

# SAVING FOR NOW, SAVING FOR LATER

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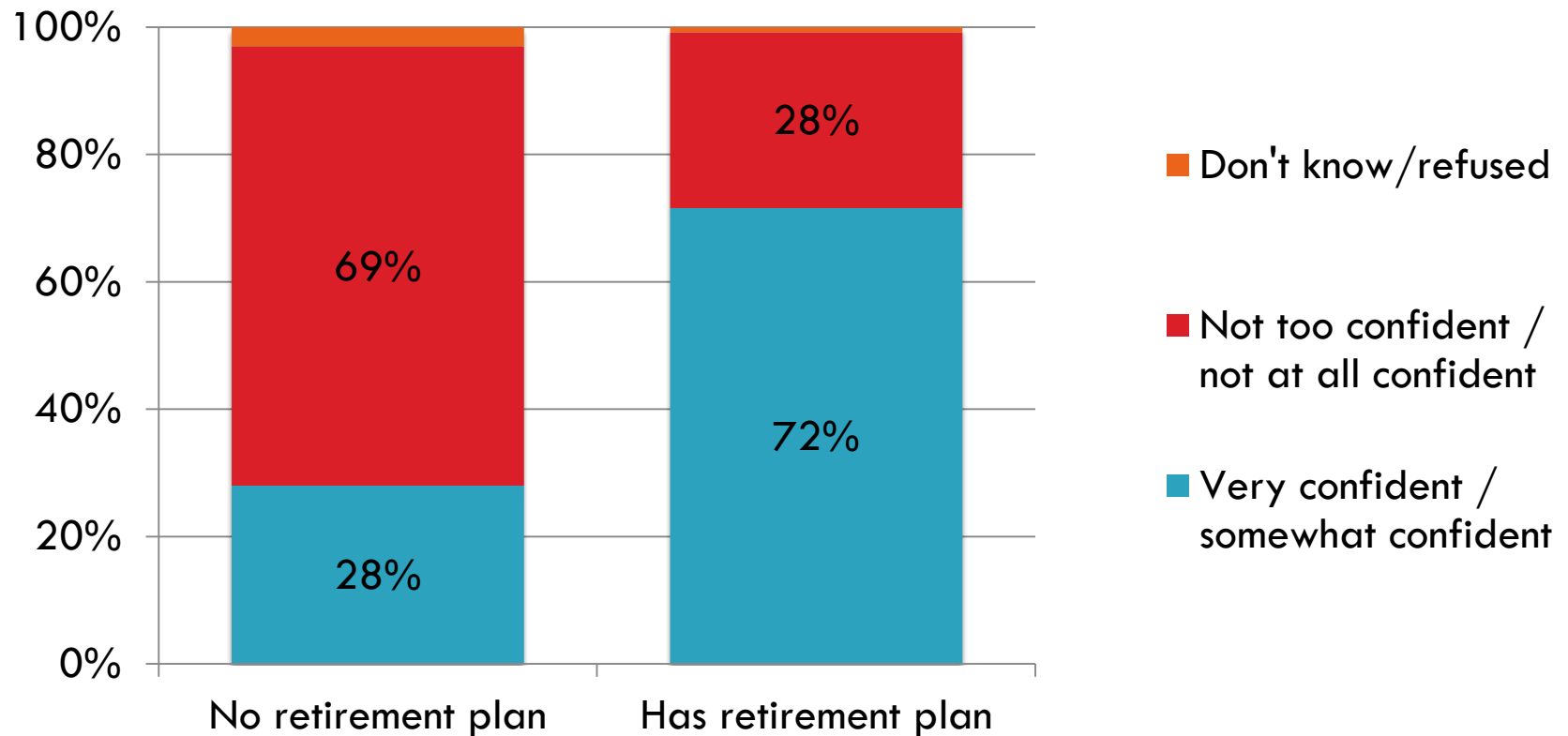
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# Lessons from Behavioral Economics Relevant to Savings

- People procrastinate when choices are complicated and they can put off taking action
- People make mistakes when choices are complicated
- People tend to compartmentalize when thinking about money (mental accounting)
- Institutional features matter...a lot
  - ▣ Defaults: opt-in vs. opt-out
  - ▣ Size and structure of the investment menu

