

Saving in Austria – Too Little and Too Late?

On October 24, 2008, the Oesterreichische Nationalbank (OeNB) held an international workshop entitled “*Saving in Austria – Too Little and Too Late?*”. The purpose of the event was to devote more attention to an important economic topic which even experts still do not understand sufficiently in all its various facets. In a small group of experts, the following questions were discussed at length: What determines people’s saving behavior? What influencing factors stand in the way of rational saving behavior? And what problems arise in the analytical conceptualization of household saving?

In his opening speech, *Peter Mooslechner* (Director of the OeNB’s Economic Analysis and Research Department) stressed the fact that household saving behavior is a key area of application for microdata. Microdata on saving behavior can be used for simulation studies as well as the empirical verification of predictions generated by theoretical models. Without microdata, economic analyses of saving behavior would hardly be sufficient. Referring to the OeNB’s Survey on Financial Household Wealth (SFHW) from the year 2004, Mooslechner underscored the idea that different social groups have different motives for saving, which in turn implies heterogeneous saving behavior. Mooslechner also noted that as early as 1930, Irving Fisher emphasized the heterogeneity of saving behavior among various groups in a treatise entitled “*The Theory of Interest*”.

Introduction to the Workshop Topic

The relevant literature frequently uses the life cycle model (Modigliani and Brumberg, 1954) or the *permanent income model* (Friedman, 1957) as a point of departure for explaining household saving behavior.² In both models, household consumption and saving decisions are interpreted as problems of intertemporal optimization. The saving and consumption behavior of households depends on their preferences, on interest rates and the present value of their lifetime income, and on wealth. The life cycle model makes it possible to generate predictions about wealth accumulation over the course of a person’s lifetime. The model relies on the assumption that young households first take out loans (i.e. borrow against future earnings) and subsequently accumulate wealth in order to secure retirement income, which they use for consumption purposes during retirement. According to this model, the development of wealth should follow a hump-shaped curve in the course of the life cycle. However, microdata on households have been used to show that observed consumption behavior diverges from the predictions generated by such models. For example, consumption actually depends more on a person’s current income than it should according to the life cycle model.

In the academic literature, therefore, this savings model has been expanded to include liquidity and credit

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² An overview of these models is presented in Browning and Lusardi (1996).

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constraints.³ In addition, planned bequests and uncertainty about future income development have also been integrated into the model. Another reason why microdata might contradict the predictions of the simple life cycle model is precautionary saving. In the literature, this is considered an important saving motive, which must be taken into account in order to describe household saving and consumption behavior accurately. Saving also provides a safeguard against income, wealth and expenditure shocks in the future. Given incomplete insurance markets, households hold assets as a precautionary measure in order to maintain their planned consumption paths at least to a certain extent. However, findings based on microdata indicate that precautionary saving accounts for 2% (e.g. Lusardi, 2000) to 40% (Carroll and Samwick, 1998) of household assets. The vast differences between these estimates make it almost impossible to assess the significance of precautionary saving. In light of these problems, Kennickel and Lusardi (2004) suggest surveying households directly regarding the extent to which they save for precautionary reasons,⁴ and the authors come to the conclusion that approximately 8% of overall assets are held for precautionary reasons. Precautionary saving plays an especially important role among older households and business owners. Low-income households, on the other hand, exhibit a low level of precautionary saving. Precautionary saving and liquidity constraints can also compound each other, and it is thus

often impossible to isolate the individual impact of each factor completely.

Saving in Austria

For Austrian households, estimates of the share of precautionary saving in their wealth are only partly available. However, the results of the OeNB's 2004 SFHW have been used for research on many topics related to saving behavior (e.g. financial literacy, debt, and investment behavior).⁵

In their presentation, *Pirmin Fessler* and *Clemens Jobst* (OeNB) referred to one subsection of the 2004 SFHW. The results of this study corroborate the idea that a majority of Austrian households save only very little, while a small minority of households put aside a large amount. The vast majority of households indicated that they put money aside for health emergencies, for unemployment or simply “for a rainy day.” Of those who do save, the majority do so without a specific reason (“for a rainy day”). Among the respondents under 29 years old who put money aside, only about one fourth stated that they were saving in order to secure retirement income. This saving motive reaches its highest level in cases where the head of household is between 40 and 49 years of age. Chart 1 illustrates the significance of precautionary saving.

