Dr. Olivia S. Mitchell on global financial literacy

The reliance on defined contribution plans gives individuals most of the responsibility for their own retirement.

Yet people around the world—young and old, of all education levels, from Sweden to Japan to Brazil to the United States—struggle to make sound decisions about even the simplest financial matters. This lack of financial savvy threatens to undercut DC plans' promise.

For this reason we have a duty to support greater financial literacy—but how? We asked Wharton's Olivia S. Mitchell about her research on financial literacy worldwide.

BY FREDRIK AXSATER

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FREDRIK: What is your greatest concern about financial literacy around the world?

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OLIVIA: By and large, the level of financial ignorance almost everywhere is shocking. And we have hard evidence that non-financially literate people don't plan and don't save. My research shows that people who fail to plan for retirement have half the wealth of people who do.[1] Moreover, in several surveys—most recently in Chile—we confirmed that being more financially literate is associated with much more pension saving.[2]

FREDRIK: How do you define financial literacy?

OLIVIA: By "literacy" we mean an understanding of the basic building blocks of finance: interest compounding, risk diversification and inflation. We developed three questions, one for each topic, and asked them in eight countries around the world. (See "*Sprechen sie* money?" on facing page.)

It's interesting to note that well-educated people are not necessarily financially literate. For example, Japan and New Zealand have excellent educational systems, but their respondents still scored low on the risk diversification questions.

1 Lusardi, A. and O.S. Mitchell. "Baby Boomer Retirement Security: The roles of planning, financial literacy, and housing wealth." *Journal of Monetary Economics*, 2007.

2 Behrman, J., O.S. Mitchell, C. Soo and D. Bravo. "Financial Accumulation." *American Economic Review P&P*, forthcoming.

Dr. Olivia S. Mitchell is the International Foundation of Employee Benefit Plans Professor, professor of insurance/risk management and business economics/policy, executive director of the Pension Research Council, and director of the Boettner Center on Pensions and Retirement Research, all at the Wharton School of the University of Pennsylvania.

FREDRIK: There's some debate about the effectiveness of financial literacy programs. What's your perspective?

OLIVIA: We're beginning to see a groundswell of evidence that financial education can directly enhance people's financial health. A handful of studies have looked at young adults who received mandatory financial literacy education in high school. They have found that these young adults did more planning and saving than peers who didn't go through the programs.[3]

We have found similar evidence worldwide. One of my colleagues was working to introduce rainfall insurance to farmers in India who depend on rainfall for survival. He found that the farmers were much more likely to buy the insurance when he provided financial literacy training: They understood the risks they faced and how to protect themselves.

People need more than the basics, of course. They also need to learn how to implement their plans. We all know that it can be far too easy to procrastinate! Giving people both the knowledge and the means to act is critical.

FREDRIK: What can employers glean from your research?

OLIVIA: Auto-enrollment and target date funds make it convenient for people to save more and to invest in diversified, automatically rebalanced portfolios. But automation alone doesn't solve the problem. Participants also face many other issues, including the need to manage the distribution phase. So plan sponsors will do well to engage and educate their participants if they are to better prepare them for the last third of life. P

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Sprechen sie money?

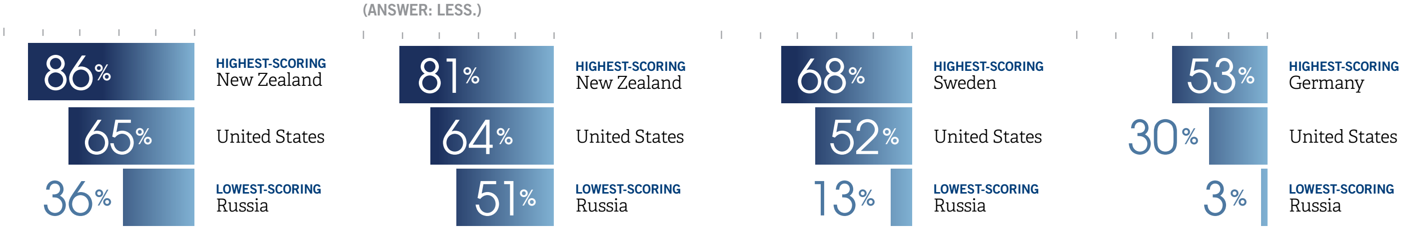
Olivia S. Mitchell and her colleagues posed the following questions to people around the world:

SAY YOU HAVE $100 IN A SAVINGS ACCOUNT THAT PAYS 2% INTEREST. AFTER FIVE YEARS, WILL YOU HAVE $102, MORE THAN $102 OR LESS THAN $102?
(ANSWER: MORE THAN $102.)

IMAGINE THE INTEREST RATE ON YOUR SAVINGS ACCOUNT IS 1% PER YEAR AND INFLATION IS 2% PER YEAR. AFTER A YEAR, COULD THE MONEY IN THE ACCOUNT BUY MORE, LESS OR THE SAME AMOUNT AS TODAY?
(ANSWER: LESS.)

TRUE OR FALSE: A SINGLE COMPANY'S STOCK USUALLY PROVIDES A SAFER RETURN THAN A STOCK MUTUAL FUND.
(ANSWER: FALSE.)

ALL THREE QUESTIONS ANSWERED CORRECTLY



Online extras

To download a copy of Olivia S. Mitchell and Annamaria Lusardi's study "Financial Literacy and Retirement Planning in the United States," visit financialliteracyfocus.org and click on "Academics," then "Flat World."

Visit ssga.com/dc/theparticipant for audio excerpts of our full conversation with Olivia S. Mitchell.

3 Bernheim, D. "Financial Illiteracy, Education and Retirement Saving." Living with Defined Contribution Pensions, 1998. Bernheim, D., D. Garrett and D. Maki. "Education and Saving: The long-term effects of high school financial curriculum mandates." *Journal of Public Economics*, 2001. Bernheim, D. and D. Garrett. "The Effects of Financial Education in the Workplace: Evidence from a survey of households." *Journal of Public Economics*, 2003. Lusardi, A., O.S. Mitchell and V. Curto. "Financial literacy among the young." *Journal of Consumer Affairs*, 2010.