

Executive summary

Introduction

This report examines in detail what is known – and what is not known – about the effectiveness of different sorts of interventions designed to raise saving by households.

Concern that many individuals are not saving enough, particularly for retirement, has been prominent in UK policy discussions for many years, as evidenced by repeated revisions to the retirement pension system.

Background

The standard economic model of household saving behaviour suggests that households save when income is high, needs are low, or expected returns are high. This perspective reminds us that low saving can sometimes be an optimal response to the economic environment (including public policies) and in such cases compulsion could cause great harm. The interventions suggested by the standard model focus on raising the return to saving. This can be by tax-favouring saving, by matching contributions or by ensuring that the means-testing of benefits does not lower the return to saving excessively.

An obvious extension to the standard model is to take seriously the proposition that saving and investment decisions are inherently complicated, and the information required in order to make good decisions is sometimes costly to obtain. This opens up the possibility that financial education or policies to reduce search costs might improve household decisions.

There has been much recent interest in ‘behavioural economics’. In the context of saving decisions, this would mean, for example, models

that relax the assumptions of stable and time-consistent preferences. Such models suggest a range of new policy options, including changing defaults in pension saving, helping people to invest in restricted-access savings vehicles and changing the way in which saving decisions are framed.

Regardless of the theoretical perspective that motivates any intervention or policy, we require empirical evidence on the efficacy of that intervention. Empirical assessment of any intervention designed to raise household saving faces a number of challenges and we identify two as particularly important:

- Outcomes must be measured in a comprehensive way so that genuinely new or incremental saving can be distinguished from the reshuffling of portfolios.
- Counterfactual saving (saving in the absence of the intervention) must be estimated in a credible way so that the causal effect of the policy can be identified.

As we survey the evidence on different interventions and policies, we pay particular attention to these two issues.

Financial incentives

One policy often employed in an attempt to boost household saving is to increase financial rewards to saving. The intention is that the carrot of increased future spending power for households who choose to save more will lead to greater household saving today.

The incentives for different people to save in different forms can be – and in the UK are – affected by tax and benefit policy. For many in the UK, funds placed in private pensions are relatively tax-favoured, with funds held in cash deposit accounts over long periods of time being relatively tax-unfavoured. But there is considerable variation across individuals. Those who expect their effective tax rate to fall when they retire face a stronger incentive to save in a private pension, whereas those who expect it to rise face much weaker incentives (or in some cases no incentive at all) to save in a private pension.

An obvious way to boost household saving might appear to be an increase in the generosity with which the tax and benefit system treats

saving in some or all forms. But economic theory suggests that the impact of such a reform on household saving is actually ambiguous. A substitution effect – lowering the cost of consumption in the future relative to consumption now – will tend to boost saving, but an income effect – boosting the lifetime income of savers – will operate against this by tending to boost spending in all periods.

Some empirical studies have attempted to assess the impact of reforms which have made more tax-favourable forms of saving available. However, the difficulty in estimating the counterfactual savings that would have been made in the absence of these reforms goes some way to explaining why different studies reach very different conclusions on the amount of new saving generated.

What is very clear from the empirical evidence is that financial incentives can have a very large impact on the form in which savings are held. What is less clear is the extent to which such incentives provide a significant boost to overall saving. One group for whom financial incentives to save are likely to be particularly weak are those lower-income households who expect to be in receipt of means-tested support in retirement. There is a lack of empirical evidence on the extent to which the disincentives to save for retirement created by such means testing do in fact lead to lower levels of private saving. This is an area where further research could be fruitful.

Information, education and training

Providing financial education and information is advocated as a way to raise savings. People with higher levels of ‘financial literacy’ appear to save more. But this need not imply causation – providing financial education in itself will not necessarily raise saving rates.

Financial education is often included as part of a wider package of interventions: for example, alongside measures to raise the returns to saving. Without independent variation in the different parts of the intervention, it is not possible to disentangle the effects of education from other parts of the package.

Financial education can target young people. There is some relatively good evidence that this translates into adult saving behaviour. Several studies suggest that parental attitudes to saving also influence children’s

later adult saving behaviours, which implies there may be inter-generational spillovers from policies which promote saving.

