

# 1

## Introduction

Occupational pensions are a relatively recent innovation. Their history is well documented: see, for example, Ginn et al. (2001), Munnell and Sundén (2004), and Thane (2006). Our intention is not to provide another account of their genesis. Rather, we begin the book with the issue of *why* occupational pension systems came into being, what their current purpose is, and whether they meet the (relatively modest) goals as set out in many governments' policy manifestos. This forms the backdrop for our critical examination of financial decision-making, and in particular saving for retirement. The implications for pension policy and institutions are examined in the concluding chapter of the book.

It is important to distinguish between the rationale for a public state pension, and the rationale for an occupational pension system. Although the two are related, they are nevertheless distinct in their genesis and *raison d'être* as well as in their subsequent evolution. The concept of a state-funded old age pension was first mooted to deal with the problem of the impoverished elderly in the industrial societies of the late nineteenth century. As Thane (2006) points out, prior to the mid-twentieth century the assumption in most countries was that families and communities would support themselves through work and thrift. In this sense, the collapse of traditional networks and institutions of support related to processes of industrialization and waged-work that created new forms of poverty in old age—and the proposed solutions to deal with them—were intimately bound up with notions of morality and concerns about incentives to save and work.

According to Sass (2006: 79), the British civil service pension plan of 1859 “became the model in the use of old-age pensions for developing a career managerial workforce.” What is important about this observation is that the goal of this, and other similar models of pension provision, was workforce management and control. Especially in the Anglo-American world, occupational pensions were conceived as an enterprise benefit rather than a welfare benefit, and a tool for managing staff retention and development (Standing, 2009). This model of supplementary income, linked to the evolution of white

and blue collar work, was fundamentally related to the development of a standard model of employment in industrial societies. This model of employment, which reached its zenith in the post-WWII period, was associated with Fordist and later Taylorist methods of production, large vertically integrated firms, Keynesian economic and social policy, and a male-breadwinner model of economy and society.

The standard contract of employment, which underpinned this model, was never universal. Yet management practices and the structure of the archetypical industrial firm provided incentives for corporations and companies to bond workers to their firms through pay and benefit structures, promotion pathways (generally internal labor markets), pension plans, and promises of job security (Stone, 2005). Meanwhile for labor, the era was typified by negative freedoms and partial or, according to Standing (2009), fictitious de-commodification facilitated in part by the state: freedom from job insecurity, freedom from destitution in retirement. These negative freedoms were part of the social compact, which favored relative stability in labor relations, strong national-level institutions and production regimes, and a stable share of national income for labor (so as to encourage consumption).

The unraveling of this social compact has been associated, in relation to labor and employment, with the rise of neo-liberal government policy and forms of governance, a new era of globalization driven by technology and finance, the global integration of low-wage economies from the global "south" (especially China, India, and Brazil), the construction of flexible labor markets, and welfare state retrenchment. It has also been typified by increased social and cultural tensions around migration, changing family and community structures, and changing demography (ageing societies). Individual agency and responsibility has been articulated as a set of freedoms, positive and negative, *against* the constraints of the traditional welfare state: freedom to change jobs and occupations, freedom to choose how one's assets are invested, freedom from taxation, freedom to choose where and how traditional services (education, health, social care) are delivered (see Beck and Beck-Gernsheim, 2001; Charles and Harris, 2007; Frericks et al., 2007).

A significant feature of this change in orientation has been an increasing emphasis on the importance of occupational pensions for an "adequate" retirement (although it is worth remembering that the UK government always understood the potential role of occupational pensions in deflecting pressure for improving the rate of the minimalist state). Blair's Labour government, for example, made a commitment to shift from an average of 40 percent (now) to 60 percent of income from private pensions by 2050, reversing the historic dependence on the Basic State Pension (see DSS, 1998; Foster, 2010; Waine, 2009). And yet the affirming of this policy commitment has coincided with the decline in the scope and adequacy of occupational pensions for most

employees in the private sector. If this target is to be met, it will have to come from increasing the coverage rate and value of defined contribution pensions in the private sector.

