Does Mandatory Saving Crowd Out Voluntary Saving?

Evidence from a Pension Reform

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Research Question & Motivation

Large cohorts are entering retirement age and with rising longevity a significant share of households does not possess adequate savings

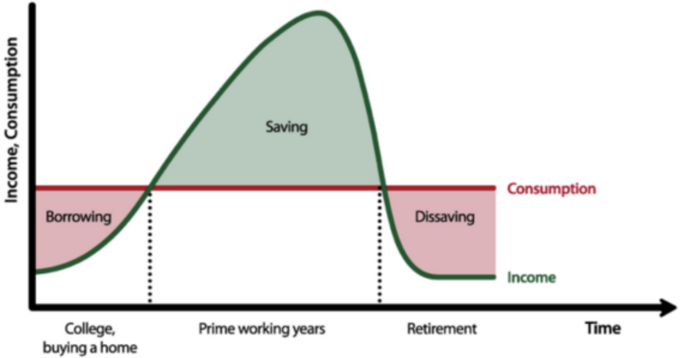
Policy response: Increase reliance on mandatory retirement savings

How do households adjust their voluntary savings when faced with policies raising their mandatory savings?

- Do they completely offset the effects of the policy, leaving aggregate saving unchanged?
- Do mandatory saving policies lead to higher aggregate saving?

Why Would Households Respond by Reducing Voluntary Saving?

Permanent income is unchanged

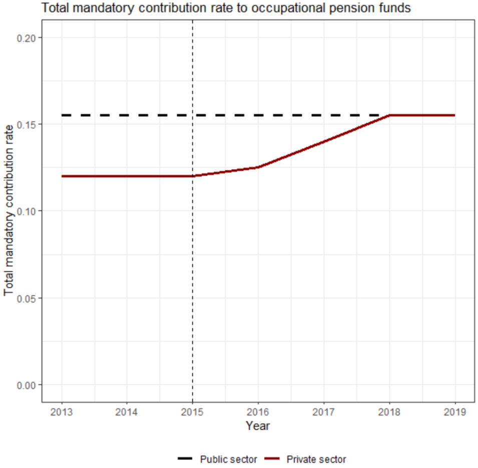


This Paper

- We construct high-quality measures of household consumption and saving using detailed third-party reported data on income, housing, financial wealth and assets from Icelandic tax registries
- We exploit a recent large pension reform in the private sector labour market in Iceland to study how pension saving affects voluntary saving
- We conduct a survey among workers in both the private and public sector to gauge their saving motives and the awareness of the reform

The Reform - Stylized

The reform raised mandatory pension contributions rates from by 3.5pp (from 12% to 15.5% in 2016-2018)



Key Findings

We do not find evidence suggesting individuals respond to higher mandatory saving by reducing their voluntary saving

Survey results suggest widespread ignorance about pension savings, although those who report saving for retirement as their main motive for saving seem to have lowered their voluntary saving after the reform was implemented

