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BAD FINANCIAL HABITS: THREE WAYS GOVERNMENTS CAN WORK WITH FINANCIAL INSTITUTIONS TO IMPROVE PERSONAL FINANCE

HOW TO AVOID A FINANCIAL "SUGAR" TAX

By IMD Professor John W Walsh

IMD
Chemin de Bellerive 23
PO Box 915,
CH-1001 Lausanne
Switzerland

Tel: +41 21 618 01 11
Fax: +41 21 618 07 07
info@imd.org
www.imd.org

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People in the developed world have too much debt, spend too much and save too little. In 2017, Americans had an all-time high of $13 trillion in debt, the average credit card balance was $6,375, also an all-time high, and 1 in 3 Americans had less than $5,000 saved for retirement. Given that people are living longer, and social security systems are underfunded, and likely to offer more paltry payments in the future, it's unsurprising that the business press has been warning of a coming personal finance apocalypse.

As defined-benefit pension plans are being replaced by defined-contribution ones, individuals are more and more responsible for financing the lifestyles of their future selves. Given that the data illustrates widespread financial illiteracy, it seems people are ill-prepared to take on this responsibility. Politicians are and should be worried.

What to do?

When it comes to preventing people from doing things that might harm themselves, government interventions have been a traditional response. Tobacco consumption comes with warnings and prohibitions. Alcohol packages implore us to "drink responsibly". The developed world's obesity epidemic is being tackled by sugar taxes. Gamblers face restrictions on where and how they can gamble. In all these areas, governments are trying to mitigate the negative consequences that our worst impulses might bring onto ourselves. By comparison, little is being done to thwart our spendthrift present selves from impoverishing our future.

A recent report from the UK, jointly authored by the Government-funded Money Advice Service and the Behavioral Insights Team, aims to change this. Studying UK residents who were defined as financially "squeezed", they identified three challenges: **1.** Getting people to build up a savings buffer so they can withstand an unexpected financial shock, such as a car repair or a medical bill. **2.** Getting people to seek financial advice, much of which is already available but underutilized **3.** Getting people to repay debt sooner and to control spending.

We know when making decisions people anchor their thoughts on early information and then have difficulty adjusting afterwards (this is why discounts from a "regular" price are so effective). The report found that the minimum monthly repayment on a credit card bill has a similar effect. When the minimum amount was given as the default, only 55% of people chose to enter a higher amount, with 45% choosing the minimum amount. By presenting the choice differently, using a slider on a scale where people could move the slider to the amount they wished to pay this month, only 13% chose the minimum amount when the slider was initially placed at the minimum and that went down to 4% when the slider was placed at an initial value that was higher than the minimum. Academics have known for a long time that the way decisions are presented to people greatly impacts the outcome, and in this case a small change could have a dramatic impact on individuals' finances by encouraging them to pay off credit card debt sooner.

Proposed solutions

Oscar Wilde famously said he could resist anything but temptation and he's not alone. Like diets established annually on January 1st, the best intentions for our finances are often defeated by momentary impulses. The report proposes offering people the ability to put category-specific spending limits on credit cards that have to be over-ruled at the time of purchase – so, for example, rather than an immediate authorization for a pizza delivery, the individual would be asked whether he wishes to proceed with the purchase given he has exceeded the weekly limit he had set for fast food purchases. Adding an additional obstacle to impulse purchase can reduce the temptation. And, by the way, Oscar Wilde died penniless.

One positive aspect when it comes to individuals' lack of interest in their finances is that when they initially set pension contribution rates they generally don't revisit and change the amount. The

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automatic monthly saving compounds over the years, unnoticed by the disinterested and unaware beneficiary. The report proposes leveraging this once in a lifetime opportunity to save by including what they call a "Sidecar" account. This would sit alongside the pension account, with monthly amounts taken from salaries automatically, and would increase the likelihood individuals would accumulate a savings buffer to handle occasional unexpected shocks. A pilot is planned with the UK-based National Employer Savings Trust pension scheme. Due to regulations, individuals must choose to opt-in to the scheme. In early tests, the proposed, but not mandatory, percentage of savings amount (1%, 3% or 5%) had an interesting impact – the lower the proposed percentage, the higher the opt-in rate, but, due to the anchoring effect discussed earlier, those who were suggested the higher percentage were likely to save more when they did opt-in.

There are many potential subtle ways individuals can be influenced to act in their own best interests. It is refreshing to see government agencies work in partnership with financial institutions to implement solutions to a huge society-wide problem. It would be uplifting to see more financial institutions proactively act in similar ways for the benefit of their customers. One can't help but think that if they do not, regulatory levers will be pulled to implement the financial equivalent of a sugar tax.

John W Walsh is Professor of Marketing at IMD.

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