

Active vs. Passive Decisions and Crowd-out in Retirement Savings Accounts: Evidence from Denmark

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Policy Question

- U.S. spends approximately \$100 billion per year on subsidies for retirement savings accounts such as 401(k)'s and IRA's [JCT 2012]
- Goal of these subsidies is to increase savings rates
- We evaluate whether subsidies accomplish this goal
 - Do tax subsidies encourage families to save more...
 - or simply induce shifting into tax-advantaged accounts?

Prior Work

- Extensive research on this question over three decades using U.S. data [e.g. Hubbard 1984, Skinner and Feenberg 1990, Poterba, Venti, Wise 1996, Engen, Gale, Scholz 1996, Engelhardt and Kumar 2007, Gelber 2010]
- But answer remains highly debated
- Main problem: lack of high quality data on household savings in *non-retirement* accounts in the U.S. [Bernheim 2002]
 - U.S. studies have good information on retirement account balances and agree on impacts of policy within these accounts
 - But identifying policy impacts on saving in non-retirement accounts has proven much more challenging

Danish Savings Data

- To obtain more precise evidence, we turn to data from Denmark
- Universe of Danish income tax returns, 1994-2009
 - 4.3 million individuals (aged 18-60)
 - 45 million observations on savings
- Data on total financial savings from 3rd party reports to tax authority
 - High quality savings measures that with little reporting and measurement error

Should U.S. Policy be Informed by Danish Data?

1. Pension system in Denmark is similar in structure to the U.S.
 - State-provided defined benefit plan (analogous to Social Security)
 - Employer-provided defined contribution accounts (401(k)'s)
 - Individual retirement accounts (IRA's)
2. Savings rates for working-age individuals are comparable
3. Policy impacts *within* retirement accounts in Denmark match the U.S.
 - Ex: impacts of subsidies and defaults on retirement contributions
 - Savings decisions *outside* retirement accounts likely to be similar as well

Overview

- We analyze two types of policies using quasi-experimental methods
 1. Automatic contributions by government or employers to workers' retirement savings accounts
 2. Tax subsidies for retirement savings
- Main finding: Automatic contributions raise total savings much more than price subsidies
 - Interpret this result through a model of active vs. passive savers

Impacts of Government Policies on Saving for Active vs. Passive Savers

Automatic Contribution

	Raises Pension Contribs.?	Raises Total Saving?
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Active Savers

No

No

Passive Savers

Yes

Uncertain

Impacts of Government Policies on Saving for Active vs. Passive Savers

	Automatic Contribution		Tax Subsidy	
	Raises Pension Contribs.?	Raises Total Saving?	Raises Pension Contribs.?	Raises Total Saving?
Active Savers	No	No	Yes	Uncertain
Passive Savers	Yes	Uncertain	No	No

Impacts of Government Policies on Saving for Active vs. Passive Savers

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Data	?	?	?	?

Outline

1. Impacts of Tax Subsidies
2. Impacts of Automatic Contributions
3. Testing for Active vs. Passive Choice
4. Policy Lessons

Part 1
Impacts of Subsidies for Retirement Saving

Impact of Subsidies: Quasi-Experimental Design

- Denmark has two types of tax-deductible savings accounts:
 - Capital pensions: paid as a lump sum
 - Annuity pensions: paid as annuity
- Subsidy for *capital* pensions for individuals in top income tax bracket was reduced in 1999
 - Tax treatment of annuity pensions unchanged

Taxation of Capital Pensions

Pre-1999

Tax At Time of Contribution

0%

Tax on Capital Gains

~20%

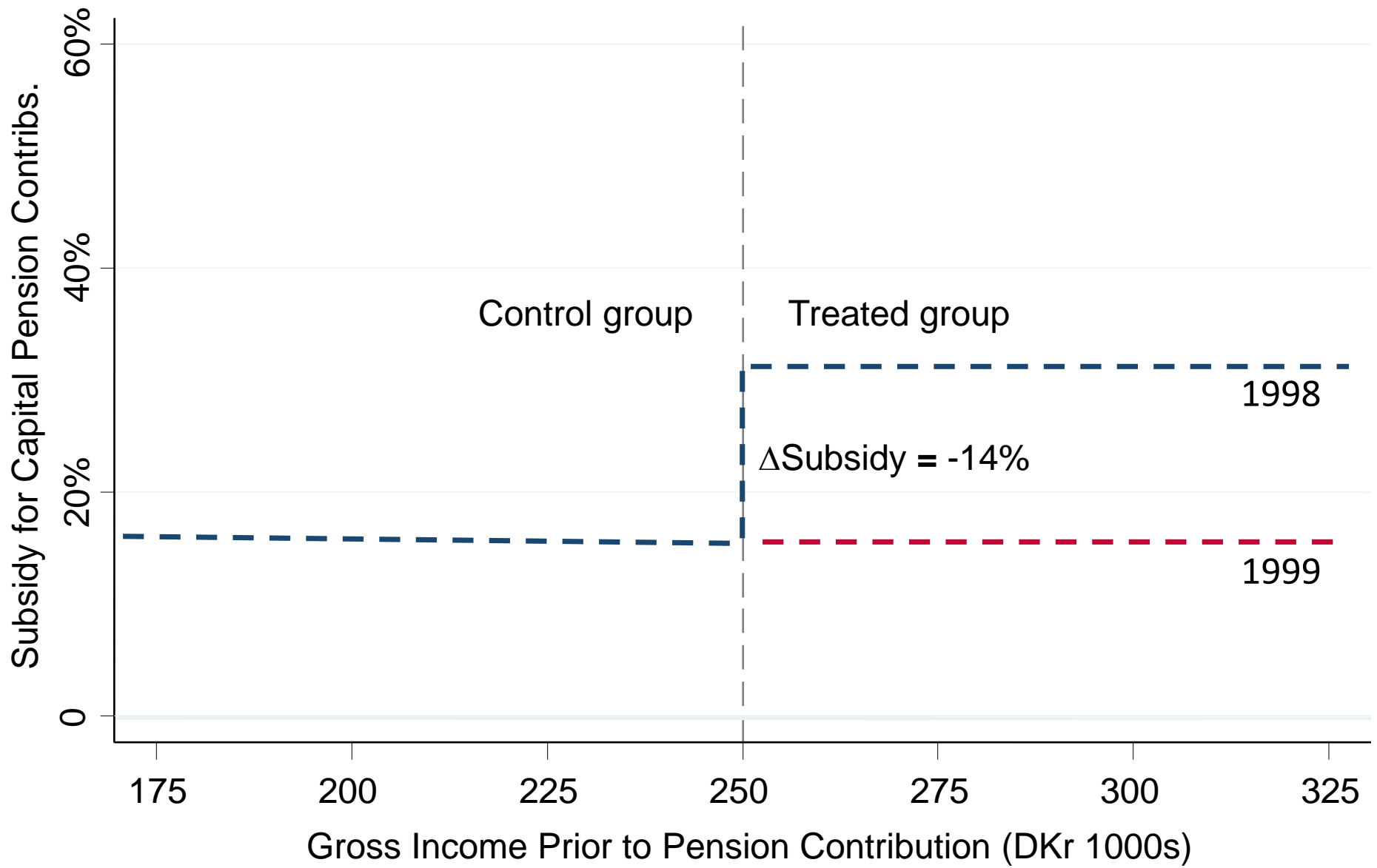
Tax on Payout

40%

Taxation of Capital Pensions

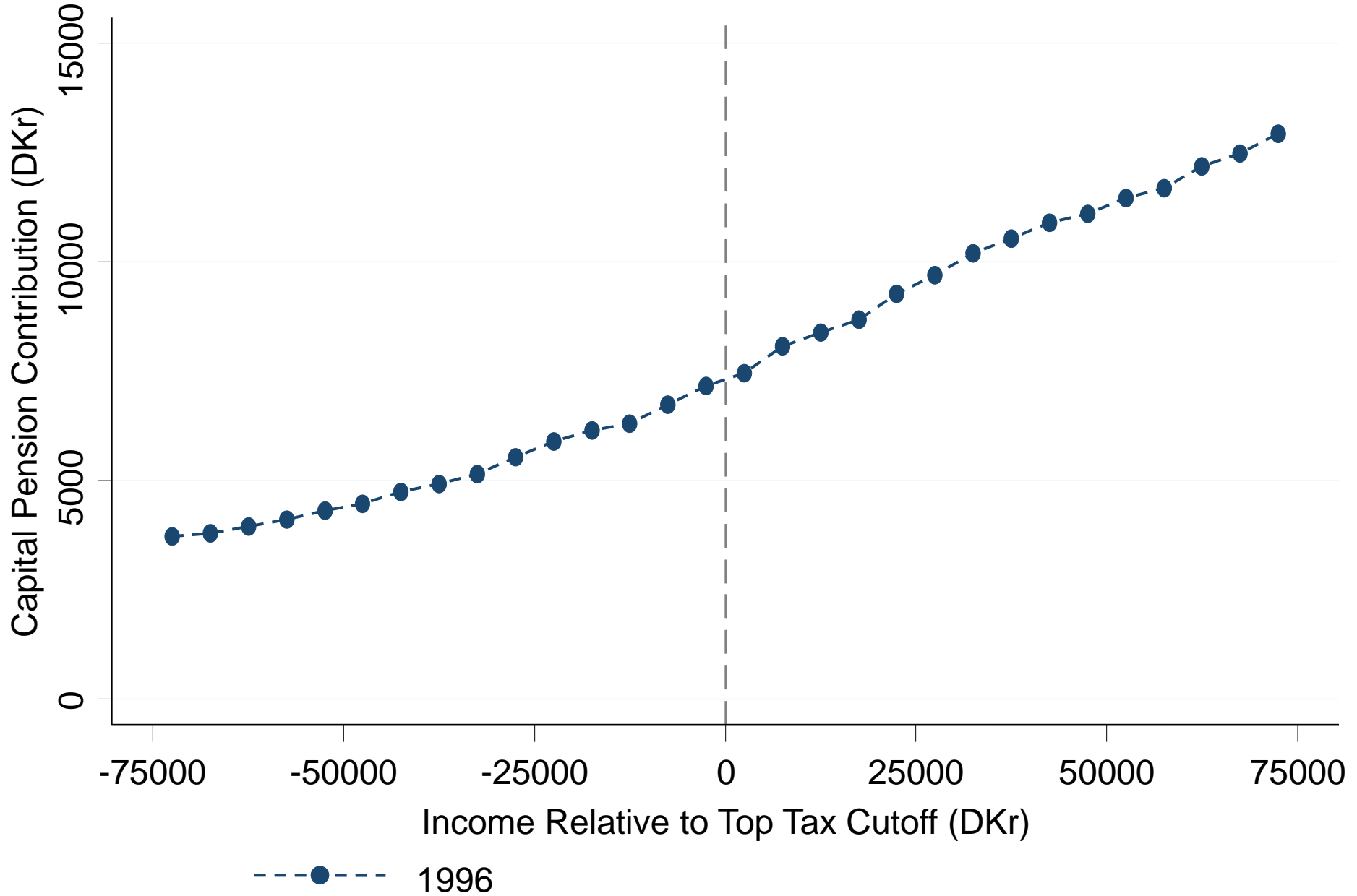
	Pre-1999	Post-1999
Tax At Time of Contribution	0%	14% if in top tax bracket
Tax on Capital Gains	~20%	~20%
Tax on Payout	40%	40%

Change in Subsidy for Capital Pensions in 1999

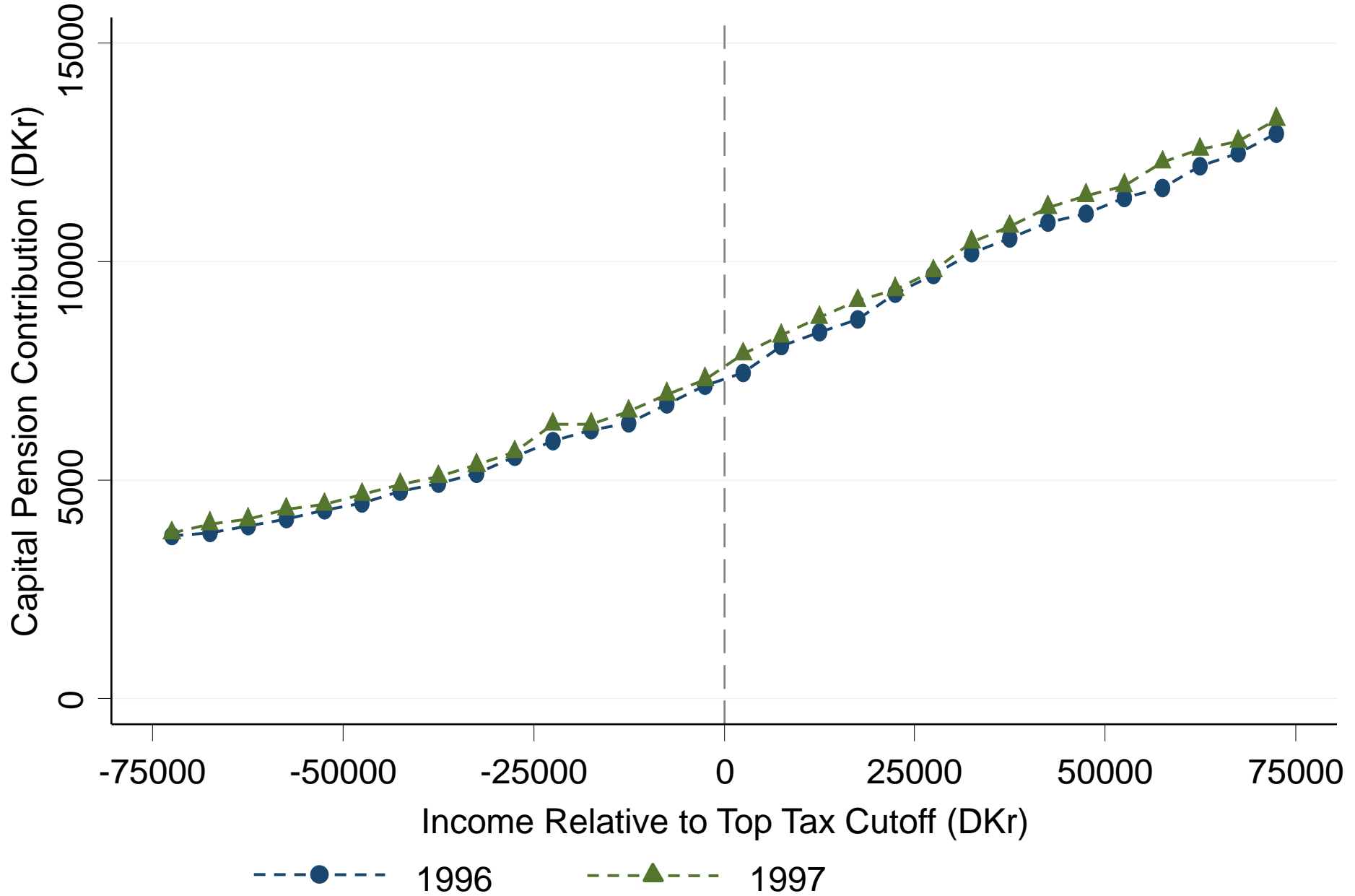


Note: \$1 \cong 6 DKr

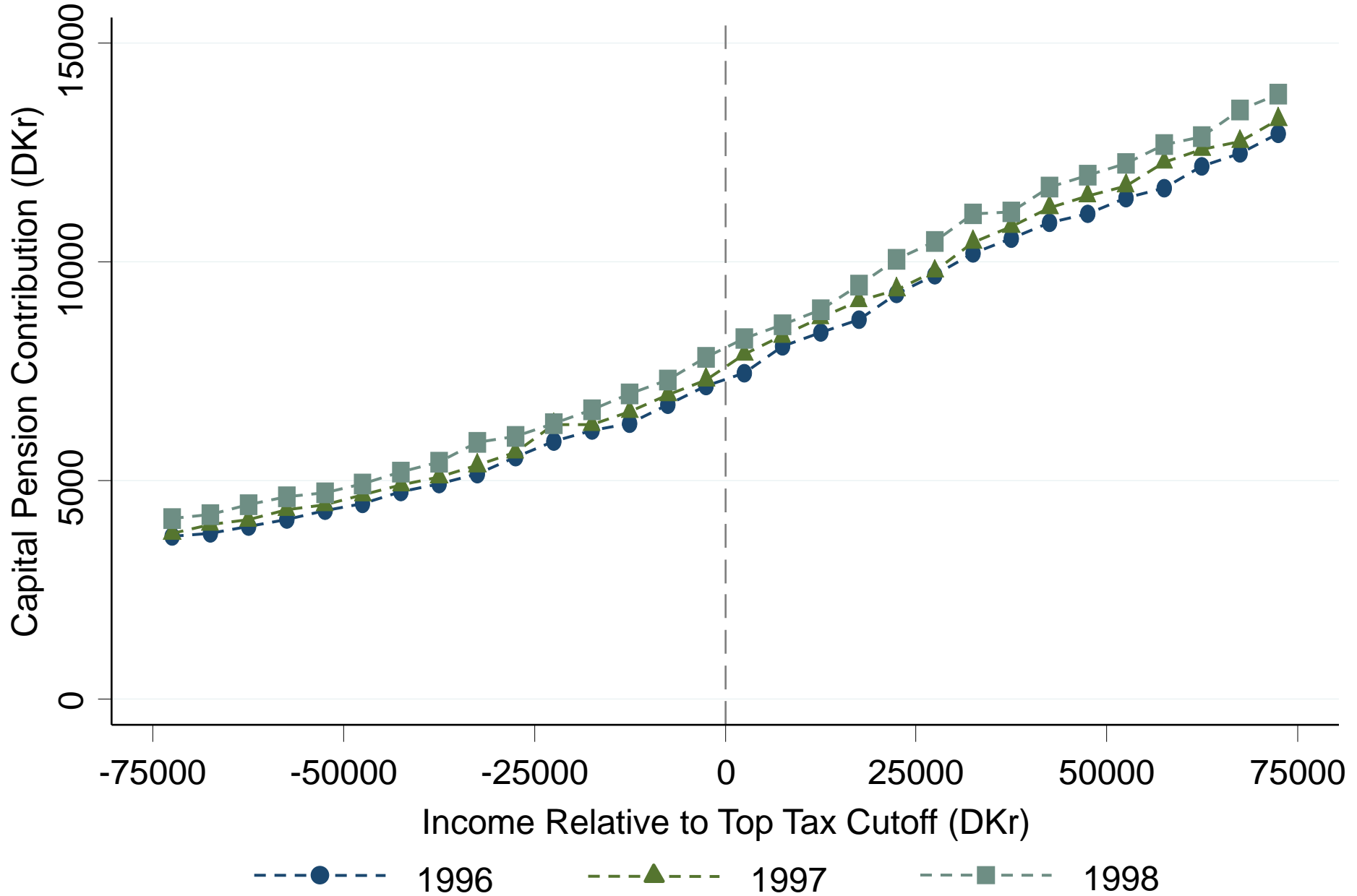
Impact of 1999 Capital Pension Subsidy Reduction On Capital Pension Contribs.



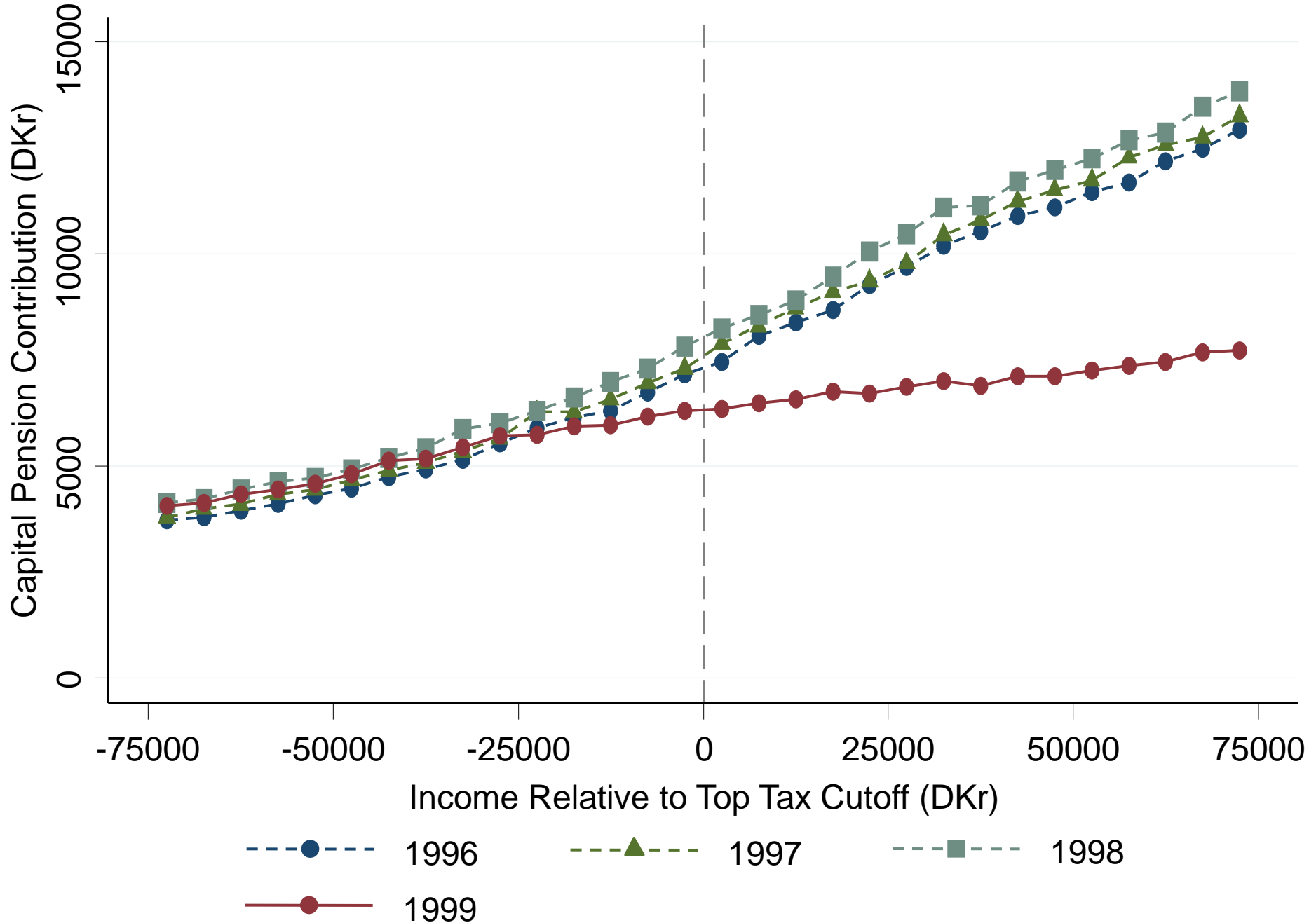
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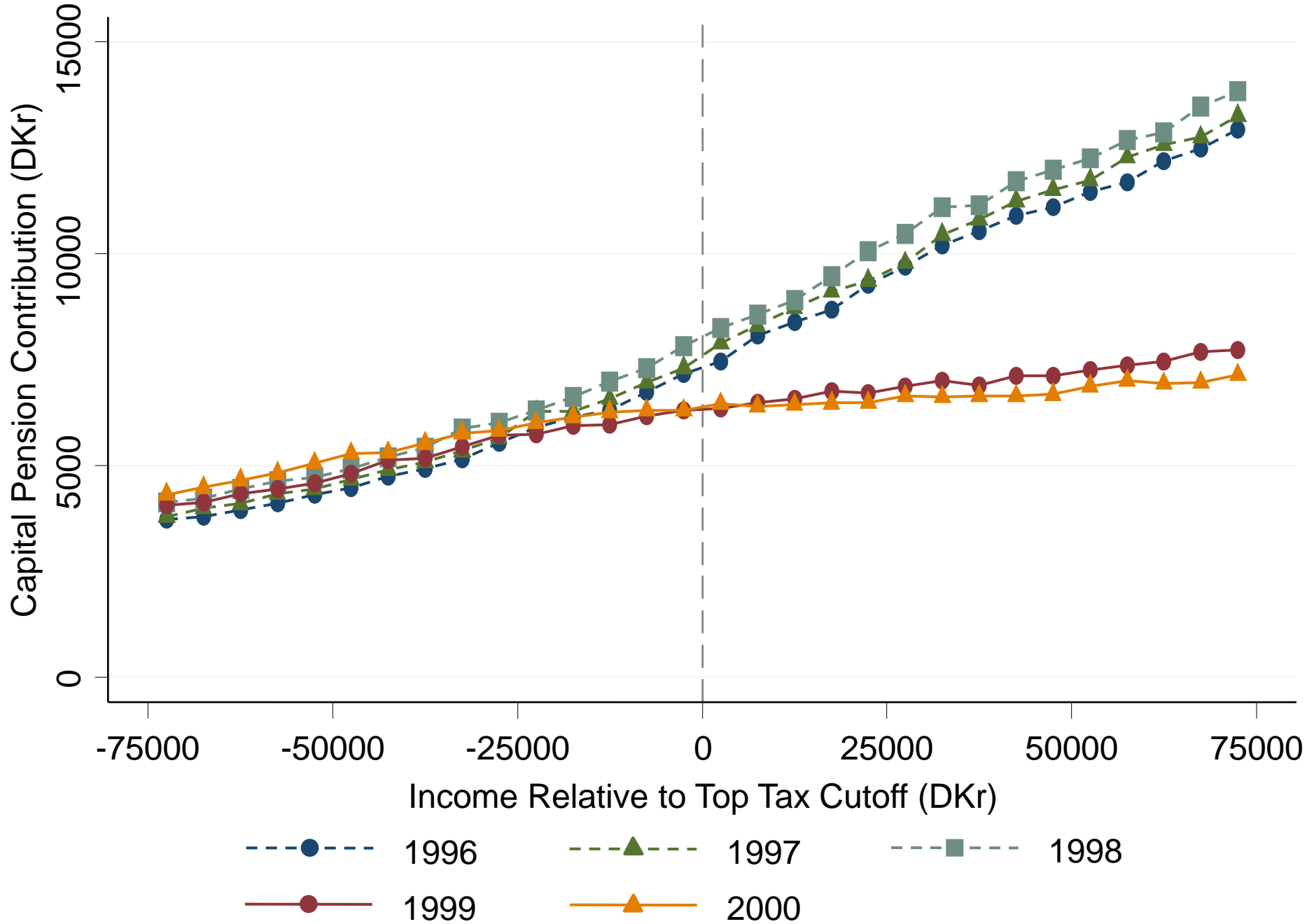
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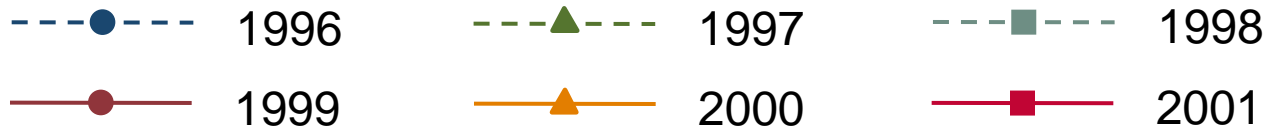
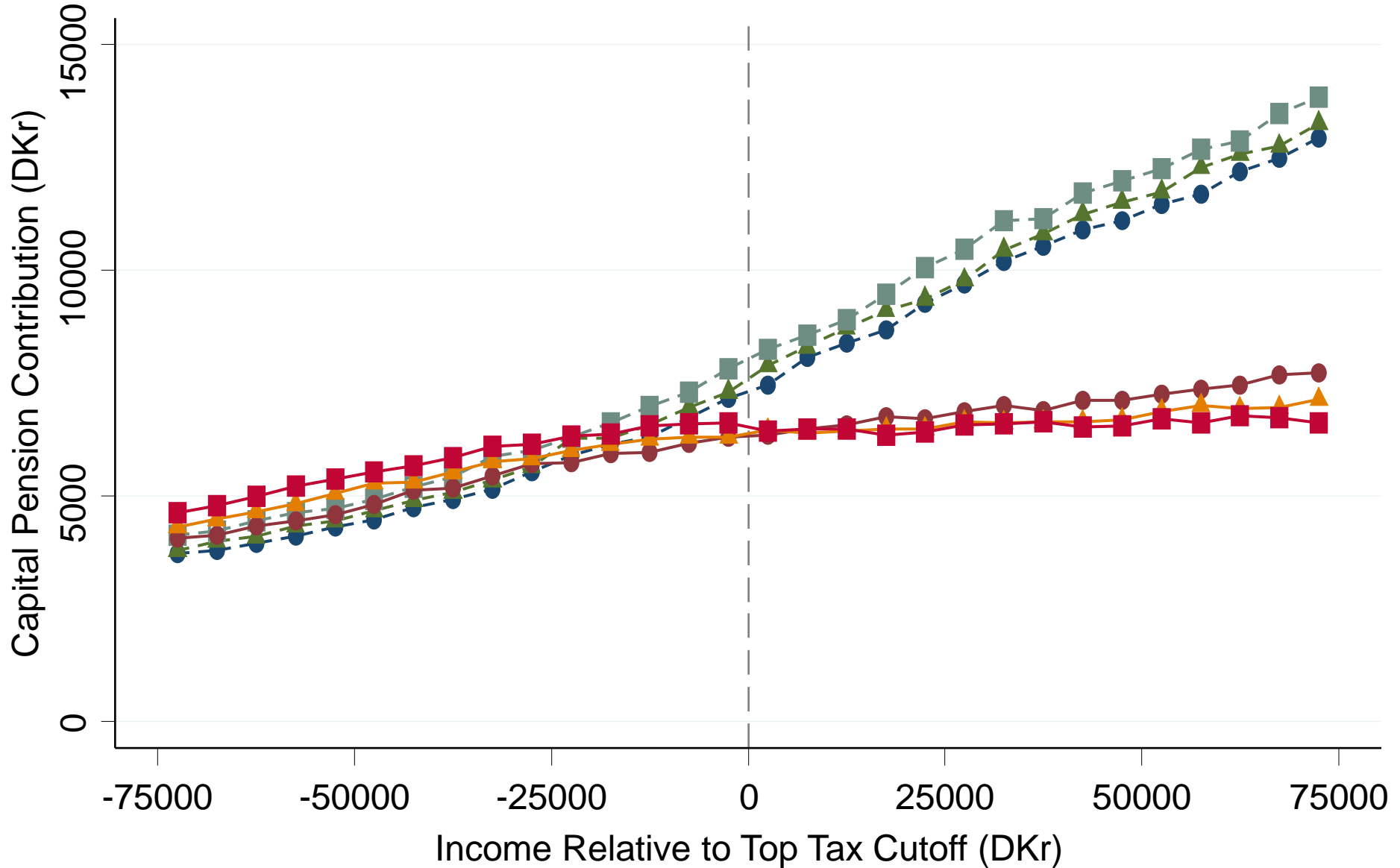
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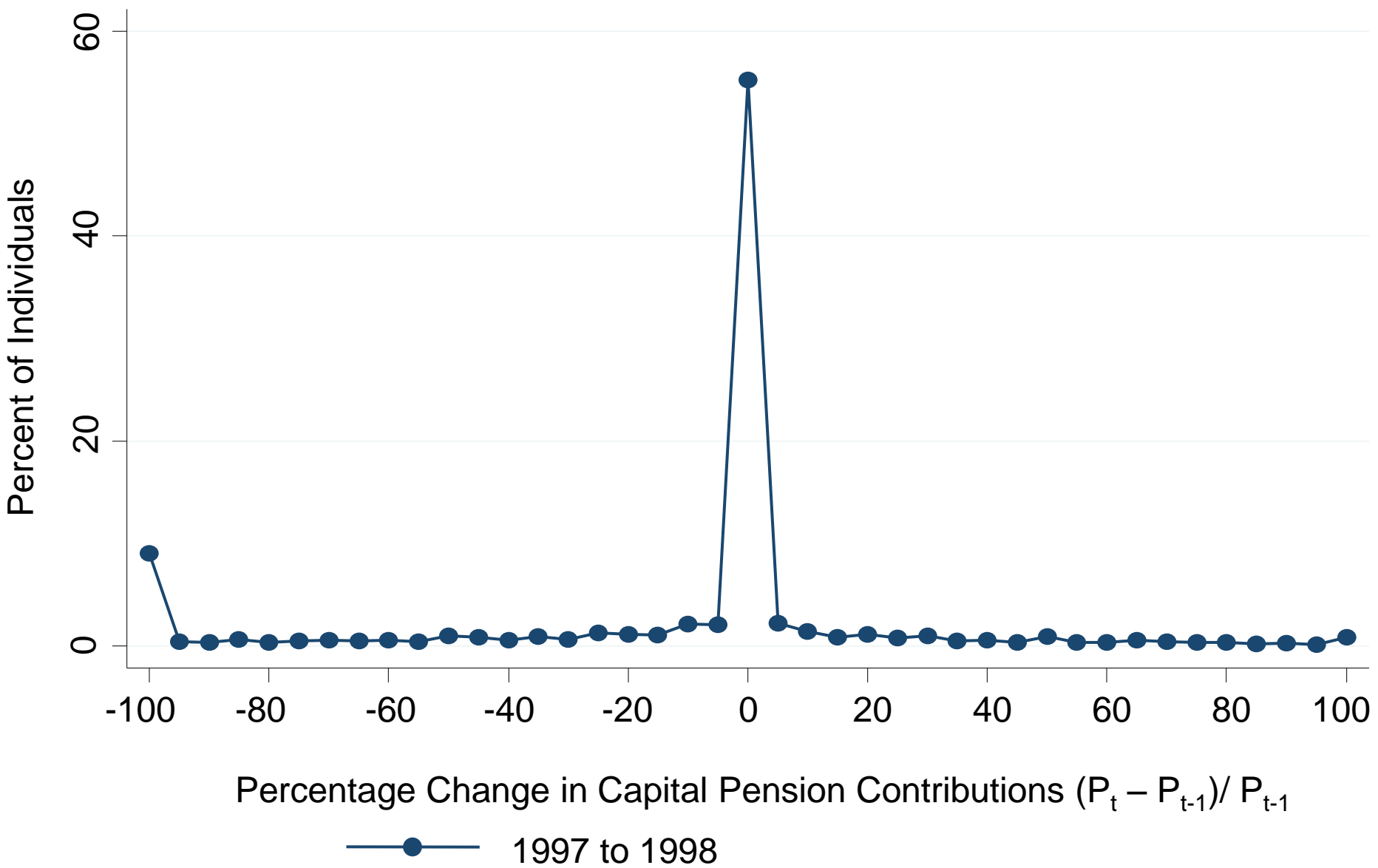
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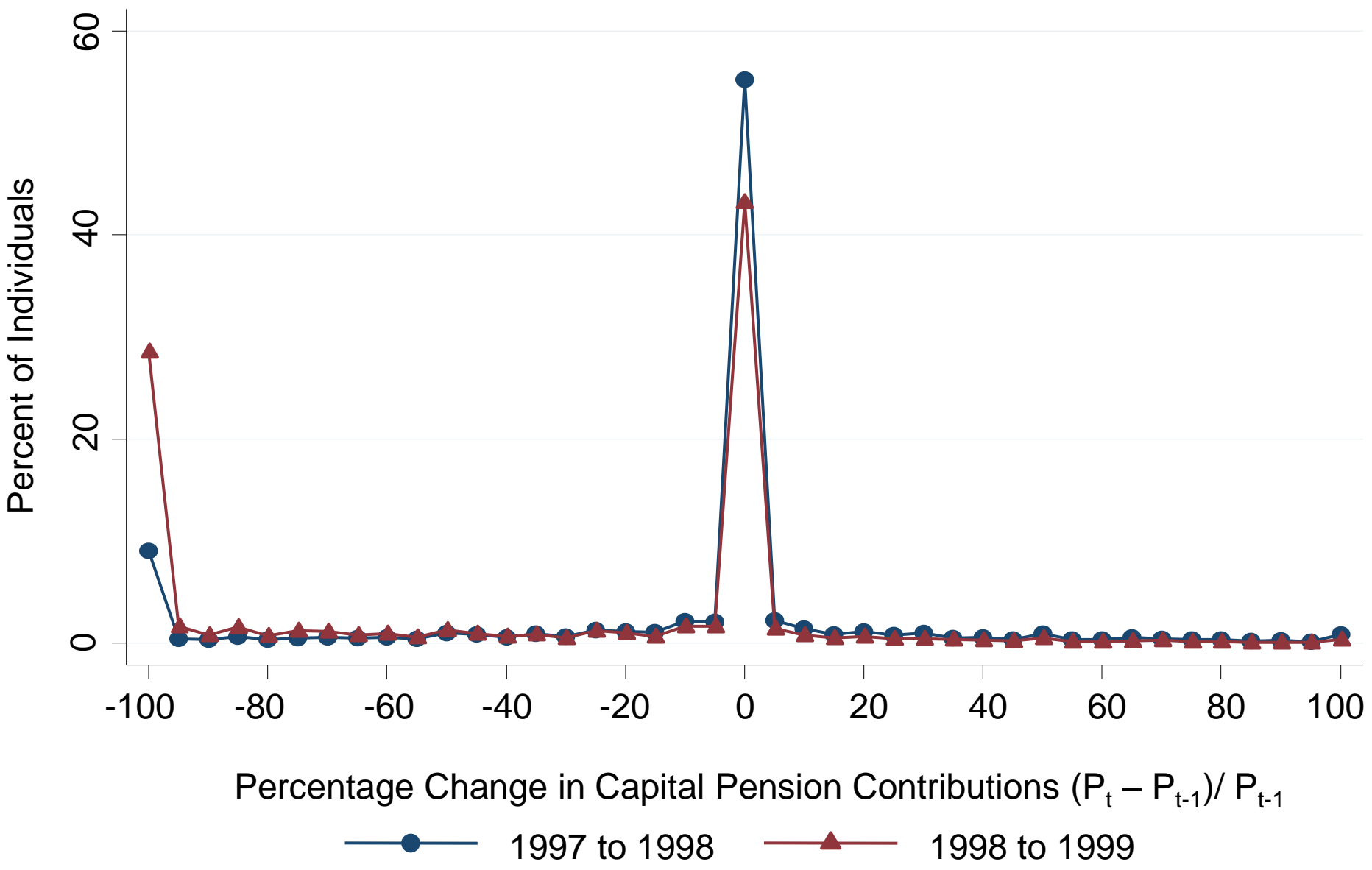
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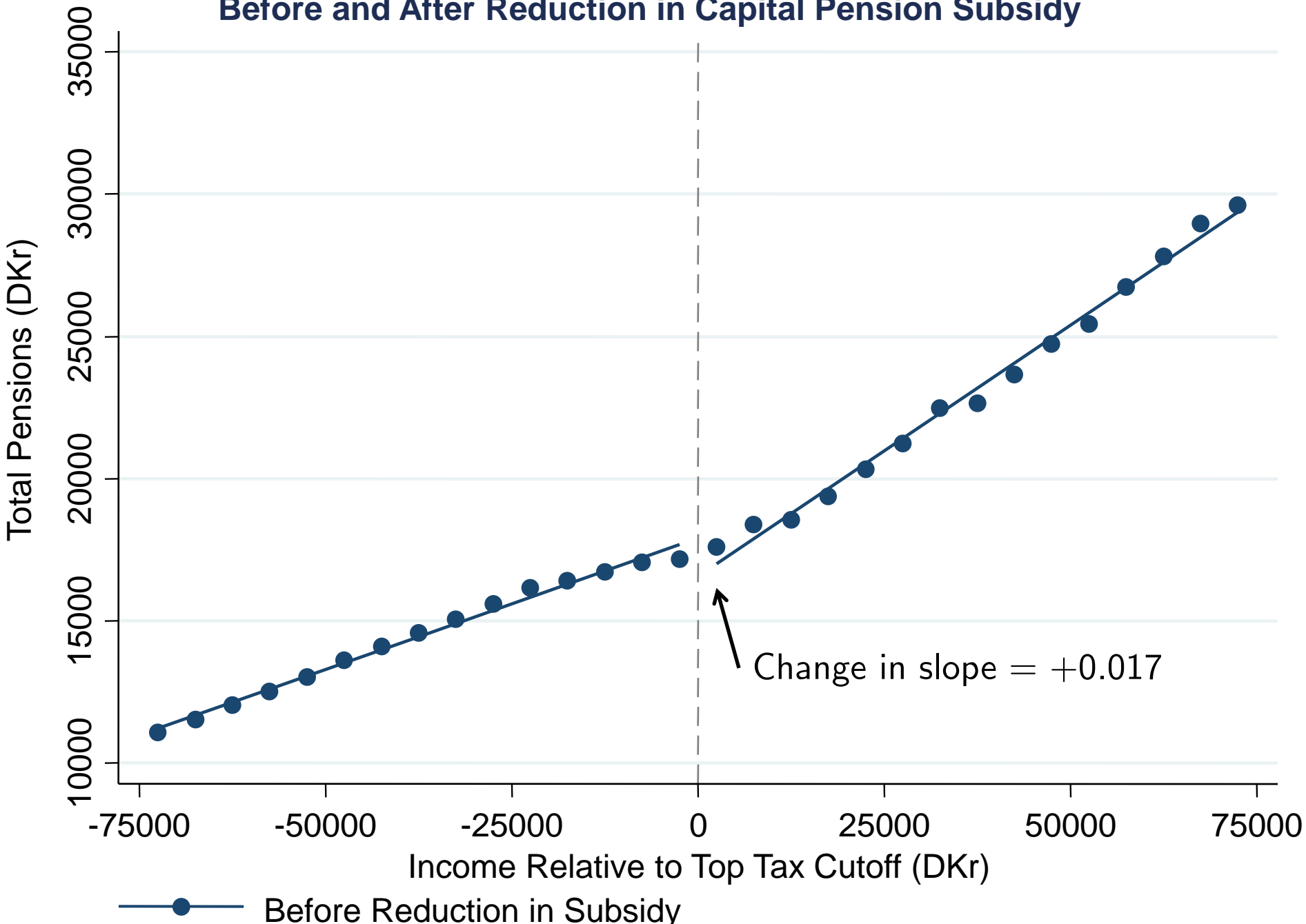
Impact of 1999 Capital Pension Subsidy Reduction on Distribution of Capital Pension Contributions



