# The power of defaults

## Rowena Crawford, associate director at the Institute of Fiscal Studies (IFS), discusses the success of automatic enrolment and the power and pitfalls of nudges

The government's automatic enrolment policy has been widely hailed as a considerable success. Nearly four out of every five private sector employees were members of a private pension by 2019. This is a higher proportion than at any point in the past 30 years.

One caution against this apparent success is the possibility that additional saving undertaken now might be offset by less saving later. In other words, automatic enrolment might have a bigger effect on the timing of pension saving than on the amount of saving done over a lifetime. But emerging evidence on this is reassuring, finding an increase in the proportion of private-sector employees expecting to have any private pension income in retirement. This suggests that many of those brought into pension saving by automatic enrolment were otherwise not planning to do so at any point in their working life.

The rollout of automatic enrolment looks to have occurred at a good time. The period since 2012 has finally seen household incomes generally rising faster than inflation, and increases in the income tax personal allowance, particularly in April 2019, will have meant that many employees will not have seen a drop in their take-home pay despite increased pension contributions. The economic prospects for 2020, however, do not look so good. Stock markets have been reeling as concerns about the coronavirus pandemic have grown, and many households will now be experiencing sharp falls in their earnings.

In order to understand how individuals' pension saving might respond to this turn of fortunes, it is useful to consider why the automatic enrolment policy has been so successful at increasing pension membership. The policy encourages pension saving through various channels, including increasing the availability of workplace pensions, providing a financial incentive to contribute in the form of a minimum employer contribution, and strongly nudging individuals' behaviour by defaulting membership. Recent research has shown that the success of automatic enrolment has arisen from all these channels. The increased availability of workplace pensions is particularly important for those working for small employers. The defaulting effect is powerful and, as a result, younger employees, those on lower wages and with lower levels of education, and those in rented accommodation have seen especially big increases in pension membership. Membership is now strikingly similar across groups of employees with different characteristics and circumstances.

In fact, in some cases the default effect may be too strong. Automatic enrolment has even boosted pension membership to high levels among those who appear less financially secure: those with little liquid wealth, and even those who are behind on some important bills. At least some of these individuals could be better-off not saving in a pension until their financial security improves. This should not detract from the success of automatic enrolment. Many of those brought into pension saving look to be currently financially secure and should benefit from being encouraged to save. But it does highlight that behavioural nudges can be very powerful, and must therefore be used with care. This needs to be borne in mind as the automatic enrolment policy is developed to expand coverage and potentially in future to increase contribution rates.

In terms of the current situation, the power of defaults is perhaps cause both for reassurance and concern. Reassurance that individuals are unlikely to withdraw permanently from pension saving in response to what, for most, will hopefully be only a temporary (albeit in some cases sizeable) drop in earnings. Concern that if some individuals are severely affected by income falls, they might not temporarily reduce their pension saving even when that would be a very appropriate response.

The trade-off inherent in automatic enrolment – between nudging people to make savings choices, in a way that should turn out to be appropriate for the many, versus communicating clearly that pension saving is a choice, the appropriateness of which will depend on individuals' circumstances – may be about to be thrown into sharp relief.

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