COMMENT TO
"THE WELFARE AND LABOR MARKET EFFECTS OF MANDATORY PENSION SAVINGS: EVIDENCE FROM THE ISRAELI CASE" BY ADI BRENDER

Martino Tasso[*]

Summary of the paper

This very interesting paper studies the effects of a major mandatory pension savings reform introduced in 2008 in Israel with respect to both the heterogeneous response of employees in terms of saving behavior and the tax incidence of the contributions to the pension funds. Adi looks at this issue from an empirical point of view, using a random panel with administrative information on about 300,000 employees.

The reform, gradually implemented in 2008-14, consisted in the introduction of a new mandatory pension arrangement targeted towards those without prior pension savings, which complemented (but not substituted) the existing national insurance pension system. The new, and mostly tax deductible, contribution increased over time from 2.5 to 17.5 percent of the gross wage. As Adi shows in his work, not all employees had the same incentive to participate in this scheme. Indeed, even though the program was mandatory for some portions of the Israeli population, its enforcement was lax at the beginning (i.e., in 2008). This feature provides the author with a way to check whether agents rationally reacted to the incentives generated by the program. Through a probit analysis, Adi shows that this seems to be the case. In particular, poorer workers did not participate as much because they could reasonably expect to exploit the income floor guaranteed by the national insurance pension system (after their retirement) and because they had fewer chances to take advantage of the tax deductibility of the contribution (during their working years). Moreover, the author shows that, among workers who choose to participate at first, the majority stuck with the minimal contribution rates, that is, just enough to be compliant with the law. Therefore, it seems that the program sub-optimally forced low-income workers to save too much, early in their working lives.

The second part of Adi's work looks into the issue of the incidence of the new contribution. According to the law, employees are responsible for paying only one third of the new contribution; clearly, the economic incidence does not simply follow the legal apportionment of a tax, but depends on the relative elasticity of demand and supply. Indeed, since the contribution to the new pension fund created a wedge between gross labor costs and net wage, it is interesting to study who bears the burden. The author answers this question by looking at wage dynamics in the five years following the implementation of the reform and finds that wages were reduced by nearly the full amount of the increase in employers' contributions.

The author concludes that this program, which was originally meant to stimulate savings among poorer individuals, turned out to be both inefficient (in terms of life-cycle allocation of consumption) and costly (in terms of net earnings) for many of them, given its interaction with the tax-and-benefit system in place.

[*] Bank of Italy.

Comments

I found the first part of the work particularly convincing: my comments are, therefore, mainly calls for future research on the topic.

This study is about the effects of economic incentives on the participation to a pension savings program, which, as Adi pointed out, benefited of several tax advantages. Thus, an important question from the policy perspective is whether the program induced an overall saving increase or it simply encouraged a shift from one saving vehicle to another. In my opinion, this is a question worth answering, maybe using some additional data on households' savings allocation.

Moreover, since many scholars in this strand of literature attach a great importance to *financial literacy* in explaining households' saving patterns, it would be interesting to check whether the correlation between income and saving behavior, found in the paper, is robust to the inclusion of the education level as a control.

Finally, in some countries, workers are allowed to draw from their retirement accounts early in some specific cases of need. In those countries, a mandatory savings program thus works as an insurance program too. I believe that this feature matters when evaluating the "optimality" of the program. My understanding is that this characteristic is of limited importance in Israel; nevertheless, as the lessons learned thanks to this paper could be easily extended to other countries, I believe a clarification about the nature of the saving program should be made.

In the second part of the paper, in order to evaluate the incidence of the program, Adi compares the wage dynamics in 2007-12 of two distinct groups of employees: those who did not have pension savings in 2007 e were therefore forced into the mandatory savings program (treatment group) and those who did (control). One could worry that control and treatment group differ substantially in some unobserved characteristics (in fact, the former saved, while the latter did not). Adi compares the 2007-12 period to the 2001-06 one, which experienced a similar labor market dynamics, to account for this possibility. In my opinion, one alternative way to address this concern would be to check whether the so called *parallel trend assumption* holds, i.e. whether wage dynamics of the two groups before 2007 are similar. It could also be interesting to verify that placebo policies generate differences in wage dynamics which are not statistically different from zero. Perhaps, as an additional robustness test, focusing on new young workers (first time employees) in 2007 and 2008 respectively could reduce the severity of the problem of comparability of treatment and control group: one could argue that these workers face different institutional arrangements in an almost random fashion.

Finally, I think that the text should clarify the exact definition of the dependent variable in most of the analysis, that is, whether individual wages include the employee's and/or the employer's contributions.

Conclusions

I found Adi's paper very interesting, thanks to both its focus on a highly relevant issue from the point of view of economic policy and the care of the analysis. I really enjoyed reading it and I thank Adi for the opportunity of sharing my thoughts about this piece of research with him. Indeed, since other countries may face similar problems, this work could teach important lessons which could be usefully applied even outside Israel. In general, this paper reminds us of the great importance of the linkages of different economic policies. Because of them, even the most well-intended policies could unfortunately generate unplanned outcomes.