# Who Feels Confident About Their Financial Prospects in Retirement?

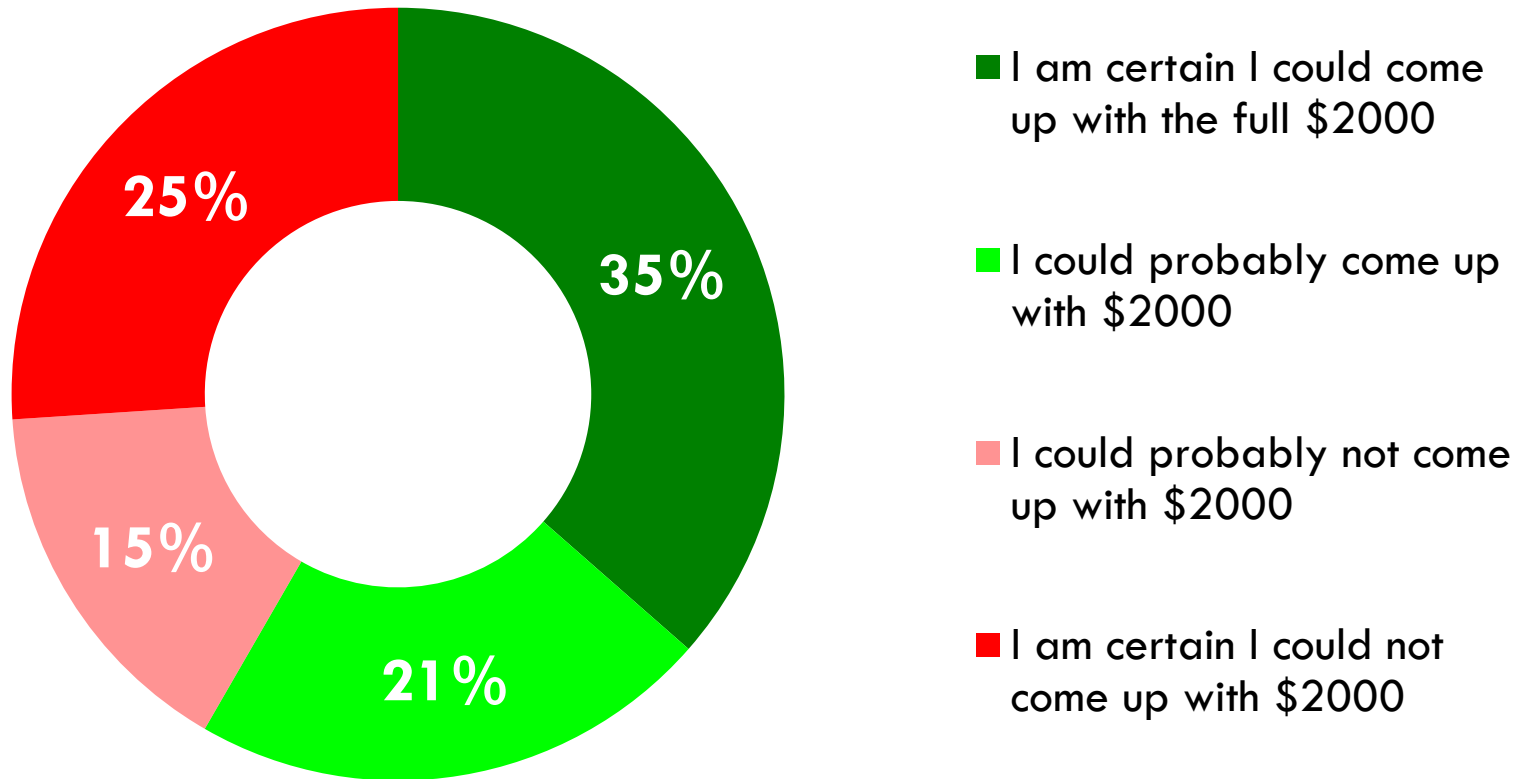
Overall, how confident are you that you (and your spouse) will have enough money to live comfortably throughout your retirement years?



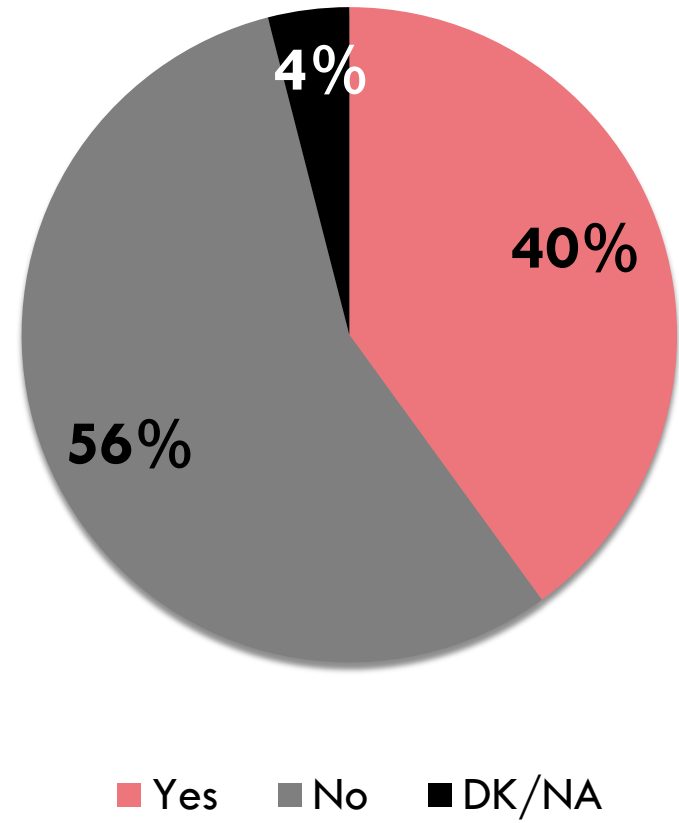
# Life Happens....



