

An Investigation of Time Preferences, Life Expectancy, and Annuity versus Lump-Sum Choices: Can Smoking Harm Long-Term Saving Decisions?

Abigail Hurwitz, Orly Sade

We used proprietary data from an Israeli insurance corporation and exploited the fact that Israeli pension insurance policies do not take health conditions or smoking status into account in annuity pricing to investigate the potential effect of being a smoker on long-term savings disbursement choices at retirement. We found that contrary to the theory suggesting that smokers have higher discount rates (and thus should prefer the lump-sum option), and even though the pension insurance policy-pricing mechanism means that (all else being equal) smokers would be offered the same annuity as nonsmokers, smokers did not prefer the lump-sum option. In a survey of life expectancy perceptions, we found support for the conjecture that smokers experience a certain degree of self-illusion regarding their own life expectancy and do not perceive themselves as having a shorter than average life-span.