EconoFact Chats: Fixing Personal Finance
John Campbell, Harvard University
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Michael Klein
Hi. I'm Michael Klein, executive editor of EconoFact, a nonpartisan web-based publication of The Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein
John Campbell and Tarun Ramadorai begin their new book, *Fixed: Why Personal Finance is Broken and How to Make It Work for Everyone*, with five stories of people whose financial decisions led to ruin: a woman who borrowed heavily for college and ended up in debt but without a degree; a man who worked for Enron and whose retirement account invested entirely in that company's stock, which became worthless when Enron failed; a widow whose retirement income based on interest from CDs and money market funds dried up; a British man whose payment protection insurance, in fact, offered no protection; and a botanist in India who purchased an insurance plan bundled with a stock investment portfolio sold by the State Bank of India, that lost nearly all of its value in five years. The title of their book refers to the way in which the financial system is fixed against ordinary people, as illustrated by these five examples. John and Tarun detail these problems, offer practical financial advice to readers, and argue for rules and regulations to address the problems in this compelling, and very readable book. I'm very pleased to welcome John Campbell back to EconoFact Chats. He is a professor at Harvard University, and widely recognized as one of the world's leading experts on financial markets. John, thanks for joining me today for this podcast.

John Campbell
Oh, you're welcome, Michael. Thank you for having me.

Michael Klein
John, this book seems to me to be a real departure for you. Your previous books, like *Financial Decisions and Markets: A Course in Asset Pricing*, and the ever-popular *The Econometrics of Financial Markets*, were technical treatises written for experts. What prompted you and Tarun to write this book?

John Campbell
We had two motivations. One is that we and other economists know things that ordinary people can benefit from learning about personal finance, and we'd like to spread that knowledge—or savviness, if you like—more broadly. The other is that we believe the financial system has fundamental design flaws that need to be addressed. Reform is needed, and it won't happen unless the general public comes to understand the problem. I might add that my family for years have been complaining about the fact that I've never written a book they can read. So I decided to respond to that complaint with this book.

Michael Klein
Well, they can read this. This is very readable, and I hope this helps quell any family disagreements. Another thing that struck me about this book was its title, *Fixed*. That's pretty provocative, and you're a mild-mannered guy, John, not at all a bomb-thrower. Why did you choose that title?

John Campbell
We actually considered an even more provocative title, *Rigged*, but we gave up on that idea once we realized there are already six or seven books, including some about finance, that use that word. *Fixed*, of course, has a similar meaning, referring to a game that's unfair and siphons profits from naive players to sophisticated insiders. And we argue in the book that the personal finance system is actually fixed in this sense, but also that it can be fixed in the other sense, that you can repair a broken machine. So our title has two meanings, and both of them are deliberate.

Michael Klein
So to give some background, what should the financial system do for ordinary people who just want some financial security, and the ability to borrow for college or to buy a house and to have a secure retirement?

John Campbell
I think economists understand pretty well what financial products are needed for these purposes. There are things like savings accounts, that are both safe and liquid but also pay some interest, credit access arranged before you need it, so it's there when you need it, retirement accounts that allow you to save for retirement without being taxed too heavily along the way and that are universally accessible, student loans with flexible repayment arrangements, and mortgages that are simple and understandable. Now at a more general level, what people need are financial products that they can understand and easily shop for on the basis of quality and price. But we argue that today, too many financial products are complicated, difficult to compare, confusing, and therefore daunting to shop for. As a result, many people stick with familiar financial brands from big companies that they know, and they don't pay much attention to fine print or fees. So we'd like to create a system where buying a financial product is more like buying an over-the-counter pain medication. If you have a headache, you can go into the pharmacy—CVS or Walgreens, or whichever your pharmacy is, and you can compare…you find the painkiller shelf, and you can compare a brand name product like Advil with the pharmacy brand of ibuprofen. And you count on the fact that the active ingredients and the dosage are the same, and you can easily compare prices and make your choice. Today, we're a long way away from that, and that's the essence of the argument we make in the book.

Michael Klein
This isn't just a problem in the United States, right? As illustrated by those examples you use to start your book.

John Campbell
No, these problems are worldwide. Naturally, those of us in the United States are most concerned about our own problems, but they exist almost everywhere, and in fact are even more severe in countries like China and India, where there is a vast new middle class that has emerged from

poverty in recent decades, and now needs to figure out how to use modern financial products without having much experience with these products.

Michael Klein
Why doesn't the financial system deliver on these needs? I guess one reason is that it's fixed against the interests of many people. But also, you know, financial decisions are daunting to many people as well, right?