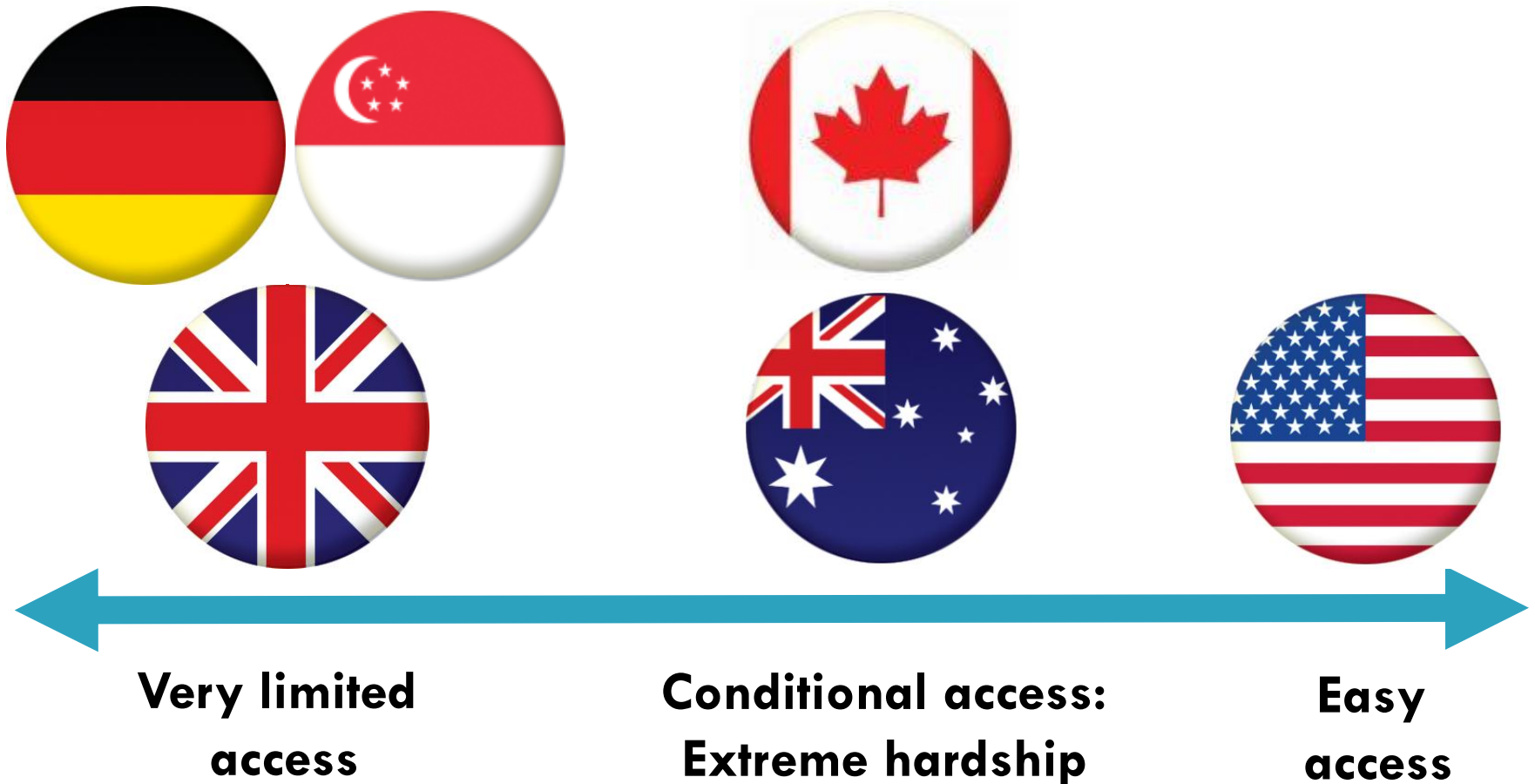
# How confident are you that you could come up with \$2000 if an unexpected need arose within the next month?



