‘Saving More’ Trumps ‘Working Longer’

By Editor Test *Tue, Feb 23, 2010*

"I'll-work-till-I-drop" is often the first, but rarely the most sensible, response to a setback in retirement savings.

“I’ll postpone retirement” is the first thought that many people have when their retirement accounts drop in value. But emergency financial counseling can persuade them to decide to increase their saving rate instead.

That is one of the conclusions of a survey conducted by a team at the Center for Retirement Research at Boston College last summer. The finding was important, say the designer of the survey, because it shows that well-timed advice can produce more positive financial outcomes for many people.

Why is saving more preferable to retiring later? Because few people can or do work as long as they’d like, according to the paper that describes the survey, “Workers’ Response to the Crash: Save More, Work More?”

“The intent to work longer is potentially a powerful response to the loss of retirement wealth. But many workers retire earlier than planned. Increased saving is a more certain and immediate response to a large negative wealth shock,” researchers Steven A. Sass, Courtney Monk and Kelly Haverstick wrote.

This team asked people ages 45 to 59 about the impact of the financial crisis on their finances. Two-thirds had retirement accounts that lost value. Each expressed their way of coping with the loss. Later the researchers (in the guise of a “finance professor”) told some of the people: *You could offset your loss by saving 11% more each year, retiring one year later, or living on 8% less in retirement*.

 After this minor intervention, there was a definite shift away from inertia, as well as a shift from working longer to saving more.

The percentage who said they would do nothing to recover their investment losses fell (to 24% from 41%) while the percentage who said they would work longer fell (to 28% from 36%).

The segment who said they would save more *and* work longer rose (to 30% from 13%) and the percentage of those who said they would save more rose (to 18% from 10%). In sum, 48% said they would save more, either with or without working longer.

The study supports the argument that retirement plan participants should receive counseling after a market crash so that they do not a) fail to respond at all to the crisis and b) that they do not simply delay pain or sacrifice into the future by making hard-to-keep resolutions to work longer.

Counseling worked best on those who had succumbed to inertia. “A striking 60% reconsider[ed] their decision, with 24% saying they would increase their retirement age, 20% saying they would increase their savings, and 16% saying they would do both. This outcome suggests that credible information can substantially change both retirement and savings behavior."

Not surprisingly, individual responses to the survey reflected personal circumstances to at least some extent. People who were more dependant on their investments for retirement security (as opposed to those with good pensions), those closer to retirement, and those with higher degrees of anxiety about their losses tended to respond more actively to the impact of the crisis on their finances.

The survey also showed:

A widespread rise in the expected age of retirement. About 40% expect to retire later than they had before the downturn with most of those who intend to work longer delaying retirement by four or more years.

Relatively little change in retirement saving. Two-thirds of respondents reported no change in how much they save for retirement in 401(k)s, IRAs, or other accounts.

A decline in spending. However, nearly 60% reported that they are spending less (which is equivalent to saving more if income is unchanged).

Some reallocation of retirement savings. About 30% reported changing the allocation of assets in their accounts or contributions to these accounts, with 81% reallocating away from stocks.

A substantial minority did nothing. Forty-three percent did not intend to change their planned retirement age or savings rate. These households may have suffered little or no loss of retirement savings; may plan to only decrease consumption; may be too overwhelmed to take an active role in rectifying their financial situation; or may just be unaware of their options.