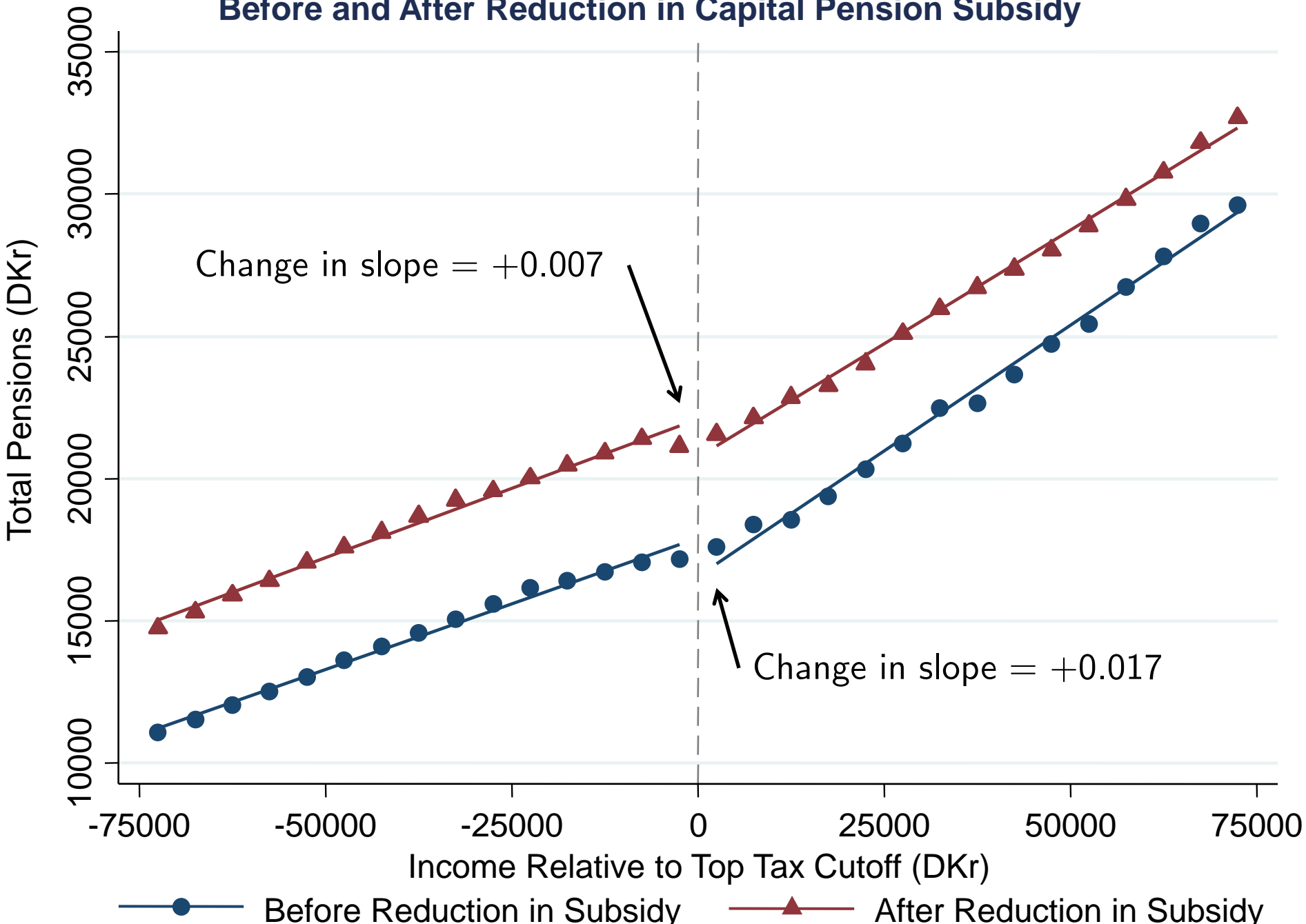
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Total Pensions vs. Income: Before and After Reduction in Capital Pension Subsidy



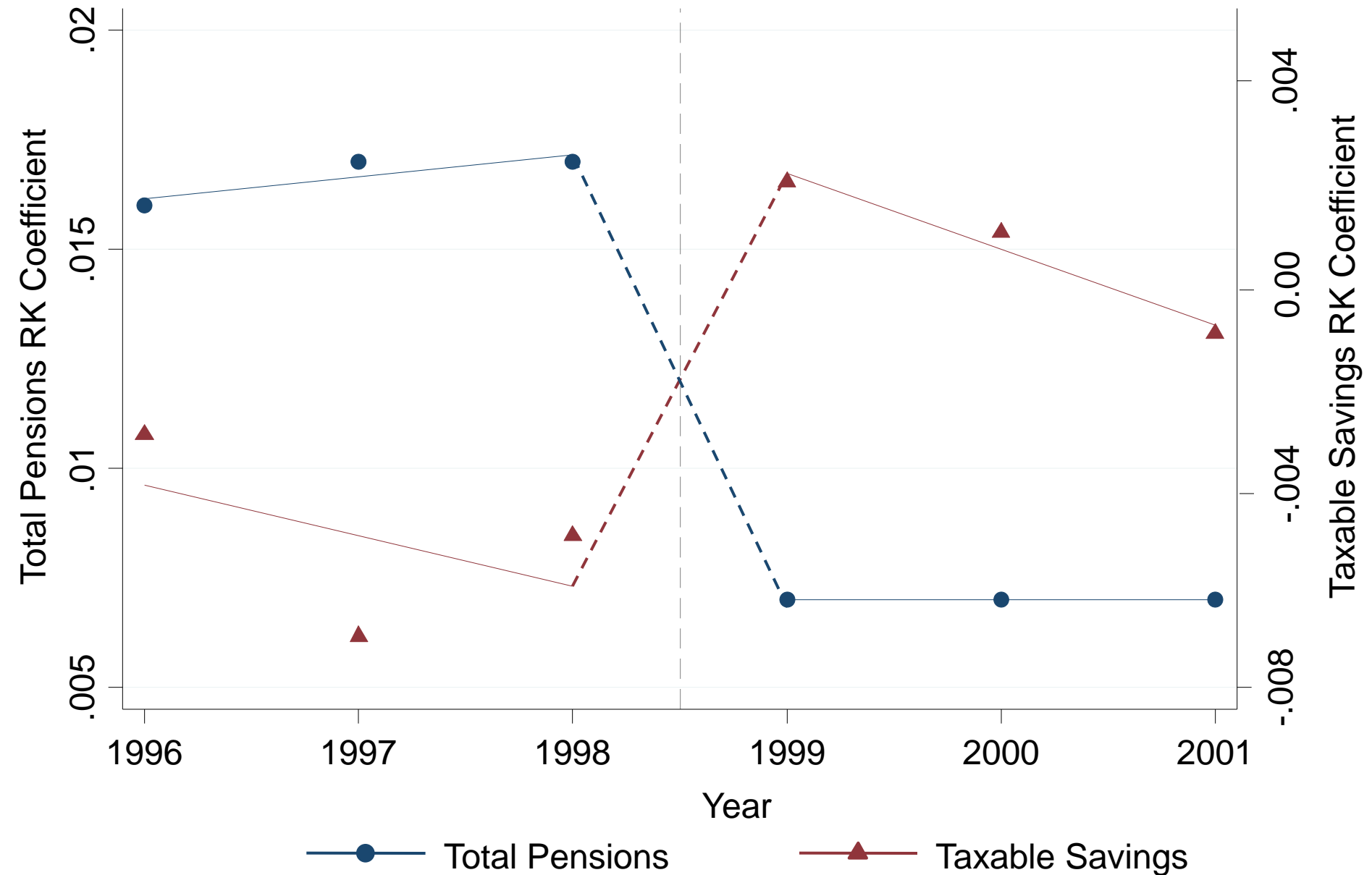
Total Pensions vs. Income: Before and After Reduction in Capital Pension Subsidy



Change in Marginal Propensity to Save in Retirement and Non-Retirement Accounts at Top Tax Cutoff by Year



Change in Marginal Propensity to Save in Retirement and Non-Retirement Accounts at Top Tax Cutoff by Year



Crowd-Out Estimates

- Consider impacts of a DKR 1000 increase in pre-tax income
 - DKR 10.0 less contributed to retirement accounts when subsidy fell
 - MTR of 60% → disposable income rises by $0.4 \times 10.0 =$ **DKR 4.0**
 - DKR 3.92 of this is deposited in taxable savings
 - DKR 0.08 is consumed → net saving falls by DKR 0.08
- 98% of the increase in pension contributions due to subsidies is financed by offsetting reductions in savings in taxable accounts
- Based on this estimate, we calculate that each DKr 1 of tax expenditure on subsidies raises total saving by less than 1 cent

Impacts of Government Policies on Saving for Active vs. Passive Savers

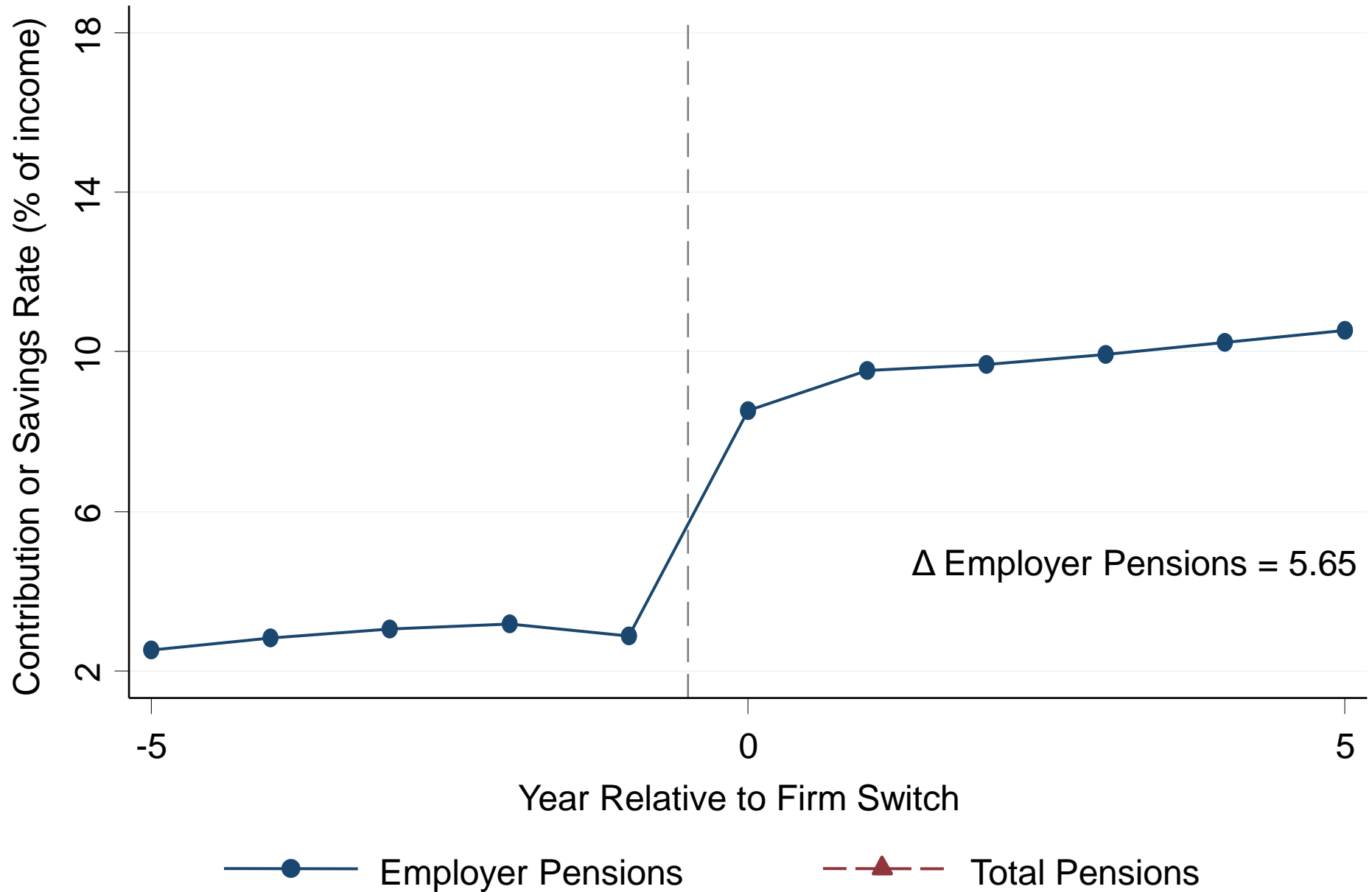
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Data	Yes	No	?	?

Part 2
Impacts of Automatic Contributions

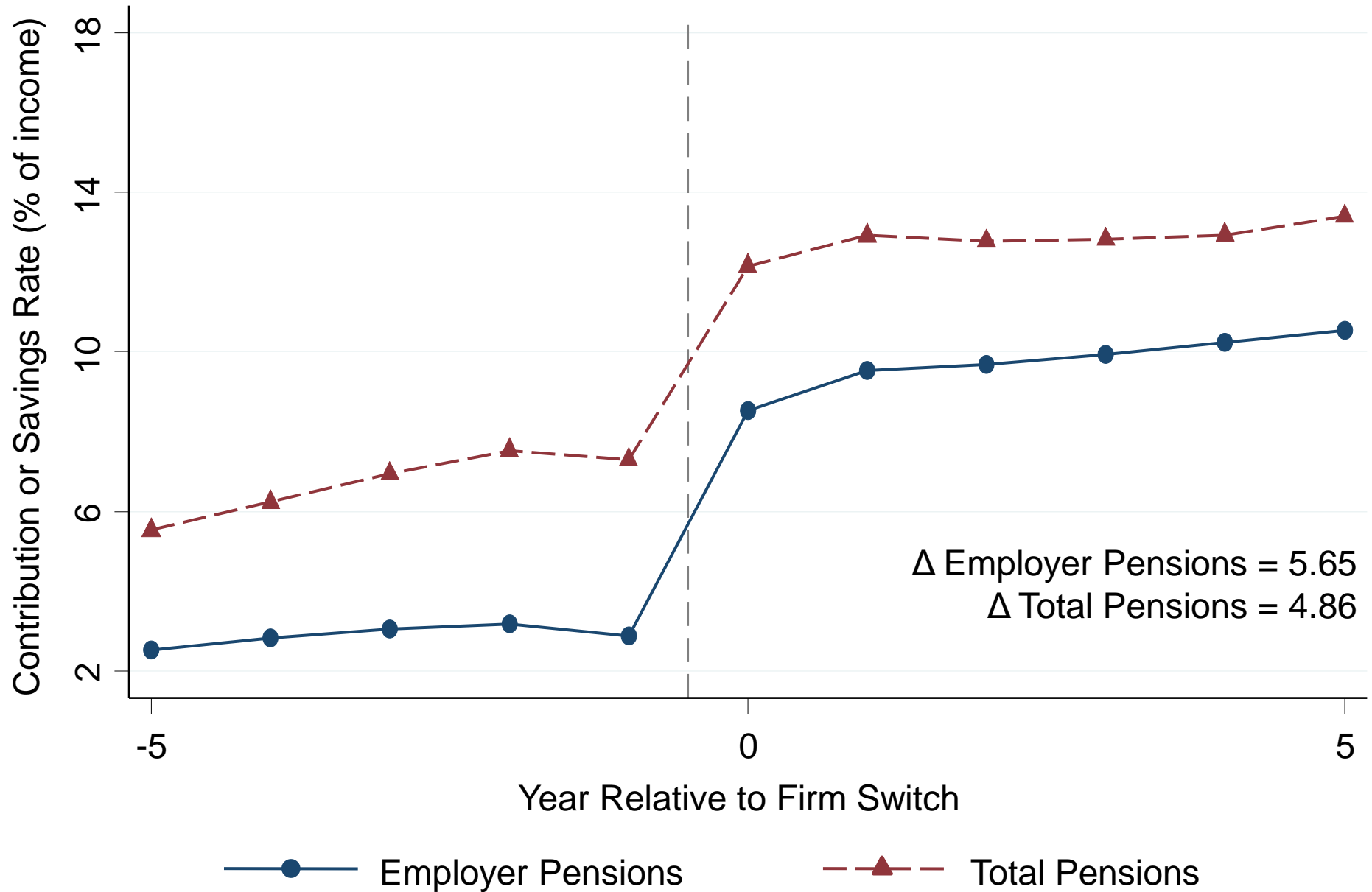
Impact of Automatic Contributions

- Two quasi-experimental research designs:
 1. Variation in employer-provided pensions
 2. Government mandatory savings plan
- Present results from the first research design here
- Study impacts of sharp changes in employer pension contributions when individuals switch jobs
 - Focus on individuals who made individual pension contributions prior to switch, who can offset changes in employer contributions

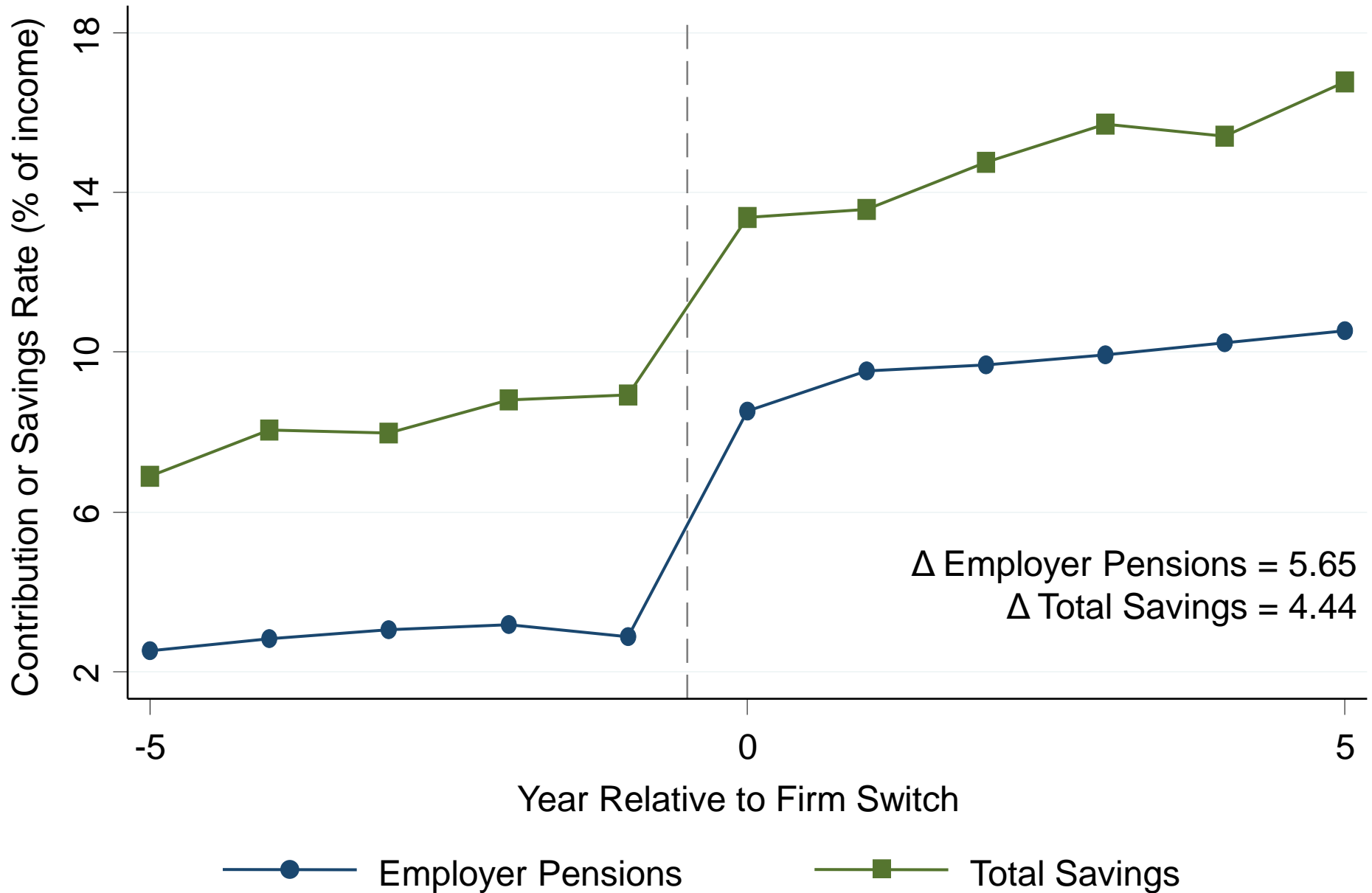
Impact of Switching to Firm with >3% Increase in Employer Pension Rate



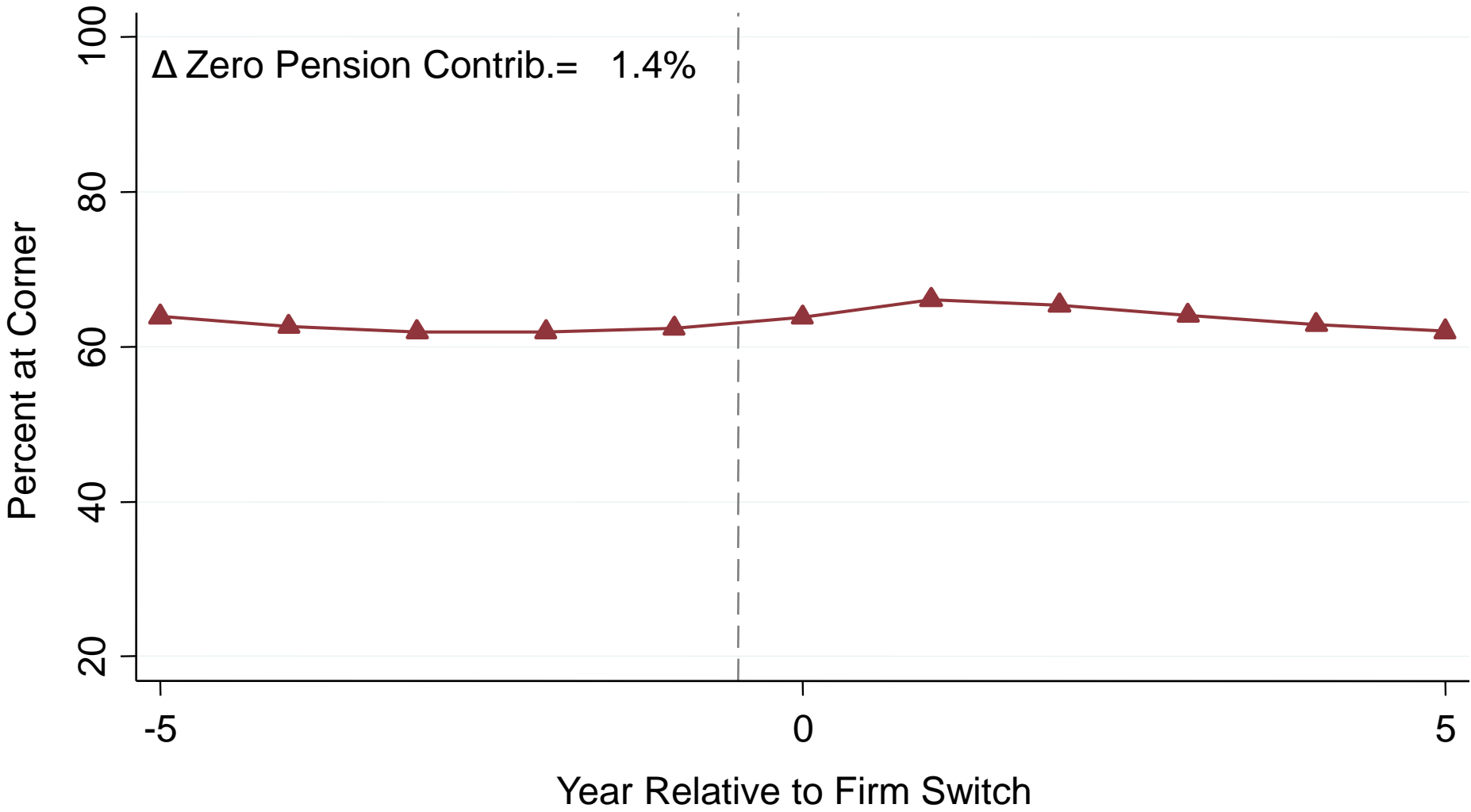
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Impact of Switching to Firm with >3% Increase in Employer Pension Rate

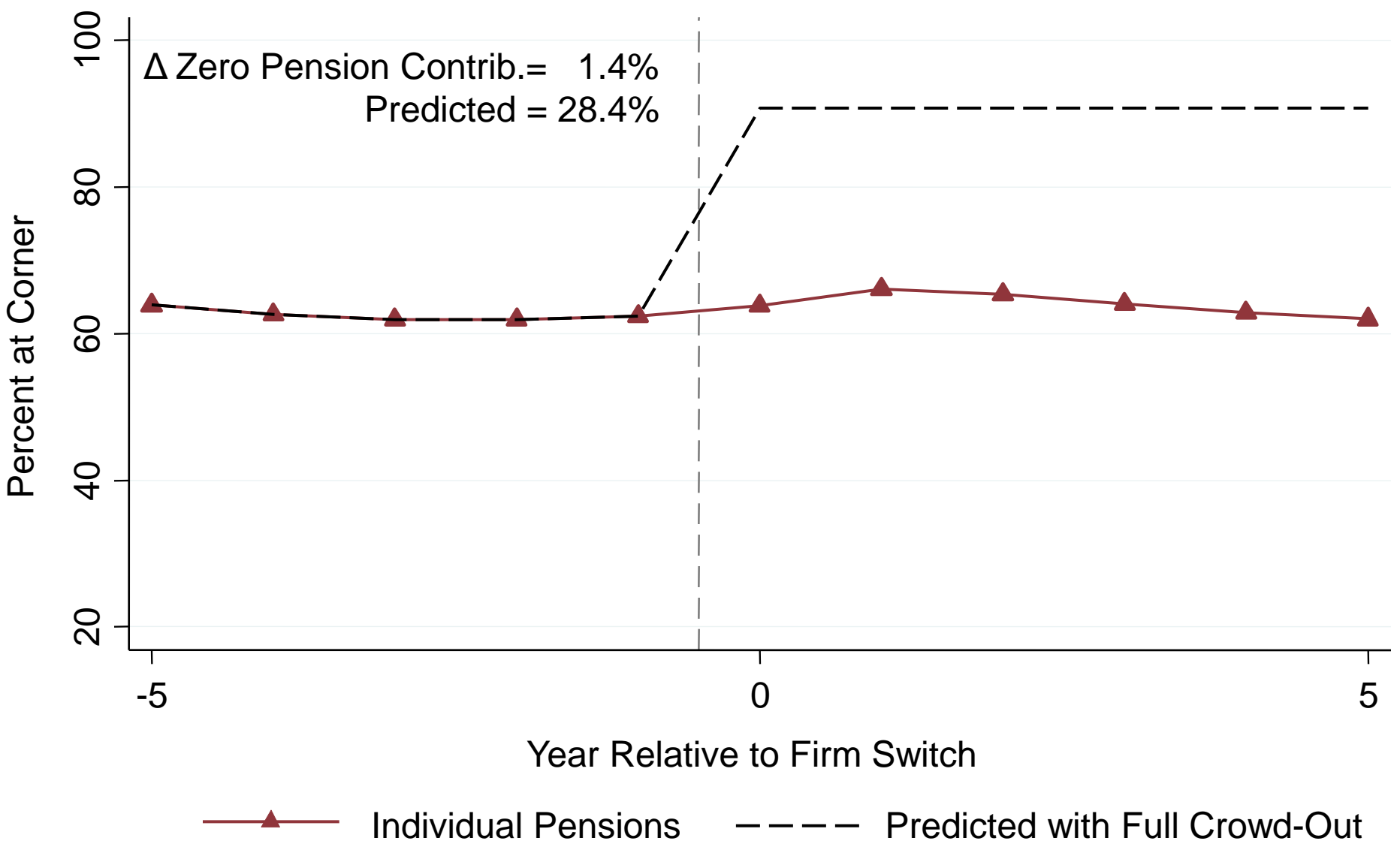


Fraction at Corner around Switches to Firm with >3% Increase in Employer Pension Rate

