

Saving for Retirement: Why People Wait

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An estimated 20% of Dutch people are expected to end up with insufficient retirement savings¹. Underlying this problem are several reasons, some of which are the responsibility of the individual. People do not save at all, people save too little, or people invest unwisely². But saving for retirement is not just about making the right choices, it is also about making choices at the right time.

Timing is so important in the context of retirement saving because there, waiting can cost money. The exponential growth of savings over time is so powerful that starting early is key to building sufficient retirement wealth³. Still, people wait too long, even when there are financial costs⁶. They wait before they enroll in a retirement plan, they wait before they increase their savings rate, or they wait before they adjust their investment strategy. If we want to motivate people to start saving earlier, it is crucial to know why they wait.

In this Netspar Survey Paper we answer this question. Instead of focusing on the financial advantages and disadvantages of saving for retirement, we investigate the psychological reasons for waiting. We distinguish four categories of reasons: (1) people do not consider the cost of waiting, (2) people underestimate the cost waiting, (3) waiting has psychological benefits, and (4) people have reasons external to the cost and benefits of waiting. We give an overview of these categories and we provide preliminary implications.

1. People do not Consider the Cost of Waiting

A first reason for why people wait to save is that they fail to consider the financial cost of waiting. In a dynamic decision situation like retirement saving, timing affects the outcomes. We know that people often do not spontaneously consider all factors that are relevant to a decision, and in this case people may not take into account the cost of waiting. This type of ignorance is comparable to people's tendency to neglect opportunity cost when making decisions. People know that money spend on a car cannot be spend on something else. Yet, they do not always take these opportunity costs into account^{7, 8}. Similarly, it is possible that people wait to save for retirement because they do not think about the cost of waiting. Simply reminding people that in retirement saving, waiting costs money, may thus already affect their choices.

2. People Underestimate the Cost of Waiting

Even people who realize that waiting has its cost, may still underestimate what this cost is. People have been shown to have problems calculating or estimating the effect of compound interest, regardless of whether they used a calculator⁹. As a consequence, most people also underestimate the cost of waiting, making it more likely for them to wait. In other words, people wait to save for retirement because they think that waiting is cheap. If this is the case, then explaining or teaching people the power of compound interest may help speed up retirement saving.

3. Waiting Has Psychological Benefits

People may also wait because waiting has psychological benefits. One of such benefits is regret avoidance. Saving for retirement involves making decisions: choosing between plans, choosing how much to contribute, and choosing how to invest the money. These decisions potentially elicit regret, and regret is particularly strong when it is hard to justify the decision¹⁰. In the context of retirement saving, actions are often harder to justify than inactions. Therefore, when people are uncertain about what the best option is, they may prefer to wait because this minimizes potential regret.

Inaction as a form of regret avoidance is worse when people have missed a better opportunity in the past. This is inaction inertia, the tendency to forego an attractive opportunity because an even more attractive opportunity was missed before, and it also plays a role in retirement saving. Imagine a woman of 45 who realizes that she is not saving for retirement. She learns that the perfect moment to start saving was at age 25, when returns on her investment would have been much higher than now, twenty years later. Research on inaction inertia suggests that in these situations people would become less likely to start saving, because they want to avoid the regret from missing the initial opportunity¹¹. Only when present saving opportunities are explicitly 'decoupled' from the past, for instance by indicating how present saving opportunities are inherently different from past saving opportunities, may people again realize that it is always better to start saving for retirement today than tomorrow¹².

Another psychological benefit of waiting is that it helps people gain confidence. Research demonstrated that, even when all information was already available, participants who lacked confidence still preferred waiting over choosing immediately¹³. Moreover, participants who waited, had gained confidence afterwards. So, even if it does not lead to more information, waiting can make people more confident about their decision. This is also illustrated by people's need to 'sleep on it' before making important decisions. When it concerns retirement decisions, people often lack confidence, and waiting may thus be a way to gain confidence. As a solution, financial education could emphasize how much people already know about retirement saving, instead of emphasizing how much there is to know. This would make people feel more confident, and take away some of the psychological benefits of waiting.

Sometimes people wait to do something, simply because the future seems a more appropriate time. People discount both benefits and costs over time. Benefits seem less attractive in the future than in the present, and costs seem less painful in the future than in the present. This present bias causes people to delay tasks that bear immediate costs but little immediate benefits, such as studying for an exam, doing the dishes, or saving for retirement¹⁴. These tasks involve an investment, in the form of effort, time, or money, and this investment is perceived to be less painful in the future. A related reason for people to delay saving for retirement is because they believe that they will have more money or more time available in the future^{15, 16}. This is one of the reasons for why giving people the option to commit themselves to future savings has shown to be effective¹⁷.

4. Reasons External to the Costs and Benefits of Waiting

As we have discussed so far, people wait to save for retirement because they do not consider the cost of waiting, because they underestimate the financial cost of waiting, or because waiting has psychological benefits. However, it is also possible that people wait without even

considering the trade-off between the costs and benefits of waiting. The literature on heuristics shows that people often make decisions based on a single cue instead of on an elaborate analysis of costs and benefits^{18, 19}. Whereas research on heuristics mostly refers to decisions between two alternatives, it may also apply to decisions between acting immediately and waiting.

One cue that plays a role in choosing to wait is the importance of a task or decision. Research has shown that people defer important decisions more than unimportant decisions²⁰. Moreover, this deferral of important decisions was not affected by other supposedly relevant factors, such as the financial cost of waiting. Apparently, decision importance serves as a cue for people to invest time and effort in a decision, regardless of whether this will improve or harm the outcome of the decision. This importance heuristic may explain why many people wait to save for retirement; the decision is simply too important to make right away. Increasing, emphasizing, or explaining the importance of retirement savings, for instance through financial incentives or financial education, can thus backfire by causing people to wait more. It may be more effective to explain why saving for retirement is urgent, instead of explaining why it is important.

Implications

This Netspar Survey Paper provides an overview of reasons for people's pervasive tendency to delay retirement saving. Such an overview is theoretically relevant because it identifies explanations that would remain unidentified based on a purely rational account of decision-making. Furthermore, this can be of practical value because it has implications for how to decrease the tendency to wait. Based on the research that we discuss, how can we help people to start saving sooner? Some preliminary recommendations:

- ***Emphasize the cost of waiting.*** People wait less when they consider that waiting has a cost.
- ***Explain the power of compound interest.*** People make better financial decisions when they are able to correctly calculate or estimate the effect of compound interest.
- ***Emphasize the uniqueness of present opportunities, not the foregone ones.*** People are more likely to act on attractive opportunities when these are decoupled from missed opportunities.
- ***Emphasize how much people already know, instead of how much there is to know.*** People wait less when they feel confident.
- ***Provide options to self-commit.*** People make more future-oriented decisions when decisions come into effect in the future instead of immediately.
- ***Focus on 'why now?' instead of on 'why?'.*** People wait less when they know why something is urgent, not when they know why something is important.

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