Financial illiteracy and irrational thinking are causing a dangerous shortfall in retirement savings

6 March 2019

The majority of people in Western countries fail to plan sufficiently for retirement, and most will face large social security expenditures to support aging populations as life expectancy increases, according to Ben-Gurion University of the Negev (BGU) researchers.

The study, The Effect of Attitudes Regarding Retirement on Pension Savings, published in the *Review of Economics & Finance*, reports that a majority of residents of 36 member countries of the Organization for Economic Cooperation and Development (OECD) fail to maintain pension funds or other savings plans during their working years that sustain them in retirement.

The researchers, Dr. Ravit Rubinstein-Levi and Prof. Haim Kedar-Levy, both of the BGU Guilford Glazer Faculty of Business and Management, say two main factors explain the phenomenon. First, individuals who lack pension savings believe that retirement planning can be postponed. Second, they tend not to acknowledge the need to retire at a certain age and give less thought to retirement. They also tend to be more optimistic regarding their future and expected financial status and believe the government is responsible for them maintaining a reasonable standard of living after retirement.

In terms of the rational decision-making paradigm in economics, most research suggests that the cause for inadequate savings by individuals stems from low financial literacy. "Psychological theories suggest that people without savings are more likely to avoid the cognitive dissonance by ignoring the troubling information," the researchers say.

Since individuals do not make rational decisions in complex matters such as retirement planning, the researchers suggest an alternative behavioral approach. Instead, they would focus on affecting a few particular attitudes that guide individuals' savings decisions or raising awareness about the needs for retirement, which is harder to ignore.

The researchers note that since 2008, Israeli law has required employers to pay into pension funds on behalf of their workers. This is similar to requirements in other OECD countries including Belgium, Norway, Germany, Italy, France, Austria, Sweden, and Great Britain.

However, they also show that law enforcement is lax, particularly with regard to small businesses and temp workers. Furthermore, they add that throughout the Western world, only a minority of people save enough during their working careers to avoid a decrease in living standards after retirement. As a result, poverty among senior citizens will present a growing fiscal and social challenge for governments in the coming decades.

"Throughout the industrialized world, governments have shifted the onus of preparing for old age onto the shoulders of private individuals," says Dr. Rubinstein-Levi. "In Israel, this means that 50 percent of Israeli senior citizens would live below the poverty line were it not for National Insurance Institute (NII) payments. That figure goes down to 30 percent after the payments.

To address the issue, the researchers recommend that policymakers act to improve financial education and stress the role of personal responsibility in maintaining standards of living after retirement. This would result in individuals giving more thought to their retirement and starting to plan for it at a younger age, possibly by seeking aid from experts.

"It is true that public awareness about financial planning has increased in recent years, but behavior has not changed significantly," Dr. Rubinstein-Levi says. "As people are living longer, it will become more important to address this issue effectively in coming years."

Provided by American Associates, Ben-Gurion University of the Negev

APA citation: Financial illiteracy and irrational thinking are causing a dangerous shortfall in retirement savings (2019, March 6) retrieved 20 May 2019 from https://phys.org/news/2019-03-financial-illiteracy-irrational-dangerous-shortfall.html