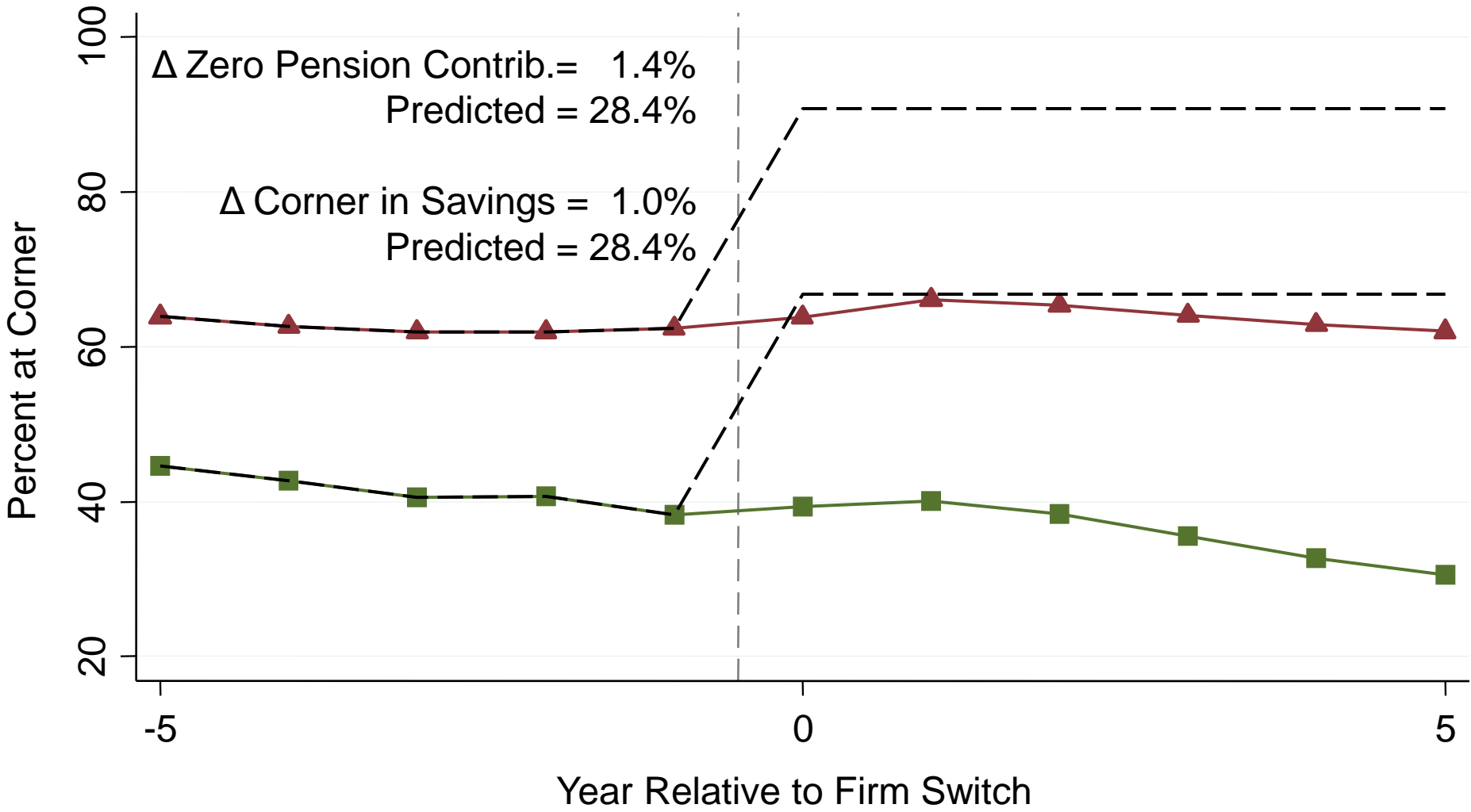


—▲— Individual Pensions

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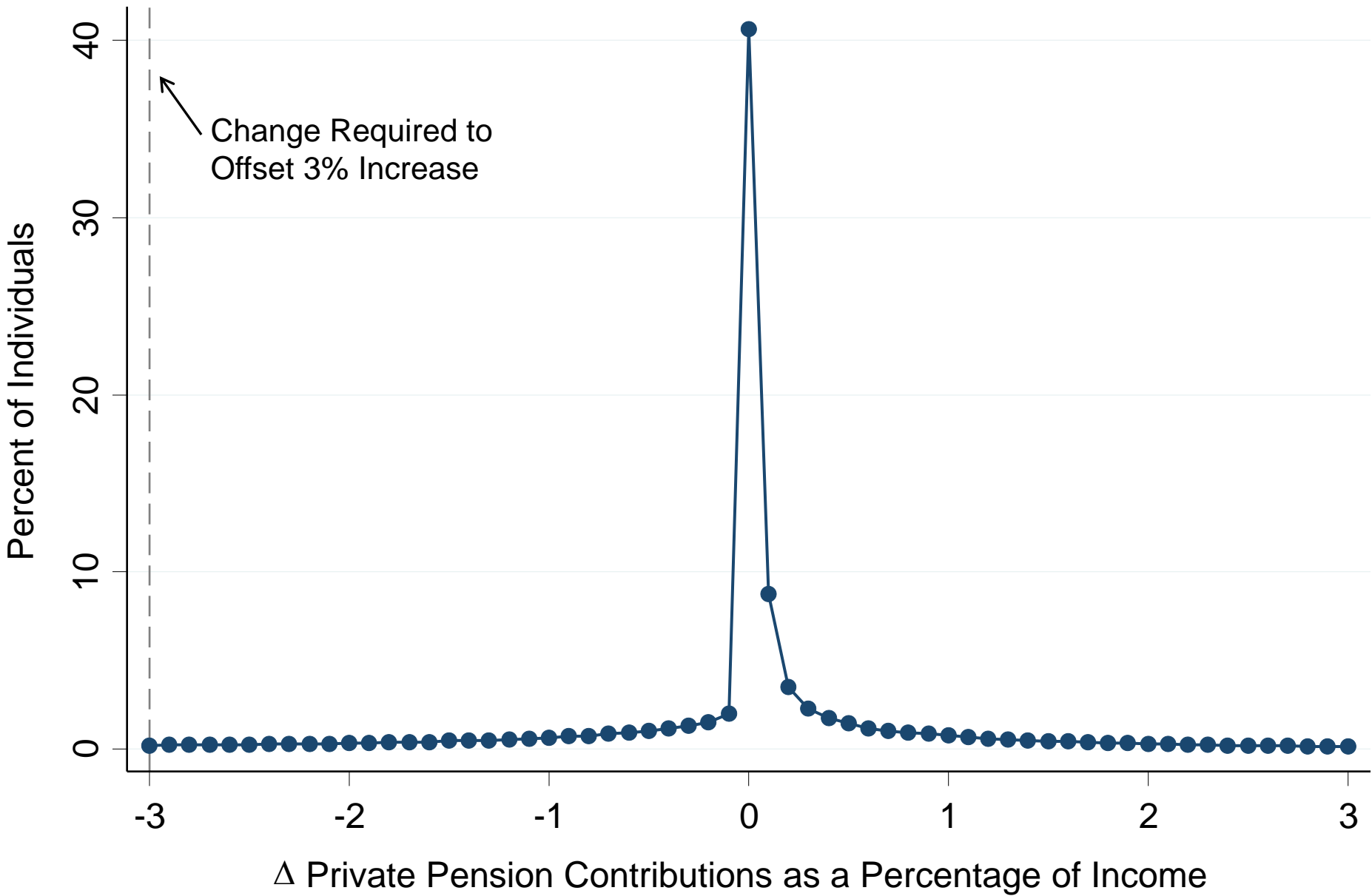


Event Study of Fraction at 0 Corner around Switches to Firm with >3% Increase in Employer Pension Rate

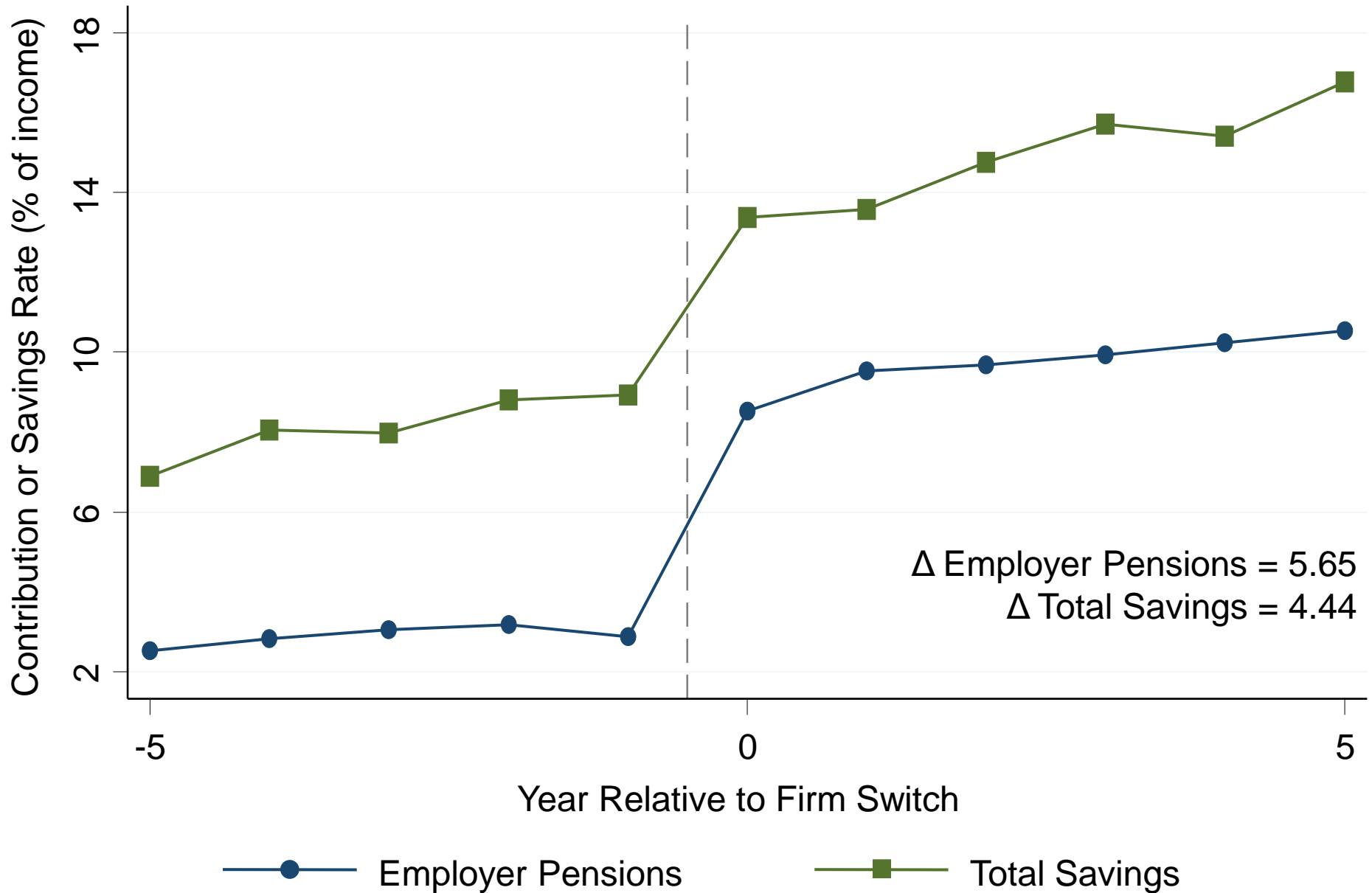


—▲— Individual Pensions - - - - Predicted with Full Crowd-Out
—■— Total Savings - - - - Predicted with Full Crowd-Out

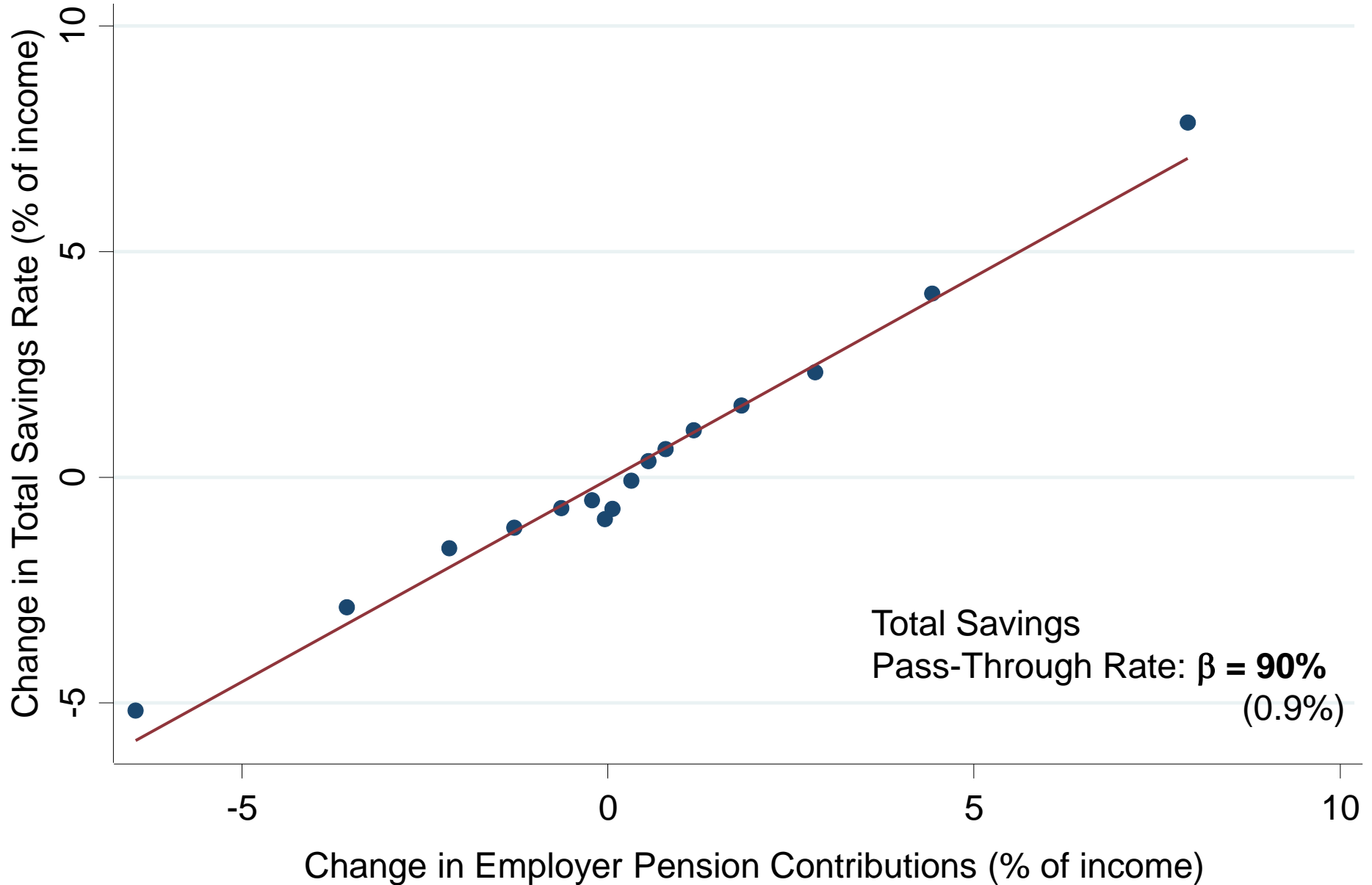
Changes in Individual Pension Contributions in Year of Firm Switch



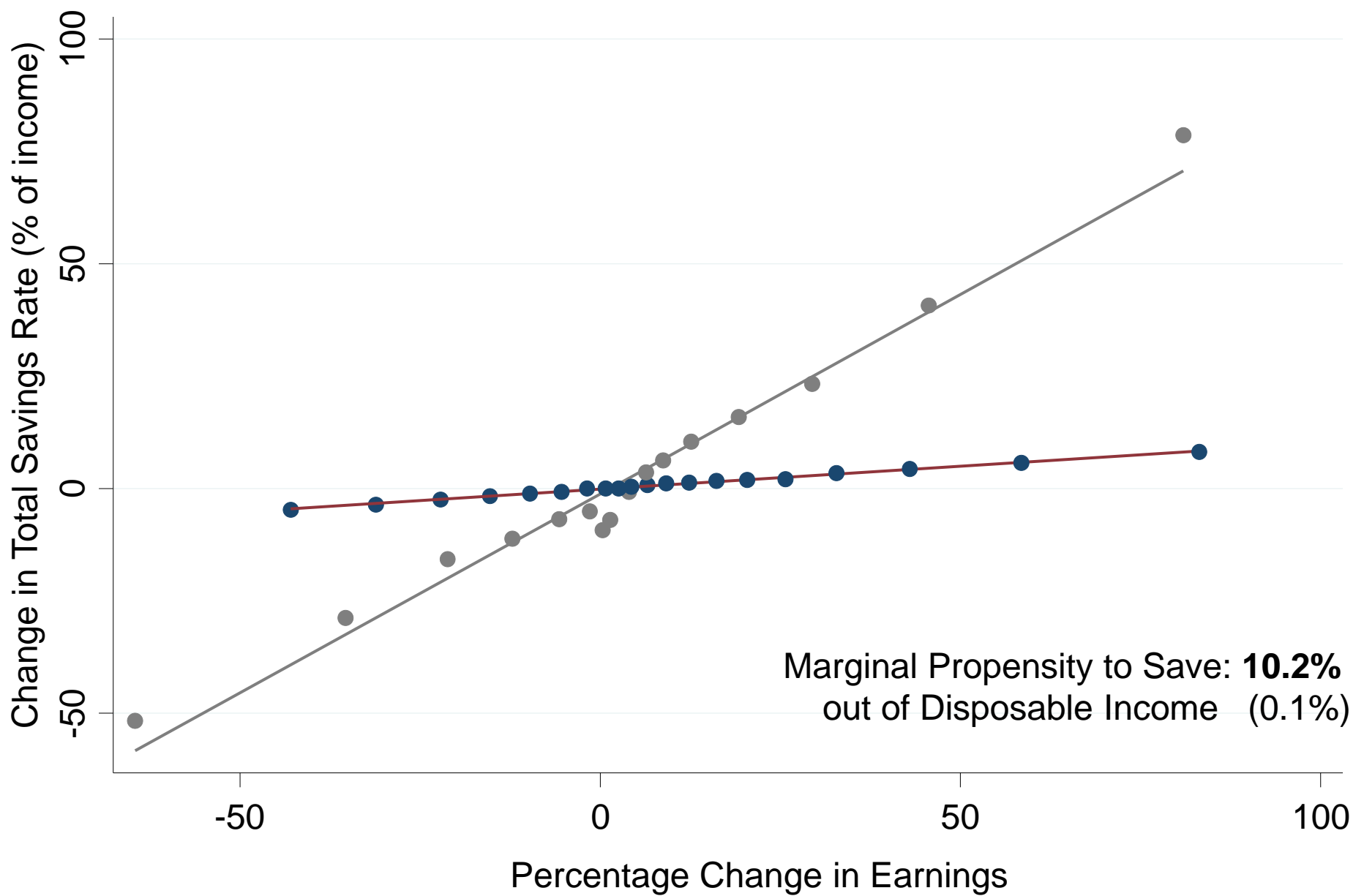
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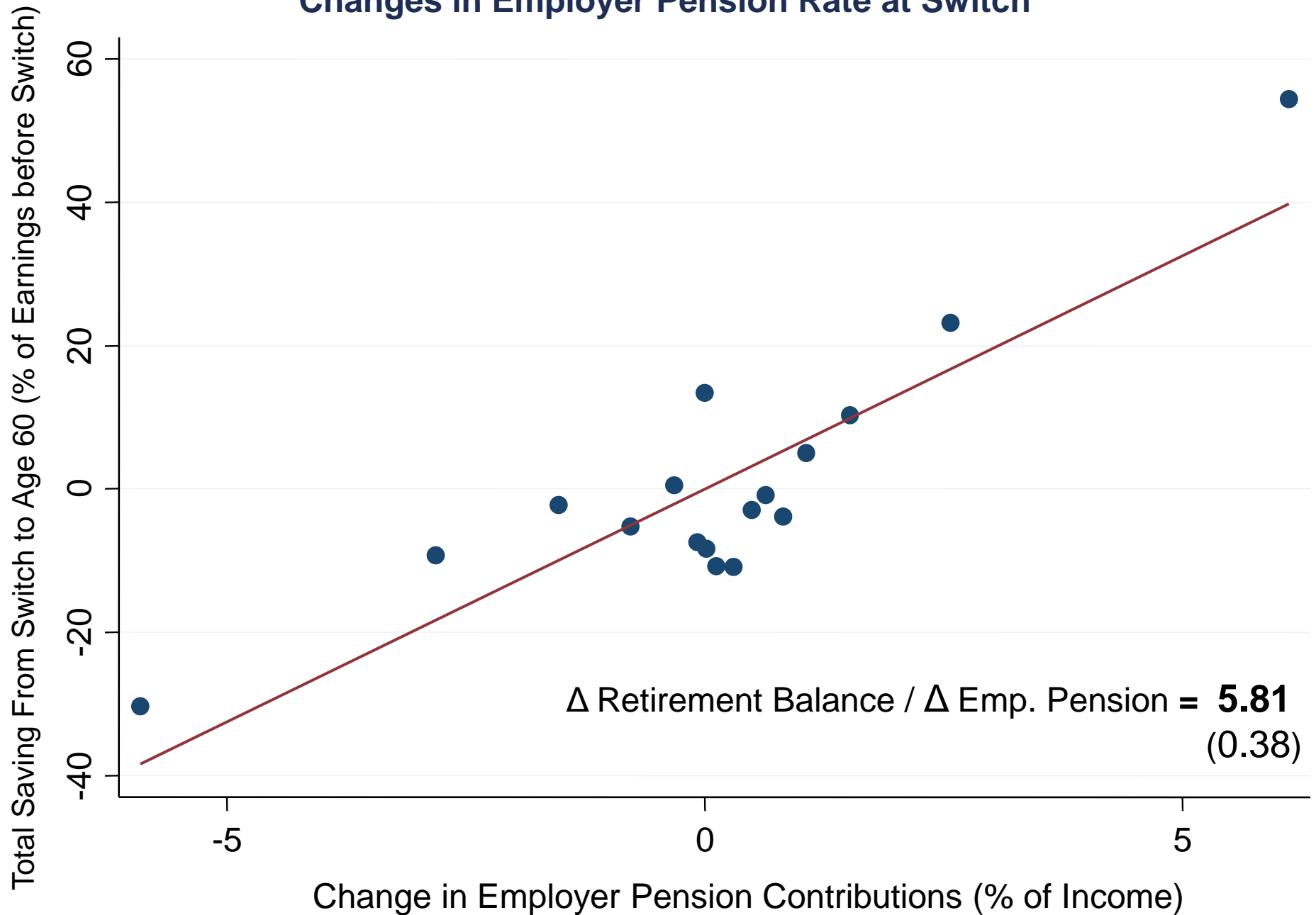
Changes in Total Savings Rates vs. Changes in Employer Pension Rates for Firm Switchers



Changes in Total Savings Rates vs. Changes in Earnings for Firm Switchers



Changes in Total Wealth at Retirement vs. Changes in Employer Pension Rate at Switch



Impacts of Government Policies on Saving for Active vs. Passive Savers

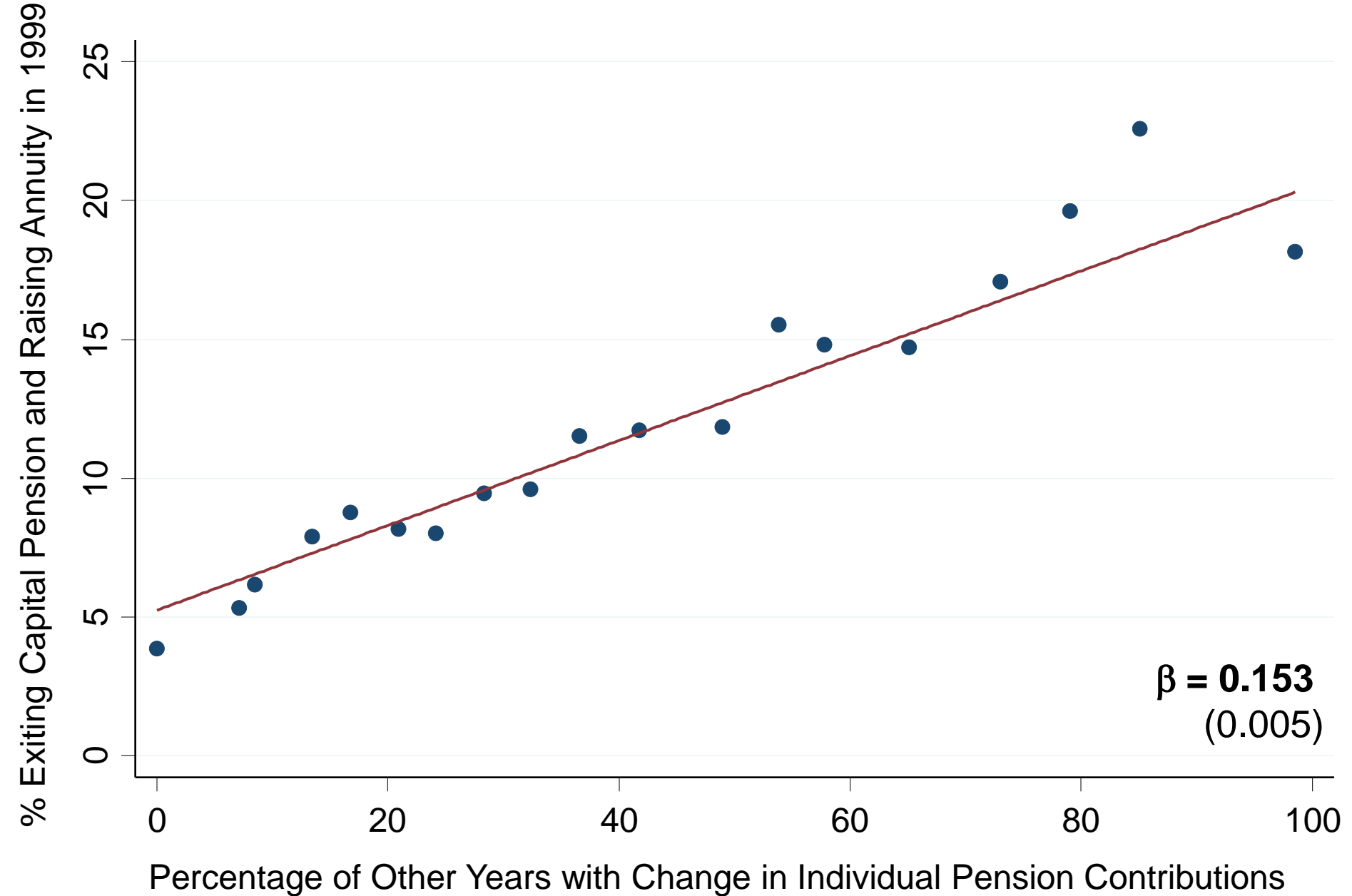
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Part 4
Testing for Active vs. Passive Choice

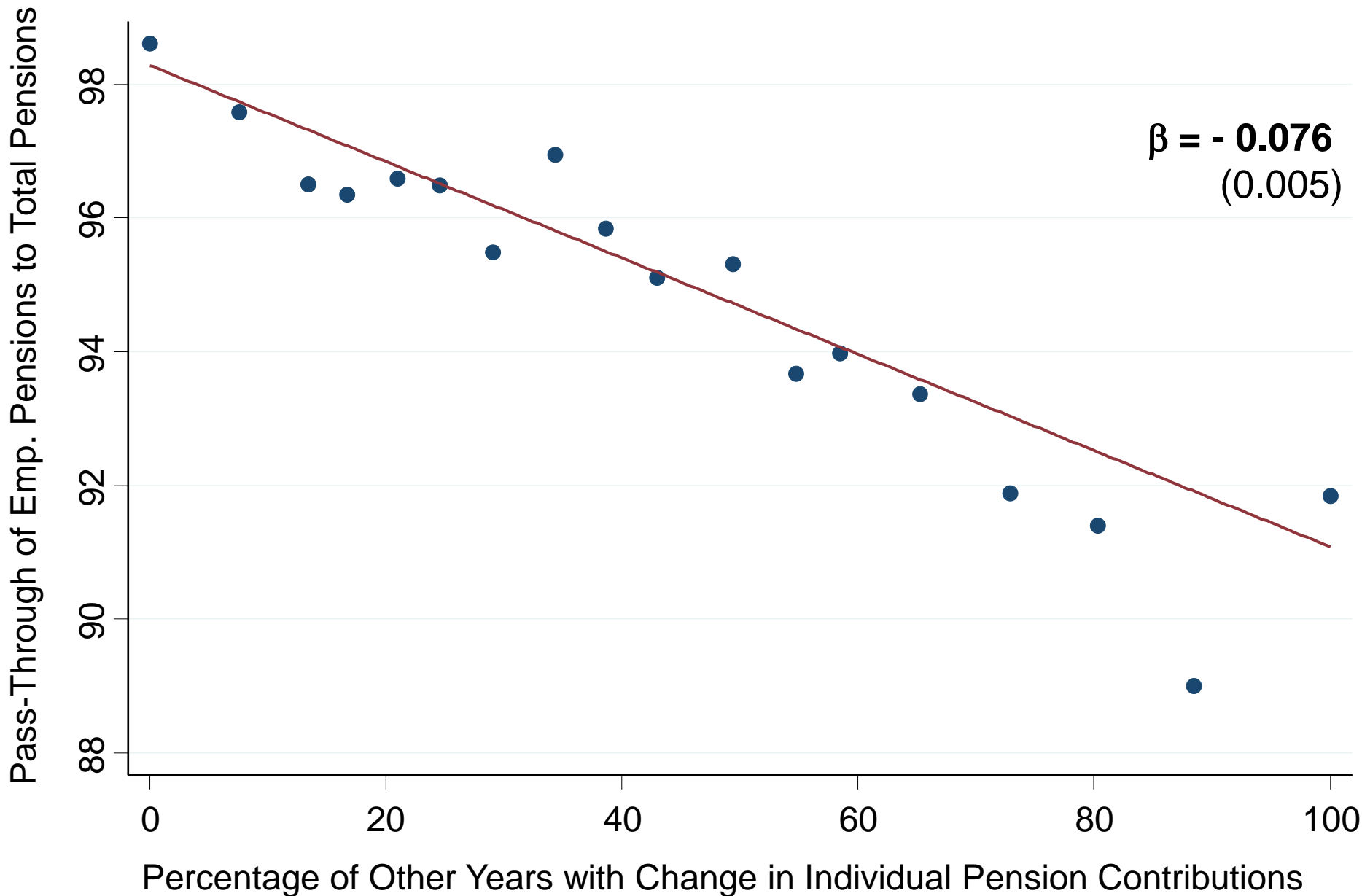
Active vs. Passive Savers

- Why do automatic contribs. and subsidies have very different impacts?
 - Important to understand mechanism to determine if results will apply in the U.S.
- Our hypothesis: auto contributions affect passive savers, while subsidy affects only active savers
- Test this mechanism by analyzing variation in response across individuals
- Note that roughly 15% of individuals respond actively to both policies
 - 17% of individuals changed contributions when subsidy was reduced
 - Less than 15% of individuals offset employer pension changes

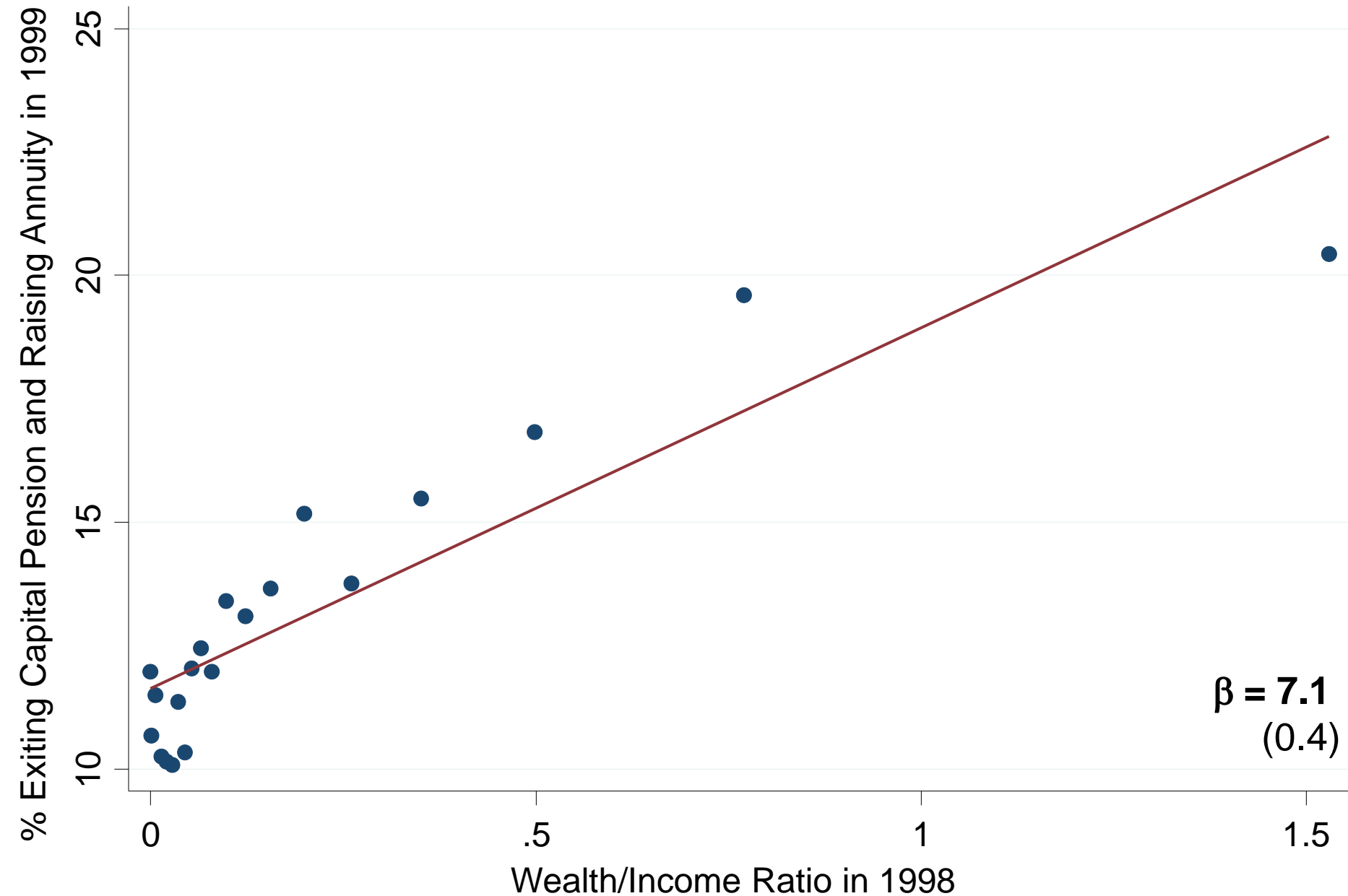
Percent Responding to Capital Pension Subsidy Change in 1999 by Frequency of Active Changes in Other Years



