

Default Enrollment in Retirement Plans: A Policy Nudge or a Passive Trap?

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ABSTRACT

This article explores the policy effects and welfare impacts of "default enrollment" in the U.S. retirement savings system. As a "nudge" tool in behavioral economics, default enrollment significantly increases retirement plan participation through inertia and status quo bias, improving savings coverage and investment quality in the short term. However, extensive empirical research indicates that default enrollment can also induce behavioral inertia: employees tend to remain at low contribution rates, not actively manage their accounts, and even experience account churn. This "passivity" not only weakens long-term savings but also reflects a structural mismatch between employer incentives and employee benefits. Therefore, relying solely on increased participation rates is insufficient to demonstrate welfare improvements. This article advocates retaining the advantages of default enrollment while introducing automatic contribution increases, regular re-enrollment reminders, and financial education to mitigate long-term passive behavior and truly enhance individuals' retirement financial security.

KEYWORDS

Default Enrollment; Nudge; Retirement

1. INTRODUCTION

The U.S. retirement system has evolved over several decades, beginning with a public pension system introduced through the Social Security Act in 1935, which provides basic retirement income. In 1978, the 401(k) plans shift retirement saving responsibility from employers to individuals. Later, the Pension Protection Act encouraged default enrollment in workplace retirement plans to boost participation in 2006. Today, default enrollment has become a central policy for expanding retirement savings in the U.S. and many Americans are participating in default enrollment retirement plans, which increases retirement plan participation and then increases savings [1].

However, some economists argue that default enrollment may induce behavioral passivity. For example, default enrollment in retirement plans is designed to minimize savings, which reflects employer incentives rather than employees' welfare goals [2]. This raises an important question: while default enrollment in retirement plans encourages more participation and saving, does it truly improve individual welfare?

Therefore, this essay's main argument is that while Derby, Mackie, and Mortenson (2023) show that default enrollment improves participation in the short run, I argue that this is an insufficient basis for claiming welfare gains, as participation in default-enrollment retirement plans does not guarantee financial well-being and may instead foster low contributions and long-term disengagement.

2. HOW DEFAULT ENROLLMENT WORKS

2.1. The Concept of Default Enrollment

Default enrollment is a policy mechanism that affects individual behavior by presetting default options. When individuals do not actively make a choice, they will accept the default arrangement automatically. It is most found in retirement saving plans but has also been widely studied in areas such as organ donation, health insurance, and environmental behavior.

In behavioral economics, default enrollment is widely considered a nudge --- a policy tool that influences behavior by changing how choices are presented, without restricting options or altering incentives [3]. It is effective through behavioral mechanisms like inertia and status quo bias, which allows default enrollment in retirement plans to increase participation and saving [4].

2.2. Default Enrollment in U.S. Retirement Policy

In the U.S., default enrollment has become a central feature of retirement policy, particularly in 401(k) plans, which is also called employer-sponsored defined contribution retirement accounts that allow workers to allocate part of their salary to long-term savings [1]. In addition to 401(k) plans in the private sector, default enrollment has also been adopted in state-level retirement programs. For example, OregonSaves, the first state-sponsored auto-IRA program, automatically enrolls workers who lack access to employer-based retirement plans [5].

3. WHY DEFAULT ENROLLMENT WORKS

Default enrollment is widely viewed as an effective behavioral intervention to encourage retirement saving, particularly by increasing retirement plan participation among financially disengaged individuals.

Firstly, default enrollment has led to an increase in retirement plan participation. For instance, in South Dakota, participation rates among new hires rose from less than 5 percent to over 90 percent after the policy change [1]. The authors attribute this sharp increase to behavioral inertia, noting that most participants accepted the default contribution level of \$25 per month, equivalent to about 1% of income. They conclude that automatic enrollment is an effective tool for increasing retirement plan participation. And the conclusion has also been shown on a national scale, where default enrollment boosted participation and saving in the short term [6]. They found that automatically enrolling employees in an employer-sponsored retirement plan increases participation by 37 percentage points and average saving rates increase by 1.28 percentage.

Secondly, default enrollment has expanded retirement savings coverage. In OregonSaves, an opt-out auto-enrollment retirement program, economists found that default enrollment expanded participation, covering groups that have not saved, especially those with low income and high liquidity [5]. During the study period, the number of funded accounts increased from 17830 to 67731 and the average account balance rose from \$375 to \$754. More recent public data show continued improvement, with average balances reaching \$1,080, suggesting durable behavioral effects over time.

Thirdly, default enrollment has improved investment outcomes. Default enrollment into target-date funds (TDFs) portfolio really improves the quality of the portfolio, increases the share of stocks, diversifies risks, reduces non-systematic risks, and may significantly increase future retirement wealth [7]. The rate of return from the default enrollment mechanism may increase retirement wealth by 50%.

Overall, these studies provide compelling evidence that default enrollment does achieve its intended purpose in the short term—increasing participation rates and encouraging individuals to adopt better savings behaviors.