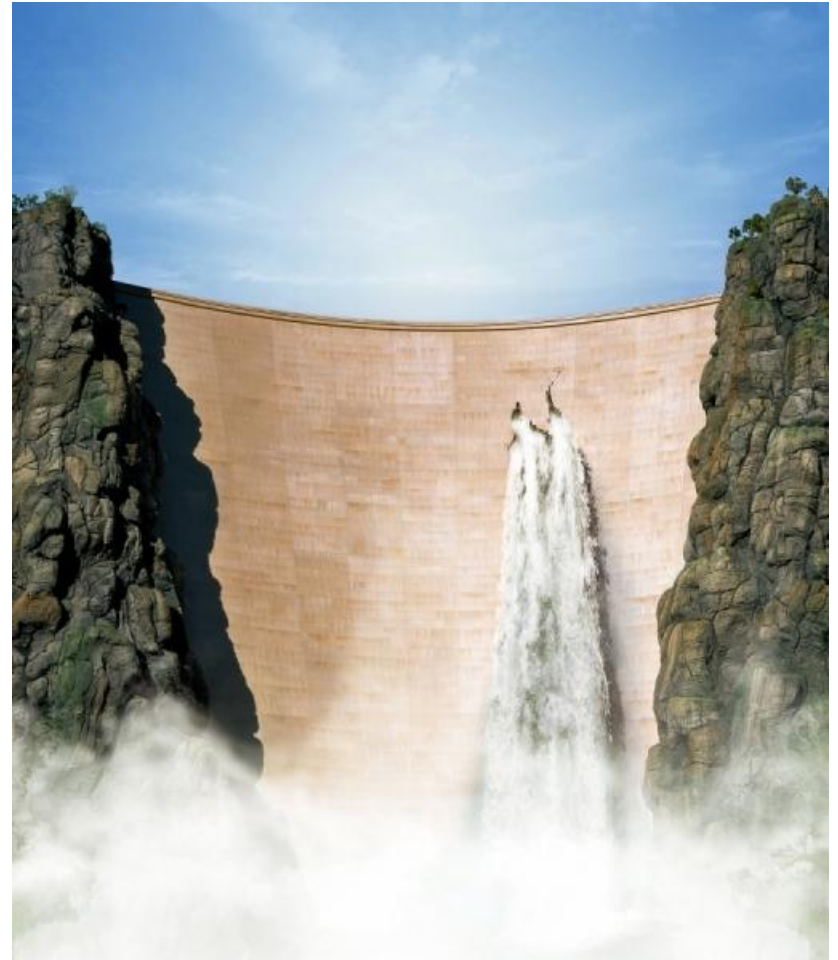
# Have you set aside emergency or rainy day funds that would cover your expenses for three months?



# How Accessible are “Retirement” Savings Before Retirement?



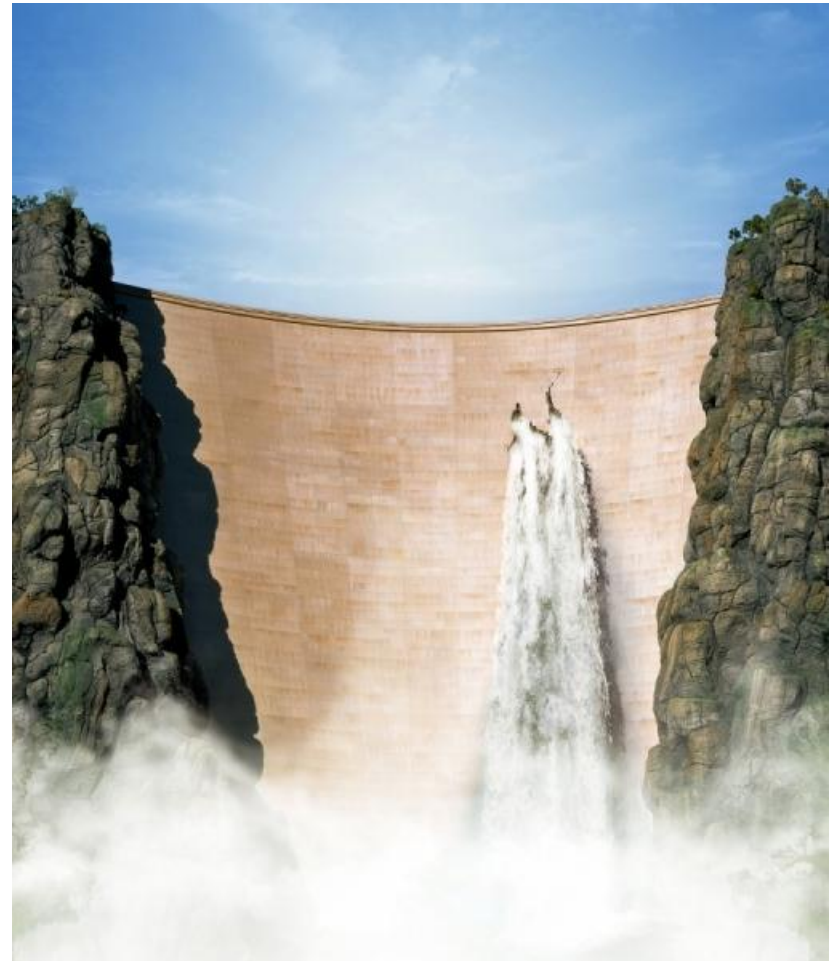
# Is This Even Relevant? How Much Leakage Is There?