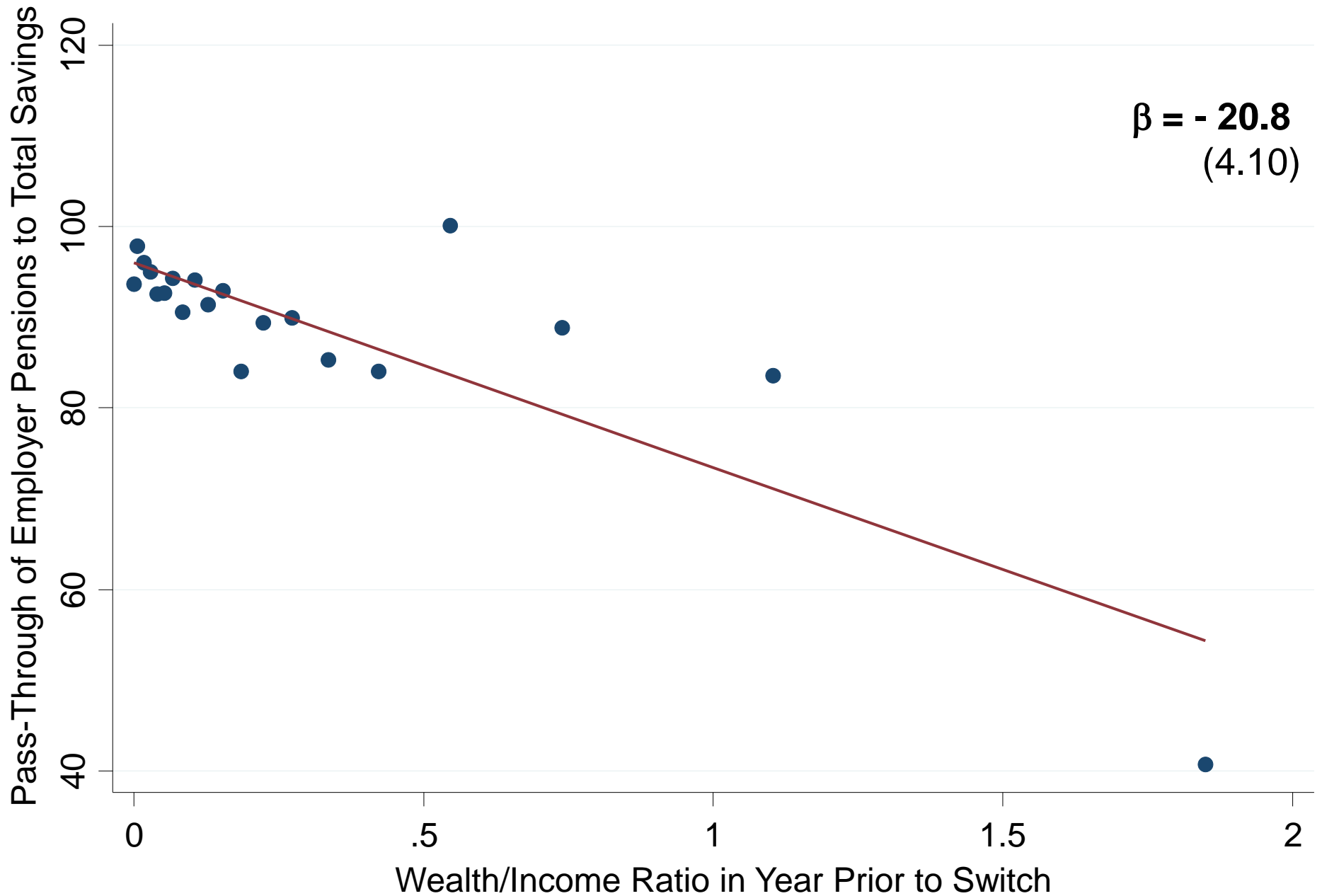
Pass-Through of Employer Pension Changes for Firm-Switchers by Frequency of Active Changes in Other Years



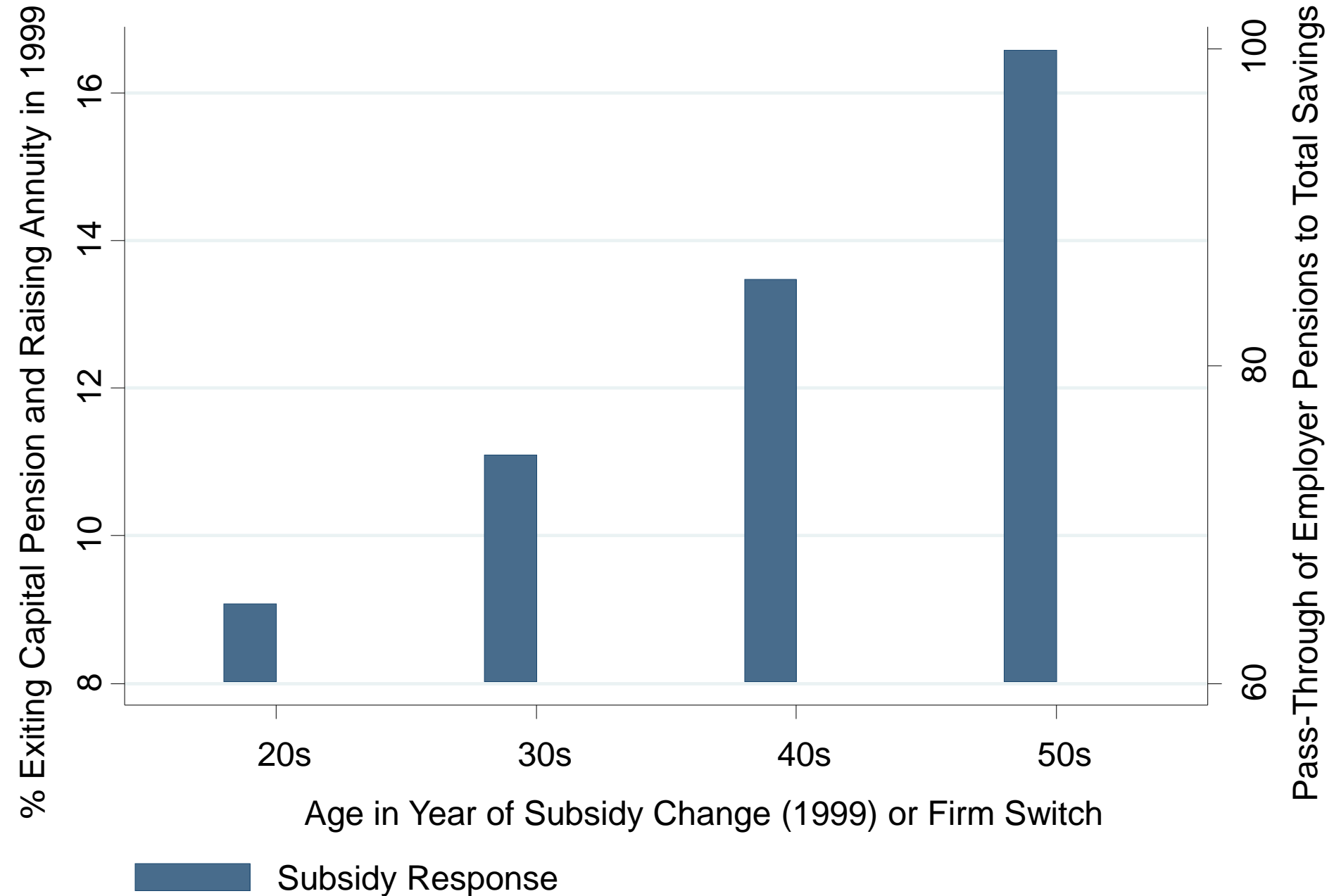
Heterogeneity in Response to Capital Pension Subsidy by Wealth/Income Ratio



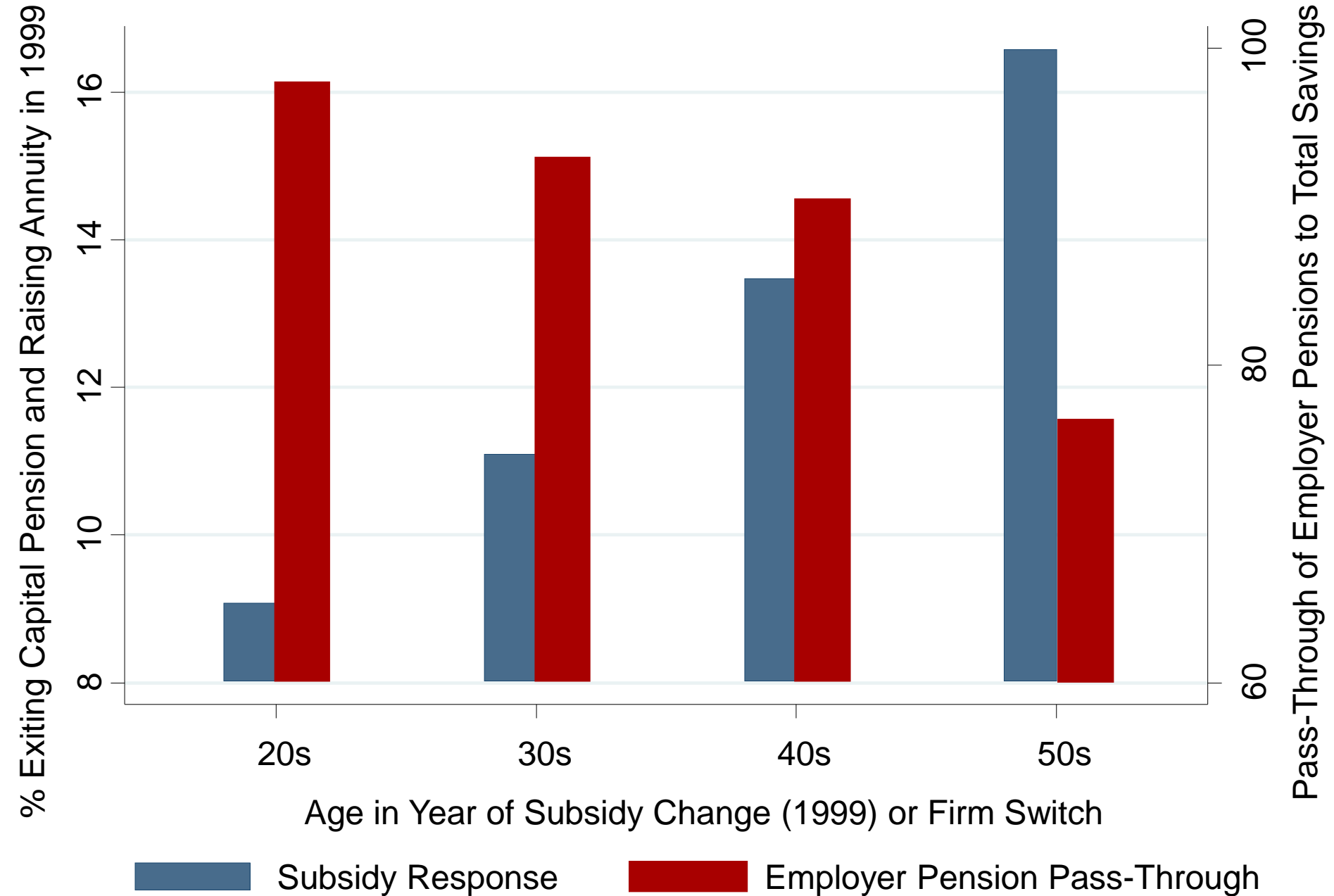
Heterogeneity in Pass-Through of Employer Pensions by Wealth/Income Ratio



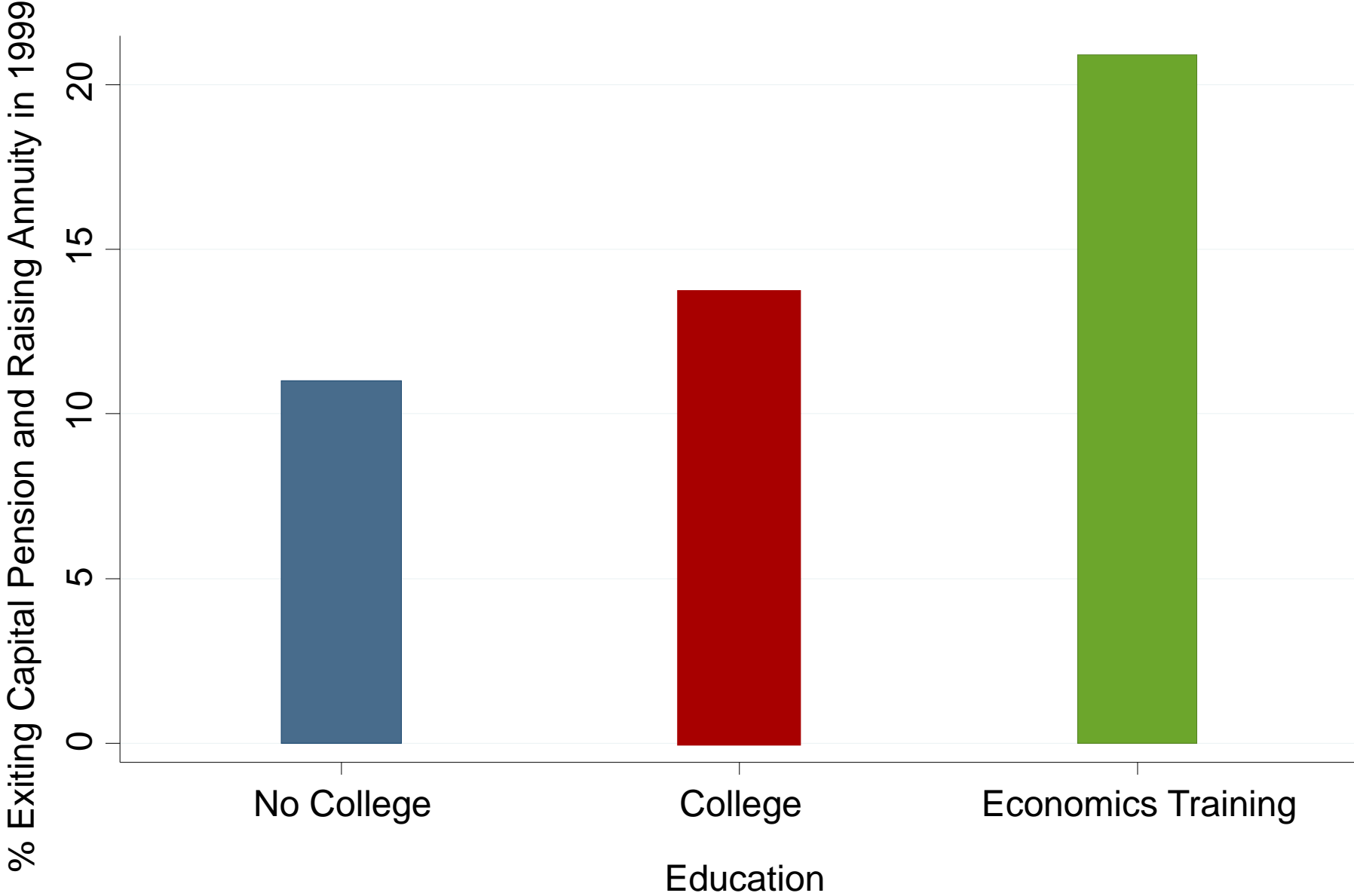
Heterogeneity in Responses to Subsidies and Employer Pensions by Age



Heterogeneity in Responses to Subsidies and Employer Pensions by Age



Heterogeneity in Responses to Subsidies by Educational Attainment



Policy Implications

Policy Lessons in Denmark

- Tax subsidies are ineffective at raising savings for three reasons:
 1. Spend money subsidizing the savings of the 85% who are passive savers, who do not respond at all
 2. Crowd-out rates very high among the 15% of active savers
 3. Active savers are already saving at higher rates → subsidies do not target those who may be least prepared for retirement
- Automatic contributions directly resolve these problems
 - Increase savings substantially because they do not require active choice by savers
 - Targets individuals who have lower savings rates

Translating the Lessons to the U.S.

1. Are American and Danish households similar?
2. Are American and Danish retirement savings institutions similar?

Translating the Lessons to the U.S.

1. Are American and Danish households similar?
 - Degree of passive behavior within retirement accounts in the U.S. is similar to our estimates in Danish data [e.g., Madrian and Shea 2001]
 - Implies that automatic contributions would be more effective than subsidies in raising total savings in the U.S. as well

Translating the Lessons to the U.S.

1. Are American and Danish households similar?
2. Are American and Danish retirement savings institutions similar?
 - Yes, with one exception: access to retirement savings accounts is mostly dependent on employers in the U.S. (e.g. 401(k)s)
 - Reducing subsidy could affect access to 401(k)s for workers
 - A small tax credit for firms should be adequate to ensure that firms continue to offer access to pension accounts
 - More broadly, no reason to tie retirement savings to firms
 - Government could raise IRA limits and allow payroll deduction

Policy Implications for the U.S.

- Findings call into question whether existing subsidies are the most cost-effective way to raise savings rates
- Alternative policies that expand existing institutions could raise savings rates significantly while reducing government expenditure:
 1. Expand defaults and automatic enrollment
 2. Allow automatic payroll-deductible contributions to IRA's
 3. Small tax credit or deduction to incentive employers and encourage auto enrollment

Active vs. Passive Decisions and Crowd-out in Retirement Savings Accounts: Evidence from Denmark

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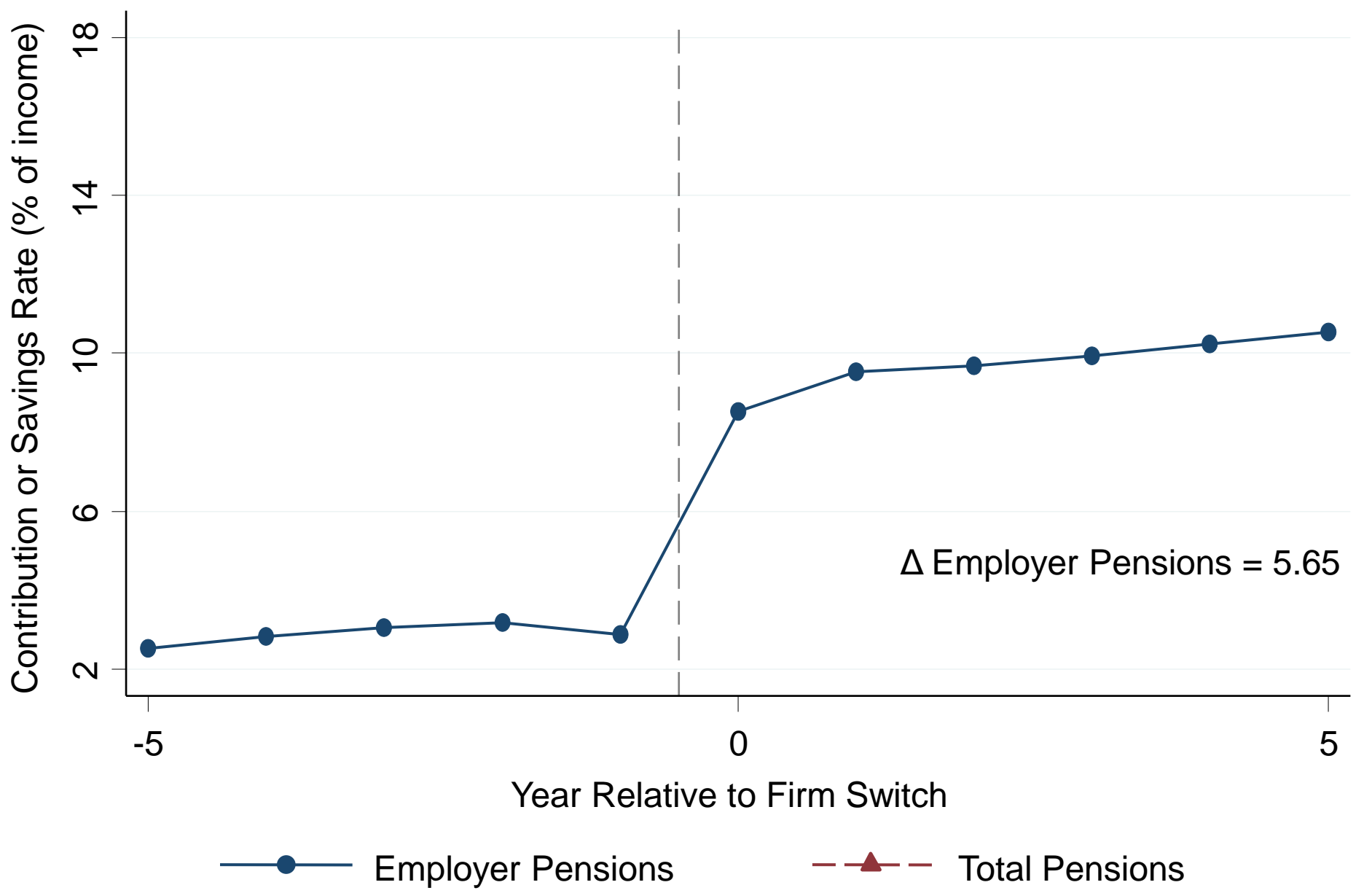
Summary Statistics

Variable	Full Sample	Top Bracket Sample
	(1)	(2)
Gross Labor Income	199,565	256,618
Gross Taxable Income	217,474	282,607
Net Capital Income	-14,549	-20,541
Assets (not incl. home equity)	51,602	60,495
Assets >10% of labor income	47%	42%
Assets/Gross Labor Inc. Ratio	0.37	0.22
Total Savings	23,904	32,752
Saving Rate	18.92%	15.32%
Liabilities (not incl. home mortgage)	76,539	95,374
Change in Liabilities	5,681	5,529
Net Savings Rate	4.06%	9.68%
Pension Flows		
Fraction with Indiv. Pension	27%	36%
Indiv. Pension	3,143	4,081
Indiv. Pension Contribution Rate	1.18%	1.25%
Indiv. Capital Pension	1,859	2,643
Indiv. Annuity Pension	1,284	1,438
Fraction with Employer Pension	59%	83%
Employer Pension	15,542	21,717
Employer Pension Contribution Rate	5.67%	6.98%
Fraction with Any Pension	66%	90%

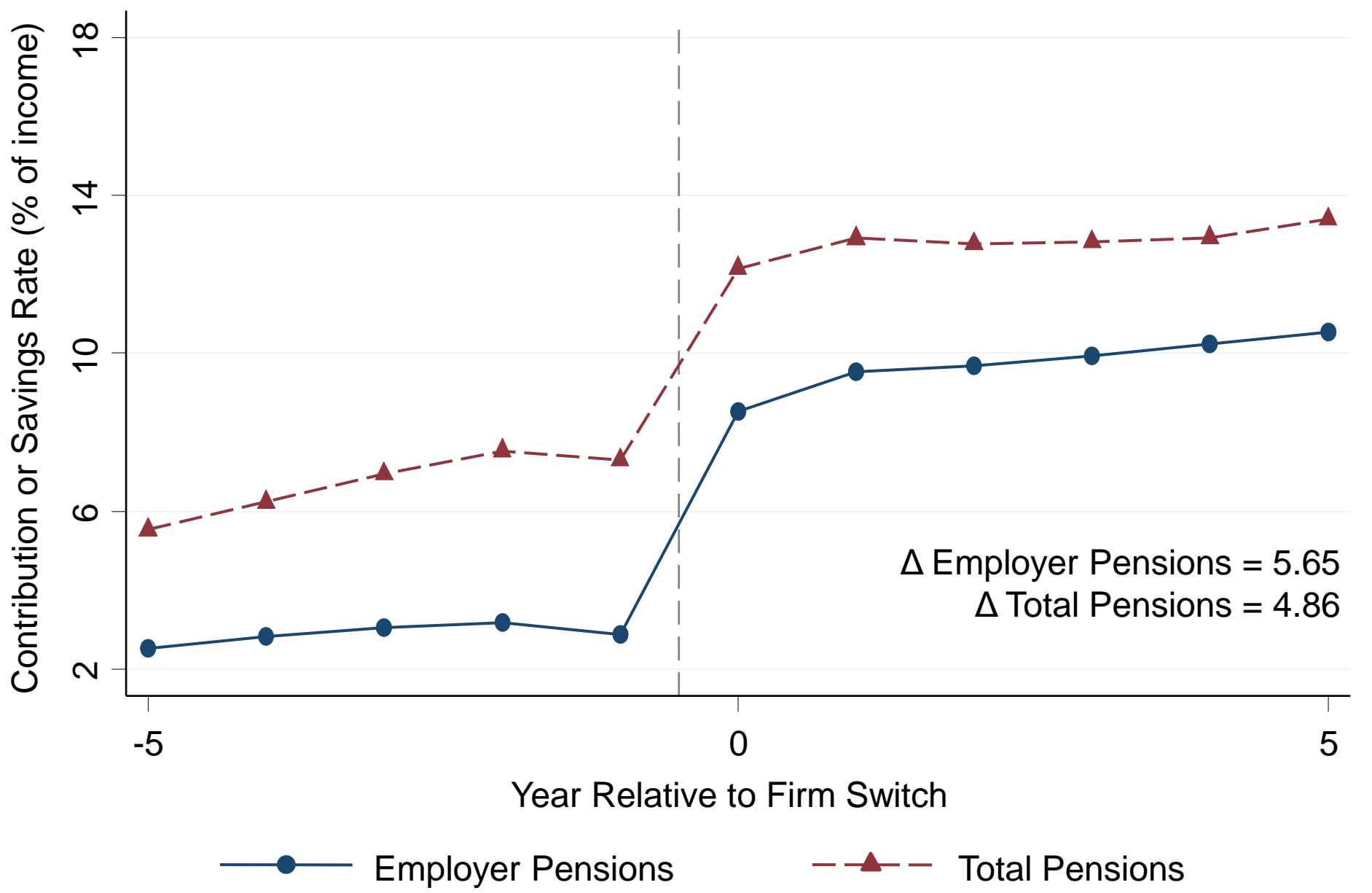
Summary Statistics

Variable	Full Sample (1)	Top Bracket Sample (2)
Demographics		
Age	38.70	41.36
Female	52%	44%
Married	48%	58%
Has Partner	62%	73%
Homeowner	51%	68%
College Degree	41%	59%
Some Economics Training	4%	4%
Number of Observations	45,428,846	17,712,370

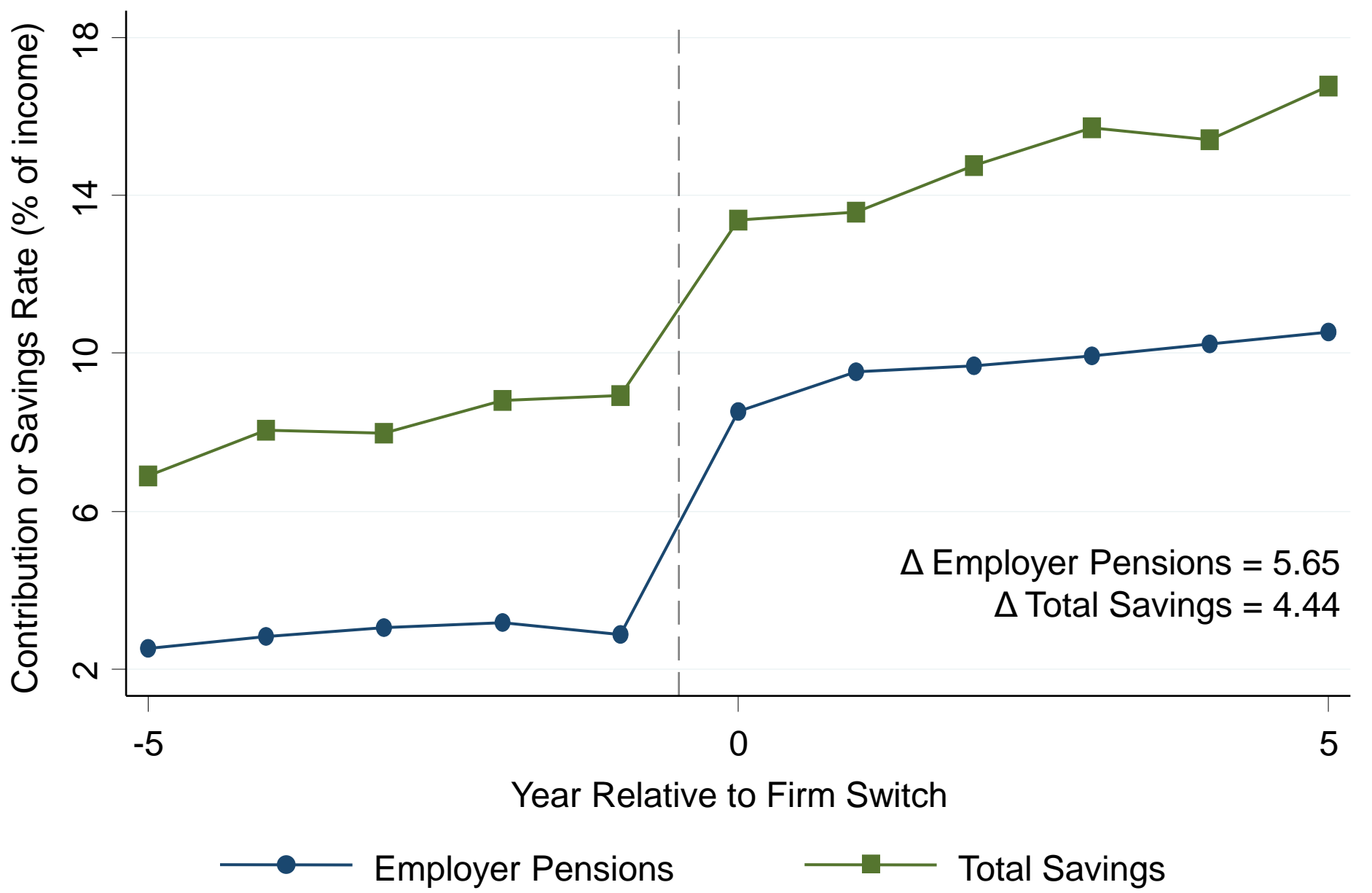
Event Study around Switches to Firm with >3% Increase in Employer Pension Rate for Individuals with Positive Pension Contributions or Savings Prior to Switch



