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Improving MyRA to help participants save enough

MyRA needs auto features to make it more effective

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In his State of the Union speech Jan. 28, President Barack Obama announced an initiative to help people save for retirement. While this program represents an important first step, there is a small change to the concept that would make it significantly more effective at no additional cost to the government. As currently conceived, the program helps people start saving now. What is missing is help to encourage them to save even more later.

To understand why action is needed, it's necessary to grasp the scale of the retirement crisis. The numbers are undeniable: 75 million Americans do not have a retirement savings plan — that's more than half of all workers.

James Poterba — Mitsui professor of economics, Massachusetts Institute of Technology — and colleagues found that 46% of retirees died with less than $10,000 and relied almost entirely on Social Security benefits for support.

To deal with this crisis, Mr. Obama outlined the creation of a new kind of retirement account called MyRA. While MyRAs offer tax incentives and security — the principal investment is backed by the U.S. government — their main appeal has to do with the ways in which they make saving easier. In particular, MyRAs allow workers to enroll in automatic savings plans, which deduct a fixed amount from a paycheck. Such a setup means workers don't have to deliberately choose when and how to save — all the details are arranged for them.

A few days after the president's speech, Sen. Tom Harkin, D-Iowa, offered his own plan, the USA Retirement Funds Act

of 2014, introduced Jan. 30. One of the main pillars of Mr. Harkin's plan is that all employees are automatically enrolled in a savings plan at a rate of 6% of pay. This is not a mandate, of course: Workers can always choose to raise, lower or stop their contributions.

As a behavioral economist who has spent decades studying the psychology of retirement savings, I applaud these attempts to make saving as easy as possible. Extensive research has confirmed the benefits of both automatic deductions and automatic enrollment. Perhaps the most relevant evidence comes from the United Kingdom, which launched the National Employment Savings Trust. The goal of NEST is to ensure that all British workers have easy access to a retirement savings plan. The initial evidence suggests NEST has been an important success, with 92% choosing to maintain suggested savings levels, i.e., they did not opt out of the savings plan. By any measure, NEST is a reminder that the best way to get workers to start saving is to make saving as easy as possible.

But I think it's not enough to simply enroll workers in retirement savings accounts. My concern is that the establishment of these auto-enrolled, low-yield accounts might have unintended consequences and generate a false sense of security among savers.

Let me explain. The underlying logic of automatic enrollment is that humans are prone to decision-making inertia: Once a default setting is established, the evidence suggests they rarely tinker with the details. This inertia can be a good thing, if it encourages people to open new savings accounts. However, the same mental tendency might also lead to serious shortfalls over time, as those automatically enrolled workers will stick with their initial savings rate, even when it's not nearly high enough. This inertia is only compounded by the fact that the default settings are often seen as implicit endorsements. For instance, employees might assume that 6% is the ideal savings rate, though it often takes double that rate to retire comfortably, especially for those who started saving late in their career.

But won't people realize they're not saving enough before it's too late? Not necessarily. For the last several years, Dan Goldstein, principal researcher, Microsoft Research, a wholly owned unit of Microsoft Corp., and honorary research fellow at the London Business School; Hal E. Hershfield, assistant professor of marketing, Stern School of Business, New York University; and I have been studying a behavioral tendency known as the illusion of wealth. In essence, the illusion of wealth has to do with the fact that a significant lump-sum amount of money — say, $100,000 in a savings account — seems like far more money than it actually is, at least when we're forced to live off it in retirement. The end result is that workers might conclude they are saving enough for retirement, when the reality is they are falling far short. If that's the case, then IRAs might come to stand for illusionary retirement accounts. They give us the illusion of security, but not the real thing.

What's the solution? We need to combine auto enrollment with auto escalation so that savings rates are gradually raised over time. (Workers, of course, can always opt out of the program.) In a 2004 study I co-authored with Richard H. Thaler — Charles R. Walgreen distinguished service professor of behavioral science and economics, University of Chicago Booth School of Business — we demonstrated that auto escalation was able to take the savings rate at a midsize manufacturing company to 13.6% from 3.5% in less than four years. In the years since, auto escalation has become a popular and effective savings tool, offered by more than half of all large corporations in the U.S., and it has helped doubling the saving rates of more than 4 million employees. It's time to make the same benefits available for the small employers and part-time workers most likely to rely on MyRAs. Under such a system, IRAs would become synonymous with automatically increasing retirement accounts.

Millions of people have benefited from the insights of behavioral economics as applied to retirement savings. We've learned that, when it comes to saving, it's really important to make things as easy as possible, which is why auto enrollment is so effective. But making it easy to save is just the start. If we are serious about fixing the retirement crisis, then we also need to make it easy to save enough.

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