Applied Economics Letters ›
Volume 19, 2012 - Issue 17

Original Articles

Exponential growth bias and financial literacy

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Pages 1693-1696 | Published online: 16 Mar 2012

Cite this article https://doi.org/10.1080/13504851.2011.652772

Abstract

The tendency to underestimate the future value of a variable growing at a constant rate, an example of exponential growth bias, has been linked to household financial decision-making. We show that exponential growth bias and standard measures of financial literacy are negatively correlated in a representative sample of Swedish adults. Since financial literacy is linked to household decision-making, our results indicate that examining the relationship between exponential growth bias and household finance without adequate controls for financial literacy may generate biased results.

Keywords:

exponential growth bias | financial literacy | household finance | survey data

JEL Classification:

D12 D14

Acknowledgements

The authors thank Anna Dreber Almenberg, Marieke Bos and Magnus Johannesson for helpful comments and Finansinspektionen for providing the data. Johan Almenberg thanks Sveriges Riksbank for financial support.

Notes

Note: The views expressed here are the views of the authors in their capacity as researchers and do not represent the views of the Swedish Ministry of Finance.

[1] 'Suppose you invest 100 SEK and the interest rate is 7% per year. If you don't withdraw any money, how much money do you have in this account after 30 years?'

[2] We elicit exponential growth bias in a slightly different way from Stango and Zinman (2009). They construct their measure indirectly based on two questions, while we use the result of one question that directly measures the bias. This may explain why such a high fraction of their sample, 98%, is in this range.

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