# RETIREMENT BEHAVIORIST

*Peter J. Walker profiles Wharton's **Olivia S. Mitchell**, a founder of modern pension research*

As the US presidential race heats up, leading pension expert Olivia S. Mitchell has a warning for candidates.

"Some of the individuals who are running for US president have talked about expanding Social Security benefits, but that's very misguided," the 66-year-old economist says, arguing that just keeping the current system solvent would require steep hikes in payroll taxes or reduced benefits.

Mitchell's research suggests that Americans would be better off with later retirement, expanded financial literacy, and economic incentives that encourage saving, planning, and smarter investing. She has called for a national conversation on entitlement reform to fix the system before benefit funding runs out. Her sobering prognosis is that people must "work longer, save more, and expect less."

Mitchell is one of the founders of modern academic pension research. She has published more than 250 books and articles, advised governments around the world, and received more than 60 professional honors and awards.

When Mitchell began working on the subject 40 years ago, the field was largely limited to actuarial analysis (mathematical and statistical calculations of risk). She has devoted her career to bringing economic considerations, especially those from behavioral economics, into the discipline. Speaking in her office at the University of Pennsylvania's Wharton School, she describes pensions as "a microcosm of everything: demographics, human resources, taxes, finance, psychology, economics, and beyond."

"The breadth and depth of Olivia's expertise about pensions is breathtaking," says Wharton Dean Geoffrey Garrett. "Her insights cover every topic that impacts the economics of retirement—including funding crises in both private and public pensions, the decline in employer-provided pensions, changing demographics, household finance, wealth accumulation, and the need for financial literacy. Her work reflects a period of enormous change in pensions and extends beyond issues in the US."

Between 2006 and 2016, the US population aged 65 and over rose from 37 million to 49 million, and by 2060 the number will almost double—to 90 million. The trillion-dollar Social Security system is the main source of retirement income in the United States, but starting in 2020, its total cost is expected to outstrip its total income. By 2035, system reserves will be depleted, making it able to honor just three-quarters of scheduled benefits. Similar stories are playing out around the world. Mitchell's research offers policymakers a road map for how to address this widespread crisis.

## Early life

Mitchell was born in Lincoln, Nebraska, where her father taught agricultural economics at the University of Nebraska. Her parents met while working for the US government in the Republic of Korea, after which they both studied economics at Harvard. Women were not common in the program at that time, and her mother was admitted only on the condition that she type her advisor's papers.

During most of Mitchell's childhood, her father worked for the United Nations Food and Agriculture Organization and was posted to Brazil, Chile, Colombia, Guatemala, Italy, Mexico, Pakistan, and Peru. The experience gave Mitchell a lifelong love of foreign cultures, languages, food, and travel. And it was a childhood steeped in economics.

"Economics pervaded my upbringing," Mitchell says. "On the wall above the kitchen table there was a clock which said, 'Time is Money.' Now it sits over my kitchen table." She says her father used a corollary economic concept to coax her into weeding the garden. "When I was five years old, we had a vegetable plot, and my father explained to me that since his time was worth more than mine, I should do the weeding. This was so logical that I decided I must increase the value of my time. So I did!"

Following in her parents' footsteps, Mitchell earned her bachelor's degree in economics from Harvard in 1974, where she too had to deal with a male-dominated environment. One older professor would acknowledge her presence in class with the greeting, "Good morning, lady and gentlemen."

"Standing up to speak and having 99 male faces turn around was initially quite intimidating, though I got over it," she says. It was a formative experience that led her to seek more female-friendly environments later in her career. This was a major reason behind her decision in 1993 to go to Wharton, which historically has had a high proportion of women faculty. She has also been active in the Committee on the Status of Women in the Economics Profession, serving as a mentor and supporter.

In 1978, at the age of 25, Mitchell completed her PhD at the University of Wisconsin with a dissertation on the effect of high local unemployment on married women's participation in the labor force.

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She took her first job at Cornell University, where she was asked to teach a course on pensions. "The book I had to teach out of was the most boring tome that you can imagine," recalls Mitchell, who, at the time, concluded that she could "write more interestingly on this theme and explore not only actuarial issues but also economics." Moreover, her mother warned of a looming pension crisis in the United States and encouraged her to investigate.

At Cornell, Mitchell married the "boy next door" in her apartment building in Ithaca. Gene Dykes would go on to become a computer scientist. Now retired, he holds the unofficial marathon world record for the 70–74 age group, even though he began running seriously only in his 60s.

The week Mitchell gained tenure at Cornell, she also gave birth to the first of two daughters. Later she set up the "Bank of Mom," a spreadsheet recording the kids' allowances and extra money for doing chores. "If they wanted to buy something, other than for school, they had to check if they had enough funds to cover it," she says.

In academia, Mitchell made her earliest major splash by cowriting, with Cornell economist Gary S. Fields, *Retirement, Pensions, and Social Security*, the first book-length examination of what influences people's retirement behavior. The study of pensions as an economic institution influencing behavior really took off afterward, she says.

"Olivia was bright and hard-working, disciplined and focused, kind and decent," says Fields, one of the world's leading labor economists. "It was clear that she was destined for high achievement."

## Modernizing retirement

Mitchell's research then expanded into designing pension plans, including Social Security, to encourage later retirement. More than 40 percent of recipients currently claim Social Security benefits at the minimum age of 62, though those who wait eight years until they qualify for maximum benefits at 70 can increase their monthly income by 75 percent, Mitchell calculates. Filing for benefits early thus usually does not maximize people's benefits.