John Campbell
Yes, finance is inherently difficult because it requires both general numeracy and knowledge of specific financial principles, and you have to be able to put all that together. Now, more schools today are offering financial literacy courses, and I applaud this. In fact, I serve on the board of a nonprofit, the Council for Economic Education, that promotes this type of education in high schools. But I don't think we can rely on these courses alone to get people to the level of sophistication they need. One problem is that high school students aren't yet making many of the big financial decisions they'll need to make later. So financial education can easily seem abstract and feel distant to them. You know, ask yourself, how effective would driver's ed be if there were only a classroom component and the students didn't actually get to go out on the road behind the wheel of a car? Probably students would forget most of what they were taught. And so financial education can too easily be like the classroom component of driver's ed. Another problem is that the financial system is always evolving. So high school education can easily be out of date by the time people actually have to open a retirement account or get a mortgage.

Michael Klein
So that has to do with education, but for the people who are past high school, it's just a really difficult thing to understand finance, isn't it?

John Campbell
It is. It's inherently difficult, and I think our intuitive understanding of finance easily goes wrong. This is where our book draws on the vast and very important literature on behavioral finance, and the sort of cognitive biases that people have. The way in which human intuition just gets things like compound interest, or conditional probabilities, things that you need to understand…human intuition easily gets those things wrong, and it's very easy to be confused. But beyond this, you know, the most important problem, which is really at the heart of our book, is that because so many people are confused about finance, they make mistakes that…we say corrupt the capitalist system. So, you know, I'm not going to quote long stretches from the book, but there is one paragraph where we say it like this, and I'm going to quote because I think this is at the heart of things. We say: 'capitalists respond to the actual demand for their products, not the demands that would exist if people were perfectly rational, and truly understood their own best interests. Since people's demands are driven by the benefits they perceive, rather than the benefits they actually get, the financial system supplies too many products with exaggerated benefits, and too few products with underappreciated benefits. And since perceived costs, rather than actual costs, drive people's demands, the financial system supplies too many products with hidden costs."

Michael Klein
Give the people what they want, not what they need, huh?

John Campbell
Yes, and you know, let me give a concrete example. Take bank accounts with so-called overdraft protection. What these do is the bank will honor your debit card or a check even if your balance goes negative, but they're going to charge you $35 for doing that, and if you inadvertently do that while out shopping and using your debit card for a few small purchases, the bill can rack up awfully fast. And people don't really think about this when they set up their checking accounts, and it's a hidden cost. It's a lot of revenue for banks, and it actually helps them offer cheap checking for everyone else, but the people who pay these overdraft fees are really losing out.

Michael Klein
You quote a line from the musical *Hamilton*—a Tory preacher arguing against the American Revolution says "they have not your interests at heart." Do those who run a so-called fixed financial system not have the interests of their clients at heart, and do they take advantage of people's lack of understanding?

John Campbell
Well, first of all, a disclaimer: I don't want anyone listening to this podcast and hearing my English accent think that I'm opposed to the American Revolution. And I also don't want to sound like a scolding preacher, Tory or otherwise. You know, it's normal in any commercial system for businesses to have their own interests. They have to make a profit and stay in business. The problem is that people easily forget this, and place excessive trust in the employees of financial firms who may indeed have expertise, but also are self-interested. So, for example, people buy mutual funds recommended by stockbrokers who are paid to promote these funds, which charge high fees, and are profitable to the fund managers, and pay nice commissions to the brokers but deliver poor results to investors.

Michael Klein
How does this tie into the notion that these people have a fiduciary responsibility, and they often tout that when you're thinking about going with them?

John Campbell
Yes, I think fiduciary duty is an important legal principle that requires that those who have a fiduciary duty do put their clients' interests first. But my concern is more that ordinary people imagine that there's much more fiduciary duty than there actually is. Most people you deal with in the financial industry are counterparties, not fiduciaries. Now it is a little different. If you have a financial advisor who has a fiduciary duty to you, then that puts you in a different part of the [inaudible].

Michael Klein
What about more competition in the financial products industry?

John Campbell
So one of the great things about competition is precisely that it limits the ability of firms to

exploit their customers, because a firm that starts to exploit its customers will be vulnerable to a competing offer from another firm that offers higher quality or a better price. But in the financial context, people's reluctance to shop gives firms room to raise prices, and lower quality with some impunity, particularly on customers who've shown that they're not paying attention. A great irony, I think, is that many ordinary people feel that if they're long-time customers of a bank or an insurance company, they're going to be offered the best products at the best prices because they're loyal customers, when in fact the longtime customers are often offered inferior products at high prices. And there's a lot of evidence of that.