## Neoliberalism, Rationality, and Choice

Liberalism has thus reemerged as a core political ethos prescribing the respective responsibilities of the individual, the community, and the state in relation to saving for retirement. The liberalism associated with John Stuart Mill combined a commitment to individual autonomy and responsibility with a recognition that not all people were equipped by reason of intelligence, education, and moral character to be fully responsible. By contrast, neoliberalism has had little patience with state paternalism; individuals are deemed fully responsible for their well-being in the global economy (Peck, 2010).

With neoliberalism came the hegemony of a certain type of economic theory predicated upon individual rationality and expressed through utility maximization. Being both a recipe for theory and a normative vision for society, this type of economics has been associated with the deregulation of financial markets, the fostering of shareholder (as opposed to stakeholder) value, and the global integration of trade and financial transactions. When considered over the broad sweep of the twentieth century, and especially developments after the First World War, individuals are increasingly responsible for their own long-term welfare—in part, a function of their performance in financial markets. And yet, at its moment of victory, the hegemony of the rational actor model has slipped away in the face of the critique from behavioral finance and the global financial crisis. Cognitive science, with its empirical focus and exacting testing protocols, has raised significant doubts about the capacity of people to play the role assigned them by neoliberalism (Langley, 2008). The global financial crisis has given great credence to this research agenda.<sup>1</sup>

It is important to remember that post-Enlightenment visions of rationality have long been critiqued from a variety of epistemological, ontological, and political positions: the Cartesian duality between the (rational) mind and (irrational, emotional) body, the association of the rational mind with the male gender and the body/emotions with women, and the translation of

<sup>1</sup> In fact, it is arguable (as many have suggested) that the global financial crisis is a test of the rational actor model and its doppelgänger the efficient markets hypothesis *and* is an expression of the hegemony of the efficient markets hypothesis for market theorists and policymakers alike. See the 2008 comments before Congress of Alan Greenspan on the assumptions made by the US Federal Reserve Bank regarding the unlikely prospect that rational market agents would act in ways that would be self-defeating. Events have proven otherwise. See Lee et al. (2009) for more details.

rationality into calculation and utility maximization at the hands of economic theorists. Feminists have been at the vanguard of related critiques, just as radical political economists have challenged the plausibility of the whole edifice. But these forms of critique made little impression on orthodoxy, whether focused on the economics discipline or on its more general model of human behavior. Economic geography has also sought to engage with and criticize a priori presumptions in favor of utility maximization and aspatial, aspatial conceptions of autonomous agents (see, e.g., Barnes, 1988; McDowell, 2005; Peet, 2000; Strauss, 2008*b*). These engagements have, however, tended to be one-sided.

If people are to be the rational actors of conventional theory and policy, however, they need to plan and act in ways consistent with their own interests and in relation to the interests of others in a well-functioning market economy. Given their dependence upon the burgeoning financial markets of the late twentieth and early twenty-first centuries, individuals have required a certain quality and quantity of financial information and knowledge, such that their decision-making is consistent with their long-term (if not short-term) well-being. These ideas rest on a number of assumptions: individual utility maximization is always consistent with the interests of the actor; all agents have equal access to timely, accurate, and comprehensible information; and markets always function efficiently.

By this logic, financial decision-making is the bedrock of neoliberalism; it is a necessary ingredient in any government policy that attempts to shift responsibility for social welfare to the individual. As such, financial decision-making is a matter of substance (e.g., knowing how markets function), and a matter of social identity and even morality (being responsible, informed citizens willing to play the role assigned to them by society at large). But, of course, in reality most people are social beings with access to, at best, imperfect information, and markets never preexist human behavior and cooperation in some “pure,” efficient form. Markets are the products of aggregate behavior, political, social, and economic norms and institutions, and the geometries of power.

In what follows, we sketch our approach to understanding the nature and scope of behavior giving due recognition to the themes of the book: cognition and context. In doing so, we follow the lead of Bernard Williams (1995: ch. 7) and others to the effect that understanding the nature and scope of human behavior is an empirical, as well as a political–philosophical, project. We eschew models of behavior that assume people are simply calculating machines, processing information from the environment against prior commitments through cognitive dispositions. While we take seriously our biological heritage, we recognize that the realization of intentions through behavior is not preordained by ironclad biological imperatives that ride roughshod over the circumstances that affect and even structure our lives.

