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Financial knowledge and key retirement outcomes: an overview of the issue

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Abstract

This special issue on financial knowledge and retirement security builds on prior studies in this journal on the economic causes and consequences of financial literacy for retirement security.

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Introduction

The *Journal of Pension Economics and Finance* published in 2011 an issue devoted entirely to the topic of financial literacy and retirement security. That issue represented the first time a group of international researchers used a common set of survey questions and approaches to explore cross-country differences and similarities across a range of countries including Germany, the Netherlands, Sweden, Italy, Japan, New Zealand, and Russia.[1] Those studies are among the most highly-cited papers ever to appear in the journal, and they have served to inform a wide range of academics and policymakers around the world.

Since that time, the *Journal* has continued to seek out and publish cutting-edge analyses of the causes and consequences of poor financial knowledge around the world. Chile with its national defined contribution retirement system has commanded the attention of many researchers, including Garabato Moure (2016) who focused on how low levels of financial literacy contribute to many Chileans doing little financial planning. A related study by Kristjanpoller and Olson (2015) analyzed how investment decisions in the Chilean pension system were shaped by financial knowledge (or lack thereof). The analysis by Disney *et al.* (2015) explores whether credit

[1] Contributors included Alessie *et al.* (2011), Almenberg and Save-Soderbergh (2011), Atkinson and Messy (2011), Bucher-Koenen and Lusardi (2011), Crosson *et al.* (2011), Fornero and Monticone (2011), Klapper and Panos (2011), Lusardi and Mitchell (2011*a*, *b*), and Sekita (2011).

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counseling in the UK can serve as a 'safety net' for the least financially knowledgeable. A related piece by Lusardi and Tufano (2015) investigates the links between debt literacy and financial fragility, finding that the least well-informed in the US pay more to borrow than their better-informed counterparts. Italian savers are the subject of work by Ricci and Caratelli (2017) who examine the relationships between financial sophistication, retirement planning and trust in financial institutions in Italy. A suggestive cross-national analysis by Jappelli and Padula (2015) indicates that financial literacy accumulated early in life is positively correlated with household wealth and portfolio allocations in later life.

The present issue extends analysis of financial knowledge to showcase new research. In particular, contributors illustrate how financial knowledge and education influences a wide range of economic behaviors, including retirement planning, consumption, investment performance, retirement, attitudes toward pension reform, and mortality. There has been substantial growth in this research arena in just a few years, and it is this richness that we are delighted to bring to the attention of our readers in this issue targeted at how financial knowledge can be taught, what difference it makes, and to whom.

In what follows, we briefly describe the papers against the backdrop of prior studies. We also offer a few comments about the value of their contributions and conclude with suggestions for next steps in this exciting research arena.

What's new in financial literacy research?

A recent overview of the economics of financial literacy (Lusardi and Mitchell, 2014) noted that financial knowledge can be usefully modeled as a form of investment in human capital. In this setting, people devote time and money to acquire financial skills that, in turn, pay off in the form of higher net investment returns, better quality retirement planning and saving, and enhanced retirement security. This model also predicts that financial knowledge differences arise endogenously, so that some groups in the population will not find it worthwhile to invest, and others will (Lusardi *et al.*, 2017). Nevertheless, enhancing financial sophistication across the board can still be socially optimal so even the least knowledgeable till earn more on their saving.

Several studies in the present issue extend our knowledge of the international diversity of financial sophistication. Boisclair *et al.* (2017) examine financial literacy patterns in Canada using the 'Big Three' questions pioneered by Lusardi and Mitchell (2007), and they conclude that 42% of respondents got them right, similar to results from the USA. People who were least well-informed were women, minorities, and the least-educated, also patterns seen in other countries. Most interesting is the finding that the most financially literate are also most likely to plan for retirement, which is critical since those who do not plan end up not saving.

Having found this result, the next question is how to enhance peoples' financial knowledge. This very practical question is the subject of work by Lusardi *et al.* (2017) who devised an online training program to educate people about how to diversify risk. Interestingly, the training was delivered in four different ways, including a video and a visual tool, which were then compared with more conventional methods

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using the American Life Panel, a nationally representative study of Americans. The authors found that the video treatment worked best, perhaps because they involved the viewers in realistic narratives that engaged them more thoroughly.

Two studies explored the relationship between financial sophistication and investment outcomes. Clark*et al.* (2017) surveyed bank employees using the 'Big Three' questions along with other metrics for financial literacy, and they then linked these to administrative data on the employees' investment patterns in their defined contribution retirement account. The authors show that the most financially aware pension participants held much more equity in their accounts, which in expectation would translate into higher excess returns and lower portfolio volatility. A financial literacy intervention was also found to be effective in enhancing excess returns.

In Jappelli and Padula (2017), the authors rely on an Italian panel dataset to evaluate how financial literacy influences consumption using an instrumental variables approach. While they do not use the 'Big Three' questions as in other studies, they proxy knowledge using indicators of whether respondents had a college degree, a degree in economics, and whether their parents had a college degree. The authors conclude that more financially literate individuals do expect higher returns on their wealth.

To round out the issue, we include two studies linking national retirement systems and financial knowledge. Gouveia (2017) discusses two experimental studies conducted in Portugal analyzing the potential for public pension reform. She concludes that more financially sophisticated individuals are more likely to favor pension reforms. Finally, Le Garrec and LHuissier (2017) examine the macroeconomic and distributional consequences of global gains in life expectancy, allowing for the impact of education. Taking into account the endogenous acquisition of skills and knowledge, they find that educational spillovers enhance the appeal of postponing retirement ages in national pension systems.

Next steps

The *Journal of Pension Economics and Finance* has a commitment to support research studies on retirement and pension-related topics around the world. This special issue on financial knowledge and retirement security continues this tradition, building on what has come before. Future work must illuminate what works and how to build financial literacy cost-effectively. In the years to come, we welcome more theoretical and empirical work deepening our knowledge of how to strengthen financial knowledge to enhance retirement wellbeing.

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