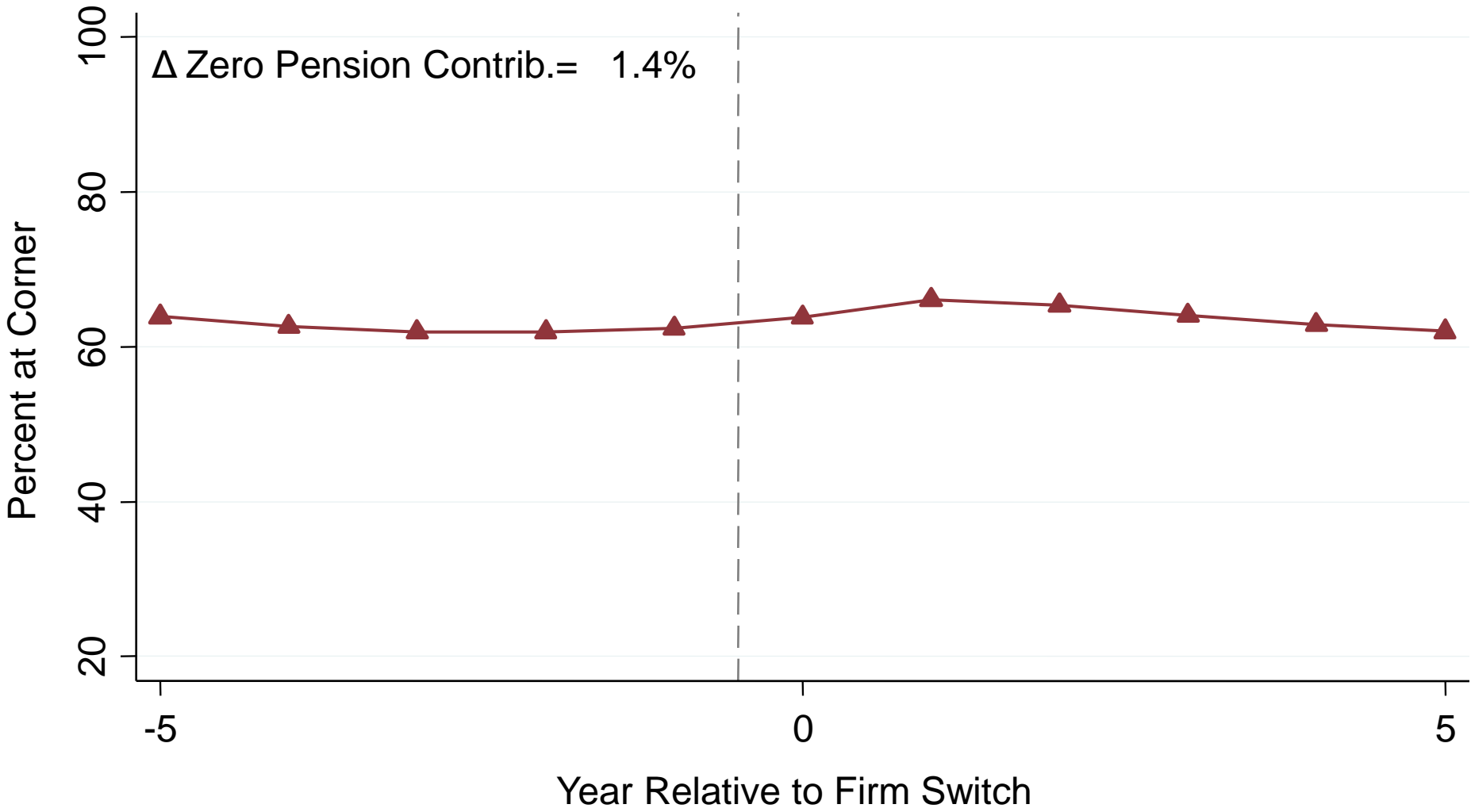
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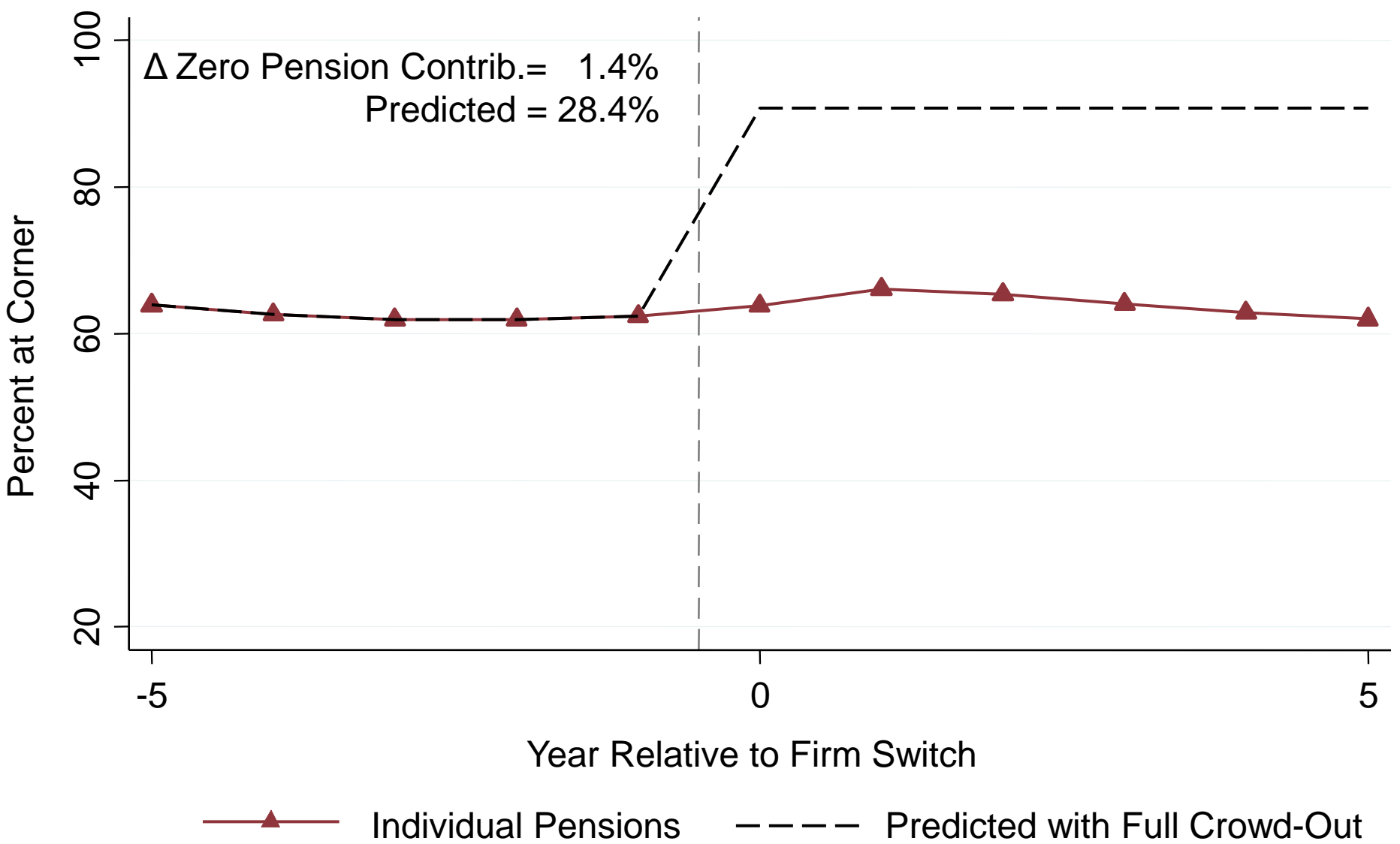


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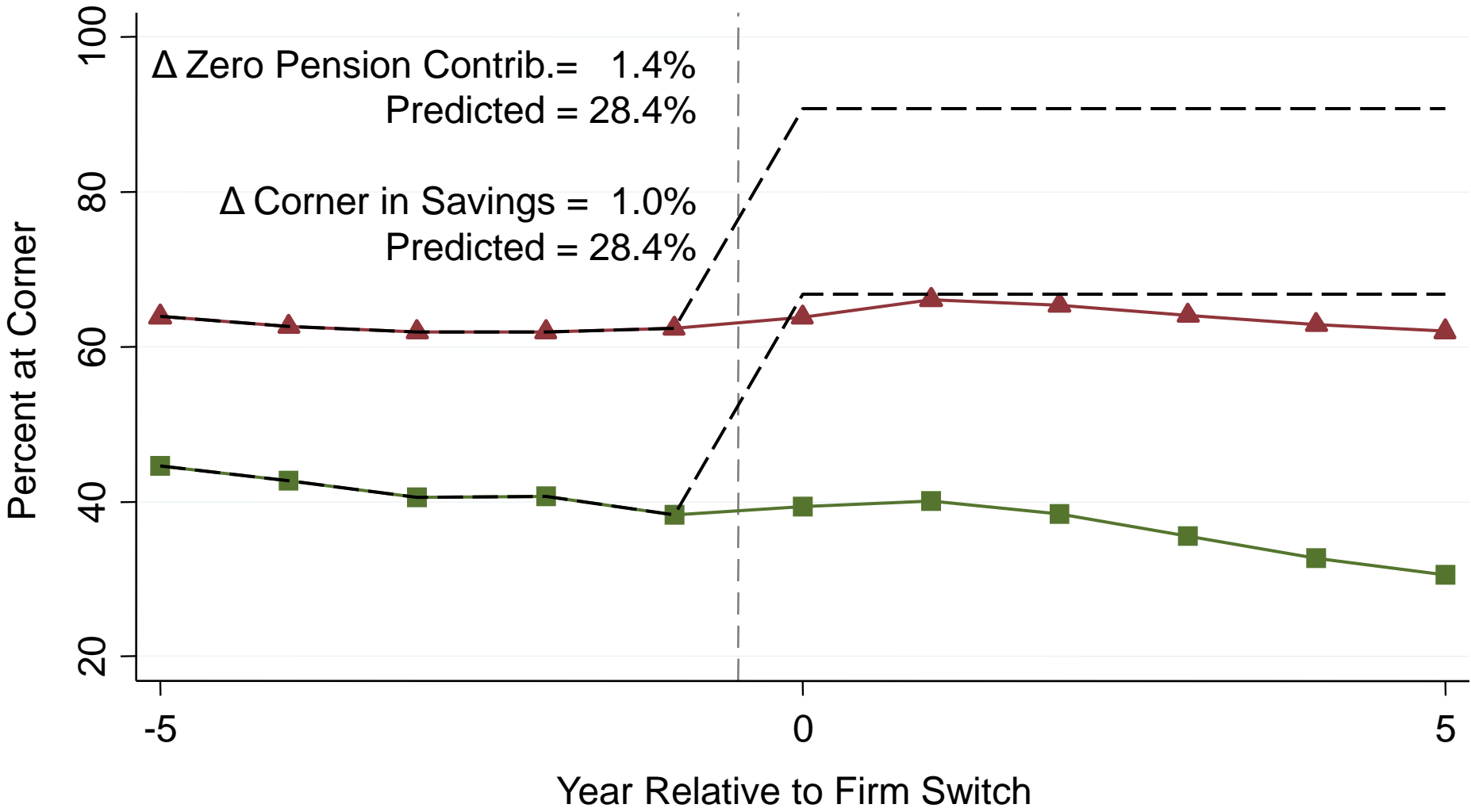


—▲— Individual Pensions

Fraction at Corner around Switches to Firm with >3% Increase in Employer Pension Rate



Event Study of Fraction at 0 Corner around Switches to Firm with >3% Increase in Employer Pension Rate

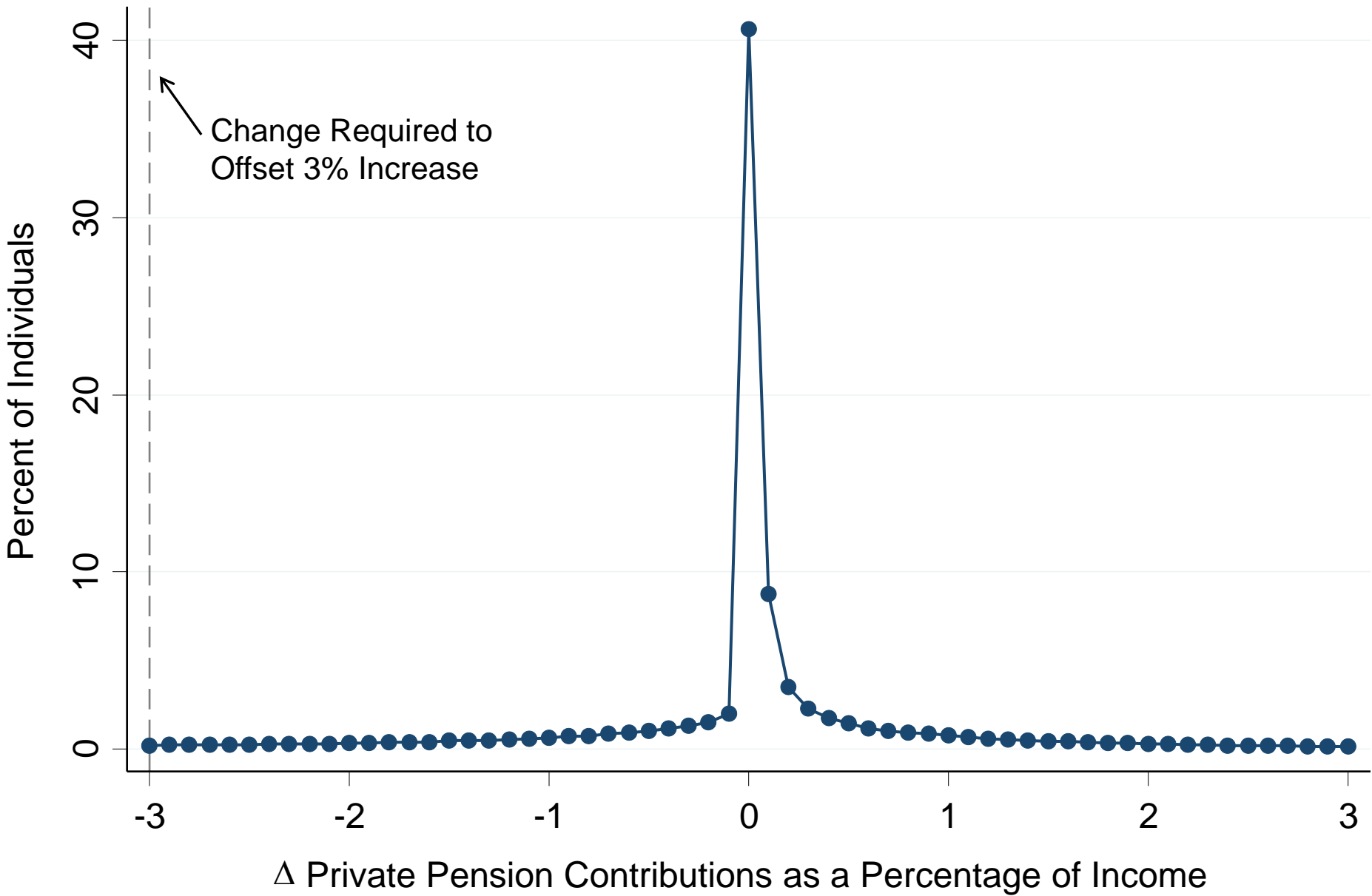


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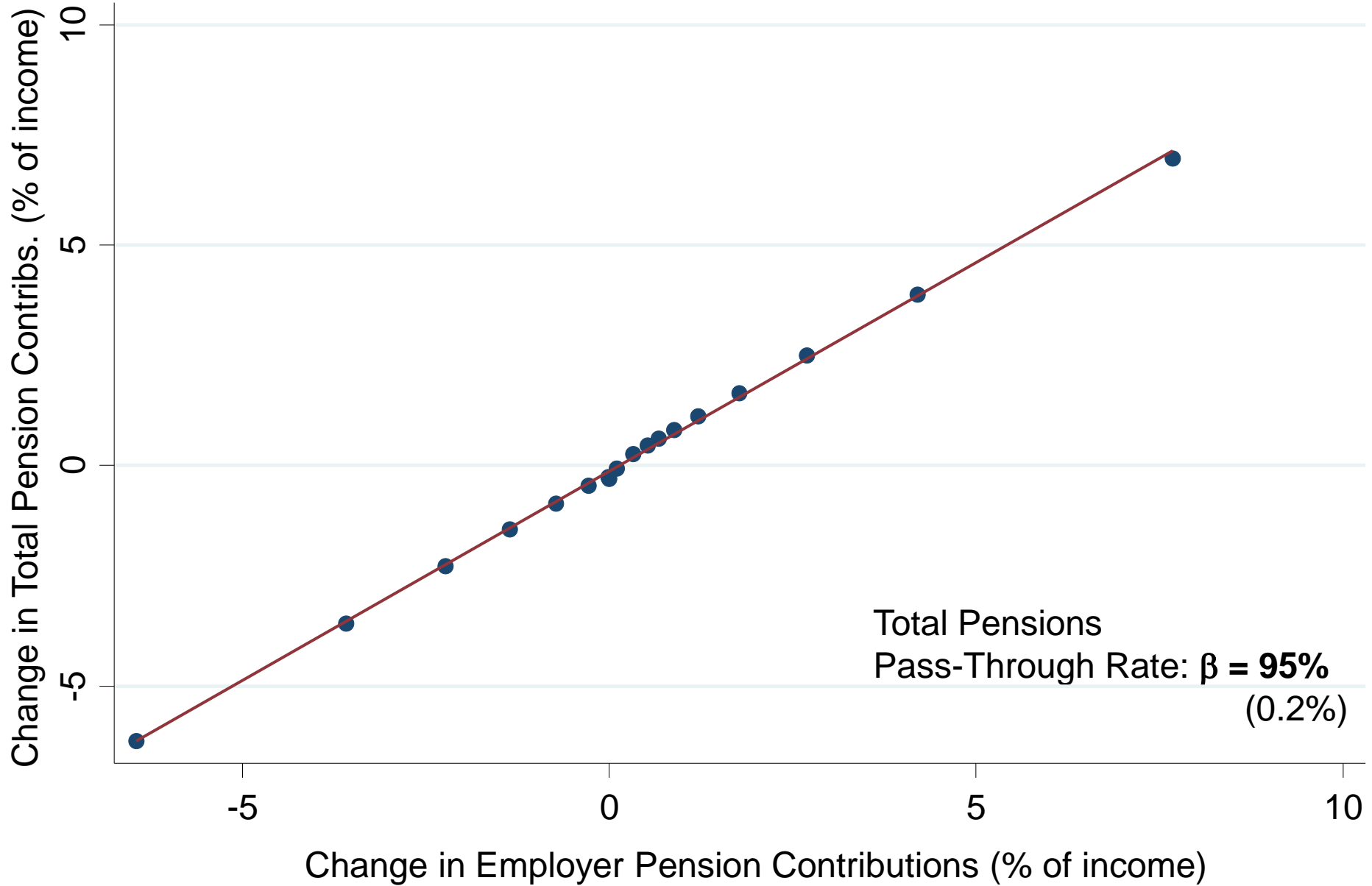
Predicted with Full Crowd-Out
- Total Savings

Predicted with Full Crowd-Out

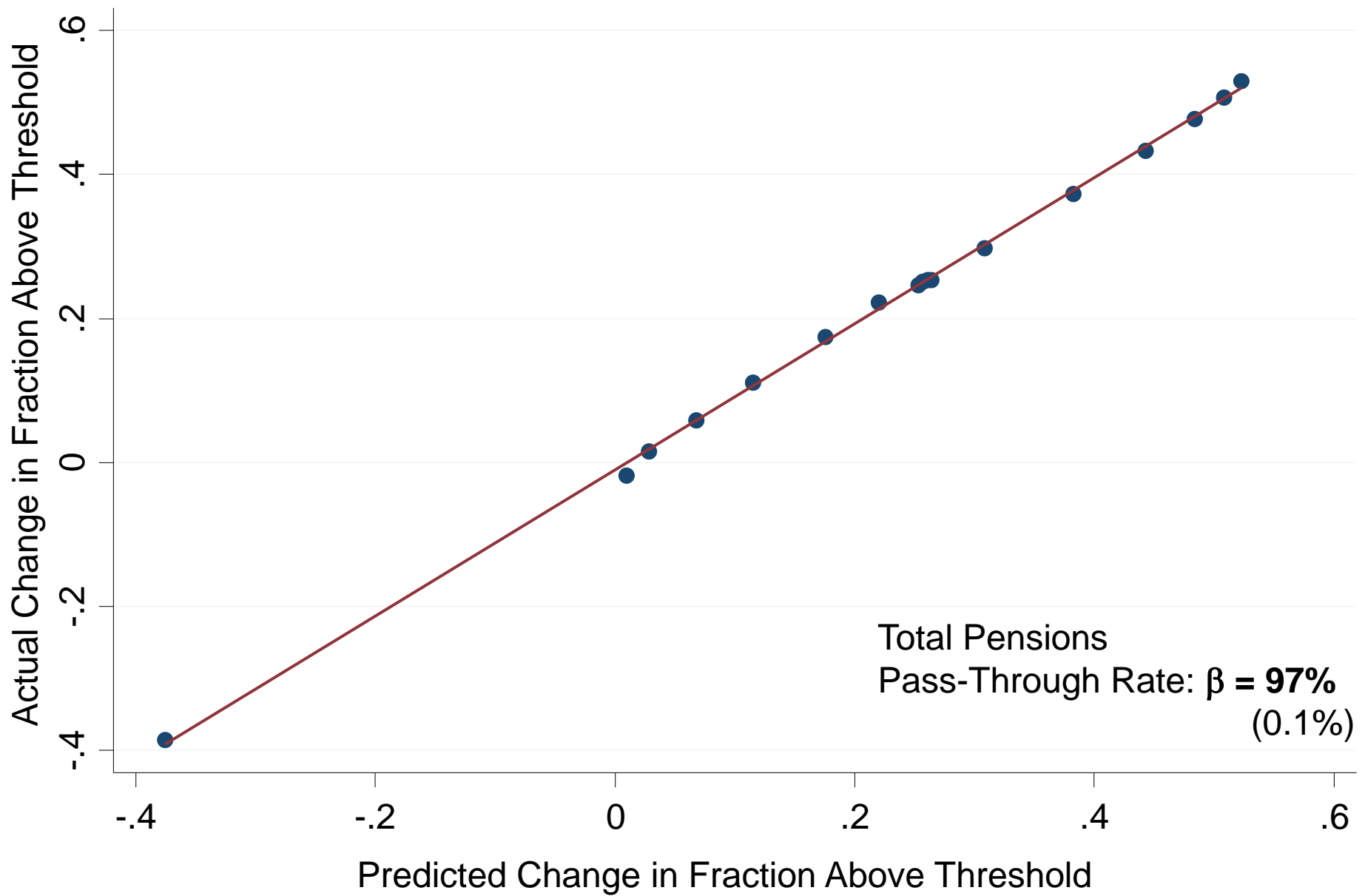
Changes in Individual Pension Contributions in Year of Firm Switch For Individuals Contributing to Private Pensions in Prior Year



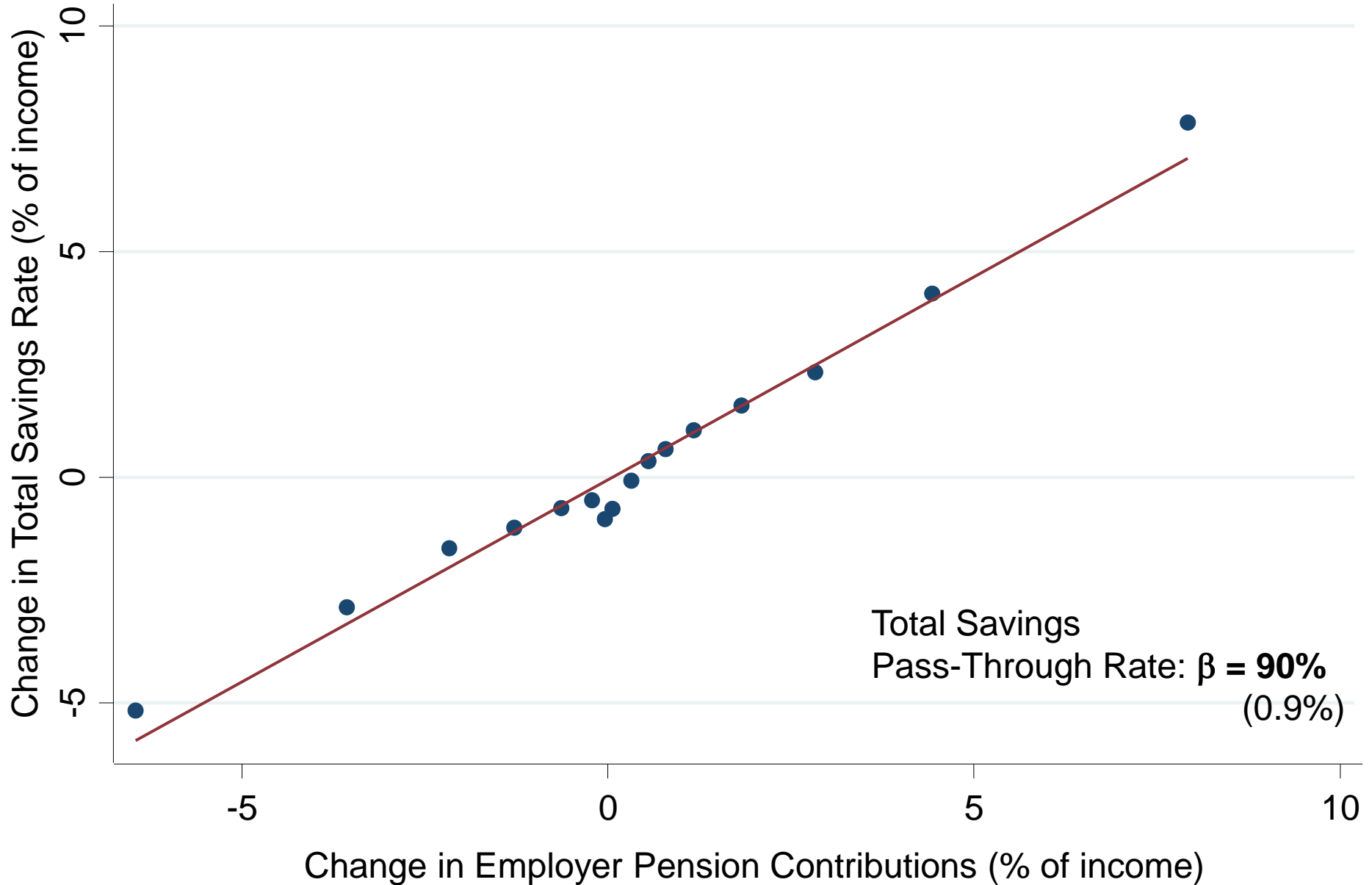
Changes in Total Pension Contributions vs. Changes in Employer Pension Rates for Firm Switchers Contributing Pensions Prior to Switch



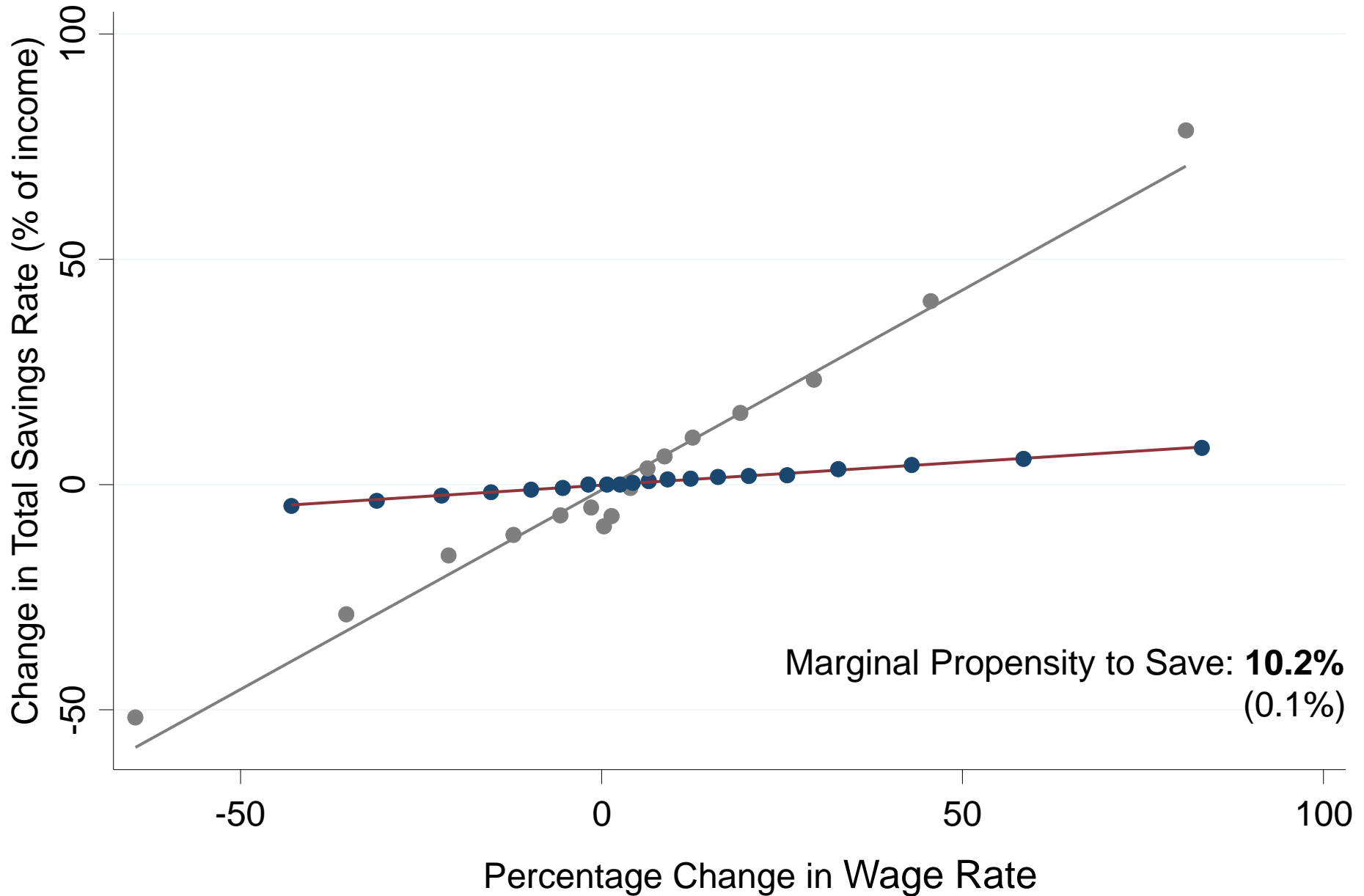
Threshold-Based Analysis of Effect of Employer Provided Pension on Total Pension Contributions



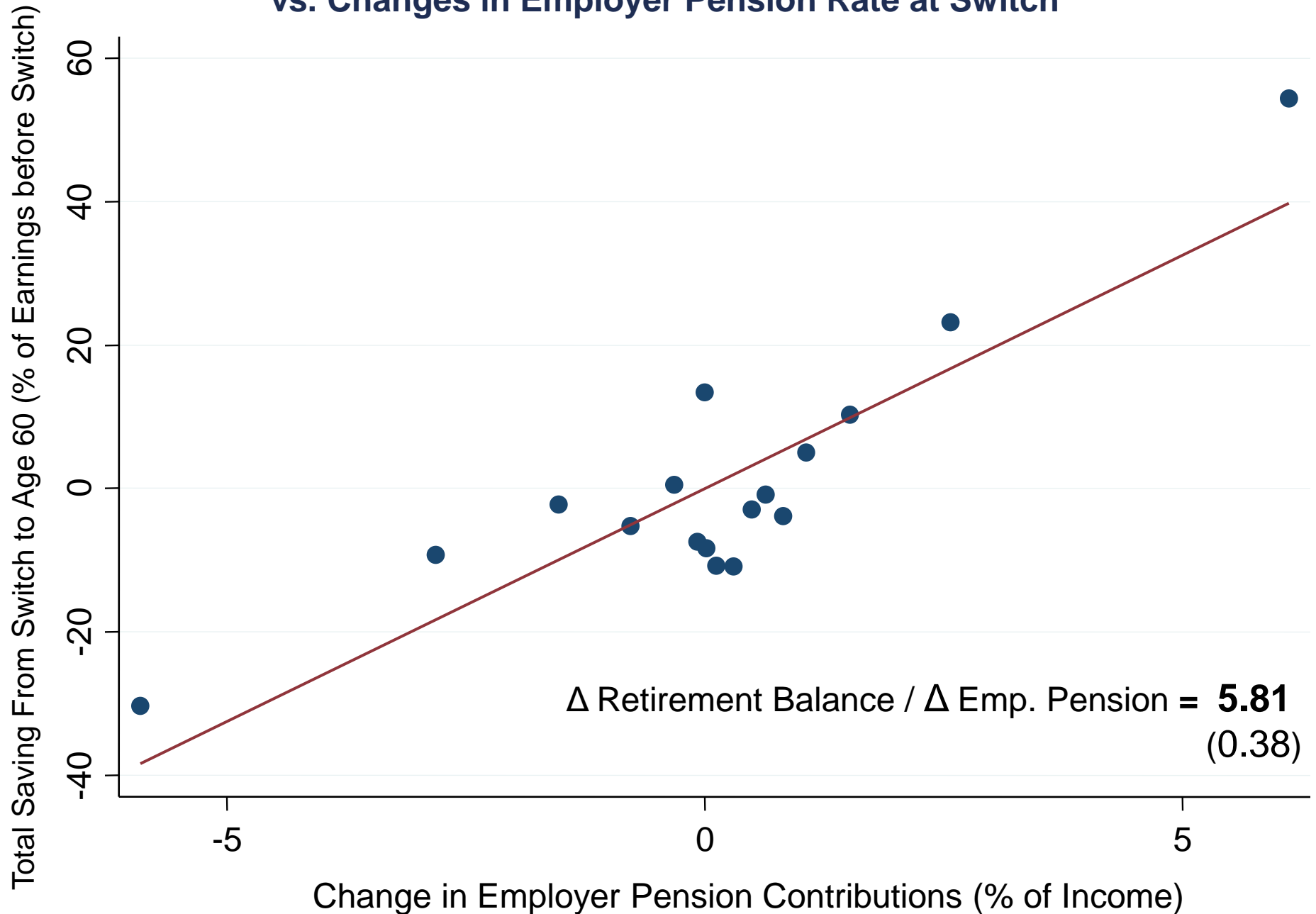
Changes in Total Savings Rates vs. Changes in Employer Pension Rates for Firm Switchers with Positive Savings Prior to Switch



Changes in Total Savings Rates vs. Changes in Wage Rates for Firm Switchers with Positive Savings Prior to Switch



Total Wealth Accrued from Switch to Retirement (Age 60) vs. Changes in Employer Pension Rate at Switch



Employer Pensions: Pass-Through Estimates

Sample:	All Firm Switches	All Firm Switches	All Firm Switches	Mass Layoff	Large Changes	First Switch	Switch Ages 46-54
Dep. Var.:	Δ Pension Rate (1)	Δ Savings Rate (2)	Δ Savings Rate (3)	Δ Savings Rate (4)	Δ Savings Rate (5)	Δ Savings Rate (6)	Δ Retirement Balance (7)
Δ Emp. Pens. Contrib. Rate Δ Wages No. of Obs.	0.947 (0.002)	0.900 (0.009)	0.888 (0.009)	0.865 (0.110)	0.897 (0.011)	0.832 (0.018)	5.806 (0.380)
			0.043 (0.001)				
	910,866	2,078,612	2,078,612	36,659	216,613	716,273	55,608