4. WHY DEFAULT ENROLLMENT MAY LEAD TO PASSIVITY

Default enrollment may induce behavioral passivity, leading individuals to stick with low default contribution rates, disengaging from managing their savings, or even abandoning their retirement accounts altogether.

Firstly, default enrollment may reduce active saving effort. Although the default enrollment has increased the participation rate of retirement savings plans, it has significantly weakened employees' willingness to save actively [8]. They found that only 67.2 percent of employees who were subject to default enrollment actively contributed to their accounts, compared to 91.1 percent of those who enrolled voluntarily. Moreover, the average contribution rate among defaulted employees was 4.9 percent, significantly lower than the 7.7 percent observed among voluntary enrollees. As a result, the average annual retirement savings of defaulted workers was approximately \$1,100 less. This path-dependent behavior on default settings is persistent and may increase the risk of long-term insufficient savings.

Secondly, default enrollment can foster passivity. While default enrollment in retirement plans increase participation, they observe that participants often exhibit passive behavior: they do not interact with their accounts, fail to update contact information, and are more likely to abandon their savings, which undermines the assumed welfare gains of default enrollment, especially among financially less literate participants [9]. The passivity was also proven by other economists, like Deby, Mackie and Mortenson. They acknowledged while there were the short-term effects of default enrollment in increasing participation and savings, default enrollment led to higher withdrawal rates and account leakage, especially among low-income earners and job hoppers [6]. And they found that the effect of default enrollment on participation decreases from 35 percentage points to just 17 percentage points and saving rate from 1.43 to 0.73 percentage points in the long run.

Thirdly, default enrollment may reflect structural misalignment between employer incentives and employee welfare. Some economists argue that default mechanisms are not designed to maximize employees' financial well-being, but rather to minimize employers' costs [2]. Their research found that many companies strategically set low default savings rates to limit their matching contributions. Specifically, most default savings rates are below the threshold at which employers must provide full matching contributions, thereby reducing overall compensation costs. This misalignment suggests that companies often adopt default enrollment systems not out of concern for employees' long-term financial security, but rather to reduce plan costs and increase participation. As a result, employees—especially those with limited financial knowledge or confidence—may interpret default savings rates as an implicit recommendation and be reluctant to increase contributions. For individuals with limited financial health, this may reinforce suboptimal savings behaviors and exacerbate chronic financial shortfalls. Therefore, rather than helping those who need it most, poorly designed defaults may inadvertently lead to persistent savings shortfalls and limit the potential benefits of retirement plans.

Finally, default enrollment in retirement plans do not make saving be stable. Although the default enrollment assumes that individuals will continue to save even when they are passive, the study found that this assumption does not hold true in practice. Employees who are default enrollment in 401(k) plans will still actively adjust their savings behavior when faced with changes in income [10]. The authors found that when income decreases, annual savings decrease by an average of \$281; conversely, when income increases, savings increase by \$925. In addition, for every week of unemployment, an individual's savings rate will decrease by an average of 0.05 percentage points. If they are unemployed for 3 months, their savings rate will decrease by about 0.6 percentage points,

equivalent to 12% of their original savings level. This evidence shows that the default mechanism cannot very stably protect individual savings, especially for economically vulnerable groups.

In conclusion, these studies provide compelling evidence that default enrollment may not claim individual's welfare gains ---- reducing active saving effort, fostering passivity, reflecting structural misalignment and doing not make saving be stable.

5. HOW CAN DEFAULT ENROLLMENT BE IMPROVED

To address concerns that default enrollment may lead to passivity in long run, there are some methods to enhance default enrollment in retirement plans. One widely studied approach is auto-escalation of contribution rates, which allows employees' savings contributions to automatically increase over time after they join a retirement plan. The "Save More Tomorrow" program, for example, raised average savings rates from 3.5% to 13.6% by leveraging inertia for gradual commitment [11]. Another strategy is periodic re-engagement prompts, which nudge participants to revisit and potentially revise their contribution levels or investment choices, thus countering prolonged inattention. Additionally, financial education can promote active engagement, as low financial literacy is a common reason for retirement account neglect.

6. CONCLUSION

Default enrollment in retirement plans effectively increases participation, especially among groups with historically low savings rates. However, participation alone does not ensure financial security. In the long run, default enrollment in retirement plans may foster passivity, such as neglecting or abandoning retirement accounts. Therefore, default enrollment in retirement plans still faces several challenges.

Policymakers should assess whether default enrollment mechanisms encourage active engagement and help people prepare adequately for retirement, rather than focusing on participation rates in retirement savings plans. To address these challenges, measures such as auto-escalation of contribution rates, periodic re-engagement prompts and financial education have been proposed. These measures aim to reduce passivity while preserving the benefits of default enrollment, seeking to refine default enrollment in retirement plans in ways that effectively promote individual financial welfare.

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