# Is This Even Relevant? How Much Leakage Is There?

- For every \$2 that flows into the US retirement savings system...
- ...almost \$1 leaks out
- **WHY?**



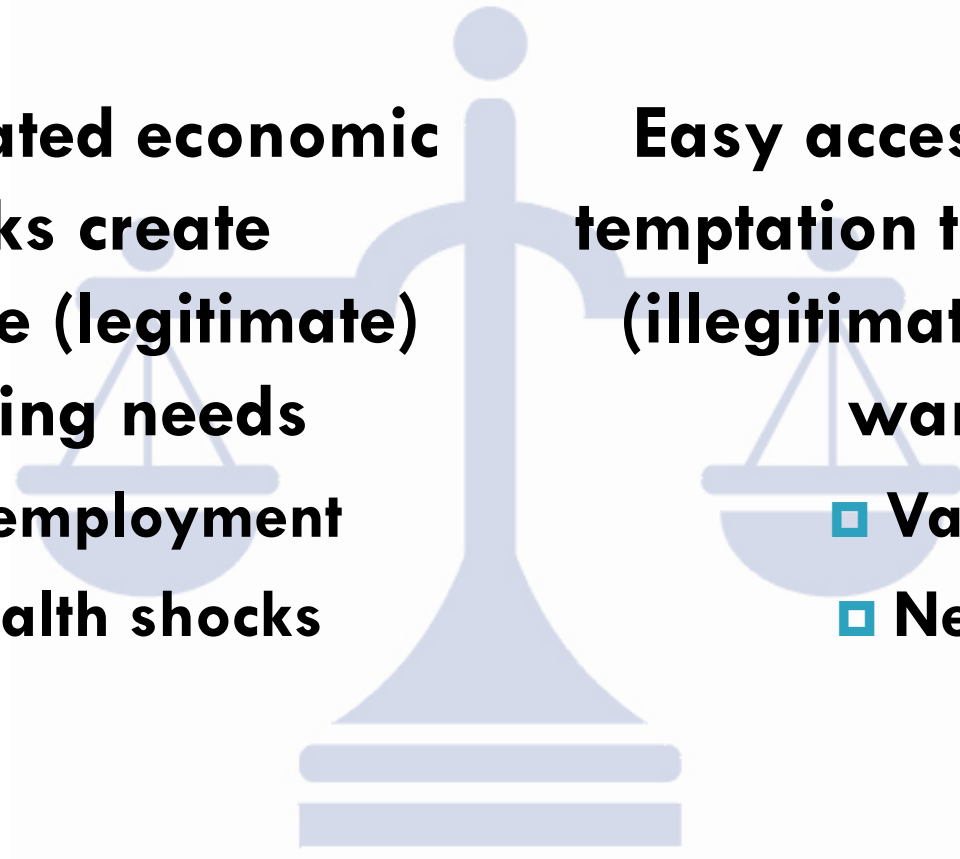
# Liquidity: The Tradeoffs

**Unanticipated economic shocks create immediate (legitimate) spending needs**

- ▣ Unemployment
- ▣ Health shocks

**Easy access creates temptation to spend on (illegitimate) current wants**

- ▣ Vacation
- ▣ New car



# How Much Liquidity Should We Have?



# How Much Liquidity Should We Have?

- Model of optimal liquidity in a retirement savings system
  - ▣ Economic shocks before retirement → need for liquidity
  - ▣ Present-biased consumers tempted to consume more more today in a liquid system
- Results: optimal system has
  - ▣ Sizeable illiquid account
  - ▣ Smaller liquid account with a modest penalty
  - ▣ Very small liquid account with no penalty

# Helping Employees Save

## Savings experiment

- India—low income country
- Cash wage low-skilled, low-income laborers

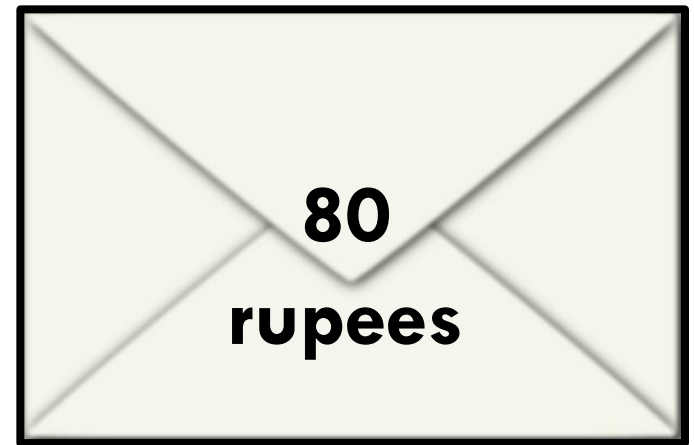
Can we help them save?



