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Teaching children to save: What is the best strategy for lifetime savings?

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ABSTRACT

We study the effect of alternative parental teaching strategies on the propensity to save and the amount saved during adulthood. Using a panel dataset from the Dutch DNB Household Survey we find that parental teaching to save increases the likelihood that an adult will save by 16%, and the saving amount by about 30%. The best strategy involves a combination of different methods (giving pocket money, controlling money usage, and giving advice about saving and budgeting). The effect of parental financial socialization is persistent with age, but decays at elder age for the propensity to save.

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1. Introduction

Saving is important over the lifespan for retirement, to sustain stable consumption needs, to purchase a home or expensive goods, and to protect against unforeseen events such as unemployment spells or health problems. This notwithstanding, people frequently do not save or save too little. Household net saving accounts for 7.6% of household disposable income in the Euro area and for 4.4% in the U.S. (OECD, 2013). Lusardi (1999) reports that one-third of Americans aged 51–60 approach retirement with very small wealth holdings. Scholz, Seshadri, and Khitatrakun (2006) find from simulation studies that 20% of American households have less wealth than predicted from theoretical life-cycle models. Sub-optimal saving is not a local phenomenon, and it is observed worldwide (see, e.g., Dobrescu, Kotlikoff, & Motta, 2012; Lusardi & Mitchell, 2011). The lack of saving has been related, among others, to cognitive deficits (Banks, 2010; Banks, O'Dea, & Oldfield, 2010), procrastination (see, e.g., Frederick, Loewenstein, & O'Donoghue, 2002; Loewenstein & Prelec, 1992), the lack of financial literacy (Lusardi,

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1999, 2004; Van Rooij, Lusardi, & Alessie, 2011, 2012) and access to financial products and institutions (Han & Sherraden, 2009; Schreiner & Sherraden, 2007; Ssewamala & Sherraden, 2004) as well as to the inability to exert self-control and delay immediate gratification (Ameriks, Caplin, Leahy, & Tyler, 2007; Bucciol, 2012; Thaler & Shefrin, 1981).

In this study, we investigate the extent to which parental financial socialization, in the form of teaching to save received in young age, helps to increase savings in adult age. The importance of saving – and the need to stimulate it – is widely accepted in the literature (among others Attanasio & Weber, 2010; Browning & Lusardi, 1996); however, our understanding of how to encourage people to save is still on an early stage. There is robust evidence that asset accumulation is positively correlated with education in general (for example see the review by Attanasio & Weber, 2010), and financial education in particular (Lusardi & Mitchell, 2014). A large body of the psychology literature looks at the saving behavior in young age (for a recent review see Otto, 2013). A smaller strand of literature focuses on the financial education received in young age, either formally at school or informally through socialization within the family; for a review see Section 2.

Although there is consolidated evidence of continuities between economic behavior in adolescence and young adulthood (Ashby, Schoon, & Webley, 2011), as now it is not clear whether the effect of financial socialization experienced in young ages is generally *persistent* throughout adult age. In addition, there is no clear evidence on *what* informal teaching strategy is more effective. Knowing the strength of different teaching strategy alternatives, and whether their effect lasts over the lifetime of the individual is clearly important for policy analysis. A careful planning of individual savings makes government intervention to support basic consumption less likely, thus alleviating the society of a cost.

In this study, we investigate the educational role played by parents in teaching children to save. We answer three main research questions: (i) does teaching children to save increase their propensity to save and the amount saved in a given year when adults? If so, how large is the effect? (ii) What are the most effective parental teaching strategies? And finally, (iii) do these effects last over time? The study more closely related to ours is by Webley and Nyhus (2013), who consider the economic socialization of a cross-sectional sample of Dutch young adults aged 18–32. In this paper, we look at their same data source and the same key variables, but we extend their research in three important directions. First, we make a thorough comparison of alternative strategies, including giving pocket money, controlling how children spend their money, giving advice about saving and budgeting, and all their combinations. Second, we investigate whether these effects – if any – are persistent or rather evolve or decay over time, considering a wide age range. Last, but not least, we perform our analysis on a large panel dataset including around 7000 observations on about 1300 individuals of different age groups and followed for up to 13 years. This dataset provides a large variability of information on several domains (such as income and macroeconomic background) that may also be related to saving behavior, and it allows us to conduct a robust analysis of the impact of parental teaching to save on saving behavior during adulthood including the retirement period.

To answer our research questions we indeed focus on household heads aged 18–80 interviewed in the panel DNB Household Survey (DHS) for the Netherlands from year 2000 to year 2012. Using a panel dataset allows us to detect age profiles and to reduce measurement errors in some key self-reported time-invariant variables, such as those regarding events arisen several years earlier. This survey indeed includes, in addition to basic socio-demographic questions, a specific set of retrospective questions on parental methods to stimulate saving received in young age.

We study the effect of all the possible strategies arising from the combination of the teaching methods. This allows us to answer questions such as: Are strategies implemented during adolescence more effective than strategies implemented during childhood? Shall parents allow their children to spend their money as they pleased or is it more effective that parents control how children spend their money? Do parental strategies crowd each other out? In other words, is a combination of strategies better than strategies implemented in isolation, e.g., is the effect larger if giving pocket money is bundled with advice on how important saving is or/and with control on children spending? Is the effect of parental teaching to budget constant over time, or does it fall with age?

We find that parental teaching to save generally has a large significant and positive effect on both the propensity to save and the amount saved when adults. When looking at the different strategies, our results show that "the more, the better," since a combination of several methods generates larger effects. The strategy of giving pocket money at age 8–12 together with parental control on how to spend the money combined with giving advice on saving at age 12–16 seems the most effective strategy. However, although giving advice taken alone is sufficient to stimulate adult savings, giving pocket money looks ineffective. In addition, the distance between the propensity to save of those who received parental teaching and those who did not tends to reduce with age. Individuals who received no parental teaching seem to procrastinate their savings as long as they can. The same evidence does not emerge regarding the saving amount.

The remainder of the paper is organized as follows. Section 2 surveys the recent literature on financial socialization and financial education programs. Section 3 discusses the data and the methodology used in the analysis. Section 4 presents the results separately by research question, and performs a sensitivity analysis to test the consistency of the estimates. Section 5 concludes, and Appendix A explains in detail our key variables.

2. Background

There is wide heterogeneity in the actual distribution of household savings. For instance, in the U.S. in 2010, the 10% wealthiest households held on average nearly 4 million dollars each, whereas 25% of the households held none or negative

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