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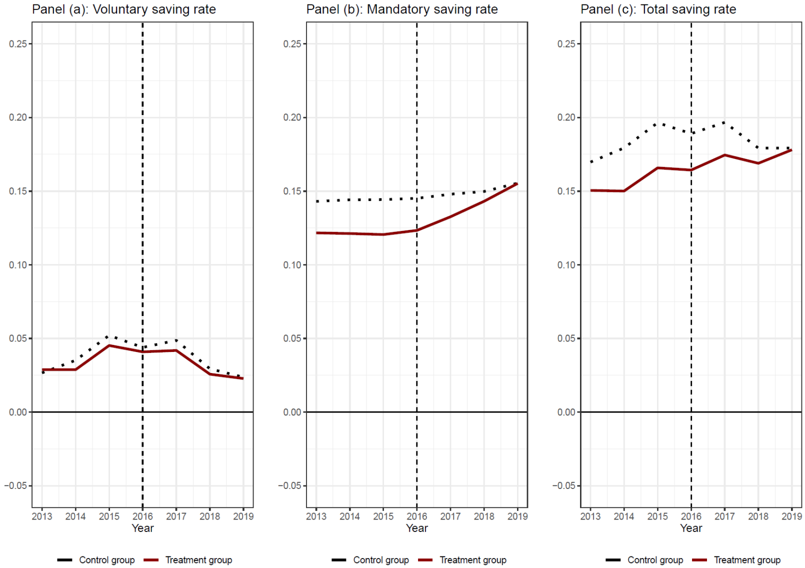
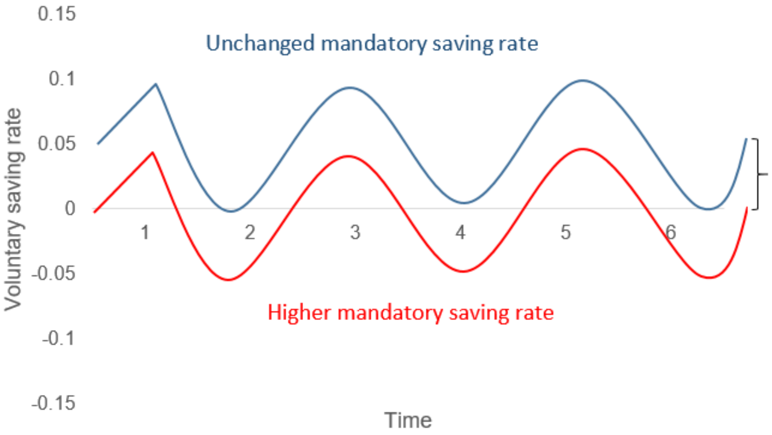


The ideal experiment

Randomize who gets higher mandatory saving and simply observe the difference in voluntary saving



In our Case, the Groups Might Systematically Differ

Private sector workers might be driven, energetic, optimistic, and favour a night out with friends over a quiet evening with a book

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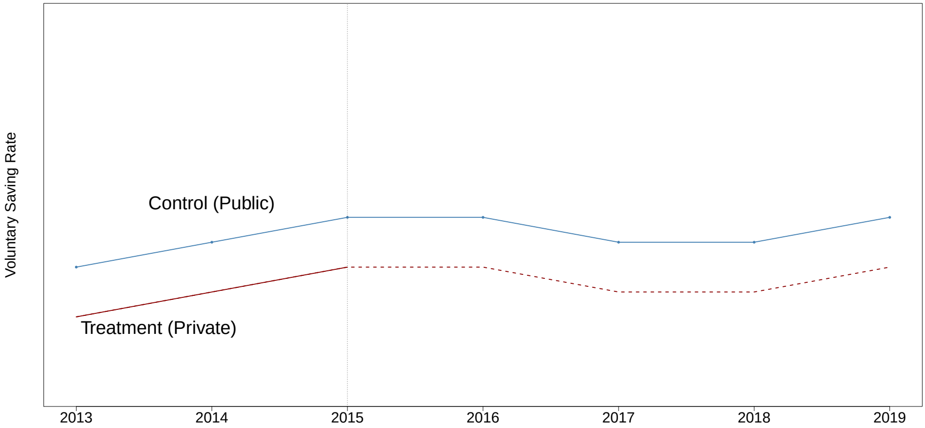
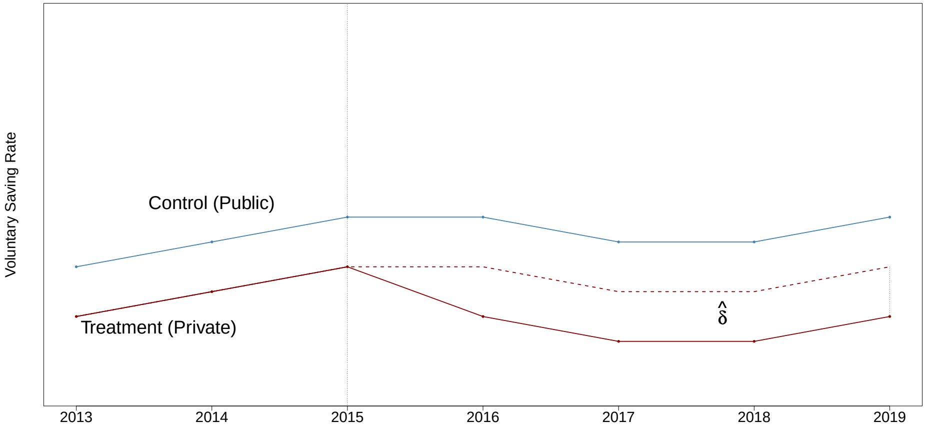
What We Do Instead - Explanatory Example

