Study finds that lure of prizes encourages saving

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People are more willing to save money when offered the chance to win a prize, according to a study from The University of Texas at Dallas.

Dr. Kyle Hyndman, associate professor of finance and managerial economics in the Naveen Jindal School of Management, examined the possibility of using lotteries to induce savings behavior.

"Most Americans undersave for retirement and many of them also are unprepared for unexpected expenses," Hyndman said. "If you ask them to come up with $2,000 for an unexpected expense, it's shocking how many people say they couldn't do it."

The study, published in the June edition of the *Journal of Public Economics*, examined Prize Linked Savings (PLS) products.

For example, a PLS savings account adds a randomly determined element to an otherwise standard savings account. Instead of receiving a typical fixed-interest rate, depositors periodically receive a chance to win a specified, and potentially large, prize in accordance with their deposit amounts—i.e., larger deposits means a higher chance of winning.

This is the first paper to provide evidence that PLS products are more effective at inducing savings as compared to a standard interest bearing account.

The problem of low savings is more severe with lower-income, lesseducated people, Hyndman said, and that same demographic also plays the lottery more often. The idea behind PLS products is to leverage the appeal of gambling to entice people to invest in savings products that offer a positive expected return.

Hyndman and the paper's co-authors conducted a controlled experiment with 96 college students to compare the success of a PLS account to that of a standard interest bearing account. They found participants were more likely to save money when they were offered the possibility of winning large cash prizes, instead of smaller fixed-interest rates.

The appeal of the PLS product appears to be greatest among men, self-reported lottery players and those who reported relatively low amounts in their existing bank accounts.

"When we made these future payments risky, people were actually more willing to save for the future," Hyndman said. "One of the things that separates this from an actual lottery is that if you buy a lottery ticket and you lose, your money is down the drain. Here, you always maintain your principal. You never lose money."

PLS products are fairly new to the U.S., but have existed in some form around the world for hundreds of years, Hyndman said.

In 2009, Michigan credit unions introduced a "Save to Win" PLS program that was adopted in North Carolina and Washington in 2013 after it proved successful. In 2014, the Savings Promotion Act was enacted, allowing covered financial institutions to conduct savings promotion raffles.

"We've already seen the implications of this research with the passage of the new law," Hyndman said, "so the question is whether these pilot projects will be maintained or expanded in light of the evidence that suggests it works."

Hyndman said although PLS products coexist with lotteries in many countries, there is potential for conflict. In South Africa, where many banks successfully offered PLS accounts, numerous people shifted money from state lotteries to PLS accounts. Eventually, PLS accounts were withdrawn from the market because South African courts ruled that they violated the state monopoly on gambling.

More information: "Do lottery payments induce savings behavior? Evidence from the lab," *Journal of Public Economics*, Volume 126, June 2015, Pages 1-24, ISSN 0047-2727, dx.doi.org/10.1016/j.jpubeco.2015.02.007

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