Michael Klein
Your book offers practical advice as well. You and Tarun write about the challenges that people face due to income volatility. What are the sources of this volatility, and what can people do to shield themselves from its effects?

John Campbell
So there's been a lot of research in recent years that's looked at the very high-frequency variation in people's income, so not year to year, but really month to month. And one of the things that economists have learned is that many people have large swings, surprisingly large swings, in income from one month to the next. Now, you know, as college professors, you and I are used to having a regular paycheck every month, but that's just not life for many people in this country. They may work part-time, with hours that are adjusted to demand, or they may run small businesses that have seasonal demand, or they may have health problems that come along. So given all of that, it's important for people to have an emergency fund, and the conventional advice, which I support, is that that should cover at least three months of typical expenses. Yet surveys show that about 40% of the US population doesn't have enough liquid financial resources to meet this need. The result is that all too many people in this country are driven to use extremely expensive sources of short-term credit, such as payday loans.

Michael Klein
Another big financial issue for people is paying for large investments like a house or a college education. To many, this seems very daunting. What advice do you and Tarun offer for this challenge?

John Campbell
Well, where college education is concerned, we actually think the US system of educational debt is broadly effective, but it has some unfortunate traps that you have to watch out for. One, for example, is that loans to parents under the so-called Parent PLUS program are granted on the basis of credit scores without regard to income. So some parents, not perhaps understanding the risks, take on far too much debt and get into severe financial difficulty. Another problem is that the standard repayment plans require fixed payments; so if you graduate and you have an extended period of low income, it can be very hard to keep up. There are better plans where payments vary with income, but the loan servicers—the companies hired by the government to interact with borrowers—often do a poor job of explaining these plans, so people don't exploit them as much as they should.

Michael Klein
What about mortgages?

John Campbell
Well there, we think the key thing is to shop aggressively. There's evidence that many people just take the first mortgage they're offered, but shopping around could save a typical borrower about $300 a year. And once you have a mortgage, you have to keep an eye on it, particularly if it has a fixed interest rate, since you can save money by refinancing when interest rates fall. Unfortunately, as so often in personal finance, the people with higher income and a better education are much better at doing this than lower-income, less-educated people. So the mortgage system, like many other aspects of personal finance, worsens inequality in this country.

Michael Klein
A little off topic, but the mortgage interest credit on your income taxes, I guess, also contributes to that inequality too, right?

John Campbell
Yes, yes, that's true, yep.

Michael Klein
So along these lines, given how expensive it is to go to college or to buy a house, do these investments make financial sense?

John Campbell
I guess I would preface my answer by saying that both college and home ownership are big personal decisions, with important non-financial aspects. So, you know, college can broaden your horizons in so many ways that don't show up in your income, and home ownership can give you security of tenure, for example, which is particularly valuable if, say, you have children in a neighborhood school, and so you don't want to move. But of course, the financial aspects are also important to consider. I would say the evidence is that both higher education and home ownership are profitable for most people, but you want to be price-sensitive, and you don't want to buy more than you need. Those are the two key principles. So, showing how that works out in practice, the return to education is typically highest for a public university in the state where you live, just because the cost is less, or a private university that offers you generous financial aid. For some people, starting at a two-year community college and then transferring to a four-year school also makes financial sense. So that's all about looking at the price, and getting exactly the higher education you need. The equivalent principle in housing is that you don't want to live in a house that's bigger than you need. Why not? Because if you do that, you're wasting the rent on the house, and no asset is likely to deliver a high return if you effectively throw away the income on it.

Michael Klein
John, when people find out that I'm an economist, I often get asked questions like, ‘Should I be buying Microsoft stock?’ And I'm sure, as a well-known finance economist, you get asked these questions all the time. How do you answer questions about investment choices?