In this chapter, we identify the larger threads of argument in the behavioral literature, thereby providing a way of placing our own approach to understanding the determinants of saving for retirement in relation to the extant theories. Given the significance we attribute to social attributes and relationships in subsequent chapters, it should not be surprising that we hope to move beyond the stripped-down versions of the rational actor model that dominates in mainstream social science and often shapes the design of pension institutions and policy, in favor of a perspective that takes seriously the context in which people find themselves. The relevance of these themes will become more obvious in subsequent chapters.

### Scope and Significance

Financial decision-making clearly matters in many aspects of everyday life, some of which are of a short-term nature while others have profound long-term consequences for welfare. Financial decision-making can be deployed for rudimentary decisions, such as discriminating between consumption items on the basis of cost and quality. So, for example, when we assess washing machines and dryers, the conventional model of behavior suggests that we should do so by comparing the attributes of various options assuming a budget constraint and some base-line preferences of expected use and location in the home (but see Iyengar, 2010 on choice overload). As summarized, this assessment process could be quite formal and explicit. In fact, the evidence suggests that people use shortcuts or heuristics, as well as social cues, to sort the available options into manageable packets where, in the last instance, issues of cost and value may be used as tie-breakers between equally desirable products. To think otherwise would be to deny the power of advertising! In these situations, financial knowledge may not be necessary to make a decision; all that may be required is a tried-and-tested decision rule and a well-honed understanding of social and cultural codes.

There are, of course, other more important decisions that cannot be easily reversed once taken, where costs cannot be recouped in any simple sense. For example, in many countries people purchase healthcare insurance where the long-term costs of underinsurance may be so significant that short-term cost-effectiveness is ignored. Likewise, in many countries, the middle class are significant consumers of private education for their children; here, cost-effectiveness must be balanced against emotional commitment, cultural capital, and (perhaps) the expected long-term rate of return of human capital. In these situations, where past decisions affect long-term welfare, financial decision-making is intimately related to individuals' discount functions—the value attributed to short-term consumption against expected long-term

well-being. People might reasonably apply some rudimentary financial decision technique in all the above cases. But buying a washer-dryer is different in *type* from buying healthcare, education, and pensions.

The distinction drawn here is between financial decision-making that is relatively shallow, being contingent on current information about short-term benefits, and financial decision-making that is relatively deep, being contingent upon long-term expected prospects and their consequences. The former refers to decisions that are typically reversible (albeit at some cost), whereas the latter refers to knowledge and decisions that are in large part irreversible (albeit with exceptions in some cases).<sup>2</sup> It can be observed that the former is almost always about events within individuals' background circumstances, where the only knowledge needed to make a decision is the information inherited from past decisions (e.g., that other products of a particular manufacturer have been reliable and good value for money). The latter may require knowledge only partially available from past decisions and is, more often than not, dependent upon financial expertise not shared widely through society. For example, calibrating the risk-adjusted rate of return on one kind of healthcare policy over other kinds of healthcare policies requires a wide range of detailed knowledge (including knowledge about the relationship between healthcare and life-time earnings).

Whether about rudimentary or complex time-dependent issues, financial information must be assembled and then applied through informal or formal decision processes and routines. In a sense, financial decision-making is more valued for its instrumental use than for its intrinsic quality. This suggests two implications. First, individuals must decide on how much information and of what quality to collect, recognizing that the costs of assembling data must be balanced against its value in decision-making. This may be an instinctive rather than a reasoned decision—one of the reasons that governments, banks, and other institutions provide information on gathering and using information (through financial literacy and capability programs). Second, given the costs of decision-making (time, effort, and other opportunities foregone), people have incentives to apply existing decision templates rather than approach each decision afresh on its own merits. Inevitably, much of financial decision-making is based on intuition and habit in case-specific circumstances (Hogarth, 2001). There are significant incentives for the vendors of financial products to blur these distinctions in the hope of cultivating immediate consumption.

<sup>2</sup> Recent research on the costs of deep, long-lasting decisions, including those that involve retirement saving, suggests that where we begin from in time and space can make a profound difference to both the path of asset accumulation *and* the end-result. In these circumstances, initial decisions on issues such as asset allocation and savings vehicles can make a profound difference to the end result—a fact of life that cannot be reversed (we cannot rerun our lives) although we may live to regret those decisions and even the cohort to which we belong.

