


Behavioural Psychology and the Financing of Retirement

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Abstract

- Economics, including its sub-discipline of Finance, has been shown to be as much at the mercy of human psychology as most of our other endeavours.
- This talk will briefly discuss some of the effects of human psychology on the discussion and practice of the financing of retirement.
- Effects range from the macro to the micro: from the framing of the social and government debate; through the selection of industry responses, products and marketing; down to the decisions made by community groups, families and individuals in the accumulation and decumulation phases.
 - Singapore already uses cognitive psychology to guide policy development; Low, Donald – Behavioural Economics and Policy Design

Factors to be discussed

- Controlled and automatic brain processes
- Culture
- Beliefs
- Trust and trustworthiness, fairness
- Emotions are important to decision making
- Ambiguity and disgust



Controlled and Automatic

- **Controlled**
 - Serial, invoked deliberately when surprised or challenged, subjective feeling of effort, can be described
- **Automatic**
 - Parallel, not accessible to consciousness, effortless
 - Kahneman *Thinking Fast and Slow* calls these System 2 and System 1 respectively
- **Automatic** in top, side and back (old brain) and body
 - Automatic processes are fast
 - Emotions are important automatic processes
- **Controlled** in frontal brain (new brain)
 - Controlled processes (slow) can often misinterpret why automatic response was what it was



Policy and culture

- Policy needs to be driven by the controlled brain processes
 - “Rational” outcomes, consistent over time
 - Slow, deliberative, effortful
- Culture drives most decision making
 - Automatic, easy, fast
 - Inconsistent decisions
- Education can sometimes make a *controlled* process become *automatic*
 - This can be a cultural change
 - Commonly used in Singapore
 - Long, slow mechanism

What is Culture?

- The way we do things 'round here
 - Too simple, but effective
- Beware of *The Fallacy of Composition*
 - Families, societies and organisations are different from the sum of the individuals
 - What is good for, or what can be done by, a component of a composite may not be good for or be able to be done by the composite
- Culture governs what is perceived at an organisational level
 - What does a group respond to?
 - Speed of perception and speed of response
 - What does a group actively look for?
 - What does a group believe is out there?

Beliefs

- The creation and use of our mind's model (view) of the world is an automatic process
 - We believe the world has a particular structure
- Perception of the world is governed by our model
 - Almost always we only see things consistent with our model
 - Facts that are ambiguous or inconsistent with our views will be interpreted/twisted to be consistent
- If evidence is needed for our view we look for confirming evidence
 - *Confirmation bias*
- Changing somebody's beliefs involves much emotional turmoil
 - Resisted strongly

Macroeconomics (as an example)

- Model of the economy is a belief for many people
 - Politicians, senior bureaucrats, commentariat
- The GFC has caused a reappraisal of neoclassical economic model that most people have
- Explains austerity thinking in North Atlantic countries
- Belief heuristics are strong

- *Relevance to this case?*

Quotes

- From the 2012 Conference Proposal:
 - *Diverting resources from other activities to the care of the elderly can have a significant impact on economic growth. p1*
 - *The ageing population is expected to have an impact on economic growth ... p11*
 - *...the capacity of the economy to support the financial needs of the elderly ... through government schemes from general taxation. p1*
 - *What are the ... options for monetising the value of a home to meet retirement expenses?*



Framing – home ownership

- Why does Singapore encourage home ownership when people are young and then want them to monetise to pay for retirement?
- This means that retirement provision for most people is primarily by investment in private houses – is this efficient?
- Broad frames need to be adopted, not narrow framing of policy questions.
 - Is the default internal model keeping the home ownership and monetisation questions separate?



Framing – economic growth

- For the purposes of this debate, why measure economic growth as *real GDP growth per annum* ?
- This is the most commonly quoted measure in general discourse
- It is not relevant for this argument – *GDP growth p.a. per capita* is much more relevant

- Associations are already in the brain for *GDP growth p.a.* and these provide a natural basis for debate.



Framing – government funding

- Under fiat money the government does not need to fund government spending by taxation

- The persistence of this phrasing is as a shortcut way of acknowledging that the inflationary effect of too much government spending needs to be balanced by the government forcing a reduction in private spending by taxation.

- The incorrect framing can lead to efficient outcomes not even being considered.



Industry response

- Trust and trustworthiness, and the concept of fairness seem to be important for exchange economies
 - See capuchin and chimpanzee studies (de Waal), oxytocin effects (Fehr), punishment for unfair behaviour (various)
- Can the industry demonstrate sufficient trustworthiness for a long-term pay-in-advance contract?
 - Does a mutual society have subconscious advantages over a public company?



Families and Individuals

- What's wrong with reverse mortgages?
- There's possibly a simple answer ...



Reverse mortgages

- RM are unknown, they are ambiguous
- ... so they are disgusting!
- This is unconscious, but is most probably a large factor
- Endowment effect
 - You are swapping a tangible asset for a promise of income
 - Even if the two things are actuarially equal the home will be valued more by its owner

Why is ambiguity aversion so strong?

- Stochasticity vs ambiguity
- Known vs unknown randomness
- Known or familiar risks generate:
 - Fear, excitement
- Unknown risks, ambiguous risks generate:
 - Disgust, fear
 - Disgust is stronger than pain
 - Remove source of disgust before a source of pain
 - Physical disgust generated by sources of infection

Conclusion

- This is too short an exposition to have conclusions
- A deeper recognition of behavioural biases needs to be maintained **at all levels** of the policy development



Questions and comments