One reason people take their benefits very young, Mitchell found, has to do with how financial advisors explain—or "frame"—this key retirement decision. In particular, advisors use a "break-even" approach that implicitly frames the decision as a risky bet on how long you think you will live. Thus, they might tell you how much you would receive in benefits if you took them early, at age 62, and then tell you that you would have to live at least 14 more years *for sure* to recoup the money forgone by delaying a few years. This analysis might show, for instance, that deferring claiming to age 70 would require that you live to age 84 to break even and start deriving a net gain.

When presented in these terms, people worry whether they will actually live that long. Unfortunately, they tend to ignore the fact that half of all people live longer than their life expectancy. Accordingly, if people are concerned about outliving their assets, it makes much more sense to defer claiming benefits and thereby avoid running out of money in old age. Informed by Mitchell's research, the Social Security Administration has stopped using break-even analyses and now provides a more neutral treatment, which should provide incentives for claiming benefits later.

Another way to encourage people to retire later is to offer lump-sum incentives to defer claiming. Mitchell's work defines these lump sums so that they do not change overall program costs, and they are attractive to older people carrying debt. In related work, Mitchell has found that retirees today are much more likely to have debt, because of bigger mortgages, larger credit card debt, and the growth of student and payday loans.

Retirement may be even further out of reach for millennials, those born between 1980 and 2000. Given the low returns generated by capital markets, Mitchell argues, millennials seeking to retire at 65 must set aside 40 percent of their paycheck, compared with the current average of just 6 percent. Of course, competing expenses such as student loans and high housing costs can make a 40 percent saving target practically impossible. Therefore, Mitchell believes that people must plan to work longer, redefine what retirement means to include part-time work, and embrace lifelong learning.

Financial literacy is a particularly crucial element of lifelong learning. About a dozen years ago, Mitchell's interest in retirement behavior—combined with the transition away from defined-benefit toward defined-contribution retirement plans requiring greater individual responsibility—led her to begin exploring what people know about key financial concepts. Mitchell and Annamaria Lusardi of The George Washington University, devised three questions for the University of Michigan's long-running Health and Retirement Study of US people over the age of 50. The two researchers were stunned to

discover that older people had remarkably low levels of financial knowledge. Lauded as comprehensive yet concise, their "Big Three" questions have been used in numerous other surveys and in more than 20 countries, painting a picture of low financial literacy among the young, the old, women, and low-income groups around the world (see *F&D* online).

Subsequent research has found that financial literacy matters enormously for financial decision making. Those who are financially literate are more likely to plan and save for retirement, make better investments, and experience less financial stress. One study found that the most financially knowledgeable employees in a business received retirement plan returns 130 basis points, or 1.3 percentage points, higher each year, compared with the average worker.

Mitchell and Lusardi also looked at the wider implications of financial knowledge and found that financial literacy can explain between 30 and 40 percent of wealth inequality. That study also included the surprising finding that Social Security benefits may actually discourage the accumulation of financial knowledge and thereby contribute to wealth inequality. "We asked the question, What if Social Security benefits were reduced by 20 percent, reflective of the projected future shortfall?" Mitchell says. "We found that this would increase incentives for low-wage workers to save and invest in financial literacy, which would, in turn, reduce wealth inequality." Their projections revealed that median assets would increase by 32 percent among those without a college education and by 19 percent among the college-educated. "It was an unexpected result," adds Mitchell.

Lusardi, her frequent collaborator, notes that "working with such a rigorous scholar has been a privilege. Our work has been able to uncover not only the low level of financial literacy, but also how much it matters, in particular for groups who are already vulnerable."

## Corridors of power

Over her career, Mitchell has also provided a great deal of expert support to public entities concerned with pensions. In 2001, she served on George W. Bush's bipartisan President's Commission to Strengthen Social Security. One of the group's main recommendations was to allow individuals to place a portion of their Social Security contributions in voluntary personal accounts. The proposal was not implemented, largely because of political opposition and the onset of the 2001 capital market collapse. Nonetheless, Mitchell considers the commission's proposals still relevant today, since the system faces shortfalls within the next dozen years or so.

Another approach Mitchell has explored to ensure that more Americans have an adequately funded retirement is longevity income annuities. Under a federal measure signed into law in December 2019, US employers are encouraged to include in workplace pension plans annuities that start paying at least by age 85. Mitchell's research shows that if people used just 10 percent of their retirement nest egg to buy such a longevity annuity, it would boost well-being at age 85 by 6 to 14 percent. With many people living into old age and health care costs rising, she sees this as key to ensuring that people will have more to spend in retirement.

Mitchell also keeps an eye on the countries she once called home, especially Chile. Uprisings on the streets of Santiago in late 2019 began because of subway fare increases, but they quickly led to a broader movement encompassing several popular concerns. One is anger that pensions for the poorest are too small and private pension fund managers' profits too large.

Five years ago, Mitchell served on then-President Michelle Bachelet's pension commission, recommending reforms for Chile's pension system. The commissioners proposed ways to ensure that the plans covered a broader segment of the population, provide a more generous solidarity pillar supporting the poor, and raise contribution rates. At present, the government is pursuing some of the recommendations, including a higher solidarity benefit and lower fees and commissions charged by private pension funds, says Mitchell.

Today Mitchell is working on the determinants and consequences of debt at older ages, the impact of pension guarantees, and how alternative tax structures will alter the way people work, save, invest, consume, and retire.

And what about her own retirement, which has surely been well planned, given her expertise? "My insights into the many risks associated with aging," Mitchell says, "lead me to conclude that, barring very poor health, I will never retire!" FD

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