The ability to save as well as saving behavior depend heavily on a household's income. High-income households tend to save on a regular basis or according to a savings plan. The lower a household's income, the more often they will simply put aside what is left

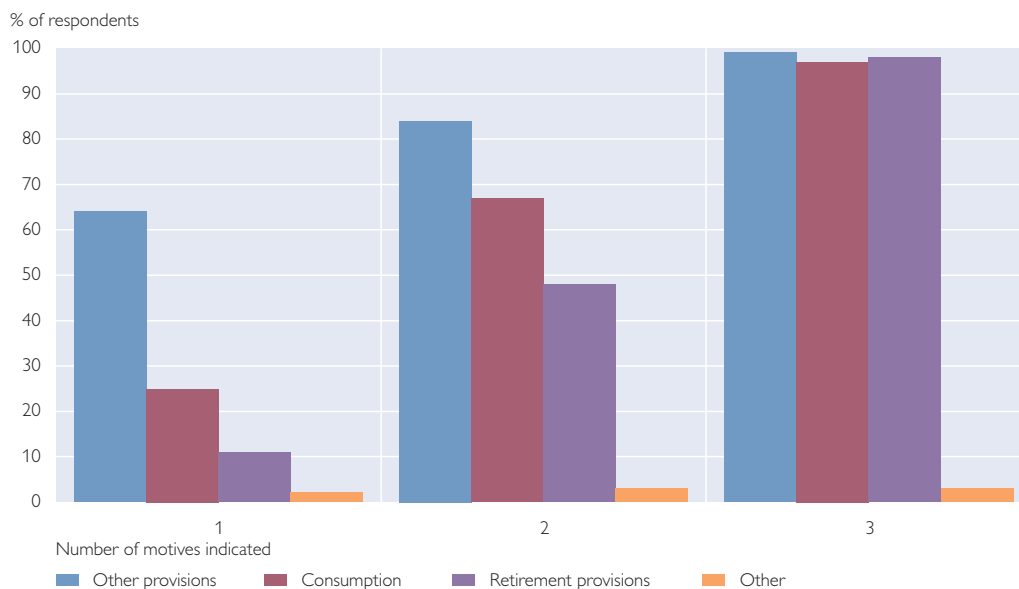
³ Deaton (1999) provides an overview of the literature on this topic.

⁴ In the Federal Reserve System's Survey of Consumer Finances, the following question is asked with regard to savings for emergencies and other unexpected events: “About how much do you think you and your family need to have in savings for unanticipated emergencies and other unexpected things that may come up?”

⁵ See Beer and Schürz (2007), Fessler et al. (2007), and Fessler and Schürz (2008).

Chart 1

Motives for Saving



Source: OeNB, based on the Survey on Financial Household Wealth (2004).

over at the end of the month or see no possibility of saving at all.

The tendency to save is more widespread among older respondents and in higher-income groups. Of the households in the survey, 82% consider individual saving for retirement to be important. The main motive behind individual retirement saving is uncertainty with regard to the state pension system. It comes as no surprise that the importance of private pension savings declines with increasing age. What is more striking is the empirical finding that this form of retirement savings is considered more important among respondents with higher levels of income and education. First, high-income households are in a better position to save for retirement. Second, due to legal regulations (earnings cap for pensions, steeper lifetime income curve), those households cannot expect state pensions to be sufficient to maintain their usual standard of living in retirement. A clear difference between in-

come groups can also be identified in the reasons why people save for their own retirement: In higher-income groups, private retirement saving tends to focus more on return considerations.

Among young people, saving is generally geared toward future consumption objectives. For example, young people put money aside in order to purchase automobiles, to furnish apartments and to buy other consumer durables. As people age, however, saving for health reasons (e.g. dental work, surgery) becomes an important factor.

In her presentation, *Annamaria Lusardi* (Dartmouth College) explained that the retirement savings landscape in the U.S.A. had undergone major changes, in particular the shift from defined benefit (DB) to defined contribution (DC) pensions. Moreover, the complexity of financial products has grown enormously, and investors generally face a far broader selection than they did just one decade ago.

Lusardi's ensuing research question was whether individuals are equipped to deal with these new developments; the answer was negative. According to Lusardi, the U.S. population exhibits only a low level of financial literacy, and financial illiteracy is especially widespread in lower-income groups, among African Americans and among people with lower levels of education.

In the 1990s, a number of private and public-sector organizations in the U.S.A. launched initiatives with a view to improving financial literacy in certain population groups. The U.K. has also been active in promoting financial education for some time now, and the OECD embraced this topic and drew up related recommendations as early as 2004. These economic policy initiatives mainly aim to change people's financial behavior.

In recent years, the question of whether higher financial literacy serves to improve financial behavior has also been addressed in numerous studies in the field of behavioral economics. While neoclassical economists assumed that people make rational decisions to optimize welfare on the basis of all available information and that more information brings about better decisions, behavioral economists point out numerous anomalies in individuals which lead to improper financial behavior. These anomalies were a key topic in the presentation given by Brigitte Madrian.

Furthermore, Lusardi highlighted the fact that it is very difficult to evaluate the effectiveness of financial literacy programs, stating that it is not sufficient to rely on the satisfaction of the participants or their subsequent investment decisions. At the same time, in her forthcoming book *“Overcoming the Saving Slump: How to Increase the Effectiveness of Financial Education and Saving*

Programs” (due out in January 2009), she argues that heightened financial literacy promotes better financial planning, which in turn leads to greater wealth accumulation.

