Proportion of Sample</i>
<b>Simple Planners</b> Yes to “tried to figure out how much to save for retirement”	31.3%
<b>Serious Planners</b> Replied Yes/More or less to “developed a plan”	21.1%
<b>Successful Planners</b> Replied Always/Mostly to “able to stick to the plan”	18.5%

# Another Question on Who “Plans”?

- For working households: How do you plan to cover living expenses in retirement?
  - Social security benefits
  - Employer pension
  - Personal assets
  - Children, family or friends
  - Do not plan to retire
  - Don't know, haven't thought about it

# Other Correlates of Who Plans

How are the following correlated with propensity to be “simple”, “serious” and “successful” planners?

- Answer to question about how respondent plans to cover living expenses
- Employer-provided pension plan?
  - Defined benefit
  - Defined contribution
  - Extent of choice in plan
- Occupation, nature of work

**Financial literacy and planning →  
Wealth?**

**Or**

**Wealth → Financial literacy and planning?**

Greater wealth means:

- Bigger payoff to investments (of time, money and effort) in financial literacy and planning
- Greater ability to pay for financial literacy and planning advice

# Characterizing the Household Optimization Problem

- Investments in wealth, financial literacy and planning are complements
- This complementarity is not captured by standard formulations of the household's intertemporal problem that ignore cognitive limitations, ignorance and cognitive costs
- Need a reformulation to calculate the payoff to policies that enhance financial literacy

# Some Implications

1. Complementarity among financial literacy, retirement planning and wealth accumulation is a potentially important determinant of the wealth and consumption distributions.
2. Lusardi-Mitchell view differs greatly in its implications from other departures from standard model. (Compare to models of self-control problems or Samaritan's Dilemma.)
3. Design public policy programs to cultivate financial literacy and encourage financial planning.