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Bounded Rationality Strikes Again: The Impact of Cognitive Ability and Financial Planners on Roth IRA Adoption and Ownership

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Abstract

Roth IRAs were introduced in the late 1990s and provide another option for tax-sheltered retirement savings. Because determining the benefits of a Roth IRA is a complex decision, we hypothesize that cognitive ability and having a financial planner have significant impacts on the timing and likelihood of using a Roth IRA. Using data primarily from the 2004 and 2008 administrations of the National Longitudinal Survey of Youth (NLSY), we find that greater cognitive ability and having a financial planner are both positively related to Roth IRA ownership and earlier adoption. If individuals with higher cognitive ability and/or a financial planner are better able to recognize and implement beneficial tax strategies, then tax policy will yield unintended distributional consequences. The complexity of a tax policy also limits its ability to modify individual behavior in the ways envisioned by policymakers.

Keywords: cognitive ability, financial planner, Roth IRA, National Longitudinal Survey of Youth (NLSY)

JEL Classification: D14, D83, H24

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