In her presentation, *Brigitte Madrian* (Harvard University) pointed out a formidable number of problems in people's financial behavior. These problems include the following:

- While attending seminars on retirement savings, participants might be convinced that they will invest in an individual retirement savings plan in the future. However, six months later, hardly any of the participants will have made the decision to do so. Surveys have often shown that people believe that they do not save enough and thus resolve to save more. For many, however, this remains a mere resolution.
- People are also influenced by the number of alternatives presented to them. Studies show that when people are offered multiple equity funds and only one bond, the majority will decide for the equity investment. Offering multiple alternatives for one option tends to encourage fixation on that option in decision making.
- Other studies indicate that the participation rate is only about one third in the case of retirement savings plans where employees are required to make an active decision to participate (i.e. opt-in systems). However, if all employees are enrolled in the retirement savings plan automatically using an opt-out system, the participation rate rises drastically.
- As a rule, people prefer investments with which they are familiar. Therefore, we can also identify a tendency to invest in stocks in one's own company despite the risks discussed publicly in the wake of scandals such as those at Maxwell or Enron.

- When making decisions, people often fail to use all of the relevant information available; they have a tendency to be short-sighted and are influenced by external circumstances. In this context, financial education can only effect change to a limited extent.

Madrian suggested that these problems might be mitigated by simplifying offers using standardized solutions and by requiring an active decision on the employee's part.

Ayuso et al. (2007) examine the effects of the 1988 introduction of tax incentives for retirement savings in Spain. The authors use data from a panel of tax returns in order to identify the characteristics of households which invest in pension funds. On the basis of a survey on household consumption, they also investigate whether there is a connection between pension fund contributions and changes in expenditure and savings. Saving rises most dramatically in the 46 to 55 age group, while there appears to be more of a substitution relationship between saving and pension fund contributions among households in the 56 to 65 age group. In a further step, the authors attempt to estimate the extent of new savings generated by the tax incentives. Using a two-sample, two-stage least-squares model, they estimate the share of new savings at approximately 5% to 19% of pension fund contributions. In contrast, households in the 46 to 55 age group and in the highest income quartile augmented their saving by nearly 65%.

The authors come to the conclusion that tax incentives do not have a particularly strong effect on household saving; instead, such incentives have a more visible effect on the composition of wealth portfolios. Therefore, in light

of the budgetary burden created by these incentives, their fiscal effect appears questionable.

In his talk, *Luc Arrondel* (CNRS-PSE) analyzed how heterogeneous risk and time preferences of households affect wealth portfolios. The objective of this analysis was to carry out a comprehensive measurement of the risk and time preferences of investors in France. What is innovative about Arrondel's approach is the fact that he develops an indicator which makes it possible to bundle various questions regarding risk aversion and time preference for the present. In this way, Arrondel is able to overcome the problem that preferences are generally examined on the basis of only three parameters: the degree of relative risk aversion, which impacts precautionary saving; the time preference for the present; and the degree of altruism, which influences intergenerational transfers of wealth (e.g. financial assistance, gifts and bequests to children). At the same time, Arrondel also shows that a sufficiently large number of heterogeneous questions covering various areas of life are required in order to address this issue.

The research presented by *Herbert Walther* and *Alfred Stiasny* (Vienna University of Economics and Business Administration) demonstrates quite impressively the far-reaching statistical limitations and problems associated with international comparisons of household saving rates. Walther and Stiasny underscore the need to devote greater attention to statistical definitions of the saving rate, and they conclude that the shadow economy systematically distorts international comparisons of household saving rates. Larger shares of income from shadow activities bring about lower employment rates and thus higher saving rates.

Conclusions

The OeNB's workshop on "*Saving in Austria – Too Little and Too Late?*" revealed that microdata are indispensable for research on saving behavior. Microdata help enhance our understanding of the economic decisions made by households. As a result, these data are becoming an increasingly important factor in monetary and economic policy. Unfortunately, Austria still has relatively few useful sources of microdata. The results of household-level surveys make it possible to question certain established convictions and enable an empirical verification of economic policy concepts and different theories on saving. Due to data problems and institutional differences, international comparisons of macroeconomic saving rates remain difficult. The results of Madrian's empirical work

point to many severe behavior problems in financial decision making.

Empirical information at the micro level is gaining in importance due to changes in the pension system and in the labor market, the liberalization of the financial markets as well as the current financial crisis. The household sector is becoming increasingly heterogeneous, which generally makes it difficult to assess household behavior on the basis of aggregate data. From the year 2010 onward, the periodic surveys planned within the framework of the Eurosystem Household Finance and Consumption Survey (HFCS) should improve the international data situation substantially and provide a more realistic picture of households' financial behavior, including that of Austrian households.

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