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Behavioral Economist Richard Thaler on the Key to Retirement Savings

Getting people to build a nest egg is simple, Prof. Thaler says: Make it easier

ILLUSTRATION: JIM FRAZIER

By **ROBERT POWELL**
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If an economist can give us 10 reasons why it's crucial to save for our retirement, a behavioral economist can give us 100 reasons why we still don't.

Richard Thaler, a professor at the University of Chicago Booth School of Business, and author of "Misbehaving," a new book about the creation of behavioral economics, credits this once-maligned offshoot of economic science with helping millions of Americans save for retirement. But he is deeply concerned about the many others: those who, for whatever reason, choose not to squirrel away the money they'll need in old age.

Prof. Thaler just celebrated his 70th birthday in Chicago. The Wall Street Journal talked to him about a variety of topics, including the use of behavioral economics in retirement planning, how to raise the

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number of workers covered by employer-sponsored retirement plans, and the need for innovation in the spending-down phase of life. Edited excerpts follow.

A good plan

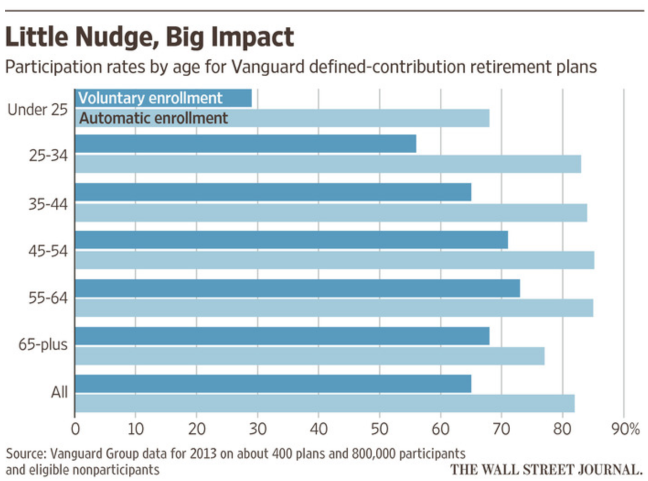
WSJ: *Of all the research you talk about in the book, what is the biggest takeaway for Wall Street Journal readers?*

PROF. THALER: Retirement savings is probably behavioral economists' greatest success story. It is a prototypical behavioral-economics problem because saving for retirement is cognitively hard—figuring out how much to save—and requires self-control. And these are two of the most important things that are left out of traditional economics. The assumption that everybody will figure out how much they have to save and then will just implement that plan is obviously preposterous.

What are the takeaways for readers? For top management, if the employees at your firm are not saving enough for retirement, realize that it is your fault. And that is because we know how to make saving for retirement much easier and more successful.

There are four ingredients to a good defined-contribution plan. The first is automatic enrollment. Second, we need automatic escalation, or "save more tomorrow," to help employees increase their savings rates over time. Third, we need good default investment vehicles. And, finally, we need to stop encouraging employees to load up on company stock. If HR departments and CFO offices would incorporate these features, most employees will have a much better chance at a comfortable retirement.

For employees, if those things are available, take advantage of them. If they are not, you have to invent your own. Get off your a— and get in the plan. And if they don't offer "save more tomorrow," then just ramp it up one or two percentage points a year until you are at least up to, say, 12%. And put it into some diversified portfolio such as a target-date fund with reasonable fees and then ignore it.



WSJ: *It's been reported that just half of employees in the U.S. have an employer-sponsored retirement plan. What can be done about that?*

PROF. THALER: The lesson from behavioral economics is that people only save if it's automatic. If people just put away what's left at the end of the month, that's a recipe for failure. And we can help. My mantra is if you want to help people accomplish some goal, make it easy. And yes, every American worker should be able to save for retirement via payroll deductions. There's just no excuse for not doing something like an automatic IRA or a myRA [a government-sponsored retirement plan for people whose employers don't offer one; it launched nationwide recently]. This should have bipartisan support.

If Congress cannot get its act together to pass some enabling legislation, then other states should follow the lead of Illinois and create their own plan. It's not a burden on employers. In fact, you're doing a favor for small employers because they can offer something valuable to employees and be a more attractive place to work.

WSJ: *Plan participants still make plenty of mistakes, like investing in high-fee funds. How can we nudge people away from 401(k) mistakes?*

PROF. THALER: Automatic enrollment, automatic escalation and good defaults; that's the three-legged stool that gives people the best shot. And helping people roll [their 401(k) into an IRA] when they change jobs. That's the biggest source of leakage. The bigger problem is on the "decumulation" side.

Spending down

WSJ: *How can behavioral economics solve that problem?*

PROF. THALER: We've made good progress on the accumulation phase of retirement saving, but the decumulation phase hasn't received nearly enough attention. This is unfortunate because the spending-down phase is even harder for individuals to solve, especially since so few people elect to annuitize their wealth. There is no widely accepted default option for decumulation—no equivalent to target-date funds. Part of the problem is that the Labor Department has not been able to find a good way to give firms a safe-harbor option for annuities. But given the dislike of annuities, that may be largely moot. This is a domain begging for innovation.


Prof. Thaler's mantra: 'Make it easy.' *PHOTO: CHRIS STRONG*

WSJ: *What's your view on Social Security claiming strategies?*

PROF. THALER: Most people start claiming benefits within a year of when they become eligible, although benefits increase substantially if they wait. Employers can help their workers decide whether it might be better to wait longer to start claiming benefits.

Here's a radical suggestion. Let's allow people to put some money into Social Security, in a lump sum (say, up to $100,000), to buy additional Social Security benefits. Benefits would be calculated the same way that benefits increase if you delay claiming, at the actuarially fair cost. This would be one way of giving people access to a very inexpensive annuity that's indexed.

WSJ: *If people are worried about running out of money in retirement, is this the solution?*

PROF. THALER: That could be one. Most economists, including me, agree that longevity insurance would make sense for a lot of people. Buy a policy that starts when you're 75 or 80. But for reasons that would make an interesting behavioral-economics study, those policies have not gotten much attention from consumers.

WSJ: *Isn't that odd in a way? Such products take the uncertainty out of retirement planning.*

PROF. THALER: People worry that if they buy an annuity like that and then die before the policy starts to pay off, their heirs will lose out. I tell them, "What you should be more worried about is if you outlive your money, you will have to move in with your kids. Ask your kids which of these outcomes they are more worried about."

WSJ: *People who are buying such products are adding the return-of-principal feature. People seem to want their cake and eat it, too.*

PROF. THALER: That's another interesting behavioral-economics problem, because no economist would recommend that option.

WSJ: *Peter Huang, a professor at the University of Colorado Law School in Boulder, suggests in a recent paper, Empowering People to Choose Wisely via Mindfulness and Thinking Tools, that law and policy can and should empower people to choose wisely for themselves by educating people. What say you?*

PROF. THALER: I'm all for empowerment and education, but the empirical evidence is that it doesn't work. That's why I say make it easy.

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