

# Have households under- saved for retirement?

Rowena Crawford, Cormac O'Dea

Discussion by Lieke Kools

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The Netherlands



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# Summary

- Research question:  
Are households undersaving for retirement?
- Approach:
  1. Derive decision (*savings*) rules based on an optimal life cycle model (OLCM).
  2. Calculate optimal wealth levels given observed earnings history.
  3. Compare to observed wealth levels to measure degree of over/under saving.
- Conclusion:
  1. People tend to oversave rather than undersave, only 8% saves too little
  2. Oversavers save much too much: at median about 226,000
- Contribution:
  1. Application of OLCM in UK setting
  2. Inclusion of risky tax advantaged asset next to risk free asset

→ Detailed (realistic) model + linked administrative and survey data

# Unexpected results: possible problems?

1. Underestimation of optimal wealth accumulation:
    - Parameter assumptions
    - Early retirement (60 instead of 65)
  2. Overestimation of actual pension income:
    - Other savings motives: exclusion of housing wealth
- Under 'extreme' assumptions still only 25% undersave

## Questions:

- Is exclusion of housing wealth that extreme? In NL housing wealth rarely used to finance retirement (Suari-Andreu et al. 2015)
- Can you explain the small impact of early retirement on optimal savings? (at the median 3000 pounds → about 600 a year....)
- What happens if you test for a combination of the above assumptions?

# Underestimation of optimal wealth?

1. Fit of simulated earnings profile (used to establish decision rules)
  - If the steepness of profile is overestimated, optimal savings may be underestimated.
  - Higher probability of unemployment at end of working life?
2. Accuracy of earnings derived from administrative data
  - If earnings underestimated, too low levels of optimal wealth are assigned.
  - Maybe also include estimated profile pre-1975 in Figure 2?
3. Choice of tax rate: 2002/3 rate, tax rate has declined over the years, especially for high incomes.
  - 'bonus' for tax advantaged saving, though also lower net earnings...

# Overestimation of actual wealth?

1. DB income is projected to 64, then compared to optimal wealth at age of observation → might lead to slight overestimation of accumulated wealth
2. What if you project all wealth to age 64 and compare to optimal wealth at 64?
  - Test included where current wealth is compared to optimal wealth at 64.
  - For younger part of sample financial crisis took place pre-64. This may have affected wealth holdings negatively (decline in house prices etc. )
3. Only couples are considered:
  - How do savings of couples compare to those of singles?
  - For example: in NL divorced undersave more often (De Bresser & Knoef 2015)

# Reporting replacement rates

1. Optimal replacement rates are between 30-70%
  - Which factors drive the heterogeneity?
  - Would be interesting to see replacement rates by earnings, nr children , ...
2. What are the observed replacement rates?
  - In line with `adequate' replacement rates communicated to the public?
  - Facilitate comparison to US (Scholz et al. 2006)
3. Deficit/surplus given in absolute values
  - 40,000 deficit may have different impact for high income earners, than for low income earners
  - Show deficit/surplus relative to current income?  
i.e. actual replacement rate compared to optimal replacement rate

# To what extent are savings `forced`?

- If important you would expect people to accumulate less in non-pension wealth.
  - Communication & degree of freedom:
    1. Membership compulsory or opt-out?
    2. Fixed contribution or free to choose?
    3. How do employer contributions relate to own contributions?
- Do people know how much they save in private pensions?



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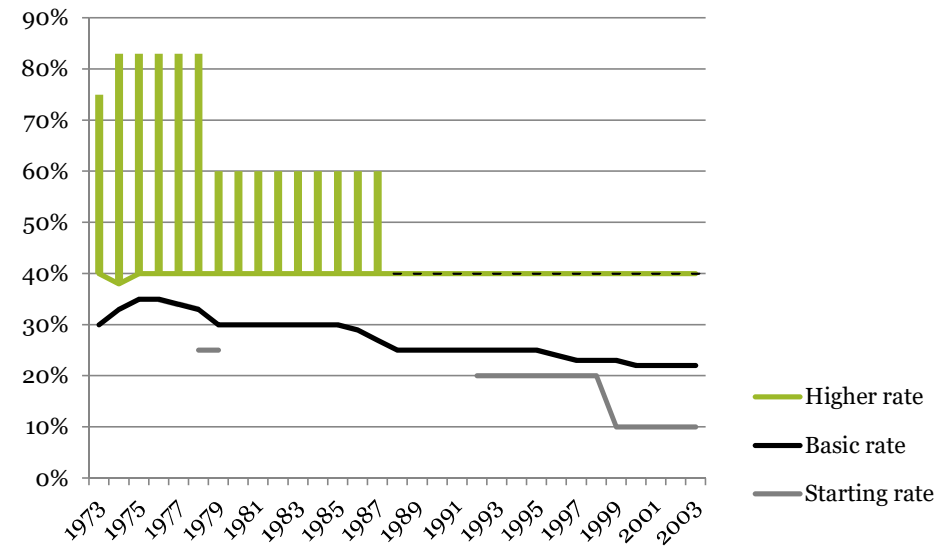
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# Historical tax rates UK



Source (accessed 22/01/2016):  
<http://www.economicshelp.org/wp-content/uploads/2012/11/Basic-income-tax-uk-48-12.jpg>



Source (accessed 22/01/2016):  
[http://www.ifs.org.uk/tools\\_and\\_resources/fiscal\\_facts/](http://www.ifs.org.uk/tools_and_resources/fiscal_facts/)