Discussion of “Age of Decision: Pension Savings Withdrawal and Consumption and Debt Response”

Sumit Agarwal, Jessica Pan, and Wenlan Qian

Amir Kermani (UC Berkeley)

NBER East Asian Seminar on Economics
June 2015

Big Picture

- Main Question: Which one is better: More or less flexible pension funds?

- The effect of "flexibility" on savings: 1 dollar increase in government subsidy for saving in pension plan increases the total savings by 1 cent. (Chetty et al. (2015))

- The effect of "flexibility" on consumption: About half of the eligible households use their 401(k) to finance pre-retirement consumption. (Beshears et al. (2011,2015), Lu et al. (2014)

This Paper

- People actually do withdraw a large fraction of their pension saving exactly upon having the option to do so (on average $15k).
- Less than 5% is used for consumption.
- Less than 5% is used to pay down debt.
- At least 2/3 of the money remains in the households' bank accounts.
- Main Puzzle: Why do households withdraw their money immediately and save it in an account that pays a much lower interest rate?

Overview of Comments

- This paper is very interesting because:
  - It is inconsistent with liquidity constraints being the main reason for withdrawals.
  - It is inconsistent with the prediction of models with hyperbolic discounting and/or self-control problems.
- What is driving this withdrawal behavior?
- What is the cost of these withdrawals?

Liquidity Constraints? Self-control?

- Liquidity constraints are not the main driver of withdrawals:
  - Low Credit Limit / Low Bank Balance / Low Income: Withdraw $10-12k, Consume $1k-$2k
  - High Credit Limit / High Bank Balance / High Income: Withdraw $18-20k, consume $0.5k

- Almost all the money remains in HH bank accounts even two years after the withdrawal.
  - Very responsible savers (inconsistent with over-consumption hypothesis)

What is driving this result?

- Survey responses to why they want to withdraw:
  - 30 percent into a bank account, use 18 percent to invest in stocks, bonds, or mutual funds, set aside 11 percent for travelling and 10 percent to buy property.
  - It seems that most of the consumption response is driven by travelling (and pilgrimage – Compare Chinese with Malay consumption response)
- This is basically saying these households think they are better investors than the central government.
- May be you found a third channel for the cost/benefit of flexibility: Over-Confidence / Better asset allocation.

Another Puzzle: Cohort Differences

- Here is another puzzle:
  - 2010 cohort could withdraw 30% of their CPF. They withdrew $11k on average.
  - 2011 cohort could withdraw 20% of their CPF. They withdrew $18k.

- Can it be that 2011 was a better year for investment?
- Can it be (dis)trust in the pension system?
- What about macroeconomic conditions?
  - Looking at households income profile and balance-sheet could shed light on this

What about Illiquidity of the Fund?

- It seems that if you withdraw once, you must wait at least until your next birthday before you can withdraw again.
- Conditional on withdrawing *something*, there is a "pre-cautionary saving" motivation for withdrawing more.
  - Illiquidity can explain the intensive margin (but not the extensive margin)
- Can you observe whether the household is a homeowner or not?

What is the "cost" of the puzzle?

- The upper-bound for cost is:
  - $10,000 × 2% = $ 200 per year.
  - The real cost is even less because of the liquidity service of the bank account.
  - Any positive NPV investment opportunity can explain the puzzle.

- The cost seems very small.
  - Compare this with studies in the US showing people leave about $1500 on the table when they do shopping for the mortgage.

Technical comment I: Normalizing the dependent variables

- Both from a theoretical point of view and an empirical point of view, better to normalize all regressions.
  - For example normalize by the average earnings of each household in the pre-period.
- As is, cross-sectional variation in the data is very correlated with household income.
- This can be problematic in an environment with wealthy-hand-to-mouth households.
  - If you have a high credit limit but also high commitments (kids tuition, housing expenses, health expenses) it is not obvious "high credit" means no liquidity constraint.

Technical Comment II: Controlling for trends

- Since we really care about following the households for one to two years after they turn 55, there should be many more periods for the pre-period and there should be more controls for the time trend.
- We don't know what happens to household income:
  - If income goes up, then perhaps absent the income increase the account balance would have been declining. (Consistent with over-consumption hypothesis)
  - If income is declining, then households behavior can be very consistent with the pre-cautionary saving motivations.

Conclusion

- The very interesting finding: Households withdraw a huge amount of money but **not** to finance consumption.
- They either allocate their portfolio better than the government… or they are under the impression that they do.
- Determinants of withdrawal that are not yet tested:
  - Households income profile, households balance-sheet
- How large are the cost/benefit of withdrawals?
  - Perhaps a model can help a lot.