

The displacement effect of compulsory pension savings on private savings

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Summary

- Paper aims to find the size of the **displacement effect** using data on mandatory pensions wealth and private wealth in the Netherlands.
 - System of mandatory retirement savings may
 - + Induce people to save more (protect individuals against undersaving)
 - Replace private savings
 - **Displacement effect**: the extent to which mandatory savings replace private savings
- Large administrative dataset
- Extensive analysis: OLS, IV, matching, FE, subsample selections
- Preferred analysis (IV): -33% for wage-employed, -61% for self-employed.
- Reasons for heterogeneity: awareness & risk averseness

Bonus I: Great data

- Administrative records on a great number of individuals
 - First one to estimate displacement effect with administrative data?
 - Ability to make substantial subsets
 - Ability to construct different income and wealth concepts
 - Current affiliation with pension fund! → distinguish those with and without current affiliation
- Question:
 - authors use (historical) information on third pillar pension savings.
 - Third pillar pension savings not taxed → no administrative records. Where does this information come from?

Bonus II: Institutional setting

- Universal public pensions provide high flat rate income above poverty line.
- Occupational pension savings allow individuals to save over and above that basic necessity.
- Mandatory pension contracts are laid down in collective labor agreements, so that sectors (roughly) differ in:
 - Having a mandatory pension
 - Level of mandatory contributions
- Identification hinges on this unique setting. Adding a separate section on the institutional setting would really help the (international) reader.

Comments analysis: Fixed Effects

- Idea: address causality
 - Years 2007 – 2010: many pension funds needed a recovery plan. Variation in moment at which pension funds need to apply recovery plan.
 - Recovery plan → decreases pension wealth → is this offset by private savings?
- Combination of displacement and marginal propensity to consume out of wealth?
 - Individuals have negative shock in pension wealth → negative shock in total wealth → drop in consumption → increase in private savings
 - Even if there is full displacement, we will not find a 1 to 1 relation when mpc is small.
 - Angrisani et al. (2015)/Cristellis et al. (2015): A 1 euro drop in housing and financial wealth leads to a corresponding drop in consumption of respectively 7/9 and 4/6 cents.

Comments analysis: Fixed Effects

- Find 3500 euros extra private savings: high!
 - Suppose mpc is 5% → corresponding wealth shock would be around 70.000
- Income/age heterogeneity
- Overall trend of declining spending during that period (report coefficients of year dummies)
- More awareness due to being a participant of pension fund in trouble?

Comments analysis: OLS/IV/matching

- OLS estimates are considered to be small (9%)
 - Possible bias due to sorting into jobs with/without mandatory pensions based on savings/risk preferences
- Solution 1: matching
 - Unmatched difference 18000, matched difference 11500
→ smaller displacement effect
 - You calculate corresponding displacement of 24% (i.e. bigger), how come?
- Solution 2: IV → displacement effect of 33%:
 - Instruments (company size and sector) do not pass validity tests.
 - Still estimates seen as 'improvement' because size more in line with other literature

Too big focus on size?

- Maybe displacement in NL is really much lower than in other countries
- Mandatory savings in NL are quite high → are we oversaving?
- Possible evidence for oversaving in your results: OLS and IV regressions show rising displacement rates with income, than substantial drop for 5th income quintile
- Low awareness? Risk averseness?

Suggestions for further analyses (I)

- For self-employed you run OLS on subset of construction workers, because more homogeneous group with less sorting
- Can you also find such a homogeneous subset among wage-employed?
- For example: wholesale & retail, ICT, finance or business for wage employed
 - high fractions of individuals without compulsory pensions, i.e. enough variation
 - probably more homogeneous group wrt risk/savings preferences than when compared to for example workers in public services and education

Suggestions for further analyses (II)

- Can you use variation only within the group with compulsory contracts?
 - Contracts are different across sectors → Contributions can range (often 20-25%)
 - I find it likely that individuals select themselves into a job with properly arranged pensions versus no pension arrangement, but selection into a job with 25% contribution versus 20% may be less of an issue
- Show age heterogeneity next to income heterogeneity



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Very promising paper

- Alessie et al. (1997) (summarizing Gale (1998)) give 8 points that result in biased estimates of displacement effect.
- This paper is able to address 5/6 out of 8!
 1. Controlling for cash earnings in stead of total compensation
 2. Differences in life expectancy
 3. Omitting retirement age
 4. Omitting age
 5. Heterogeneity in savings propensity
 6. Pension wealth should be measured net of taxes
 7. Narrow measures of non-pension wealth
 8. Measurement error in pension wealth

Why study the displacement effect?

- ‘More information on the displacement effect – and the heterogeneity thereof – can be of guidance to policy makers who are looking for ways to help vulnerable groups better prepare for retirement or to make the pension system more robust in light of an ageing society.’
- Size of the effect → To what extent can mandatory pension savings boost total savings?
 - Displacement = -1: mandatory savings does not boost total savings.
 - Displacement > - 1 mandatory savings does boost total savings.
- Information on heterogeneity in displacement effect allows us
 - to target the pension system to those that are undersaving.
 - To identify those individuals that we can allow more freedom: e.g. should we force self-employed to save?

Reasons for less than full displacement

- Inertia: in absence of mandatory system he saves too little (> -1)
- **Low awareness**: he will not react to changes in mandatory system
- Individuals save for other reasons, precautionary savings/bequests (> -1)
→ **risk averse** individuals displace less, than risk seeing individuals
- Pension wealth is held as an annuity → free savings can drop more than increase in compulsory savings (< -1)
- Binding borrowing constraints → too generous mandatory pension system, cannot be offset by borrowing against the future (> -1)