

Paternalism in Pension Systems

András Simonovits

(EI RCERS HAS + IM-BUT + ED CEU)

Personal memories on János

- 1970: My **advisor** on Theory of Teams (MA of mathematics)
- 1976: 2 weeks in the **USSR** together
- 1982: My advisor on Non-Price Control (Ph.D. of Economics), incl. joint papers
- 1984: With **Zsuzsa**, host of my family at Princeton

Research group

- Entries
- 1970: myself
- 1971: Katalin Farkas (died)
- 1972: Judit Szabó
- 1973: Mária Lackó
- 1974: Zsuzsa Kapitány
- Joint lunch at cafeteria 11:30-12:30

Related researchers

- 1958: Tamás Lipták (died)
- 1968: Judit Rimler
- 1968: Béla Martos (died)
- 1973: Tamás Bauer, János Gács and Mihály Laki
- 2008: Aladár Madarász
- Private celebrations of János' birthdays from 1998

Motivation

- Kornai against paternalism in **socialism**
 - Economics of Shortage (1980)
 - Communist System (1992)
- Kornai against paternalism in capitalism
 - **Soft Budget Constraint** (+Maskin + Roland, 2003, JEL)
 - **Health Care** (+ Eggleston, 2001)
- But also Solidarity and Welfare:
PENSION?

My „serious talk”

- Pension: compromise between autonomy and paternalism
- Autonomy is preferable in general, old-age saving in particular
- Pension paternalism is due to myopia and lack of markets (indexed life annuities)

Plan

- 1. Historical phases of pension systems
- 2. Myopia vs. inefficiency
- 3. **Voluntary** pensions with tax expenditures
- 4. **Cap** on pension contributions
- 5. Conclusions

1. History of pension systems

Funded pension

- -1889: No mandatory pensions
- 1889-: Bismarck introduced mandatory pensions for blue-collar workers
- 1918-1924: WWI + hyperinflation destroyed pension funds
- 1929-1937: Great Depression ..
- 1939-1945: WWII..

Also unfunded pensions

- 1935: F.D.R. introduces **unfunded** public pensions
- 1947: Hungary adopts PAYG
- 1957: Germany also
- 1983: Chile – funded private pensions
- 1998: Hungary – **partial privatization**
- 2010: Hungary **renationalizes** the private funds

2. Myopia vs. inefficient pension

Myopia vs. inefficiency

- Simplest OLG model for comparing pensions (à la Feldstein, 1987)
- **Myopes** are able to accumulate private savings but not enough
- **Government** is able to force workers to contribute to pensions but inefficiently

Myopia vs. inefficiency, continued

- **Critical** efficiency: voluntary saving and mandatory pension provide the same SWF
- Subcritical efficiency: pension $>$ saving
- Supercritical efficiency: pension $<$ saving
- How does the critical value of efficiency depends on **myopia**?

2. Private saving vs. public pension

Discount factor	Critical interest factor	Young-age consumption	Old-age consumption
0.95	1.018	0.82	0.30
0.96	1.012	0.77	0.32
0.97	1.007	0.71	0.35
0.98	1.003	0.65	0.39
0.99	1.001	0.57	0.43
1.00	1.000	0.50	0.50

3. Voluntary pensions ...

Voluntary pensions with tax expenditures

- **Voluntary** pensions (VP) appear to be very attractive because they replace paternalism
- In fact, most VPs rely on tax rebates or matching, therefore need additional **taxes**
- **Asymmetric** VP: only the well paid participate
- **Symmetric** VP: the low paid also participate

3a. Pure public pension ($\alpha=0$)

Wage	Voluntary contrib	Saving	Worker cons.	Pension. cons.
0.5	0	0.00	0.41	0.18
2.0	0	0.16	1.49	1.05

3b. Asymmetric voluntary ($\alpha=1/3$)

Wage	Voluntary contrib.	Saving	Worker cons.	Pension. cons.
0.5	0.000	0	0.40	0.18
2.0	0.165	0	1.43	1.17

3c. Symmetric voluntary ($\alpha=1$)

Wage	Voluntary Contrib	Saving	Worker cons.	Pension. cons.
0.5	0.008	0.00	0.39	0.22
2.0	0.032	0.09	1.41	1.04

4. Cap on pension contributions

Cap on pension contribution base

- Different countries in different times apply different **caps** in terms of average gr. wage
- Sweden: 1.3; Germany: 1.8
- Hungary, 1993: 3.3; 1996: 1.6; 2005: 3.3; 2013: no
- Reasons
 - Hidden personal income tax
 - Minimally necessary paternalism

4. Impact of pension cap on consumption

Cap	Low young	Low old	High young	High old
0.0	0.48	0.09	1.54	1.85
...				...
0.4	0.37	0.27	1.49	1.78
<i>0.5</i>	<i>0.33</i>	<i>0.33</i>	<i>1.47</i>	<i>1.77</i>
0.6	0.33	0.33	1.46	1.75

5. Conclusions

- Paternalism should be **minimized** in general
- The extent of **optimal paternalism** in pension systems depends on the discount factors and the critical interest factors
- Voluntary pension is good but tax expenditures should be taken into account
- Cap on pension contribution should be carefully chosen