# What Will Help People Save More?



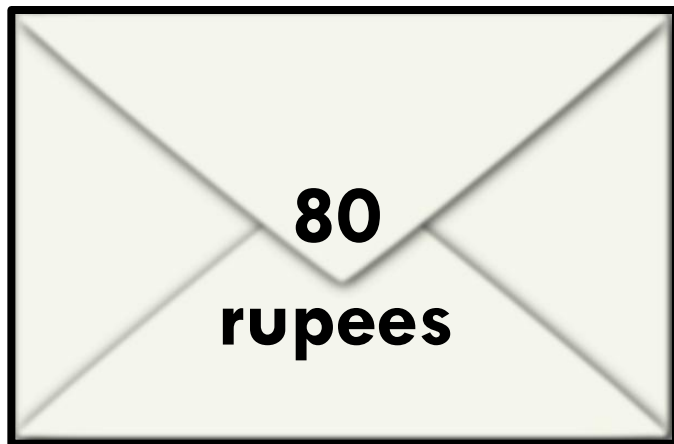
or



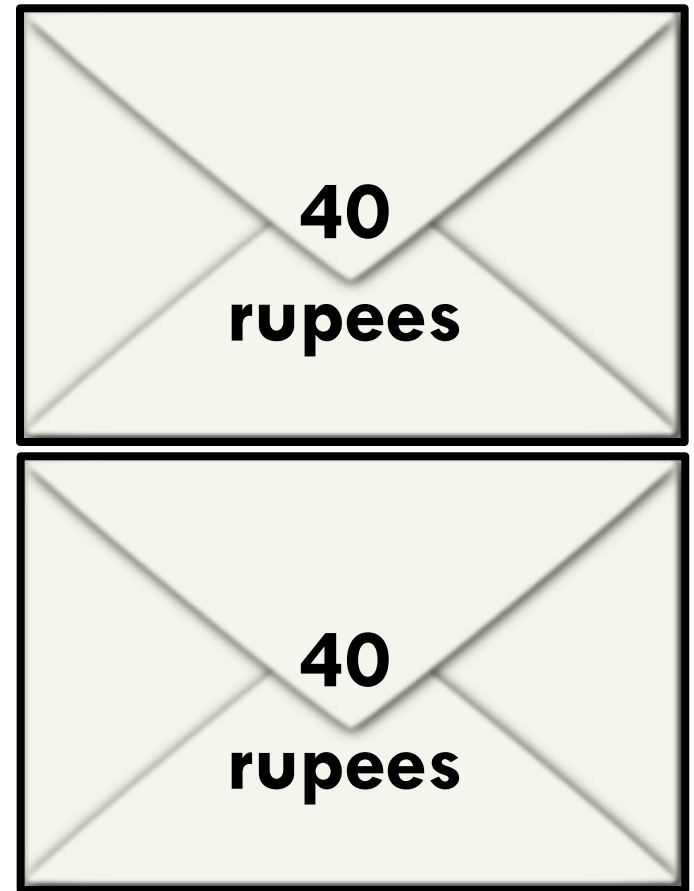
**A low savings target ...**

**...or a high savings target**

# What Will Help People Save More?



or



**A single “account”**

**...two separate “accounts”**

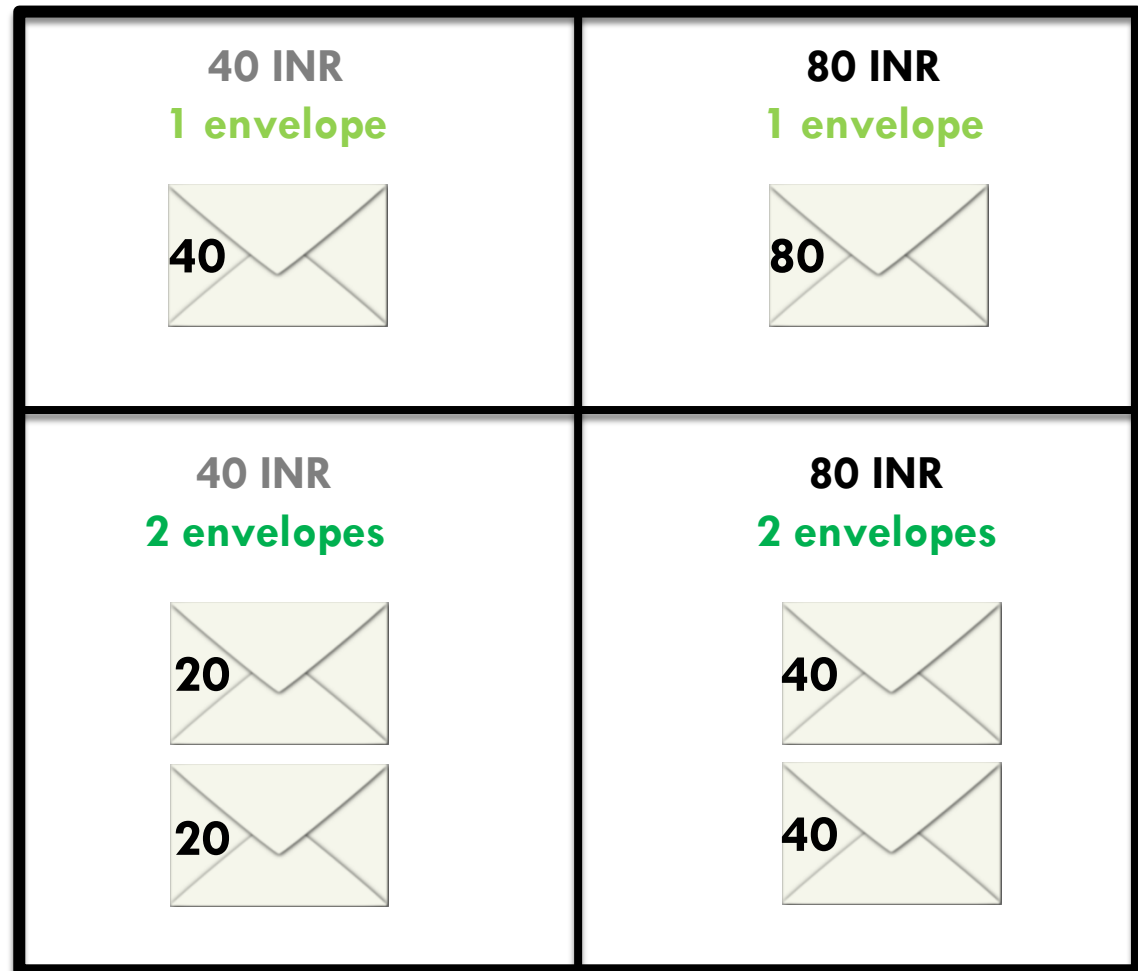
## 2 Amounts

40 INR (low) **vs.** 80 INR (high)

1 envelope

**vs.**

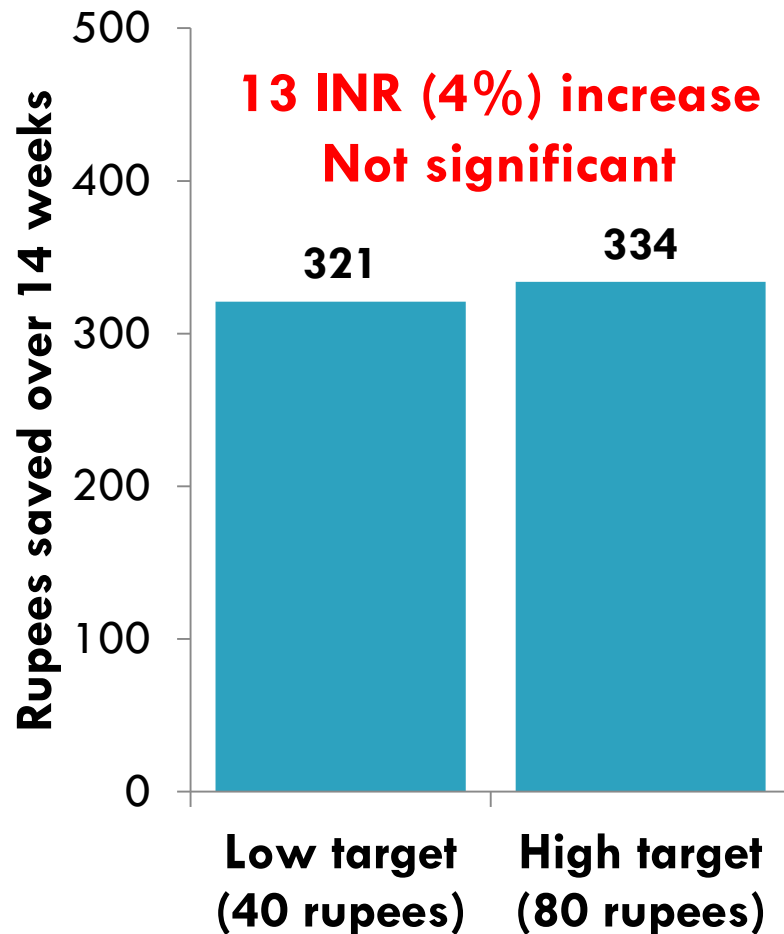
2 envelopes



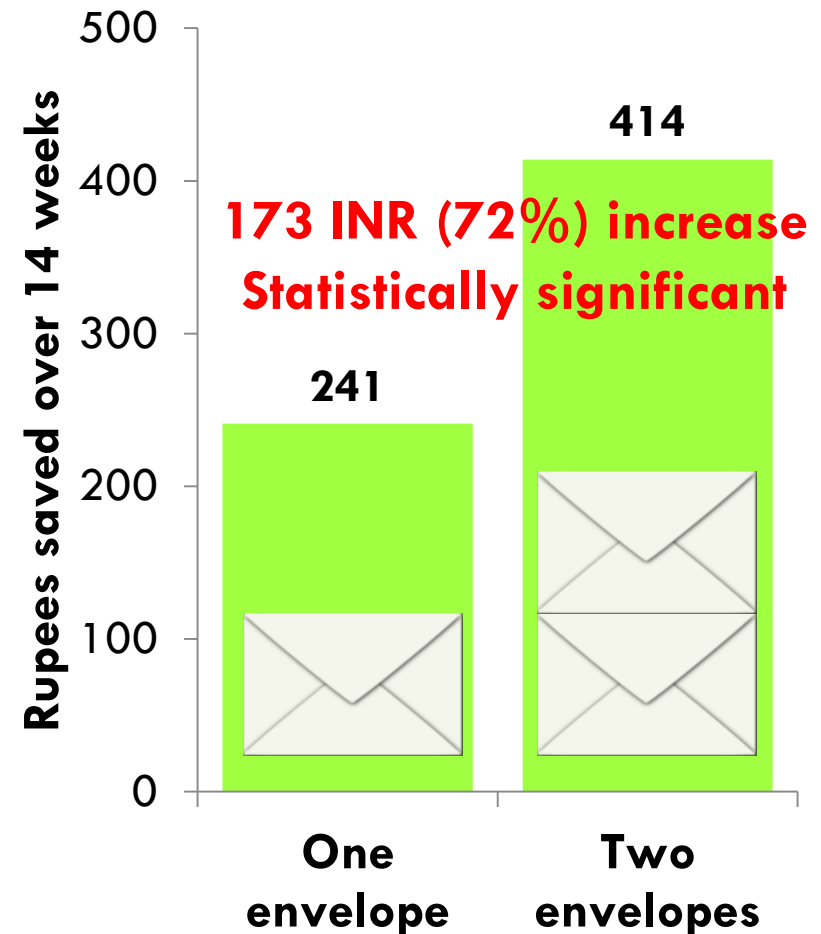


# Results of Savings Experiment in India

## Low vs. High Target



## One vs. Two Envelopes









# Likelihood of Opening Each Envelope

40 INR (low) vs. 80 INR (high)

1 envelope

vs.

2 envelopes

<p>40 INR 1 envelope</p>  <p>64%</p>	<p>80 INR 1 envelope</p>  <p>84%</p>
