Port Econ J (2015) 14:45–63
DOI 10.1007/s10258-015-0107-0

ORIGINAL ARTICLE

Socially optimal contribution rate and cap in a proportional (DC) pension system

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Received: 21 April 2014 / Accepted: 10 February 2015 / Published online: 1 March 2015

Abstract In our model, the government operates a mandatory proportional (DC) pension system to substitute for the low life-cycle savings of the lower-paid myopic workers, while maintaining the incentives of the higher-paid far-sighted ones in contributing to the system. The introduction of an appropriate cap on pension contribution (or its base)—excluding the earnings above the cap from the contribution base—raises the optimal contribution rate, helping more the lower-paid myopic workers and reserving enough room for the saving of higher-paid far-sighted ones. The social welfare is almost independent of the cap in a relatively wide interval but the maximal welfare is higher than the capless welfare by 0.3–4.5 %.

Keywords Proportional (DC) pensions · Contribution rate · Contribution cap · Maximum for taxable earnings

JEL Classification H53 · H24

An earlier version of the present paper was published as a discussion paper, Simonovits (2012). I am indebted to N. Barr, Zs. Cseres-Gergely, G. Kézdi, J. Köllő, G. Kőrösi, M. C. Lovell, Th. Matheson (my discussant at the IIPF Congress in Dresden held in 2012), J. Pál and G. Varga for friendly comments. H. Fehr deserves a special acknowledgment for his steady contribution to developing this paper. I express my gratitude to anonymous referees, especially of the POJE's; who greatly helped to improve the paper. This research has received generous financial support from OTKA K 81483.

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