John Campbell
So I am fairly conventional on this—conventional for an academic finance economist. I emphasize the benefits of diversification to limit risk. Well, actually, before that, I say first of all, you should participate in risky asset markets, because there are rewards to taking risk. And even if you're a cautious person, you should at least put your toe in the water, and take some risk. So everybody should really think about taking some risk, once you've built up that emergency fund—that three months' emergency fund, and you have that, anything else that you accumulate, you should really be taking some risk. But then you should diversify broadly, because that's a way to control the risk while still getting the high return to risky assets. And you should watch the fees. The base case that economists always recommend, and I'm no exception, is passive investing with index funds at very low fees. There are actually, I'm sorry to say, expensive index funds that charge too much—this is another example of people being ripped off—but low-fee index funds are the natural starting point. There is some evidence that directly sold active mutual funds can be just as good after fees, but they're no better. So, you know, there are some active fund managers who have some skill. They often work for big mutual fund companies that sell directly to the public, like Fidelity, for example. But the scarce resource is the skill of the fund manager, not the money of the retail investor. So it shouldn't be surprising to an economist to discover that the fund managers get the reward for their skill in the form of fees, and they don't leave anything over for retail investors. So, diversification; watch the fees; don't pay much attention to recent past performance, and participate in risky markets—these are the things I say. And if somebody says, 'Should I be buying Microsoft stock?' I tend to say you shouldn't be buying any single stock. You should buy diversified vehicles, mutual funds, or exchange-traded funds.

Michael Klein
Well, speaking of riskiness and recent returns, certain investment opportunities get a lot of attention, like cryptocurrencies or, more recently with the run-up in its price, gold. What do you think of these types of investments?

John Campbell
So, you know, gold and crypto I would regard as highly speculative investments. Economists struggle to understand what the foundation of value is. But the key point is they're not generating income. So if you buy an income-generating asset and the price falls, you can still hold on to it and get an income. So the return you get is not entirely dependent on being able to sell it at a favorable price. The problem with speculative investments like gold and crypto is that they don't generate any income, so you're buying them purely because you think they're going to go up in price. Now, you know, many people hear stories of fortunes that others have made speculating and think that they will do just as well. The problem is that speculators love to boast about their profits, and they don't talk about their losses. And so there's a systematic bias in what you hear. You're going to hear stories of investment success, but it's much less likely to happen than those stories would make out. So we warn our readers, and I would warn people I talk to and people I teach, to avoid these speculative investments and concentrate on investments that generate income.

Michael Klein
So, John, we've talked about what the financial system should do, and how people should act, but there's also a role for government rules and regulations so the system is not fixed. You have a chapter titled “Shove!”—and it has an exclamation point at the end of that word. This is meant to contrast with the idea popularized by Richard Thaler and Cass Sunstein in their influential 2008 book, which is titled *Nudge*. What's the difference between shove and nudge, and what should be shoved and not nudged, and why be more heavy-handed?

John Campbell
Okay, so first of all, you know, the idea of nudge, which is very appealing, and I can see why it became so popular and remains so popular—is that you can help people out in a very light-touch way by either making a suggestion, giving them some information along with a suggestion for what to do, or slightly more actively, but just barely, you give them a default. You tell people, ‘look, if you don't make any decision, this is what we'll put you into,’ like, for example, in many retirement accounts, you'll be auto-enrolled in a 401(k) plan with a given contribution rate and a given investment policy. And then they say, ‘if you don't like that, no problem. You can change it easily.’ So it's a very light-touch intervention, a very gentle nudge. And the idea is that for people who don't know what they want to do and aren't paying attention, they'll follow the nudge. They'll do something good because the nudge is well designed, but anybody who doesn't like it will opt out. And so it limits the complaints against the policy, because nobody's very seriously affected or inconvenienced. Now, these types of policies do have large effects at the beginning, when people start out. So, for example, auto-enrollment—yes, more people sign up for a retirement plan and contribute to it when they're automatically enrolled. The problem is that, as people have studied this over a longer period of time, they've come to realize that over time the effects fade away. For example, the people who didn't sign up—who weren't auto-enrolled and didn't sign up—later sign-up and catch-up. Maybe they save more aggressively later to catch up. And some of the people who were auto-enrolled change their jobs, and when they do, they take the money out, and so on. So the effects on the ultimate goal, which is adequate retirement saving, are much weaker than was initially appreciated. And so I think we're now in a period of rethinking, and the initial enthusiasm for nudge has faded somewhat. There's certainly still a role for these policies, but we argue that governments need to go further and actually change prices, change product availability, encourage some products by subsidizing them, or by requiring financial institutions to offer certain products. And, you know, this is a stronger intervention, but we think, given all the problems we've identified in the financial system, that's actually necessary.

Michael Klein
Is there also a difference that if you're nudging somebody, it's away from something that is just okay, toward something that's better, but you're shoving in a case where the system is fixed?