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## Rationality and Knowledge

Rationality, defined as a basic set of cognitive capabilities, is a universal characteristic of humans whatever their context or culture. But individuals who share a basic cognitive capacity as human beings also vary considerably in terms of their cognitive performance, including their ability to assess and evaluate alternatives according to the dictates for formal and/or economic logic. The latter, moreover, is likely to be the product of socialization and education rather than innate ability. More significantly what counts as sensible (or acceptable) in some societies will not necessarily be the same in other societies; context and culture (being here synonyms for environmental factors) are crucial when people evaluate or judge behavior against social standards.<sup>3</sup> Recognizing that human beings share cognitive capabilities may be an *anti-essentialist* position, *contra* arguments about the inherent superiority of a racial or ethnic group or gender, and/or about geographical determinism. It is not the same as claiming that all people all the time behave in the same way in the same situation, or that a particular socioeconomic system (e.g., capitalism) is “natural.”

Rationality represented by the subjective expected utility (SEU) maximization model makes two specific assumptions about the utilization of financial decision rules. First, given the price of knowledge, it is rational to economize on its collection and use; second, outcomes (positive and negative) are symmetrical in that they are equally valued for their consequences.

Unfortunately for the SEU model, neither of these assumptions holds true in real life. It is self-evident that agents vary in terms of the financial decision-making they can afford. The knowledge they can afford affects the options they consider, and the options considered may be suboptimal in terms of the maximization of individual and/or collective (household, community) welfare. With experience calibrated on past decision metrics, individuals may become isolated from the best options and even from the better options they can reasonably afford. This type of behavior may be legitimated by cultural preferences which serve to justify favoring some options over other options. It is also apparent that many people, whatever their socio-demographic status, are risk averse, preferring the certainty of a known but small “win” over a much larger but risky potential “win” (Kahneman and Tversky, 1979). Being risk averse may be more or less valued in different settings, attracting the admiration of some and the approbation of others. These cultural cues are likely to constrain, reinforce, or, in some instances, determine behavior (see Chapter 2 for exposition of this point).

<sup>3</sup> There is increasing research on the interplay between cognition, culture, and context, especially as regards the importance of social standards in judging risk. See the remarkable cross-nation experimental study led by Henrich et al. (2005).

Most importantly, SEU models of rationality have been criticized for their shallowness regarding social identity and the significance of the emotions. It is frequently assumed that social identity and the emotions adversely affect reason because they filter what is observed and the implications to be drawn there from. Therefore, to the extent that reason is informed by information and financial decision-making, social commitments and emotions are thought to prompt wishful thinking and biased or capricious decision-making. However, cognitive psychologists have sought to counter these assumptions with empirical evidence suggesting that the emotions may be a valuable intuitive device for first-order responses to changing circumstances. This supports the positions of those in the social sciences who contend that it is impossible to separate out the domains of emotion and calculation. If financial decision-making has a formal quality such that it is a means of assessing the virtues or otherwise of competing options, the emotions may also provide a simple mechanism for presorting options by salience. By this account, explicit financial decision-making could be added to the mix of decision techniques at the end of a sequence of more intuitive judgments, rather than being located at the start of the process.

In practice, people are more or less rational, in the “strong” sense. They approach problems from intersecting vantage points: their intrinsic cognitive capacity *and* their relationships, sociocultural ties, and experience in certain settings or environments (as suggested by Herbert Simon’s 1956 metaphor of scissors). People are also innately emotional in the sense that they bring to situations intuitive judgments based upon fear, anger, happiness, and love (see *Emotional Knowledge* section). For some theorists, however, financial decision-making is properly *the* antidote to the confounding affects of emotion and commitment. But this seems rather utopian (at best) and normative (at worst): it is hard to imagine a situation where individual behavior would not have cultural and social significance including, crucially, emotional significance, making the model quite possibly irrelevant. Being *purely* rational is surely a normative statement of supposedly logical behavior stripped bare of emotional commitment rather than a statement of lived-life.<sup>4</sup> It is also often an ideologically driven claim about proper (even laudable) behavior in the context of market-based societies.

<sup>4</sup> It is surely inconceivable that people’s behavior can be distinguished by various components, as if the emotional can be separated from the analytical, etc. No doubt people may seek to distinguish between their emotional commitments and their economic interests (for example). But this is surely an act of conscious will not behavior that relies upon the actual or hypothetical separation of these “functions” in the brain. See Ortony et al. (1988) on the cognitive emotions.