We assume that in the absence of the reform, the voluntary saving rate of the two groups **would have** moved together



What We Do Instead - Explanatory Example

The effect of the reform is then measured as the difference in the actual saving rate of private sector workers and the counterfactual saving rate



What We Do Instead - Actual results

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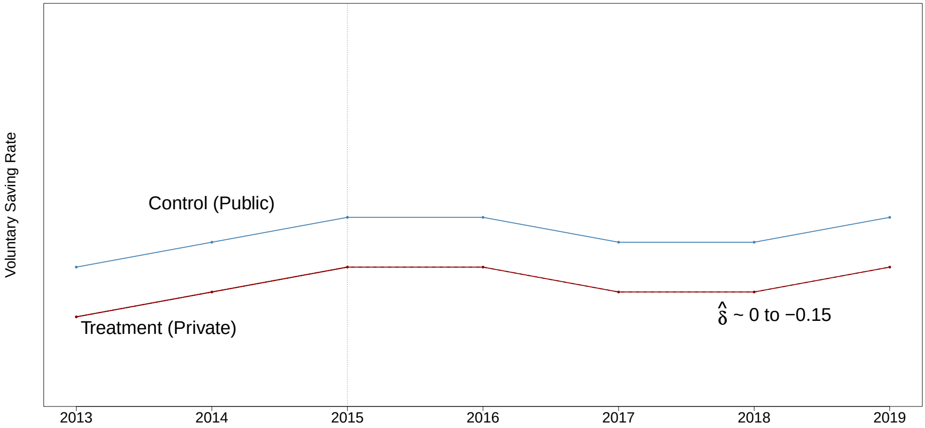
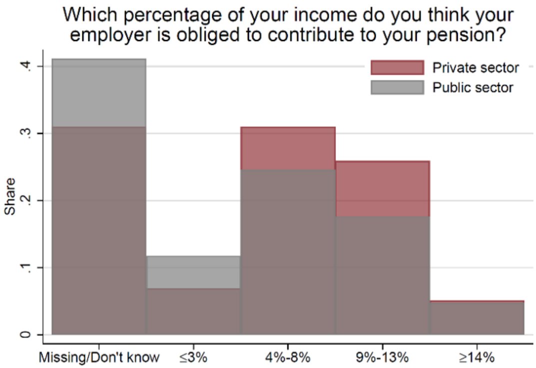


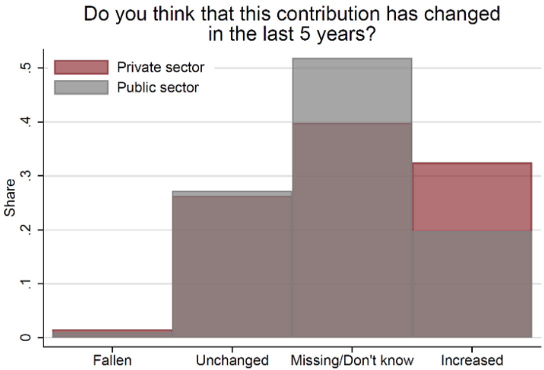
Results - Offset coefficient

- We find that households faced with a 1% increase in their mandatory saving ratio reduced their voluntary saving rate by 0 - 0.15%

- 85-100% of the rise in mandatory saving rates passed through to higher total saving

Survey Suggests Lack of Knowledge About the Reform





Conclusion and Next Steps

We do not find evidence that individuals respond to higher mandatory saving rates

We find evidence that higher mandatory saving rates raises aggregate saving

- Creates buffers against shocks. f.x. through foreign assets
- Raises the domestic capital stock through higher saving and investment
- Puzzling because the reform is so large - at some point rising mandatory saving is bound to lower voluntary saving, right?

No evidence of shifts between pension accounts due to the reform

Results seem to be driven by lack of knowledge about the reform