Assessing the impact of financial training in workplaces is complicated because it is rarely offered by employers or taken up by employees at random, meaning it is difficult to construct sensible counterfactuals. There is also a lack of good data combining employer and employee information on what training is offered, and saving outcomes.

Most of the evidence on workplace training comes from analysis of specific interventions which may be hard to generalise more widely. The findings tend to be mixed. A common result is that what people say they will do following the training is not always followed through. There is also evidence of small spillover effects for employees who are not directly affected by particular interventions.

The most convincing current evidence suggests that simply providing information alone, as opposed to formal education or training, is relatively unsuccessful in changing saving behaviour. More analysis here would be useful, particularly on whether the presentation of the information matters.

In general, there is not much very persuasive evidence on the impact of education for saving outcomes, particularly evidence focused on the UK context. New policies in this area should be robustly evaluated and designed in such a way as to allow this evaluation to be carried out: this would add enormously to the evidence base.

Choice architecture

A number of policies to boost savings are suggested by insights from behavioural economics. Most well-known among these is to change default rules for pension saving. The UK is set to require employers to default most employees into a private pension, with the reform being phased in from October 2012. This requires individuals to opt out if they do not want to participate rather than opting in if they do.

There is a large body of convincing evidence that defaults matter. They appear to raise participation rates markedly even when the costs of opting out are low. But other effects may be less desirable. People tend to contribute the default rate, which is often set low, and to the default fund, which is often conservative. The idea of ‘active decisions’ – making

people choose whether to save in a pension fund or not – as an alternative to switching default rules perhaps deserves wider attention and research.

People may want to save but find it hard to resist spending their accumulated balances. Or they may say they want to save in the future but not follow through on this plan when the future comes, if they suffer from ‘time inconsistency’. These issues suggest savings accounts which commit people to saving may be helpful.

In developed economies with sophisticated financial markets, it is not clear that policymakers should *provide* savings vehicles with a commitment aspect directly – there are a large number of such accounts already available. But policymakers could help make consumers (particularly those most prone to commitment problems) more aware of them.

Retirement savings plans which get workers to commit now to saving more for retirement as they get older could also be effective. Building this approach into default options may be a sensible approach.

There is evidence from laboratory studies that the way investment decisions are ‘framed’ (i.e. presented) affects the amount saved and the portfolio of investments. However, the extent to which these findings carry over into real-world settings is unclear. If framing matters, policymakers need to be conscious of unintentional frames in any intervention.

As with education policies, it is striking that much of the evidence on policies inspired by behavioural economics comes from US-based studies with few UK-specific findings.

Social marketing

The idea of ‘social marketing’ – using insights from the advertising of commercial goods to promote socially desirable behaviours – has gained currency in policy making in the UK recently, but has not been applied directly to savings.

Social marketing involves identifying a target population for policies, understanding from surveys and interviews what the barriers to behaviour change are for that group and then designing and testing tailored interventions.

There is some evidence from the US that this approach can have significant effects on retirement savings amongst new employees.

Using these kinds of tailored interventions with later defaulting for people who do not respond after some time might be an attractive option. However it is clear that more needs to be done to understand the impact of social marketing methods on savings more widely. Policymakers could fund, pilot and evaluate trials to assess the features of social marketing methods which appear to be most effective and what can (and cannot) be generalised.

Final thoughts

Given the long-standing policy interest in this area, our view is that the current state of the overall evidence base is disappointing (although there are of course individual studies of very high quality).

Three key limitations of the current evidence base are as follows:

- In many areas, while it is clear that an intervention has affected how wealth is held, it is much less clear whether it led to genuinely new saving, or just changed the form in which saving that would have happened anyway is held.
- For many interventions, policymakers obviously hope to achieve long-term impacts, such as to engender a saving 'habit'. However, the great majority of studies have focused on short-term outcomes. There is a real paucity of evidence on the ability of policy to deliver persistent behavioural changes.
- Many of the interventions that have been studied are actually packages of interventions, such as matched contributions coupled with financial education and information provision. Bundling interventions in this way makes sense from a policy point of view, but without independent variation in the components, it is difficult to know which parts of the bundled interventions were effective, or indeed, if the bundled interventions only work (or work better) when delivered as a package.

Addressing these limitations should be the agenda for future research in this area.