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## Risk, Uncertainty, and Scale

Financial markets are awash with information. There are information markets for vendors and for buyers. In fact, the problem is not so much the lack of information as the lack of means by which to discern relevant information and our inability to discriminate between information and information sources in terms of their relevance to market conditions. Cost and power asymmetries in access are also important discriminating factors. Directly or indirectly, financial products involve risk and uncertainty.

So, in the context of recent events in local and global financial markets, the purchase of a home mortgage may involve the vendor and buyer in complex time-dependent calculations of expected inflation and interest rates. Vendors who underestimate interest rates over a specified period of time effectively subsidize mortgagees (and vice versa). Moreover, many people do not appropriately weight low-incidence but costly risks. Continuing the mortgage example, during the 1980s and 1990s many UK home-buyers took out endowment mortgages, betting that a low-risk event (collapse of the London stock market) would not occur or would not be compounded by collateral threats to household income and wealth. More recently, vendors were willing to assume risks that were neither adequately priced nor understood in the mistaken belief that some other institutions, somewhere else, had made those assessments and could bear the downside risks.

Many people are unaware of the risks they face in everyday life. They certainly do not appreciate the fact that risks are related, such that one event may cascade to affect a person's entire well-being. To deal with these issues, governments have vigorously encouraged disclosure policies, transparency in product design and management, and the adoption of risk-assessment by formal decision trees that deliberately expose contingent risks (see Chapter 2, *Reconceptualizing Personhood* section). Most importantly, governments have encouraged "plain English" disclosure policies, using terms and concepts anchored by average rather than expert competence. But as suggested above, these policies may be compromised on three counts. First, rationality is idealized, eschewing the complications of context and culture. Second, rationality is portrayed as a logical process rather than an issue of substance. Third, rationality is conceived as unbounded, notwithstanding the fact that people more often than not are "myopic"; that is, they limit the scope of problems rather than see them whole.

"Naïve" investors are led to assume that the available information is representative of stable economic processes. Financial information is taken at face value with little appreciation of the motives of those who produce and market such information. In part, this reflects the lack of alternatives, because

independent, cost-effective expert information is costly to obtain. By necessity, risk is calibrated using past information and extrapolated into the future. Therefore, naïve investors tend to use financial information in ways that reinforce past commitments; information at odds with individual predispositions is often discarded or ignored, suggesting that the costs of assimilating such information are such that it is easier to wait for exogenous events to force through reconciliation or a change in tactics. In practice, naïve investors tend to associate cost with reputation; rightly or wrongly, the presumption is that the higher the cost of financial information the more reliable the information. This point is elaborated in Chapters 4 and 5.

“Sophisticated” investors ideally scrutinize the integrity of financial information, seeking evidence of contamination by competing interests.<sup>5</sup> Rather than extrapolating from surface trends, they look for changes in the variance of underlying time-series, believing that this is one indication of market instability. Sophisticated investors believe that uncertainty is endemic; finely calibrated risk profiles of financial products, the core of advertising programs by the finance industry, suggest a level of certainty that is not justified by the performance of financial markets. For sophisticated investors, financial judgment is more important than financial information. But there is a paradox: financial decision-making must be continuously assessed in the light of changing circumstances. It must be constructed and deconstructed at every turn.

There is nevertheless a geographical scale-effect implied by this distinction between “naïve” and “sophisticated” investors. The former draw on that which is immediately to hand, extrapolating from what they know to the immediate future, often ignorant of the causal links between current events, future prospects, and their relationships here and there (local and global). As we explain in subsequent chapters, “myopic” behavior is inevitably, though not exclusively, local in the sense that naïve planners are not Bayesian analysts.<sup>6</sup> By contrast, it

<sup>5</sup> The distinction between “naïve” and “sophisticated” investors is made by a number of authors, including Stein (2009). In his case, it is suggested that individual investors are naïve, whereas institutional investors are sophisticated; the distinction rests on the apparent advantages of the latter in quantitative modeling based upon “academic research in finance” and their use of leverage in making the most of market movements. Stein suggests that sophisticated investors are “rational arbitrageurs,” whereas individuals are not. We are not convinced that categorical distinctions such as rational versus irrational make a great deal of sense; it is probably better to talk about competence and expertise than rationality per se. In any event, considering the failure of many institutions to manage their own positions in the lead-up to the global financial crisis, it is difficult to accept that institutions are *ipso facto* rational in the sense that they are better able to conceptualize and realize coherent investment strategies.