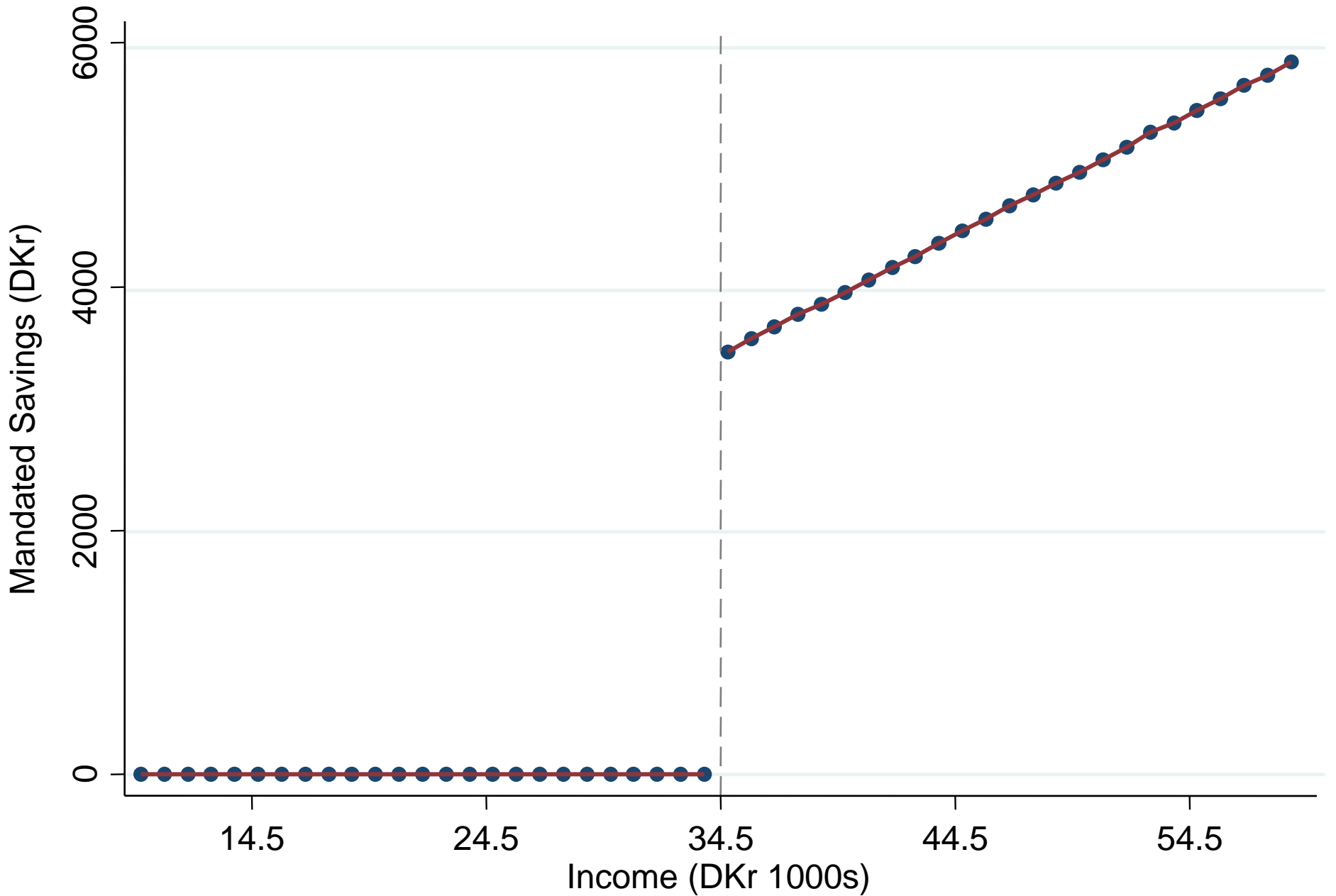
Employer Pensions: Pass-Through Estimates Robustness Checks

Sample:	All Firm Switches	Renters	All Firm Switches	Single Individuals
Dep. Var.:	Δ Net Savings (1)	Δ Savings Rate (2)	Δ Household Savings (3)	Δ Savings Rate (4)
Δ Emp. Pens. Contrib. Rate	0.899 (0.014)	0.954 (0.013)	0.868 (0.010)	0.911 (0.015)
No. of Obs.	1,858,297	941,450	2,024,950	793,188

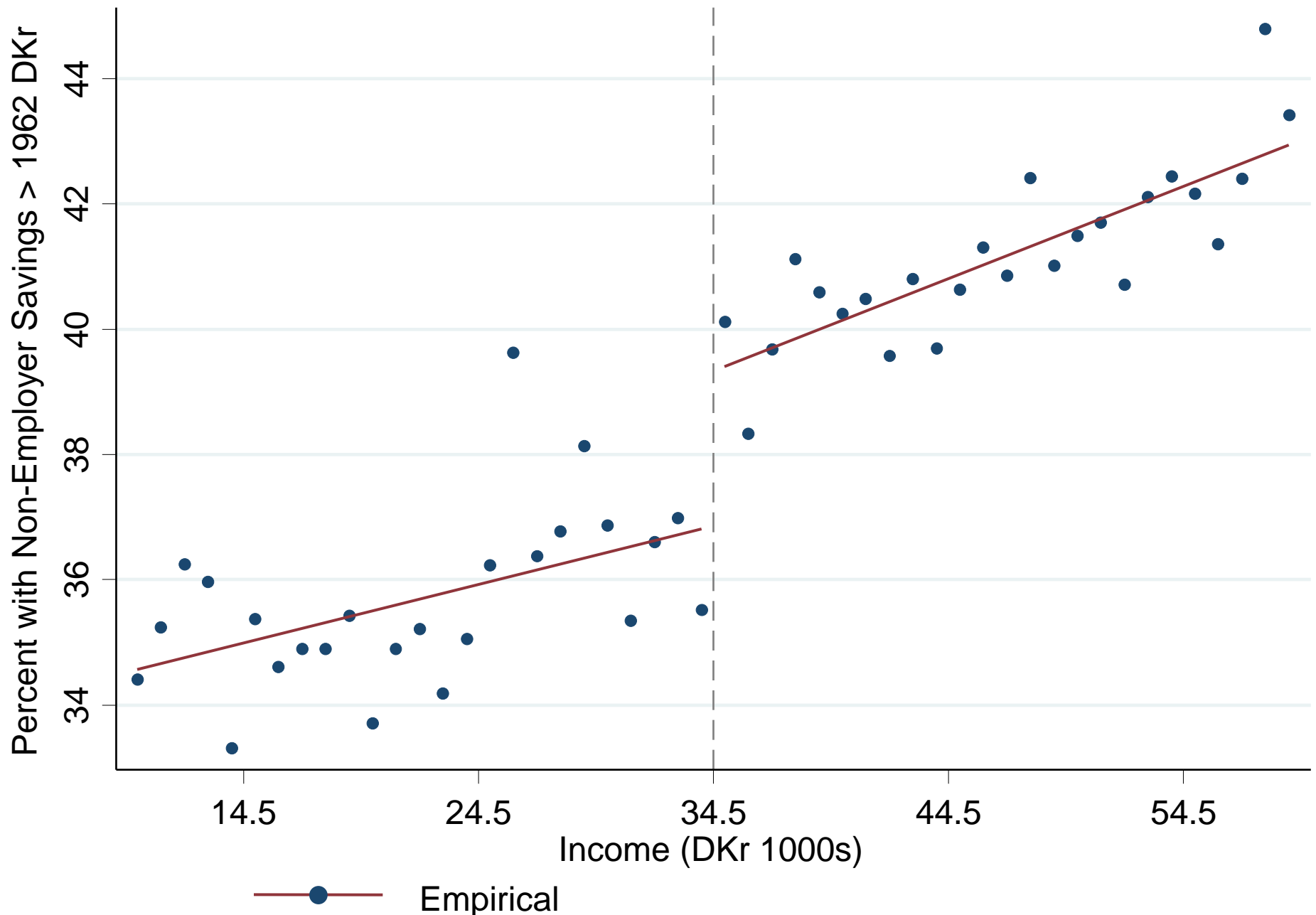
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Active Savers	No	No	Yes	Uncertain
Passive Savers	Yes	Uncertain	No	No
Data	Yes	Yes	?	?

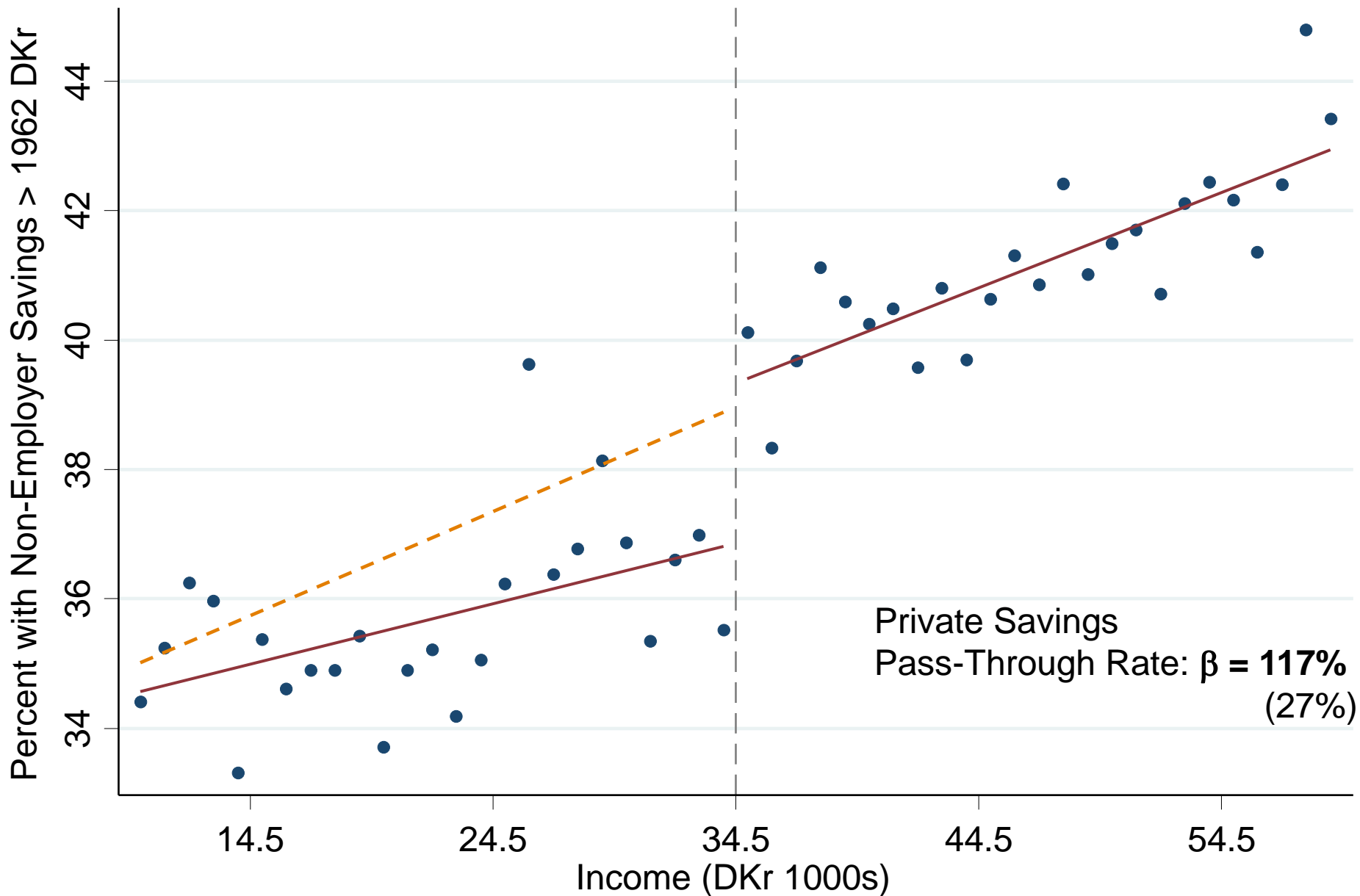
Mandated Savings (M) Around Eligibility Threshold in 1998



Effect on Mandate on Total (Non-Employer) Savings: Threshold Approach



Effect on Mandate on Private Savings: Threshold Approach



Mandated Savings Plan: Pass-Through Estimates

Dep. Var.:	Δ Total Pensions	% with Total Pensions > Mean	Δ Total Ind. Savings	% with Total Ind. Savings > Mean	Δ Total Savings	% with Total Savings > Mean
	(1)	(2)	(3)	(4)	(5)	(6)
Pass-Through Estimate	0.946 (0.251)	0.862 (0.172)	-2.248 (14.692)	1.172 (0.271)	2.771 (1.744)	1.149 (0.290)
Research Design	RD	RD	RD	RD	RD	RD
No. of Obs	37,616	183,001	92,872	156,157	92,186	156,157

Taxation of Capital Pensions

Capital Pensions

Pre-1999

Tax At Time of Contribution

0%

Interim Capital Gains Tax

~20%

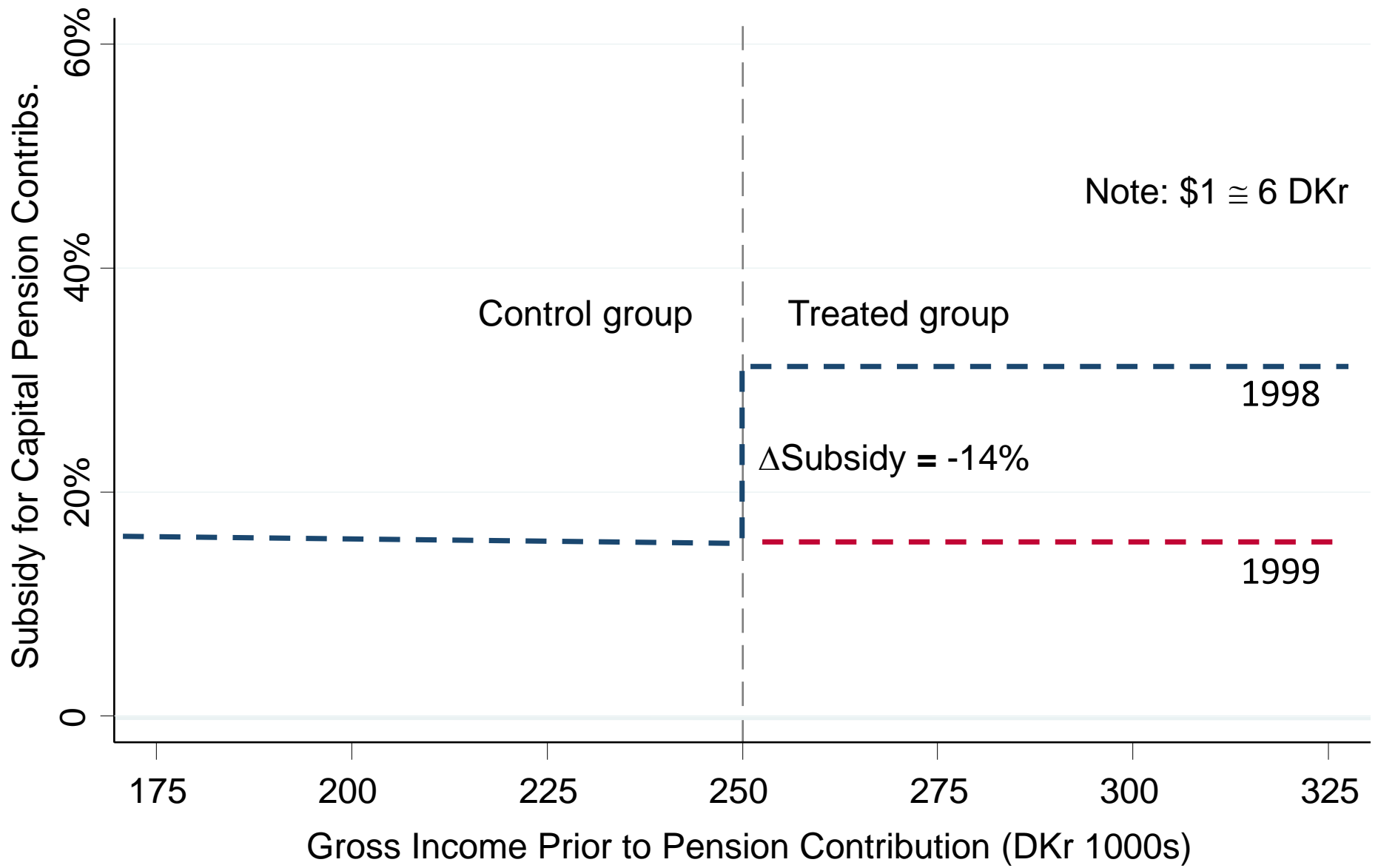
Tax on Payout

40%

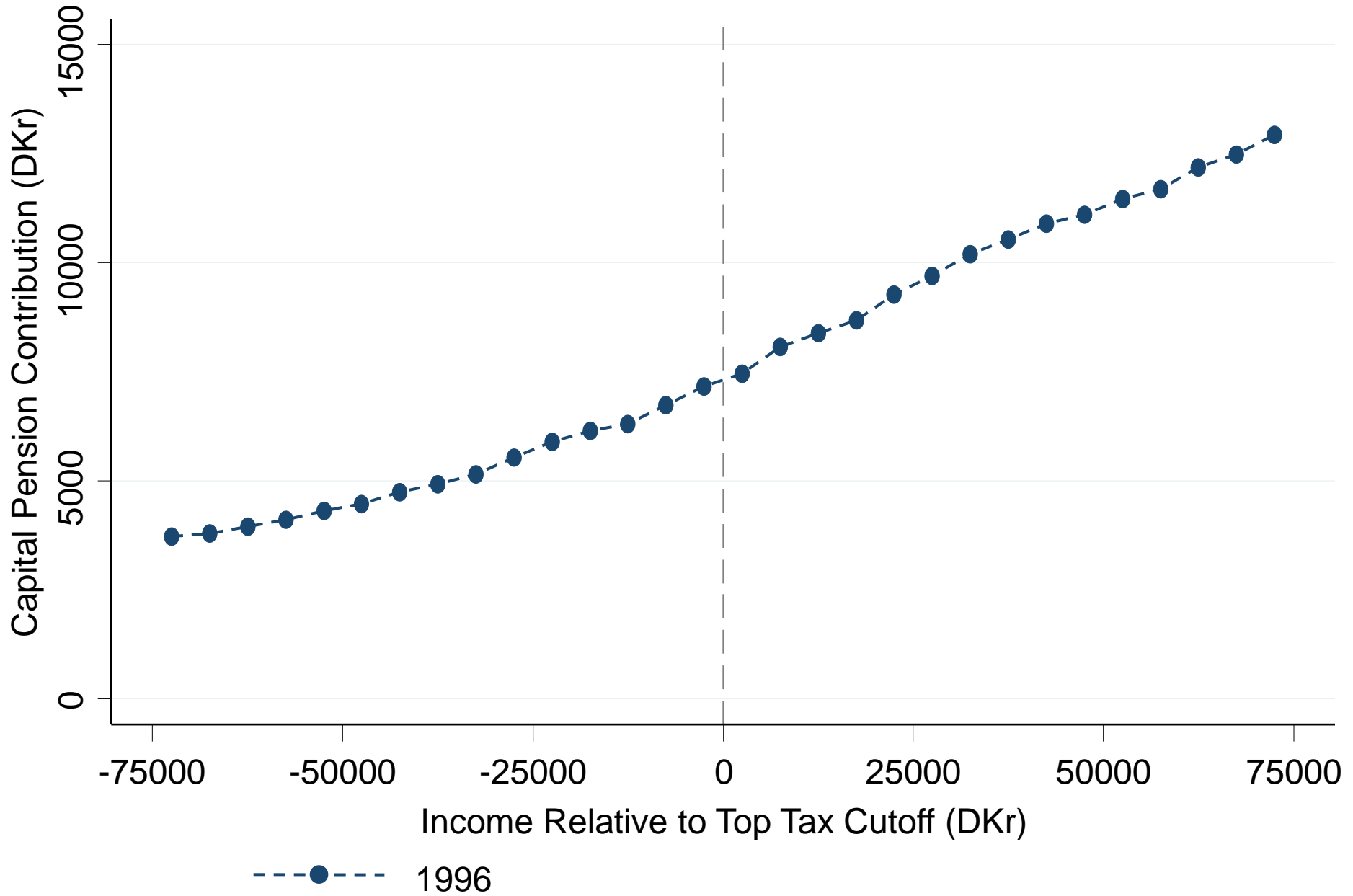
Taxation of Capital Pensions

	Capital Pensions	
	Pre-1999	Post-1999
Tax At Time of Contribution	0%	14% if in top tax bracket
Interim Capital Gains Tax	~20%	~20%
Tax on Payout	40%	40%

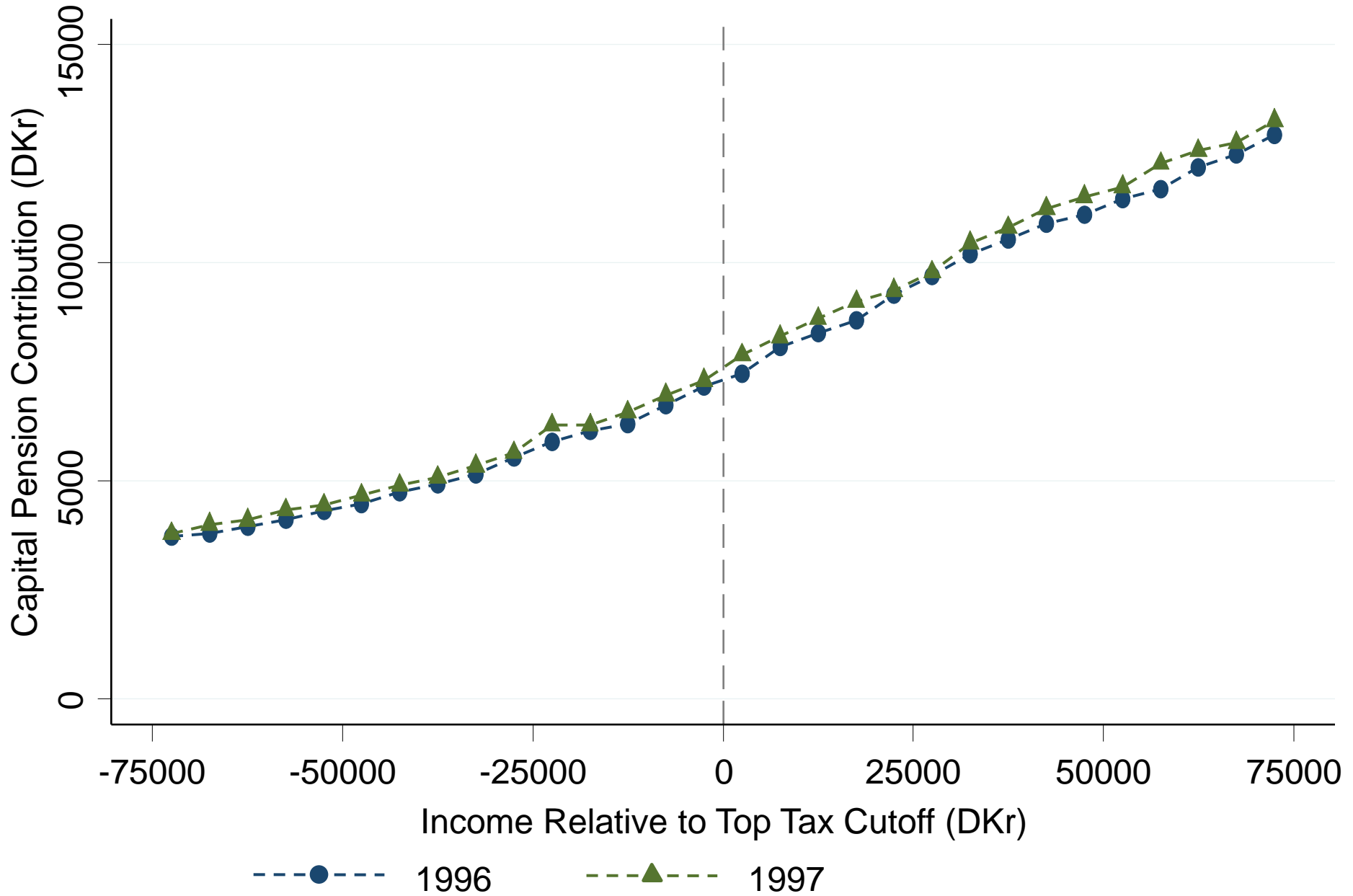
Subsidy for Capital Pensions in 1999



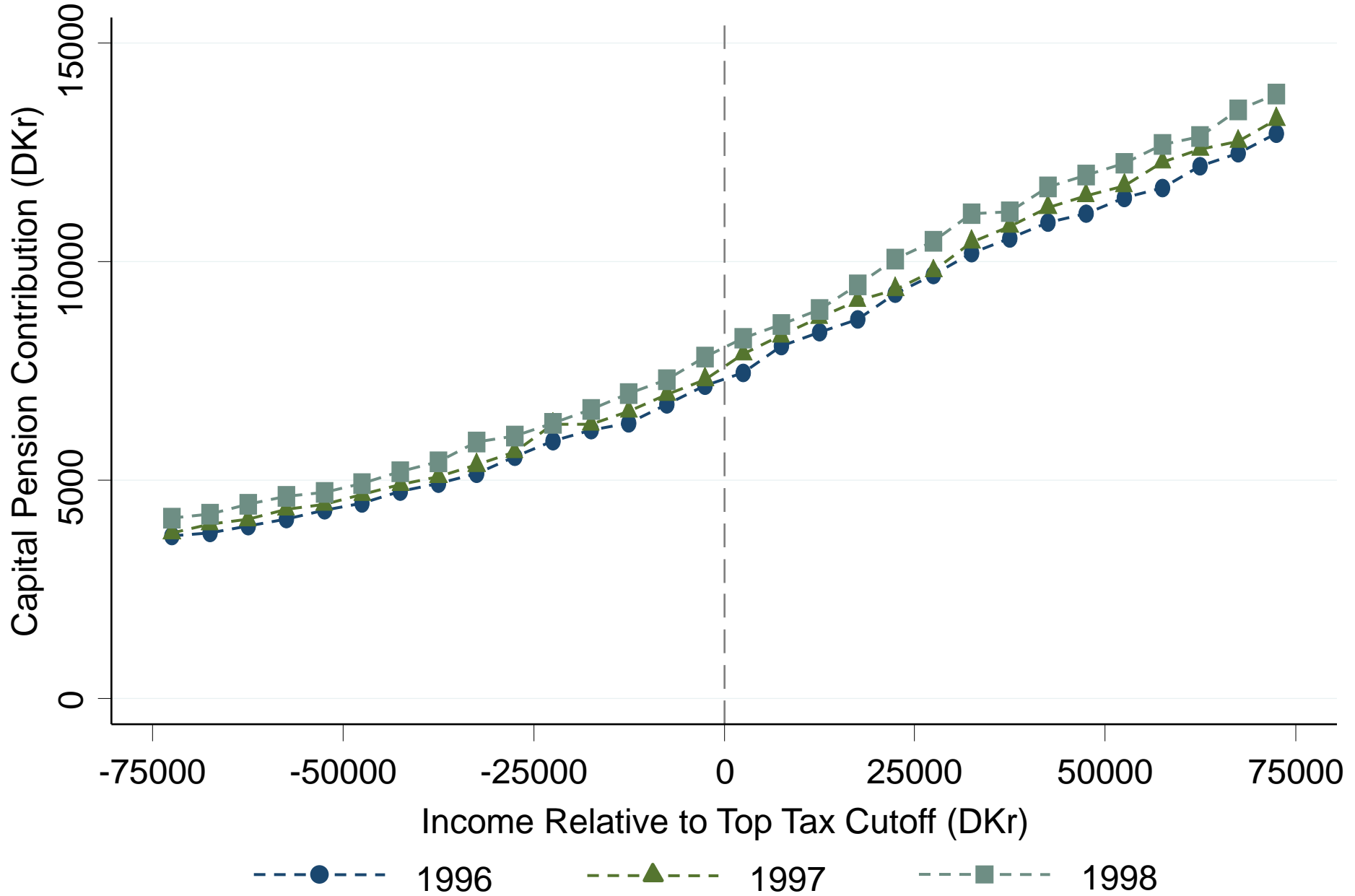
Impact of 1999 Capital Pension Subsidy Reduction On Capital Pension Contribs.



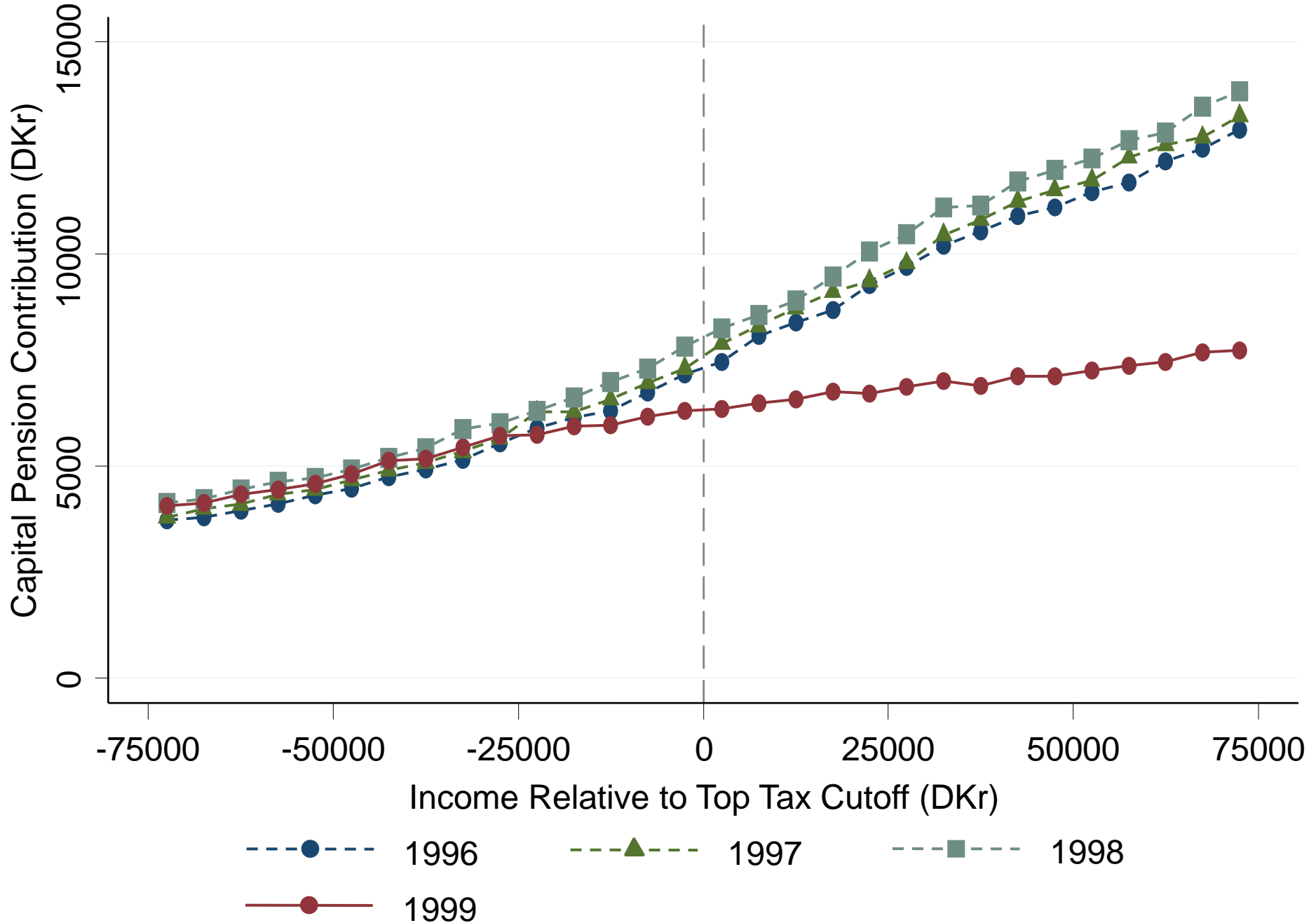
Impact of 1999 Capital Pension Subsidy Reduction On Capital Pension Contribs.



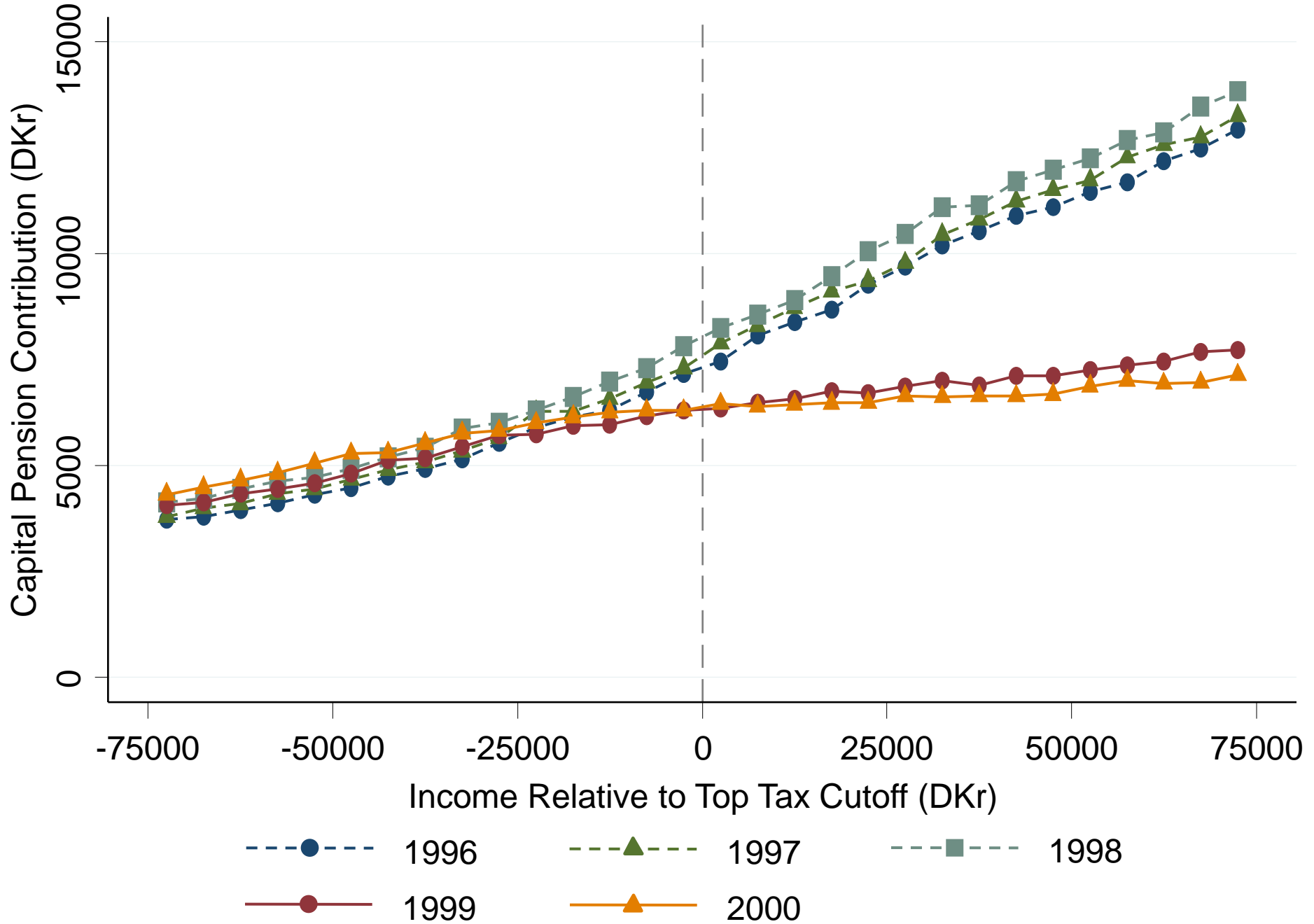
Impact of 1999 Capital Pension Subsidy Reduction On Capital Pension Contribs.



