



The Alignment of Household Preferences and Financial Decisions Leading up to Retirement

*Leandro Carvalho, Arna Olafsson, and Dan Silverman**

In the years leading up to retirement, a household will make countless decisions concerning work, spending, saving, debt, and financial portfolio. These decisions are made by household members with potentially different preferences and different abilities at financial decision making. Some household members may be more risk averse than others. Some may be more willing to trade smaller rewards now for larger ones in the future. Some may have more experience or training in making financial choices and mapping their options into their objectives. In theory, such differences could have important consequences for household financial outcomes. Depending on the mechanisms by which household decisions get made, and how well information is shared within the household, misaligned preferences or abilities could limit how well a household's members adhere to a budget, make and execute plans for retirement savings, avoid costly debt, and other important outcomes. There is, however, little empirical evidence about the relationships between within-household variation in preferences and financial decision-making abilities and household financial outcomes.

Our research addresses this gap in empirical evidence by

collecting experimental measures of both the preferences and the decision-making abilities of individuals within households. It then links these measures with individual-level, detailed transaction and balance, administrative panel data that contains information on, e.g., income, expenditures, bank and investment account balances, and credit lines. By linking these two sources of data, we can study the relationship between within household variation in preferences and decision-making ability, and important financial outcomes.

Our analysis combines data from two sources. The first is an administrative data panel of all customers of the second largest commercial bank in Iceland. These data cover the period January 2017 to March 2022. They contain the transaction and balance records of the checking, savings, credit card, and investment accounts of bank customers. There are no "joint" accounts in Iceland, but the accounts of spouses can be linked using unique but deidentified codes. (We use the term spouse to identify a member of a couple who may or may not be legally married but are officially recognized.) The second data source is a survey, conducted from October 2021 to January 2022, of 1,336 of individual

* **Leandro Carvalho** is a research scientist at University of Southern California. **Arna Olafsson** is an assistant professor at Copenhagen Business School. **Dan Silverman** is the Rondthaler Professor of Economics at Arizona State University. This research brief is based on working paper MRDRC WP 2022-446, UM19-10.

customers whose administrative records are included in the first administrative data source. These 1,336 individuals were screened to ensure they also had a spouse with records in the administrative data, resulting in 668 couples.

The survey includes questions about sociodemographic characteristics and a question (to each spouse) about who makes financial decisions. The first element is a set of incentivized experiments involving choice under risk and the allocation of resources between spouses. The risk experiments included both a standard task of allocating an endowment across risky assets and a novel task that asked one spouse to perform the same risk task as if they were the other spouse, predicting what the other spouse would choose if faced with the same decision. The allocation of resources between spouses task involved dividing an endowment between self and spouse at rates of exchange manipulated by the experiment.

The second element of the survey consists of two qualitative assessments of time preferences and financial decision-making ability. Again, the distinctive aspect of this element is to ask each spouse both about themselves and about their spouse. The time preferences assessment asks participants to evaluate their own and their spouse's willingness to postpone a benefit in order to receive a larger benefit in the future. The decision-making ability assessment asks participants to evaluate their own and their spouse's skills at avoiding financial mistakes.

We use the administrative bank records to calculate several financial choice and outcome measures. We define cash-on-hand as the sum of the balances of checking and savings accounts. Liquidity, is cash-on-hand plus the remaining credit available through checking account overdraft and through credit card. This measure of liquidity

reflects the importance of checking (aka "current") account overdrafts. In Iceland, overdrafts on checking accounts are the most common form of revolving consumer debt. Virtually all checking accounts in Iceland offer an overdraft facility, the size of which is based on credit history, income, and assets. Overdrafts can be made at any time without consulting the bank and overdraft status can be maintained indefinitely. Overdrafts charge average annual percentage rates of around 12%.

Expenditures sums all debits from all accounts, adding back transfers between accounts and credit card payments. Income measures all credits to all accounts, subtracting out transfers between accounts and credit card payments. Debt, is the amount of overdraft and credit card debt. Portfolio gives the total value of investments held with this commercial bank, and the fraction of that portfolio invested in stocks.

Our initial results suggest that, for the purposes of explaining important household financial outcomes, differences in average measures of preferences and abilities are more important than within-household differences in the preferences and abilities. There is some evidence that within-household conflicts in risk preferences are associated with higher levels of household expenditure. The average levels of time preference or decision-making ability are, however, more strongly associated with between-household differences in spending and liquidity.

While individual variation in preferences and decision-making ability is significantly related to individual variation in financial outcomes, there is only modest evidence that within-household variation in these measures is associated with between-household differences in expenditure, liquidity, and other measures of household finances. ❖

Michigan Retirement and Disability Research Center

Institute for Social Research
426 Thompson Street, Room 3026
Ann Arbor, MI 48104-2321

Phone: (734) 615-0422 **Fax:** (734) 615-2180
mrdrcumich@umich.edu www.mrdrc.isr.umich.edu

Sponsor information: The research reported herein was performed pursuant to grant RDR18000002 from the U.S. Social Security Administration (SSA) through the Michigan Retirement and Disability Research Center

(MRDRC). The findings and conclusions expressed are solely those of the author(s) and do not represent the views of SSA, any agency of the federal government, or the MRDRC.

Regents of the University of Michigan:

Jordan B. Acker, Huntington Woods; Michael J. Behm, Grand Blanc; Mark J. Bernstein, Ann Arbor; Paul W. Brown, Ann Arbor; Sarah Hubbard, Okemos; Denise Ilitch, Bingham Farms; Ron Weiser, Ann Arbor; Katherine E. White, Ann Arbor; Santa J. Ono, *ex officio*