<sup>6</sup> This discussion implies that being myopic is costly and, in a sense, self-defeating. We should acknowledge that focusing upon the local as opposed to the global, and the immediate future as opposed to the long-term, may be an effective strategy to control that which can be controlled (and action taken in regard thereof). Williams (1995: 208) is sympathetic to these coping strategies, suggesting that local knowledge is often more complex and multivalent than acknowledged by theorists.

would seem that sophisticated planners are able to look into the future with a sense of the causal linkages that join observed events with underlying processes. By implication, they are able to operate locally and globally, as in fact they may have to, given the integration of financial markets around the world. In this respect, they can be deemed Bayesian by impulse and application.

## Stylized Facts

It has become apparent that people are not the efficient information-processing machines of economic theory or, for that matter, government policy (although we should recognize that government policy is hardly ever coherent on this issue given the vestiges of paternalism that infuse the modern nation-state). On average, people are risk averse, eschewing financial opportunities that a so-called fully rational person would or should assume. On average, people are inefficient users of information, often backing ill-informed opinion when they should collect more information, or perversely collecting more information than is warranted by the scope of the problem. On average, people overvalue the near-future and undervalue the long-term future. On average, people do not carry through on past plans, “jumping at shadows” when they ought to stand by informed commitments. On average, people are poor at data analysis, befuddled by even the most elementary notions of probability and contingent risk (as illustrated in Clark et al., 2006, 2007).

But the results of cognitive science do not tell the whole story. Research on the financial behavior and planning of different sorts of people suggests a more nuanced picture. While the precise details vary by country, especially if we are to include developed economies outside the OECD, we can crudely suggest that financial literacy is distributed on a 20/60/20 basis.<sup>7</sup> That is, 20 percent of the population appears to have such poor financial competence, knowledge, and access to advice that their immediate and long-term welfare is imperiled. At the other end of the spectrum, 20 percent of the population can be characterized as sophisticated investors, combining access to expertise with knowledge and understanding of the nature and performance of financial markets. In between are perhaps 60 percent of the population, who are, at best, naïve investors subject to many of the cognitive shortcomings noted above, but with the expectations and resources to be active consumers of financial products.

<sup>7</sup> The 20/60/20 formula is provided so as to prompt consideration about the scope of competence in the population, and to represent our intuition about the facts of the matter in Western economies. We may be quite wrong, but which way? Is the bottom 20 percent really 30 percent? And does the distribution vary over time, such that in episodes of market volatility the top 20 percent shrivels to 5 percent?

It is tempting, therefore, to correlate cognitive ability in relation to financial decision-making with age, gender, and socioeconomic status. Socio-demographic status counts because status is a good proxy for income and educational resources (what Pierre Bourdieu calls *cultural capital*)—the assets needed to acquire financial knowledge and expertise so as to compensate for acknowledged cognitive shortcomings. Studies have also shown that risk aversion, for example, is frequently correlated with income and household wealth, which chimes with the concentration of equity ownership along class lines (notwithstanding the “shareholder society” supposedly heralded by the dot.com boom) and differential capacities for hedging against shocks and uncertainty. The *interaction* of socio-demographic characteristics with financial decision-making is understudied, perhaps because the testing regimes of cognitive psychologists often involve groups of undergraduates and MBA students from elite universities. This is one of the motivating forces behind our book: we show, in fact, that socio-demographic status counts in making plans for the future and that status can be an important means of discriminating between naïve and sophisticated decision-makers.

Most importantly, it appears that formal education, professional qualifications, and task-specific training can make a difference to people’s financial expertise. University-level education in subjects demanding quantitative skills and the attainment of professional qualifications post-university in areas of related knowledge do make a difference, and long-term task-specific training seems to reinforce the advantages of education and professional qualifications. Inevitably, education, professional qualifications, and training are correlated, albeit imperfectly, with household income. It is also apparent that, notwithstanding the massive postwar improvement in educational attainment, in Western societies, high-quality education, quantitative skills, and training are socially stratified and not widely distributed. This has implications for inequality in societies where social and economic welfare is increasingly subject to the performance of financial markets.