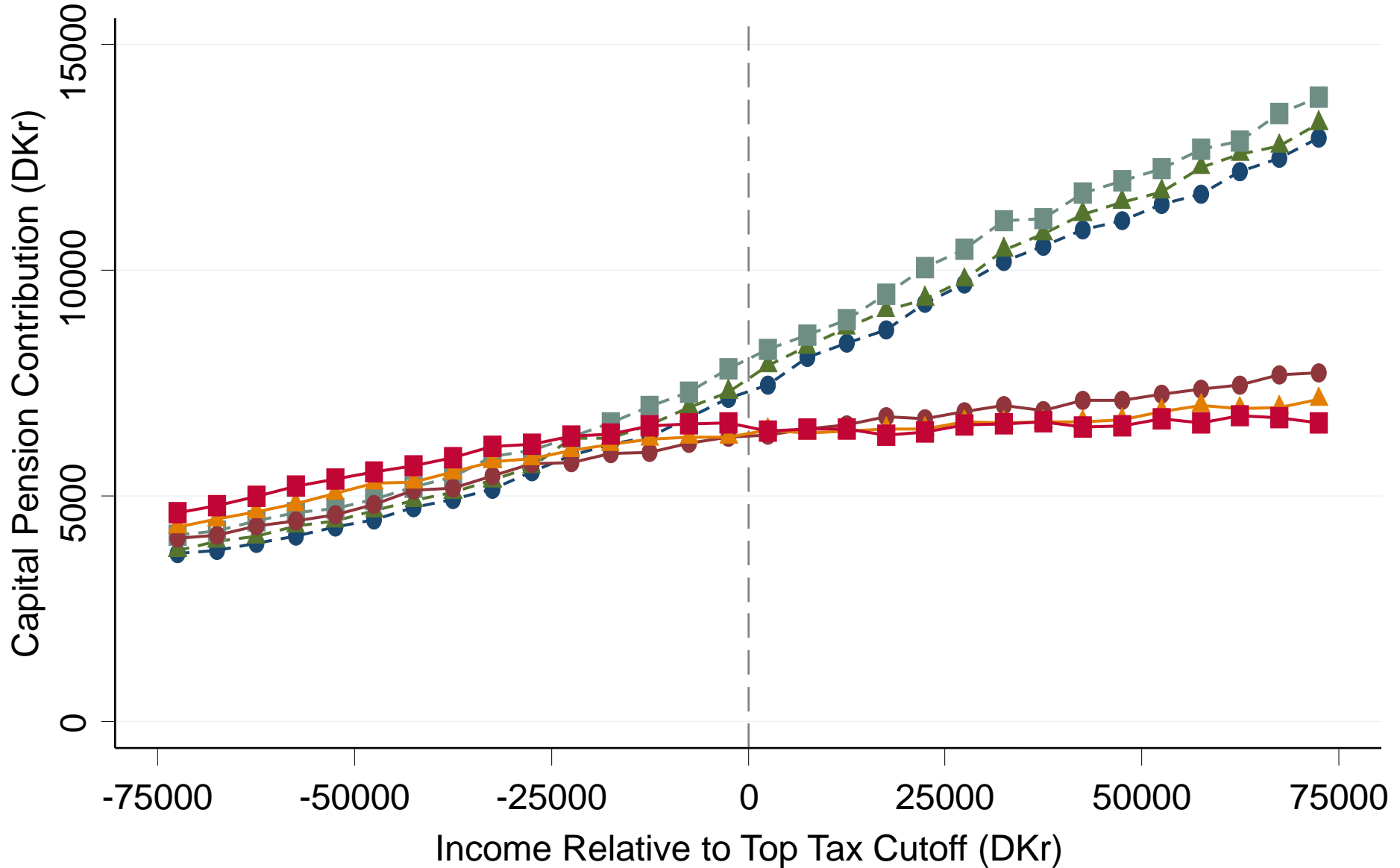
Impact of 1999 Capital Pension Subsidy Reduction On Capital Pension Contribs.



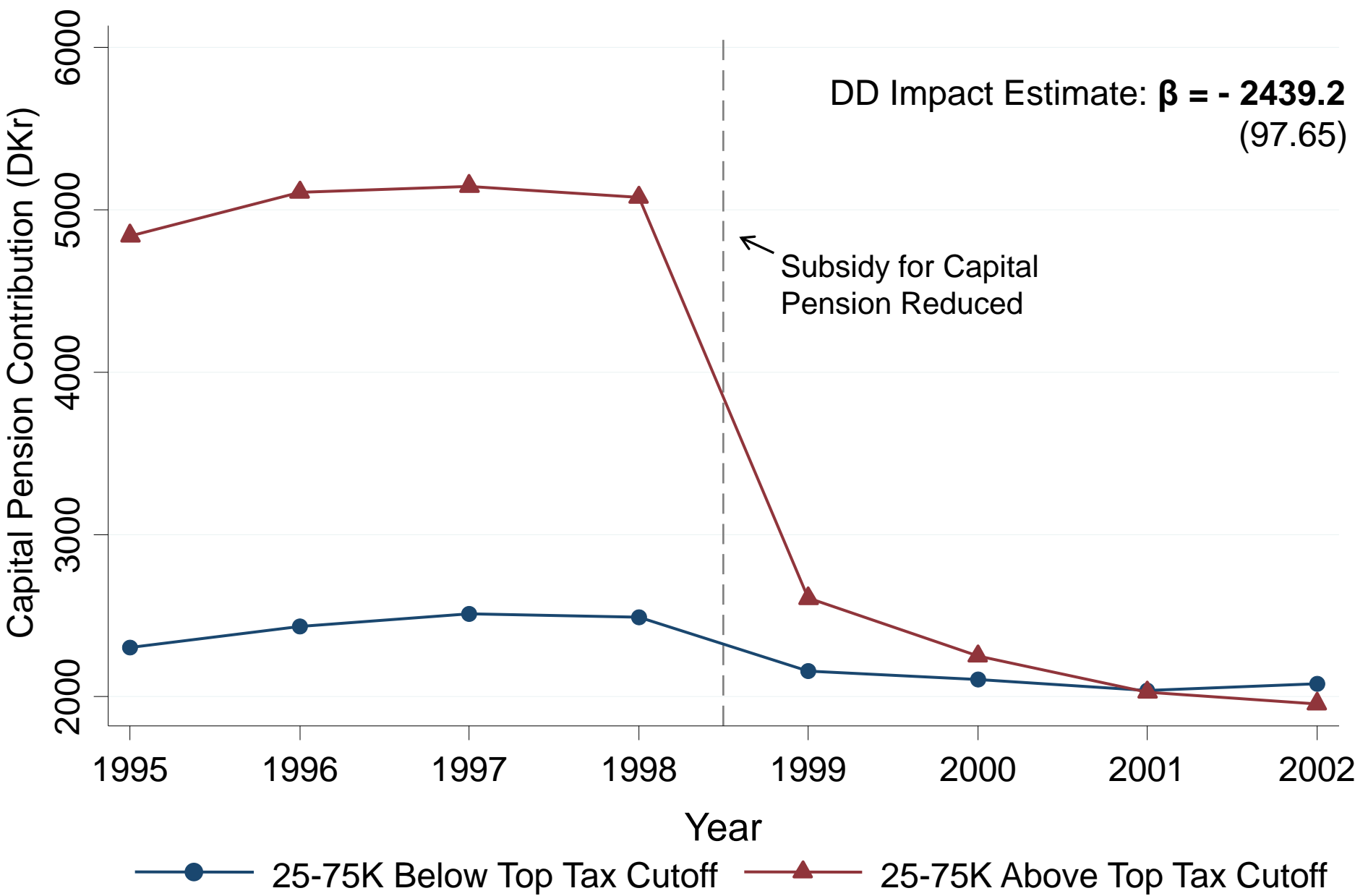
Impact of 1999 Capital Pension Subsidy Reduction On Capital Pension Contribs.



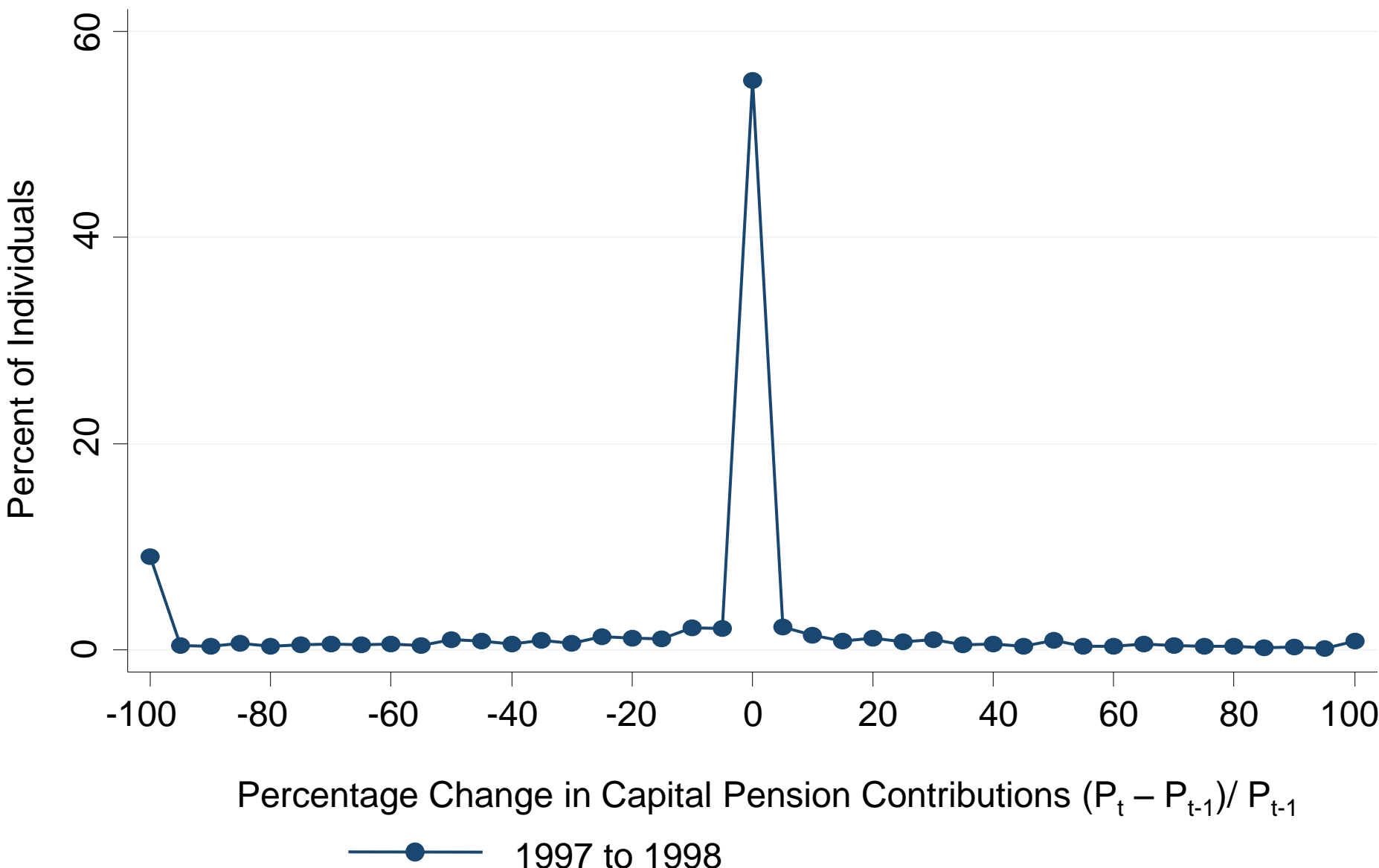
Impact of 1999 Capital Pension Subsidy Reduction On Capital Pension Contribs.



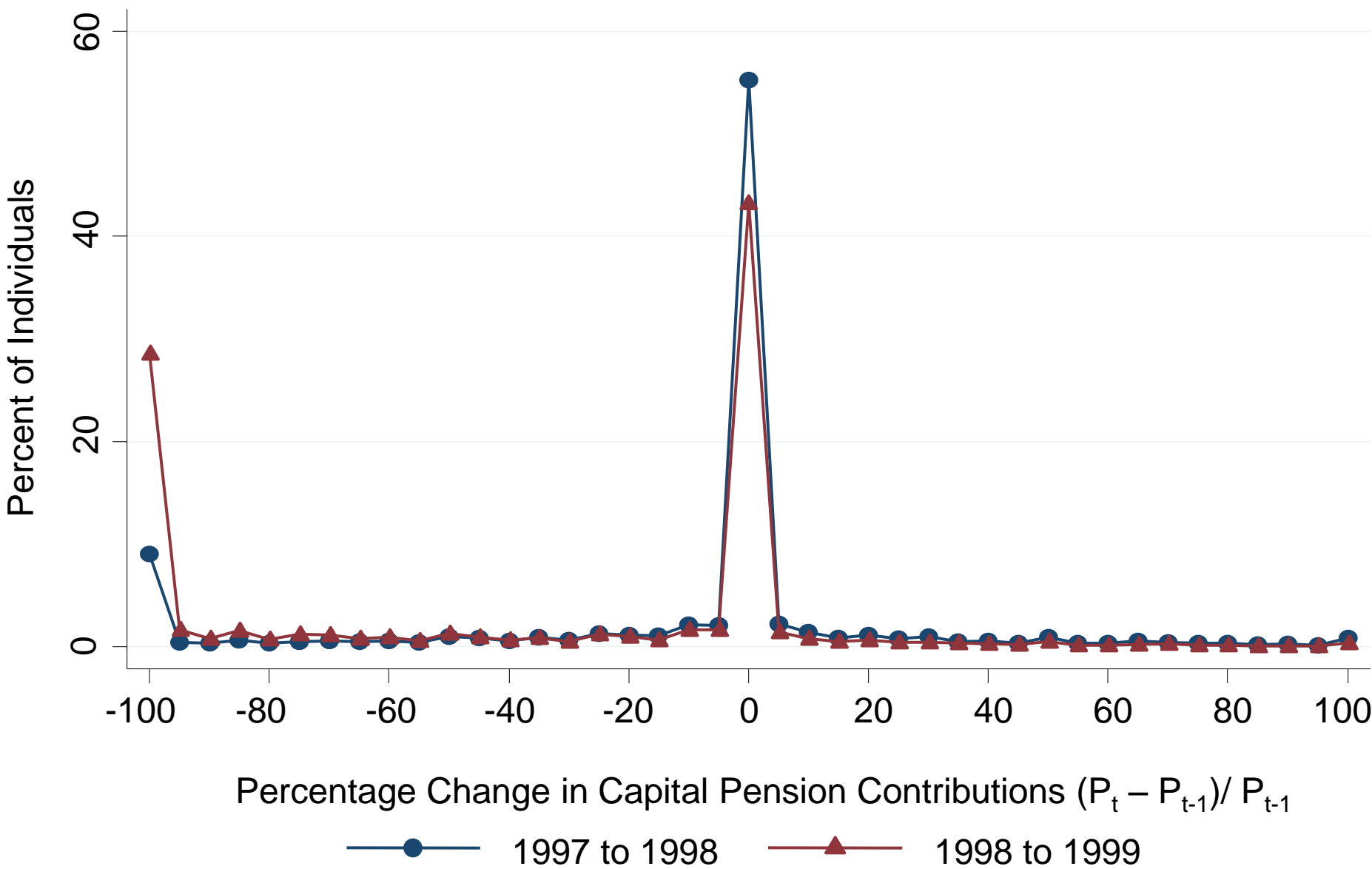
Impact of Subsidy Reduction On Individual Capital Pension Contribs.



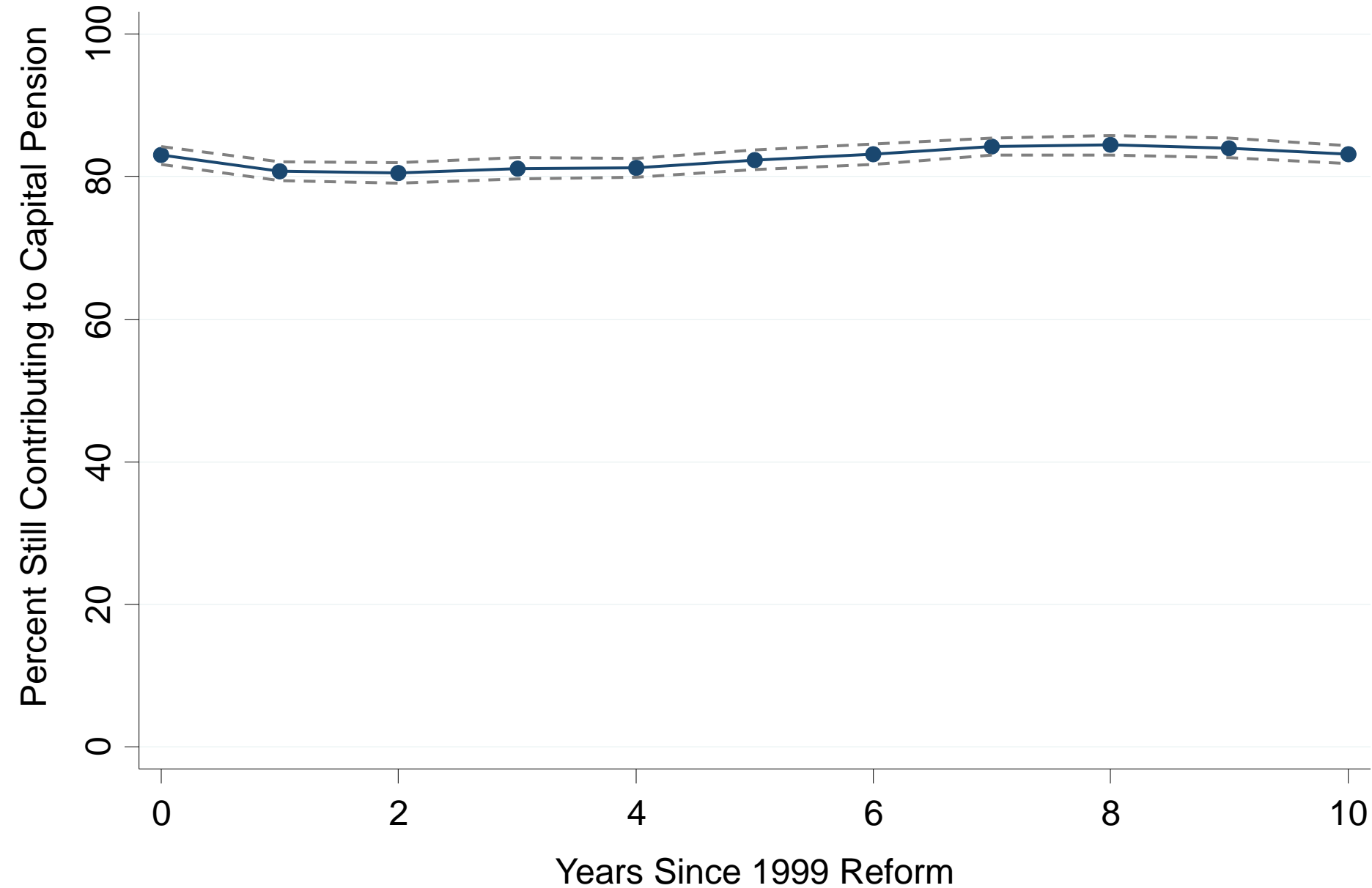
Impact of 1999 Capital Pension Subsidy Reduction on Distribution of Capital Pension Contributions for Prior Contributors



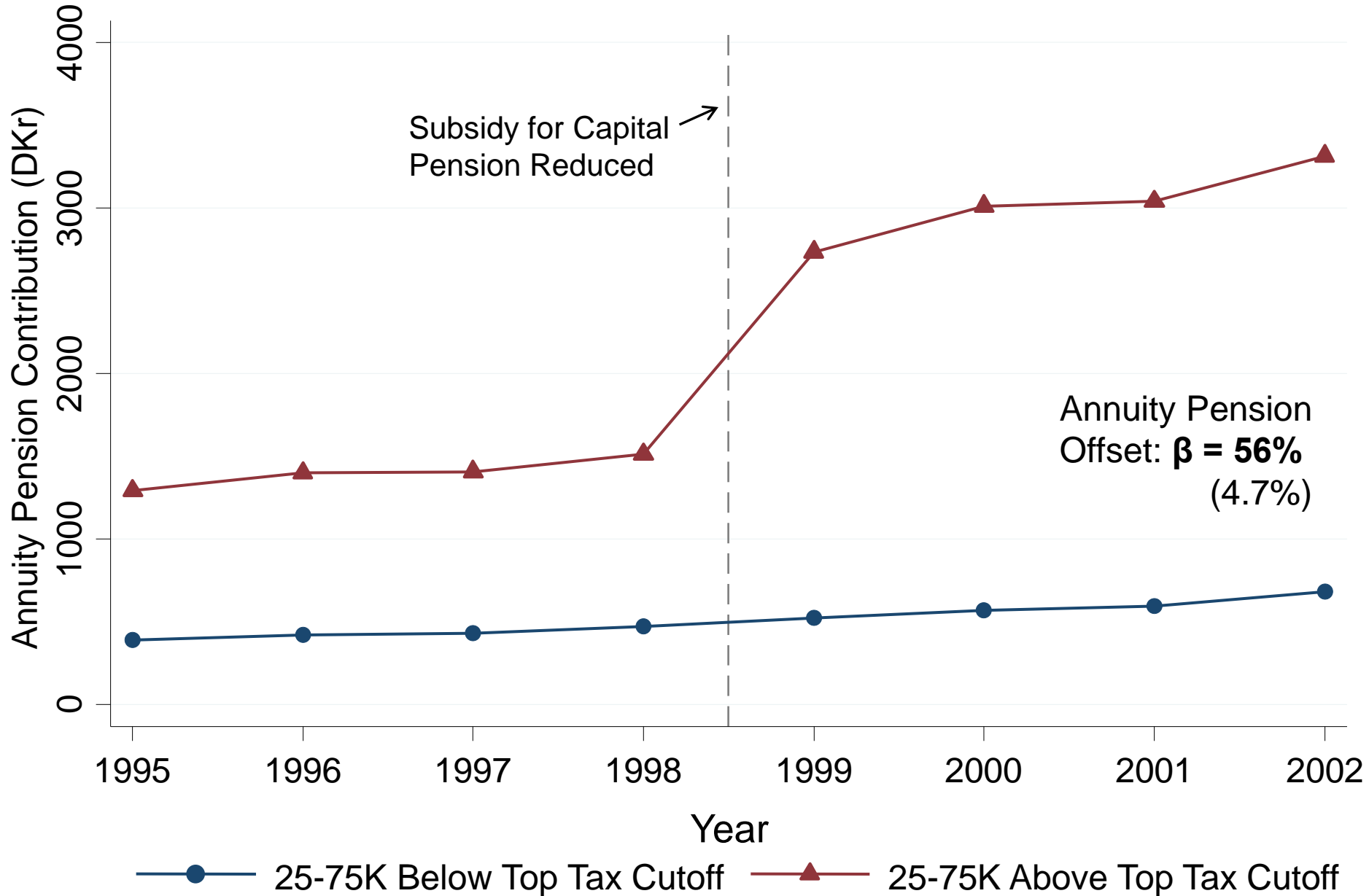
Impact of 1999 Capital Pension Subsidy Reduction on Distribution of Capital Pension Contributions for Prior Contributors



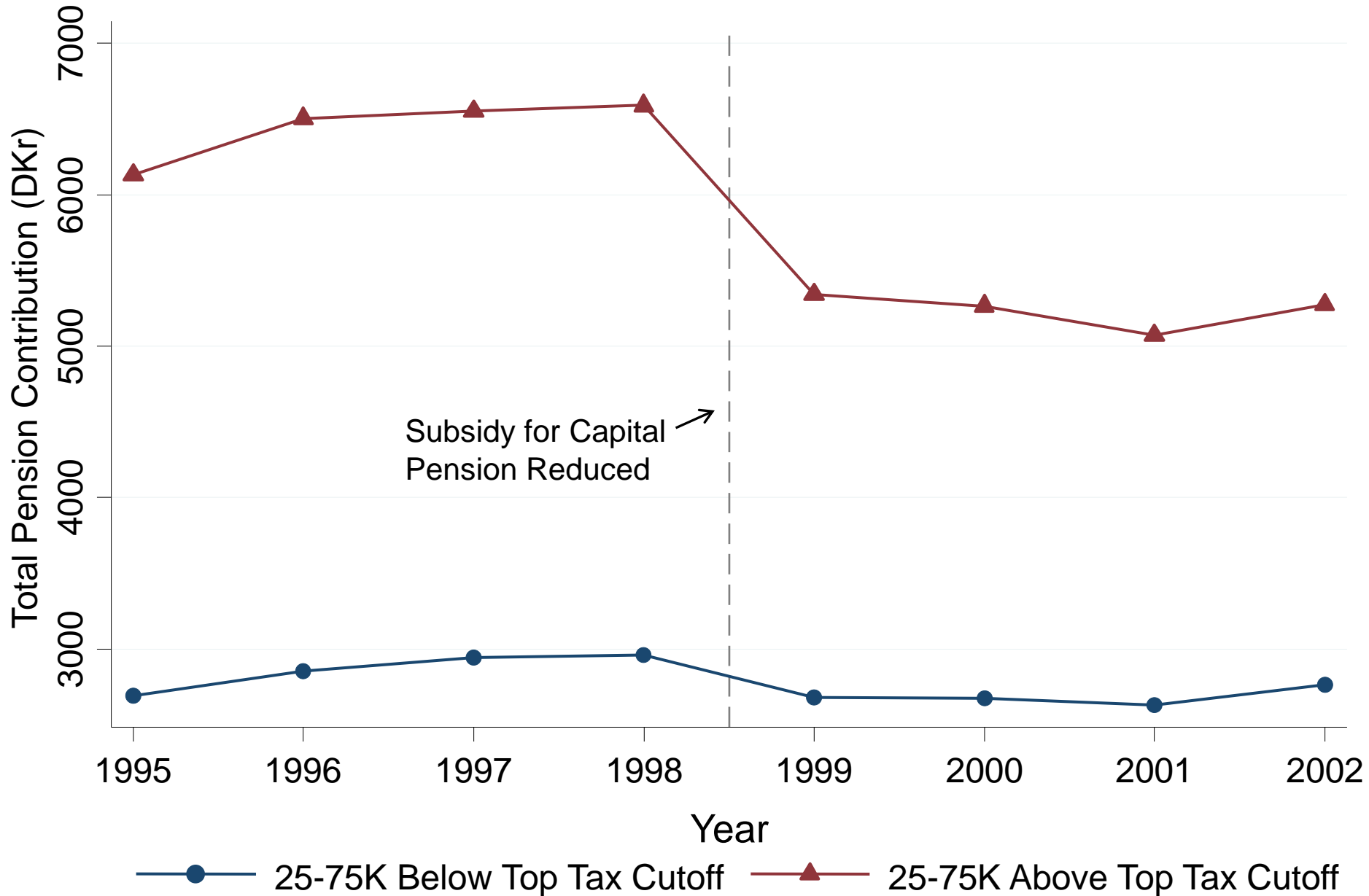
Effect of 1999 Reform on Fraction of Capital Pension Contributors by Year for Individuals Contributing Prior to Reform



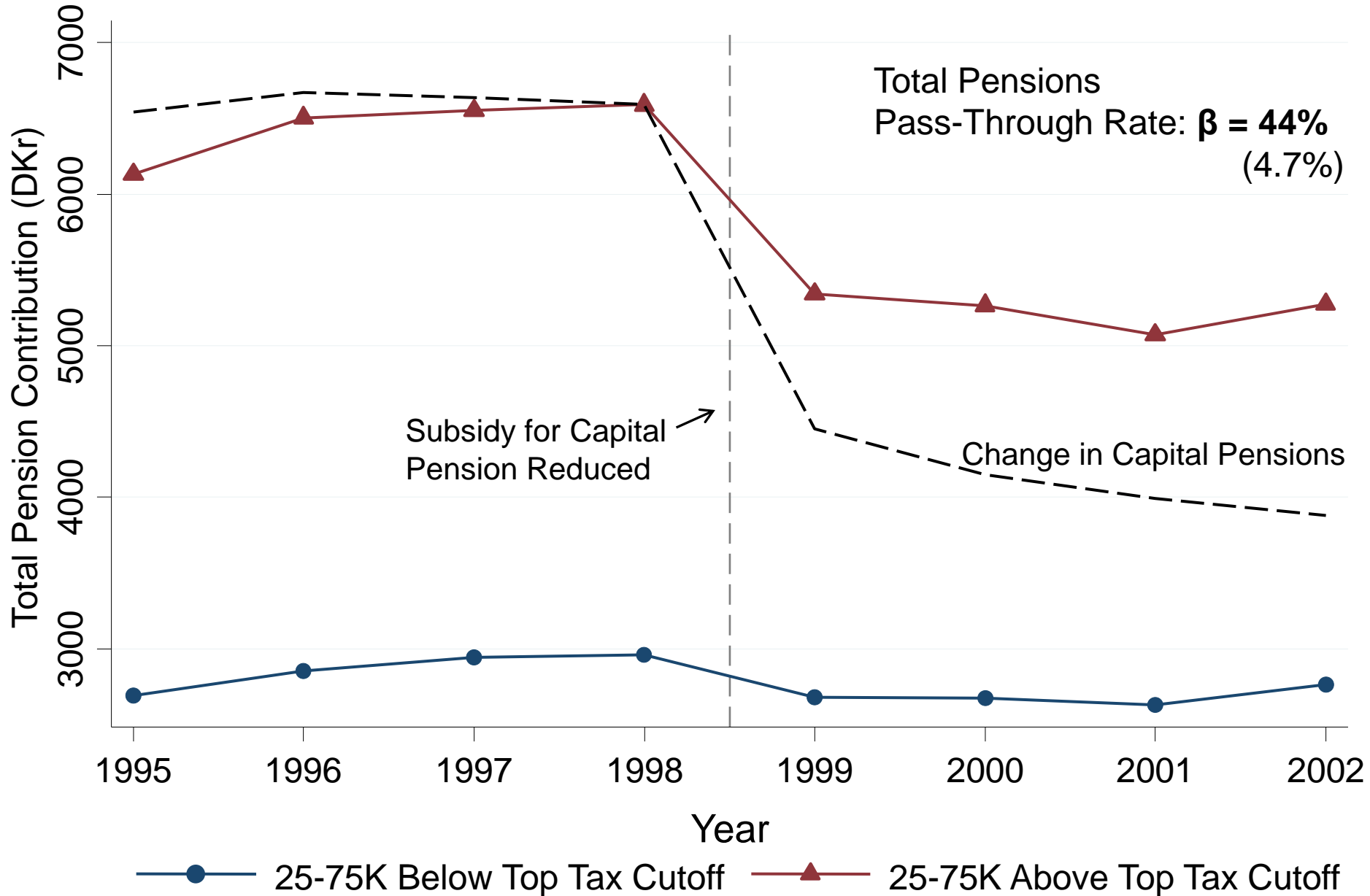
Impact of Capital Pension Subsidy Reduction On Annuity Pension Contributions



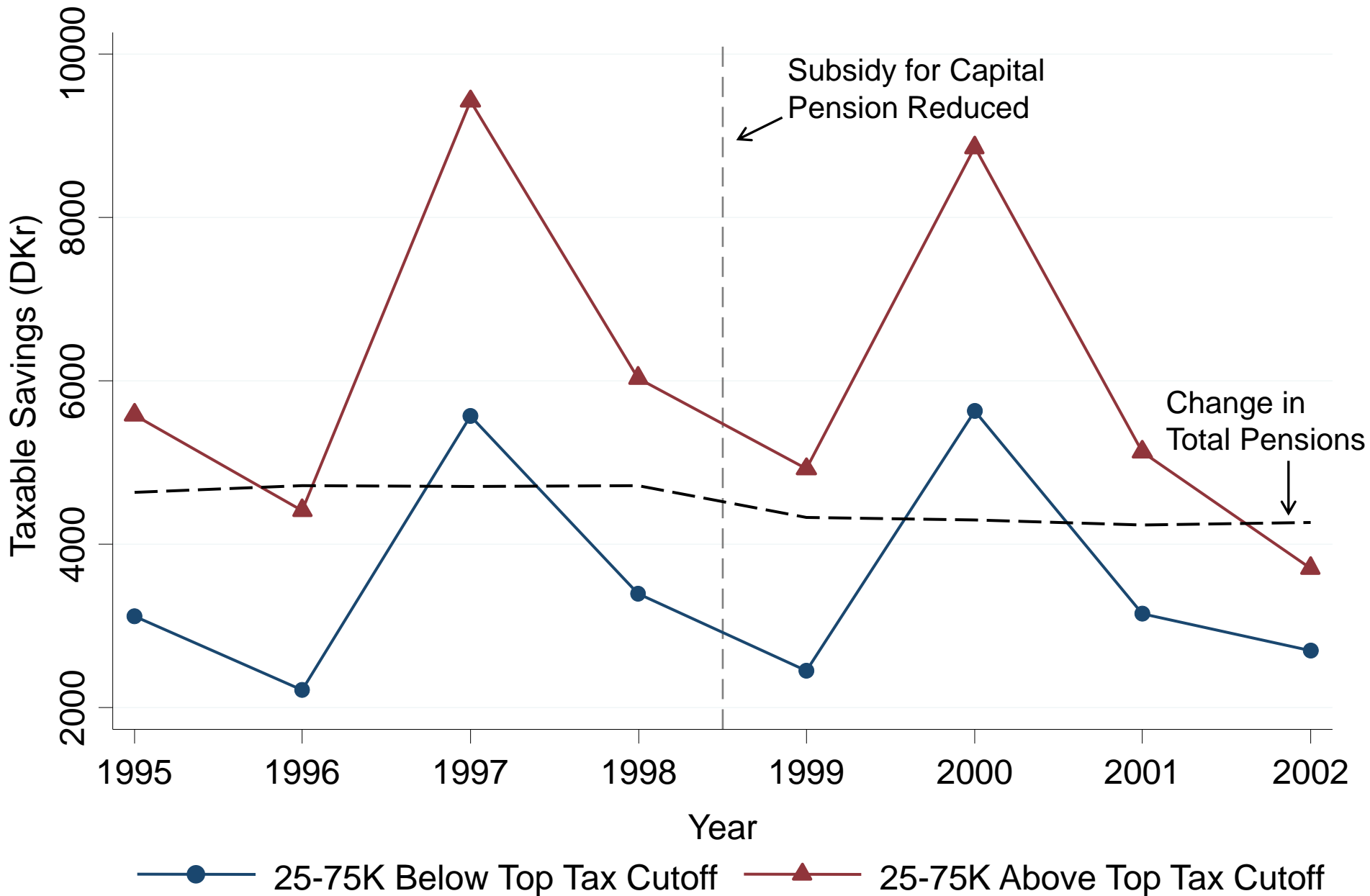
Impact of Capital Pension Subsidy Reduction On Total Pension Contributions



