Commentary: Robert Sugden

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Thomas Crossley, Carl Emmerson and Andrew Leicester have written an excellent review of the literature on how public policies can influence household saving. In this commentary I focus on just one of the themes of their review – the potential contribution of policies of 'nudging', informed by the findings of behavioural economics.

The evidence on household saving, as reviewed by Crossley *et al.*, has two glaringly obvious features. The first is that, for many low- and middle-income British households, savings for retirement are extremely low. Such low rates of saving are either highly imprudent or based on the expectation that, in the future, there will be substantial taxpayer-financed transfers to elderly and otherwise impoverished non-savers – an expectation that may be unrealistic, given the increasing average age of the population. The second feature is that individual and household decisions about retirement saving are often based on very little information or analysis, and are highly susceptible to the influence of what an economist or finance specialist would treat as irrelevant details of 'framing', such as which option is presented as the default. Because retirement saving shows these two features, some influential behavioural economists see it as a particularly suitable area for 'nudges' (e.g. Thaler and Sunstein, 2008, especially pp. 103–131). The idea is that many individuals are making bad choices, and that better choices could be induced by relatively minor changes in the ways that decision problems are presented.

Why are long-term saving decisions so often ill-considered? The answer (as psychologists and behavioural economists are well aware) is not just that personal financial decision-making is difficult. So is driving a car, but most adults are capable of learning the skills necessary to pass compulsory driving tests. One difference between the two cases is the nature of the feedback that learners receive. Many of the actions involved in driving generate instant feedback (think of the relationship between turning the steering wheel and the direction in which the car moves, or between changing gear and the noise and motion of the car). Well- and badly-executed manoeuvres are immediately apparent, facilitating learning from experience. Saving for retirement is at the opposite extreme. Until one actually retires (when it is too late to correct mistakes), feedback about the success of one's saving plans is not salient and is difficult to interpret. Many of the principles of good financial decision-making, such as the importance of diversifying one's assets and the danger of assuming that current trends will continue indefinitely, are confirmed by experience only over a long time scale. A further difference concerns the salience and timing of the rewards for successful learning. The learner driver will know friends and contemporaries who have recently been through a similar learning experience and who are now enjoying the pleasures of driving; she can expect her efforts to lead to similar rewards within a relatively short time. In contrast, a person who starts to save for retirement when he starts his first job will not experience the rewards of his actions until many years later. It is difficult for the young worker to make comparisons between his own case and that of the elderly people who are currently experiencing the consequences of their earlier saving decisions, because those decisions were taken long ago under different economic circumstances and different policy regimes. So there are good reasons to be sceptical about theories of long-term household saving behaviour that assume rational decision-making, and about the likely effectiveness of educational interventions that try to teach financial decision-making skills in the abstract.

So is nudging the solution? In thinking about this question, a useful starting point is to ask why, and on whose behalf, public policymakers might want to try to increase household saving. One possible answer is that the individuals at whom interventions are directed *want* to save more, but find it difficult to sustain a long-term commitment to saving in the face of temptations to consume. On this view, low savers are aware of their psychological limitations and want help in overcoming them; policymakers are responding to a demand (or at least a desire or wish) for intervention that comes from the low savers themselves. A second possible answer does not claim that low savers want to save more, but only that saving more would be in their best interests (as those are judged by policymakers): the aim is to steer individuals towards choices that they would have made for themselves had they been more rational or prudent than they actually are. On this view, policymakers are not responding to the demands of any particular political constituency: they are acting as individuals' guardians – or, as economists and philosophers would say, as paternalists. A third possible answer is that low savers impose costs *on other people*. If the state provides a safety net of income support and means-tested social care, low savers in their old age will be supported by transfers from others. Furthermore, if low savers make up a significant proportion of the population, when they reach old age they will be able to use their voting power to try to secure such transfers. Thus, low savers undermine the credibility of policy regimes in which private savings play an important part in financing retirement and social care. On this view, policymakers are trying to solve a collective action problem: the aim is to create sustainable institutions and to induce consistent and realisable expectations.