### Context of Knowing

By this account, effective financial planning is intimately related to conceptual and analytical sophistication. Just as plainly, the quality and quantity of financial information available to individuals is related to their socioeconomic status. There also appears to be a relationship between the quality of financial planning and expertise, education, qualifications, and training. Most importantly, many people have neither the cognitive ability nor the acquired skills to be expert decision-makers. They must therefore rely upon others through social relationships and networks to improve the acquisition and use of

financial decision-making. The evidence suggests, in fact, that most people depend upon family when seeking to extend their financial decision-making and better calibrate their decision-making. By this logic, the household is a very important resource for information, advice, and decision cues. It need not contain any more expertise than the sum of its parts; nonetheless, it may be able to rule out extremes and fanciful assumptions.

But small groups may also be subject to the influence of dominant individuals (whatever their expertise or lack thereof) and may converge on conventional or even catastrophic solutions rather than the best or even second-best solutions. This is an argument for broadening the planning environment to include the workplace and wider sections of society at large. Some thirty or forty years ago, the workplace combined paternalism with class-specific entitlements, such that the available advice and knowledge were allocated by virtue of job classification. However, evidence on the value of workplace information exchange is mixed; surveys suggest that employees rarely share financial information with one another. More often than not, employers provide the relevant information and brief programs on the issues and options. While employees often indicate that this information is useful, sign-up rates for information briefings are reported to be low, with default options dominating deliberate employee choice. Research on pension plan participants has shown that the behavioral effects of such training programs are limited, despite positive attitudinal responses.

Another source of financial planning is peer-imitation and advertising. If conventional class-related social aspirations are less meaningful in (post)modern societies, it is apparent that many people make financial decisions according to their role models (public figures) and their peers (represented in the media by television programs and the like). In part, planning-by-imitation may be driven by workplace relationships and professional ties. In part, planning-by-imitation may signal aspirations of social identity and recognition. Consequently, financial decision-making may be nothing special; the consumption (the accumulation and assessment) of information for financial decision-making is likely to be governed by the same behavioral customs and conventions that govern the purchase of fashion items such as clothes and cars, where people live, and the organizations to which people belong. It is hard to believe otherwise.

In this world of image, media, and consumption, the Internet and Web-based resources are sometimes identified as important alternative (good and bad) sources of financial information (Clark et al., 2004). It appears that access to this medium is heavily dependent upon an individual's work environment and job tasks. It also appears that younger people are more willing to use the Web to search for information and to make purchasing decisions based on web information than older people (a finding that will not surprise those knowledgeable of the adoption of innovation). However, most websites,

especially those sponsored by government and not-for-profit consumer advocates, utilize an abstract display format rather than a media-driven format, emphasizing a claimed difference between (important) financial decision-making and other kinds of (less important) consumer information. It is notable that our research suggests that people do not value “remote” sources of information; they prefer information and insight that can be gleaned through “local” relationships, whether by trust or contract (see Chapter 4).

### Emotional Knowledge

The “contextual” model of financial planning suggests that it is made at the intersection between individual cognition and the environment (the family, place of work, society at large, etc.). By this logic, the exercise of cognition provides incomplete solutions if not supplemented by specific learning (formal and informal). But there is another sense in which cognition is incomplete: the emotions also play a significant role in determining behavior. To agree with this statement is to move a significant step away from the rational actor paradigm that dominated the social sciences over the second half of the twentieth century and embrace a twenty-first-century theory of the mind-brain that stresses cognitive integration and functional interdependence. The interaction of individual cognition and the environment also suggests that the rational individual is not an island: cultural and societal interactions, personal relationships, and environmental and geographical factors matter. Thus, it provides a clue as to the nature of intuition—the moment when people reach a solution by some “unconscious” mix of cognitive response, social resources, and emotion.

