

The role of rationality on the choice to switch to FDC pension system

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Ageing of the population stands behind the worsening of the public finance's perspectives in most European countries. The natural response to such problem was the reform of the pension system. Before the reforms started, pension system used to be based only on one pillar (PAYG DB), which could be characterized by high level of inter-generation and intra-generational redistribution. The reforms were usually based on principles of "risk diversification" and "increasing the equivalency". These principles could be found in fully funded contribution based pension system (FDC system), which was newly established in many European countries (mostly CEE countries). The old pay-as-you-go defined benefit pension system was partially replaced with FDC system. The switch could be undergone either by strictly regulated approach or by so called opt-out. Opt-out means that state administration gives its citizens a choice whether to stay in the old system, or whether to choose a new one. The latter case raises the question how to estimate the proportion of population who will voluntarily switch to FDC system.

In our paper, we present a micro-based simulation model for the Czech Republic that allows us to model the individuals' switching decisions using several economic and behavioral factors within an old (PAYG DB) and a new (FDC) system. Our work is based on the assumption that the individual's choice is made on the base of rationality. It allows us to estimate the proportion of people who would opt-out to a funded pillar. In the second part of the article we release the assumption of rationality and find out arguments why more workers switched to a new system than was expected.

Our results show that only a small fraction of population would choose the multi-pillar scheme. However, this conclusion is true only under the assumption of rationality. Leaving this assumption explains why the switching strategy is favourable for more individuals than it was expected.

Keywords: pension system reform, opt-out, pension fund, rationality