Advocates of nudging often use the first answer, presenting their proposals as responses to individuals' desires for help in maintaining commitments. Thaler and Sunstein (2008) appeal to the 'New Year's resolution test'. For example: '[H]ow many people vow to smoke more cigarettes, drink more martinis, or have more chocolate donuts in the morning next year?' (p. 73). The obvious answer to this rhetorical question ('Very few') is taken as evidence that individuals want to be helped to smoke less, drink less, and eat more healthily. In the case of saving, Thaler and Sunstein cite survey evidence that that two-thirds of employees describe their savings rate as 'too low' while only 1% describe it as 'too high', interpreting this as an indication that many people recognise that they have problems of self-control with respect to saving (p. 107). The evidence of the voluntary take-up of 'commitment accounts', reviewed by Crossley *et al.*, may seem to provide some support for this hypothesis. But one should be careful in extrapolating from Christmas clubs, and from economically more significant analogues in developing countries, to retirement saving. Christmas is an annual event whose pleasures are easily remembered; not having enough money to pay for customary presents and celebrations is a distressful experience that is likely to remain in a person's memory. This is just the kind of feedback that is absent in the case of saving for retirement.

Another way of seeing the difference is to compare the emotional intensity of retirement saving decisions with that of planning for Christmas, dieting or trying to give up smoking. Although retirement saving decisions have extremely important consequences, both for the savers' current disposable incomes and for their future standards of living, the evidence reviewed by Crossley *et al.* suggests that people find it hard to maintain interest and attention when dealing with them. People are content to accept arbitrary default options or to use crude rules of thumb; if there is more than a handful of alternative options, they experience 'choice overload'. Compare this with the attention that people give to planning their Christmas consumption, or to assimilating information about different ways of losing weight. The predominant emotion associated with retirement saving decisions seems to be boredom.

In the case of retirement saving, then, it seems more plausible to advocate nudging as a paternalistic policy than as a response to a demand for commitment devices. One might argue from the evidence of lack of attention given to saving decisions that many individuals want to shed responsibility for these decisions, and that such people are willing to consent to the paternalistic interventions that are made on their behalf. The evidence reviewed by Crossley *et al.* shows that retirement saving decisions are powerfully affected by the specification of default options. Since default options do not constrain people who want to take their own decisions, there seems to be a good case for using defaults as a way of signalling what, according to a consensus of expert judgement, is most likely to be in the best interests of a typical individual.

But if this kind of nudging policy is to be carried out in good faith, and if it is to retain public acceptability and credibility, it must be governed by sincere judgements about individuals' own interests, made by authorities that command general respect. Thus, I suggest, it is not a suitable response if retirement saving is interpreted as a collective action problem. If the perceived problem is that low savers impose costs on other people, it would be misleading to claim that nudges in the direction of greater saving were in the best interests of the people being nudged. It would be unfair if people who ignored those nudges were able to continue to impose costs on others. And, even setting aside these ethical concerns, it seems unlikely that nudges would remain an effective policy instrument if they were routinely used to achieve objectives that were not endorsed by the people who were being nudged. (There may be an analogue of Goodhart's Law here: observed behavioural regularities will tend to collapse if pressure is placed on them to induce decisions that are contrary to individuals' perceived interests.) Nudging should not be seen as a substitute for institutional structures that are compatible with individuals' acting in their own interests. Rather than assuming that individuals are perfectly rational, policymakers should take account of how real human beings make choices and judgements;

but they should be extremely cautious about using policies that are dependent on systematic *ir*rationality.

If a retirement saving regime is to remain in place over the long time scale that it requires, it must continue to generate political support. The most reliable basis for continuing political support is individuals' own interests. To be sustainable, a saving regime needs to work to the benefit of everyone (or at least, of all major interest groups), and it must be expected to continue to do so even if political, economic or demographic circumstances change. It needs to foster expectations that are credible and mutually consistent. If the regime is the product of agreement across political parties and across employer and labour organisations, individuals are more likely to believe that it works to their benefit (even if they find the details too boring to think about) and that the expectations on which it is based will be realised. And if the regime *does* remain in place over a long time scale, there are better prospects for inter-generational learning about the value of saving.

If there is a concern that low savers will impose costs on others, or will threaten the sustainability of an otherwise desirable regime, that problem needs to be tackled head-on, and not by nudging individuals to do what may not be in their long-term interests. A consensus needs to be negotiated about the level of income support that people will be guaranteed in old age, however imprudent their previous behaviour may have been. This level needs to be consistent both with prevailing ideas of humanity and social inclusion and with the realities of a democratic politics in which the imprudent have votes. To ensure that this guarantee is sustainable and does not undermine the motive to save, it is surely reasonable to impose a corresponding requirement that individuals engage in minimal saving. In this context, nudging seems out of place.

Reference

Thaler, R. and Sunstein, C (2008). *Nudge: Improving Decisions About Health, Wealth, and Happiness*. (New Haven, CT: Yale University Press).