John Campbell
Yes. Nudges can easily be undone if financial institutions actually have an incentive to undo them. So one example is overdraft protection, which I mentioned earlier as an example of a sort of a trap with checking accounts. And the default there, by law, is that you don't have overdraft protection. The problem is that banks—you know, when you open a bank account, you're talking to this nice person behind the counter, and they say, ‘Oh, I'm sure you're going to want this

overdraft protection. Just check this box,' and people do. So, you know, that's called a counter-nudge, and that's another reason why, in a fixed financial system where there's a lot of conflicts of interest, nudges are unlikely to be sufficient.

Michael Klein
John, you close the book by advocating for a starter kit for people's finances. What would be the attributes of such a starter kit, and what would be its basic instruments? And maybe you don't want to go into too much detail, so people will buy the book.

John Campbell
[Inaudible] just the whole book.

Michael Klein
Right—but just broadly, you know, what would somebody have in a starter kit?

John Campbell
Sure. So first of all, you know, the starter kit is a metaphor. We're referring to the basic sports equipment that you need before you go out on a field and play. You're going to need cleats and pads and a bat or a helmet—whatever the sport is—you're going to need the equipment, right? You don't just sort of go out there with nothing. But we're thinking about the very basic things that people need to look after their financial interests. Now, the attributes that we're looking for, we list four of them, and if I list them, it's going to sound a little bit like four out of Disney's seven dwarves—but "simple, cheap, safe, and easy" are the principles. So, we want these products to be simple so people can understand them without having advanced education. We want them to be cheap—affordable, low fees. We want them to be safe—so, you know, not things that are going to blow up and cause large losses in certain scenarios. And we want them to be easy—meaning easy to manage once you've bought them, so there aren't extremely challenging and tricky decisions to make regarding exactly when should you refinance your mortgage, that kind of thing. So those are the principles. And then what we do in the book is, in each domain of personal finance, we work through that domain, and we describe in some detail what products we're talking about. So, we start with transactions accounts—you know, checking accounts and savings accounts. And then we talk about short-term credit; we talk about retirement accounts; we talk about mortgages, educational debt; different types of risky investments; retirement products; and so forth. Our idea is that in each of these cases, the financial regulator needs to specify a product design in terms of its standard features and the way in which prices are quoted. It's very important that this be predefined so that the institutions that offer the products—they can set their own prices—but they have to quote the prices in standard units so that people can compare them, just the way they can compare the bottles of ibuprofen on the pharmacy shelf. We're not banning other products, but we're suggesting that financial institutions should be required to offer these starter-kit products, and then people can shop for them, and the force of competition will keep them affordable.

Michael Klein
So to conclude John, it just doesn't seem like in the current political environment there's much support for this type of initiative, no matter how beneficial it would be. For example, the

Consumer Financial Protection Bureau has been shuttered. In the absence of government support, and given the current landscape, what would you advise people to do?

John Campbell
So let me preface my answer to that question with one remark, which is: because we are taking a global perspective on this, we hope that there are going to be places, even in 2025 and 2026, where some action might be taken along the lines we suggest—if not in the US, possibly not in the UK, then maybe in other countries. The wheel of political fortune will turn and is at different places in different countries. So we hope to have an impact even in the short term. And then you're right, in the US, it's going to be longer term, if it happens at all. So your question: what would you advise people to do? Well, it depends on what stage of your life you're in. If you're young, the important thing is to start saving, and to really start budgeting even before saving. I would say, thinking about your personal finances, making a plan, not just going along blindly, is the first step. But that's going to mean starting to save, and you should try to do that in a tax-favored way as early as possible in your life, probably using what's called a Roth retirement account—an IRA or a 401(k). I would say that younger people should save with a lot of risky financial assets, because as a young person, you have a lot of earning power, which is a relatively safe asset—an implicit asset that you have—and so you can afford to take more financial risk. As you get older, it's appropriate to invest more conservatively. And of course, this is what target-date funds—target-date mutual funds—actually do automatically. I guess another principle would be, keep it simple, and beware of bundled financial products. For example, whole life insurance is a bundled product; it's partly saving and it's partly insurance. It's very hard to understand, actually, and I tend to favor a set of ingredients, each of which is simple and transparent and easy to understand, where you can see the fees you're paying and hopefully compare them with competitors' offerings.

Michael Klein
So again, the book is by John Campbell and Tarun Ramadorai, *Fixed: Why Personal Finance is Broken and How to Make It Work for Everyone*. This is a really good book, John. I very much enjoyed reading it, and congratulations on its publication. I hope it gets the readership and the attention it so justly deserves. And thanks again, John, for being my guest on EconoFact Chats.

John Campbell
You're welcome. Thank you. Thank you for having me.

Michael Klein
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