<p>40 INR 2 envelopes</p>  <p>65%</p>  <p>30%</p>	<p>80 INR 2 envelopes</p>  <p>85%</p>  <p>43%</p>

# Parallel Accounts



**Retirement  
Account**

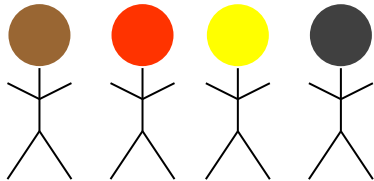
**Rainy Day  
Account**

# Proposal: Parallel Retirement and Rainy Day Savings Accounts

- **Automatic enrollment**
  - ▣ Would require some regulatory reform
- **Mental accounting: two separate accounts**
  - ▣ Create a psychological barrier to using the “retirement” account for purposes other than retirement
  - ▣ Limit the “budget” available for rainy day expenditures
- **Separate but integrated**
  - ▣ Contributions divided across the two accounts based on account balance in the rainy day account
  - ▣ Division between the two accounts adjusts automatically depending on the balance in the rainy day fund
  - ▣ All contributions allocated to the retirement account once a target balance in the rainy day fund is met (e.g., 3 months income)

# Measuring the Impact: Outcomes

## Worksite A



Retirement Plan Only  
(Business as Usual)

Control Group

## Employee Differences Across Worksites A and B in

Retirement savings contributions

Credit scores

Personal debt

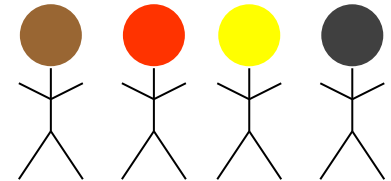
Use of non-traditional credit  
products

Financial stress

Productivity

Turnover

## Worksite B



Retirement Plan AND  
Rainy Day Account

Treatment Group

# Summary and Conclusions



- Many employees are under financial stress
- Employers are in a good position to help
- Many things employers can do
- Need to understand the problems of employee
- What solutions will best help?
- Design, test, and measure impact