Saving for Retirement Is Harder Than It Should Be

By The Editors | Bloomberg
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The U.S. government has long offered myriad contrivances and enticements to get Americans to save enough for a comfortable retirement — so far with woefully inadequate results. But why should it be involved at all? Why can't people be responsible enough to prepare for an entirely foreseeable event?

There are two answers. First, people turn out to be pretty bad at thinking about the distant future: It seems our brains aren't wired for it. Second, compounding that problem, the financial choices involved are complicated — and thanks to bad policy, needlessly so. Encouraging people to save more for retirement, and helping them do it wisely, would make a lot of Americans much better off.

In recent decades, the U.S. system of retirement saving, such as it is, has shifted sharply toward personal responsibility. Long gone are the days when employers commonly offered guaranteed pension plans to supplement bare-minimum Social Security benefits. Such corporate largesse has given way to defined contribution plans, which — for those lucky enough to have access — place the onus on employees to set aside enough money, choose the right investments, and eventually figure out how to make the savings last.

Retirement is a uniquely difficult thing for people to think about. When they're young and stand to benefit most from the power of compounded returns, they tend to put off saving — not because they're irresponsible, but because the future seems very far away or too uncertain, or because they have too little income. And they find the task of managing retirement accounts daunting, with countless potential combinations of contributions and investments. Throughout their working lives, they often fail to take full advantage of employer matching funds — effectively passing up free money.

Worse, when people do invest, they make mistakes. They fail to diversify or get out of bad investments, and incur penalties by making early withdrawals. On average, their retirement accounts achieve significantly worse returns than old-fashioned company pension plans — a low bar, considering that the latter are often invested in fixed-income assets paying meager returns.

The result: Americans aren't ready for retirement. As of 2019, nearly half of people approaching the end of their working lives had no money saved in an employer-provided 401(k) plan or individual retirement account. Those that did had a median balance of $144,000, nowhere near enough to ensure a comfortable old age. For the lowest-income fifth of workers, the median balance was just $32,200.

This is a problem not only for millions of future retirees. The elderly poor will weigh heavily on the social safety net, potentially overwhelming state budgets across the country. If they can't afford professional care, younger family members will have to skip work to fill the breach, reducing the economy's productive capacity.

Financial education can help, but goes only so far. When it comes to reaching consumers, motivated sellers of high-cost mutual funds and deceptive annuities will always be better and faster than officials with pamphlets on prudent investing. Worse, retirement-account balances peak just as many people are starting to experience age-related cognitive decline, making them particularly vulnerable to financial predators.

It's in the public interest that the government set up a simpler retirement-saving system that steers people toward better choices. It has taken some small steps in the right direction — for example, by encouraging companies to automatically enroll workers in savings plans. For the most part, though, its haphazard collection of tax incentives and account options remains unacceptably confusing, incomplete and inefficient. The next editorials in this series will explain how it got that way, and how to fix it.

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