Although emotional expression is modulated by social learning, basic emotions have a built-in physiological origin. Emotions such as fear, disgust, happiness, and anger are mediated by innate brain circuits in higher primates, humans included. Other emotions like love are even more modulated by culture and learning and more ascriptive in origin; ascribed behavior draws social approbation or admiration (including imitation). Following Aristotle, we can argue that the emotions may be thought to be a form of visceral judgment made about a situation and the behavior that follows. In this sense, the emotions “value” information by visceral judgment, providing a response that may or may not be overruled by deliberation and the application of social resources. This way of integrating the emotions with decision-making and behavior recognizes that most behavior is cognitively responsive rather than consciously reflective.<sup>8</sup>

<sup>8</sup> Folk-law in the finance industry would have it that men and women are different in that the former are analytical and the latter are emotional (left brain/right brain dominant, etc.). This claim

So, for example, fear may be the response of many people to the financial market crisis. As a basic emotion, but with a large overlay of acquired triggers and meanings, it represents foreboding about a sudden reversal of fortune bringing to the fore the likely negative consequences of such an event. It may follow a stock-market bubble characterized by euphoria and the suspension of disbelief (“irrational exuberance”), and be prompted by deep-seated emotions from our biological past, but applied to very different material circumstances. It is little wonder, therefore, that risk aversion is so systematic among humans across the whole range of experience, whether they are educated or not, skilled or not, or reflective or not. Taking this one step further, fear and happiness may (respectively) amplify or discount adverse financial information, just as these emotions may select among the available financial information to fashion an interpretation of current circumstances. Fear and happiness are shared human experiences that lead to “herd behavior” (analogous to Akerlof and Shiller’s 2009 “animal spirits”).

For those less convinced about the role and significance of the emotions in financial planning, consider a more social emotion: love. Clearly, love is associated with biological drives such as sexual desire and reproduction. On the other hand, love is also associated with socially desired behavior such as care for the young, companionship, respect for the old, and a commitment to the welfare of family and friends. Not all people are bound by love; some are entirely selfish (self-love). However, the comparison is revealing. Those committed to others may have very shallow discount functions, whereas those who are wholly selfish may have very steep discount functions. Love may give rise to hyperbolic discount functions, whereas selfishness may be manifest as weakness of will. As feminists have long pointed out, caring behavior is essential for both social reproduction and social cohesion. Either way, people’s need or otherwise for approval may be a powerful determinant of how they respond to financial markets.

## Looking Forward

Financial planning is a field of research and an area of public policy that is bound to grow in significance over the coming years, notwithstanding the global financial crisis. The consequent retrenchment of inherited state institutions and commitments is likely to move Western societies further in the direction of dependence upon global financial markets (somewhat paradoxical given the public costs of the financial crisis). The

is empirically ill-founded and makes gross generalizations about people from specific environments with distinctive and hierarchical segmentation of tasks and functions.

place of financial planning at the intersection between the retreating state and the growing responsibilities of individuals for their own welfare suggests that it is one of the most important determinants of long-term social welfare. At the same time, so many of us appear to be naïve decision-makers and investors; we lack the skills of financial professionals and will never have enough information and knowledge to make up the difference. The relative inability of people to manage shortfalls in decision-making, the costs and benefits of social resources, and the play of emotions suggest that some market agents will benefit from exploiting these dichotomies. Here lies an issue of political economy, in that the welfare consequences of such inadequacies in the context of the global financial crisis are bound to flow back into the political arena.

As described, financial planning is vital to the well-being of adult men and women. Less understood are the possible pay-offs of financial education and financial literacy programs aimed at young children and teenagers. In play, in this regard, are a series of complex issues having to do with the cognitive development of children as they mature to adulthood and the degree to which they are able to assimilate information from the environment in their putative decision frameworks. Also at stake is the political project of creating “investor subjects,” ideologically acclimatized to the individualization of risk (Langley, 2006). At the other end of the age distribution there are issues of similar significance, notably the consequences of ageing for cognitive functioning and the capacity of the elderly to respond to changing circumstances. At its core, liberalism values human autonomy and responsibility whatever people’s ages. But there are counterarguments for the desirability of some level of paternalism, especially on the side of those who are simply not able to play the roles assigned to them by neoliberalism.

In any event, there remains a most troubling issue: how individual choice through financial decision-making is exercised in the context of culture and emotion. It was suggested above that intuition is one expression of their interrelationship. It was also suggested that focus on cognition at the expense of cultural expectations and emotional commitments would be incomplete as a matter of empirical reality and as a matter of relevance. While easily expressed as such, there are few frameworks available that allow for a means of integration. Furthermore, given the significance of financial information and knowledge for well-being, the academic literature has preferred silence on these issues to a fully fledged research program that would set the shape of things to come.