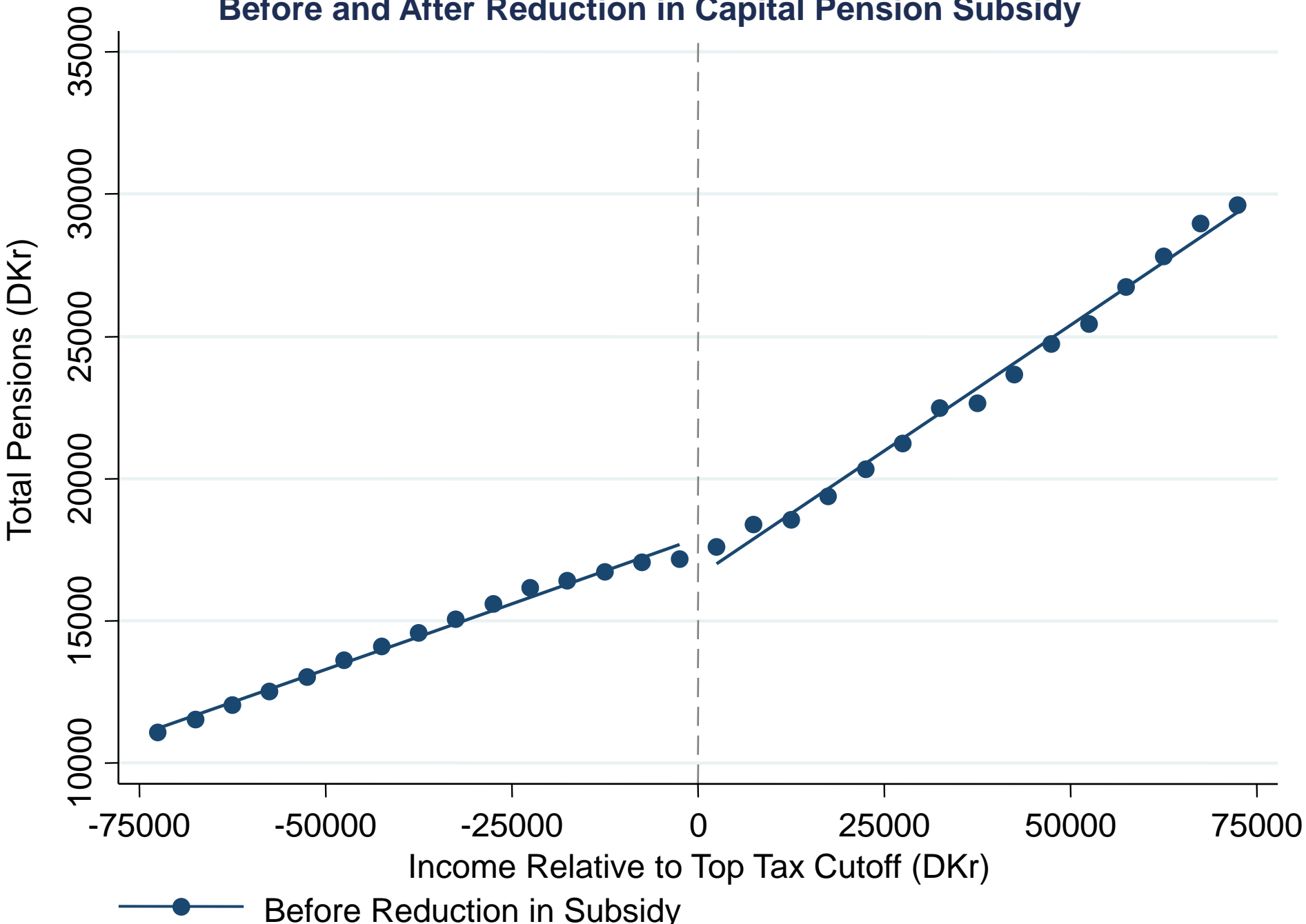
Impact of Capital Pension Subsidy Reduction On Total Pension Contributions



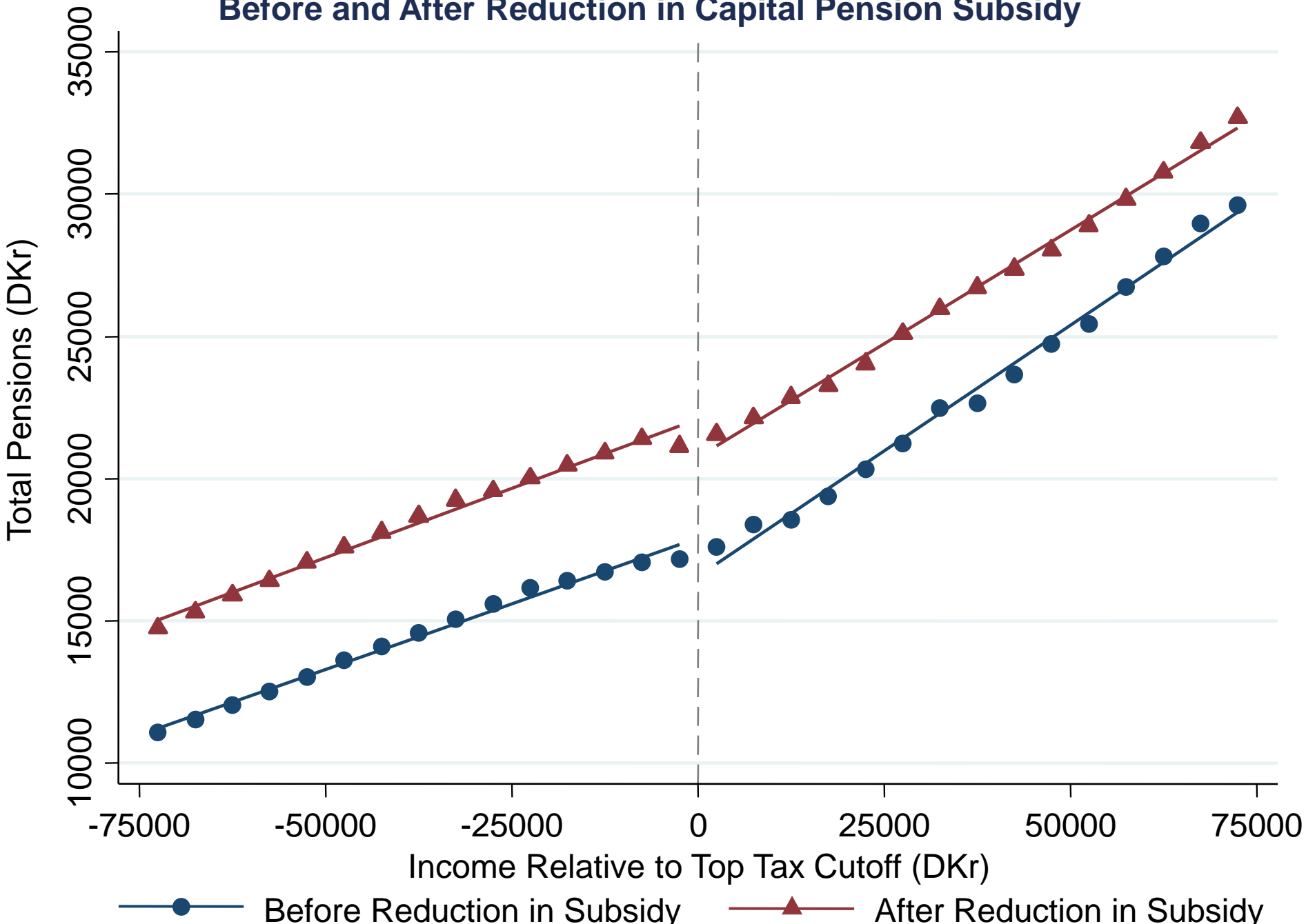
Impact of Capital Pension Subsidy Reduction On Taxable Savings



Total Pensions vs. Income: Before and After Reduction in Capital Pension Subsidy



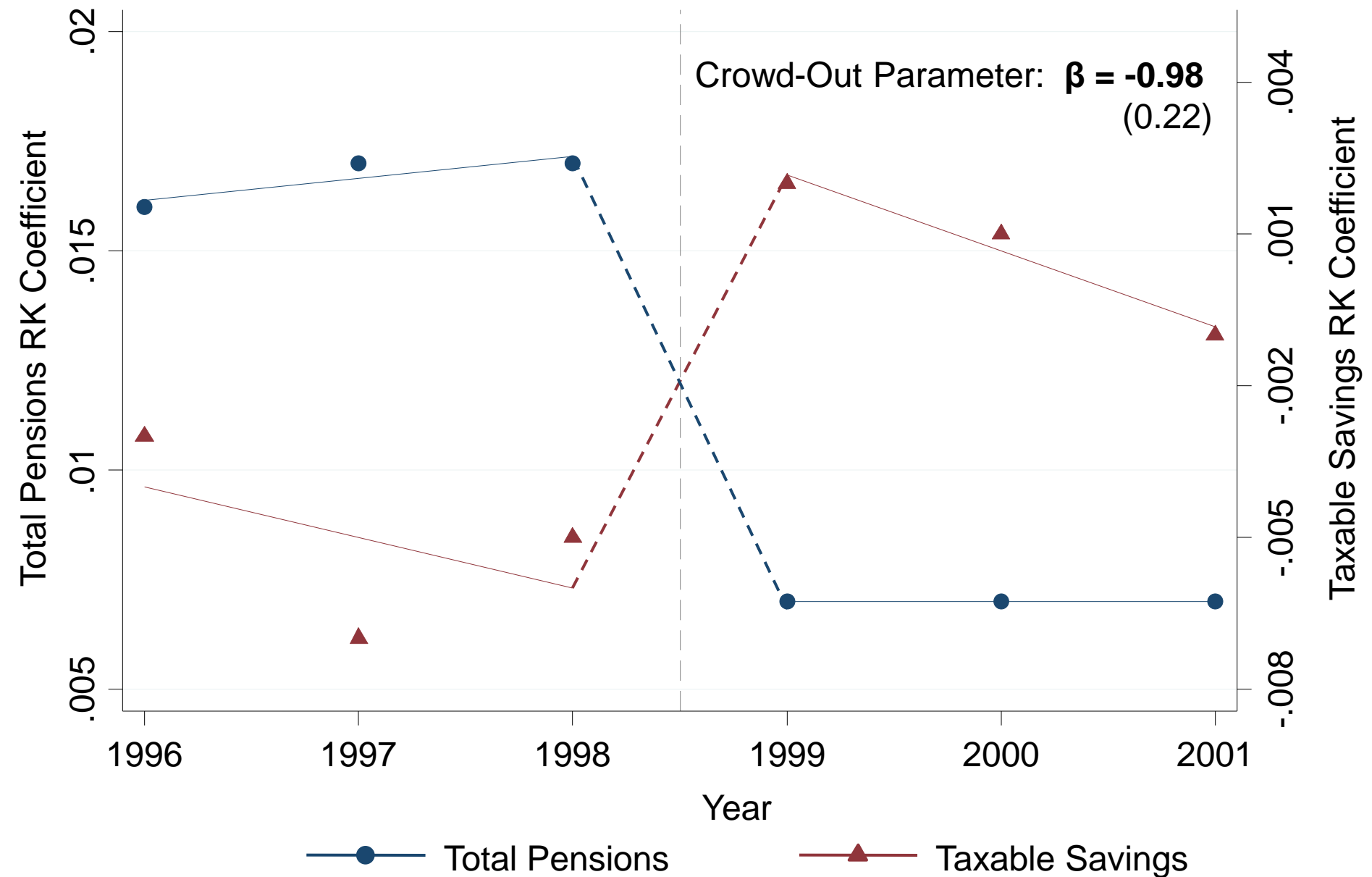
Total Pensions vs. Income: Before and After Reduction in Capital Pension Subsidy



Change in Marginal Propensity to Save in Retirement and Non-Retirement Accounts at Top Tax Cutoff by Year

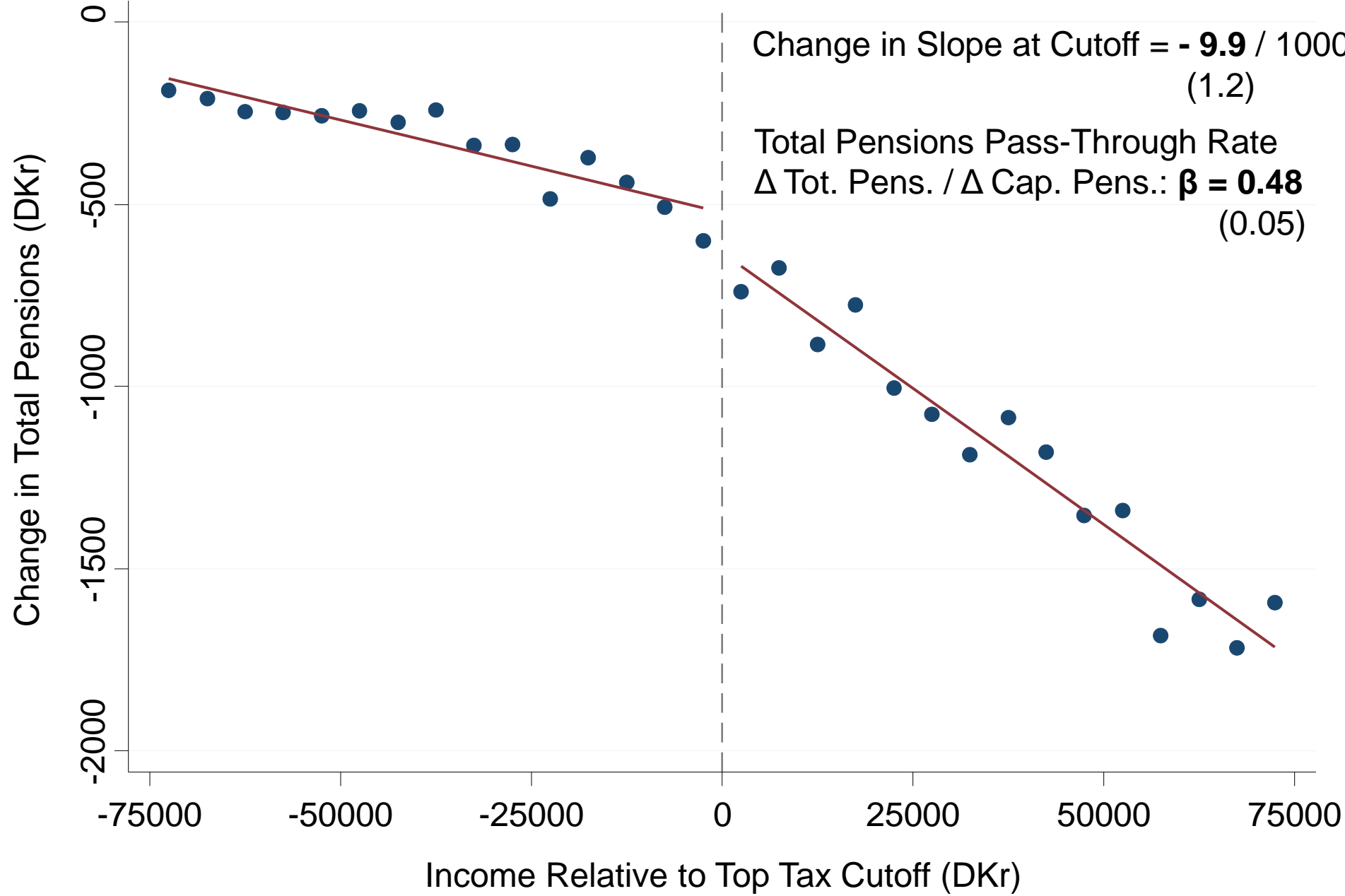


Change in Marginal Propensity to Save in Retirement and Non-Retirement Accounts at Top Tax Cutoff by Year



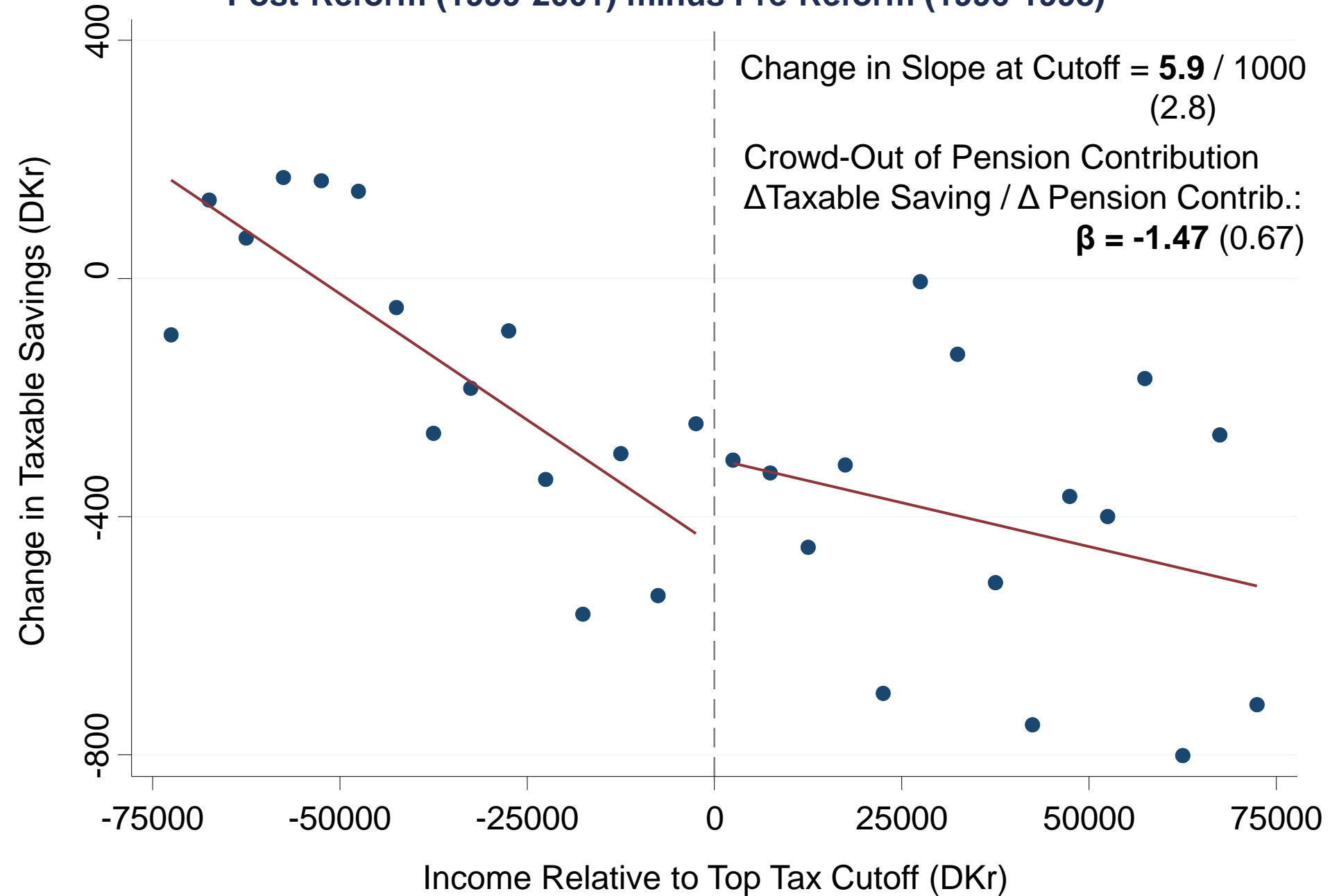
Change in Total Pension Contributions

Post-Reform (1999-2001) minus Pre-Reform (1996-1998)



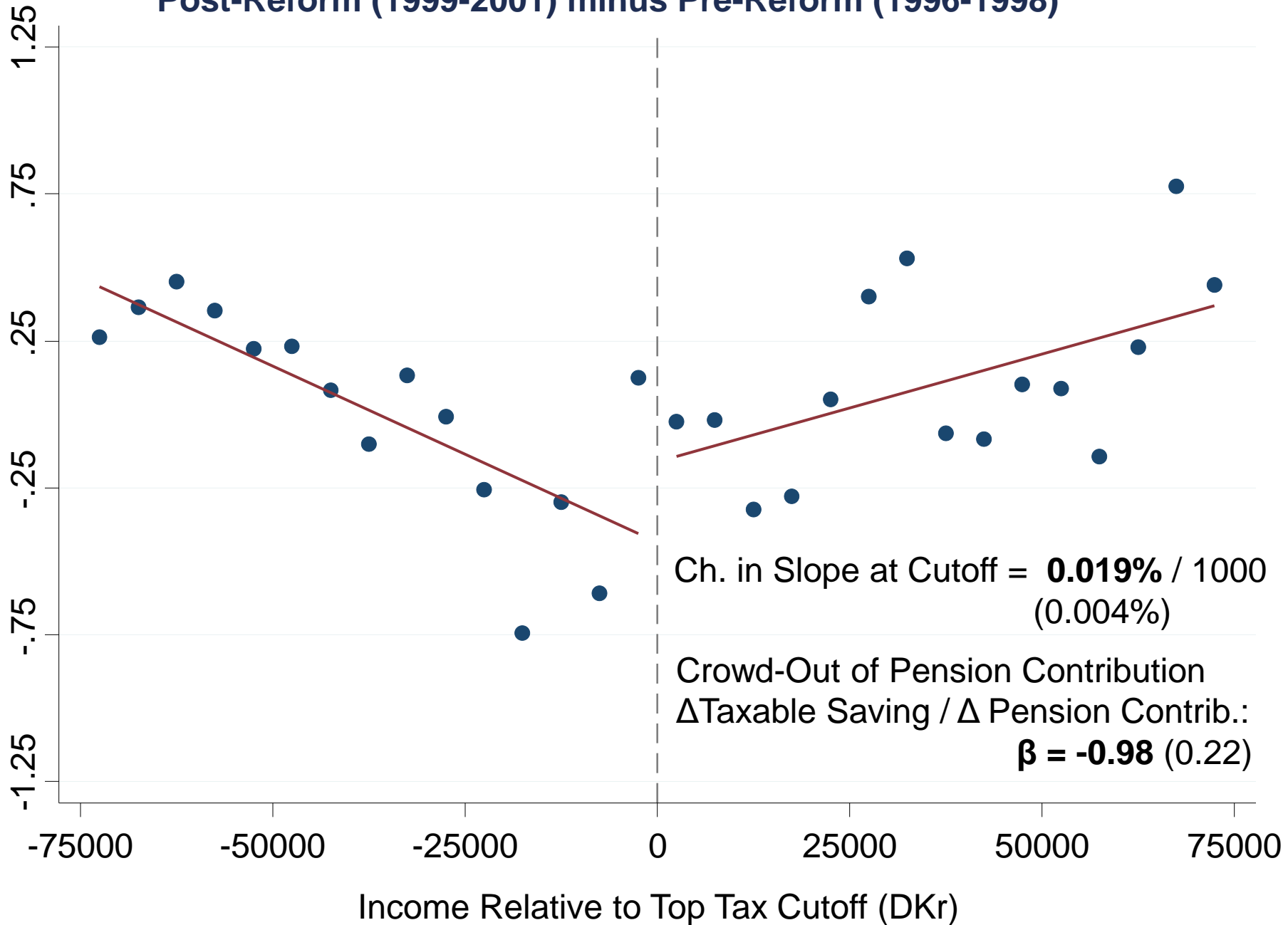
Change in Taxable Savings

Post-Reform (1999-2001) minus Pre-Reform (1996-1998)



Change in Fraction with Above-Median Savings Post-Reform (1999-2001) minus Pre-Reform (1996-1998)

Change in % with Taxable Savings Above Median



Crowd-Out Estimates

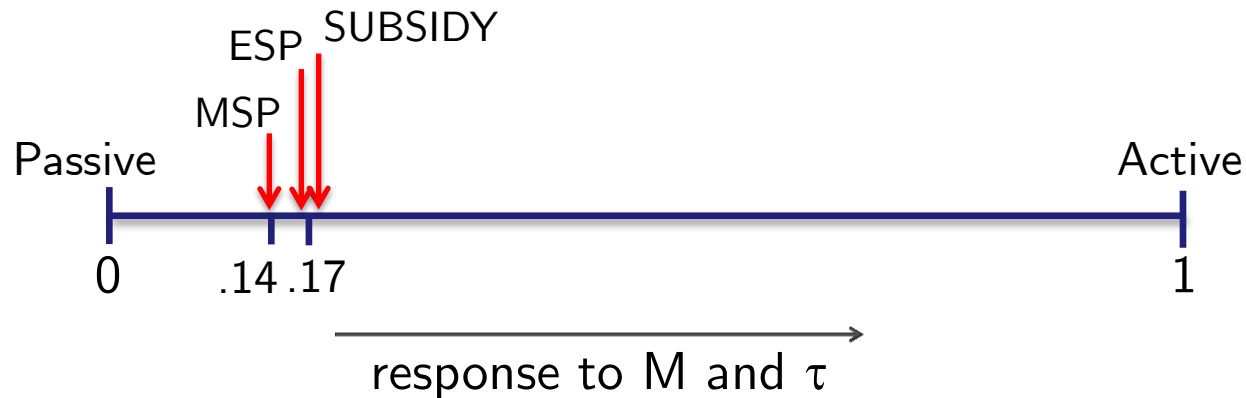
- Consider impacts of a DKR 1000 increase in pre-tax income
 - DKR 10.0 less contributed to retirement accounts when subsidy fell
 - MTR of 60% → disposable income rises by $0.4 \times 10.0 =$ **DKR 4.0**
 - DKR 3.92 of this is deposited in taxable savings
 - DKR 0.08 is consumed → net saving falls by DKR 0.08
- 98% of the increase in pension contributions due to subsidies is financed by offsetting reductions in savings in taxable accounts
- Based on this estimate, we calculate that each DKr 1 of tax expenditure on subsidies raises total saving by less than 1 cent

Pension Subsidy Pass-Through Estimates

	Difference-in-Differences			Regression Kink	
	Annuity Contrib.	Total Pensions Contrib.	Taxable Savings	Taxable Savings	Taxable Savings Threshold
	(1)	(2)	(3)	(4)	(5)
Capital Pension Contrib.	-0.562 (0.047)	0.438 (0.047)			
Total Pension Contrib.			0.867 (2.453)	-1.471 (0.665)	-0.980 (0.222)
No. of Obs.	4,697,656	4,697,656	4,697,656	7,011,068	7,011,068

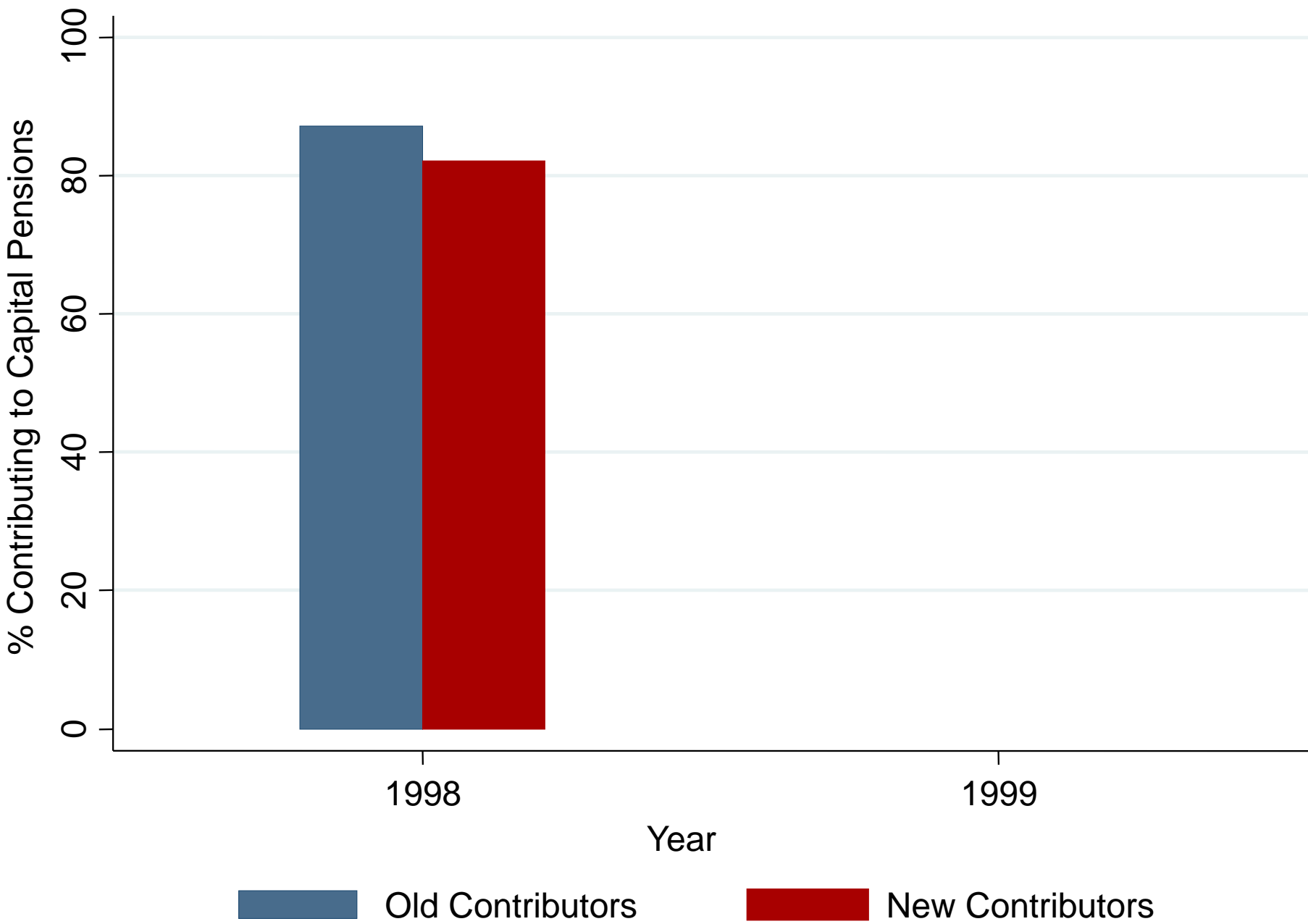
Heterogeneity: Active vs. Passive Savers

- Use pass-through of automatic contribs. and extensive-margin response to subsidy to quantify degree of active response

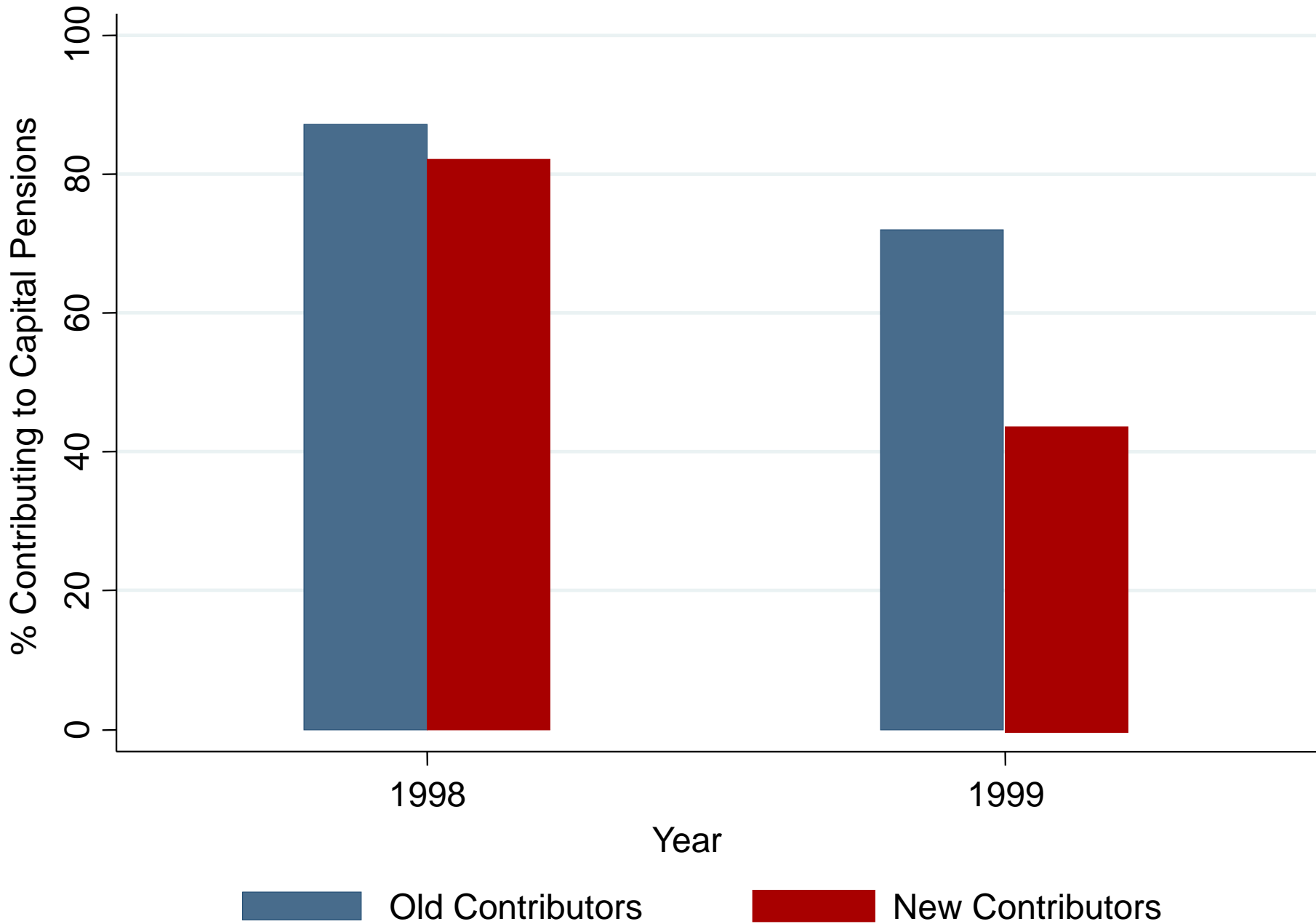


- Employer Pensions: 1 minus pass-through = 16.8%
- Mandated Savings Plan: 1 minus pass-through = 13.8%
- Subsidy Reduction: fraction who reoptimize pension = 17.4%

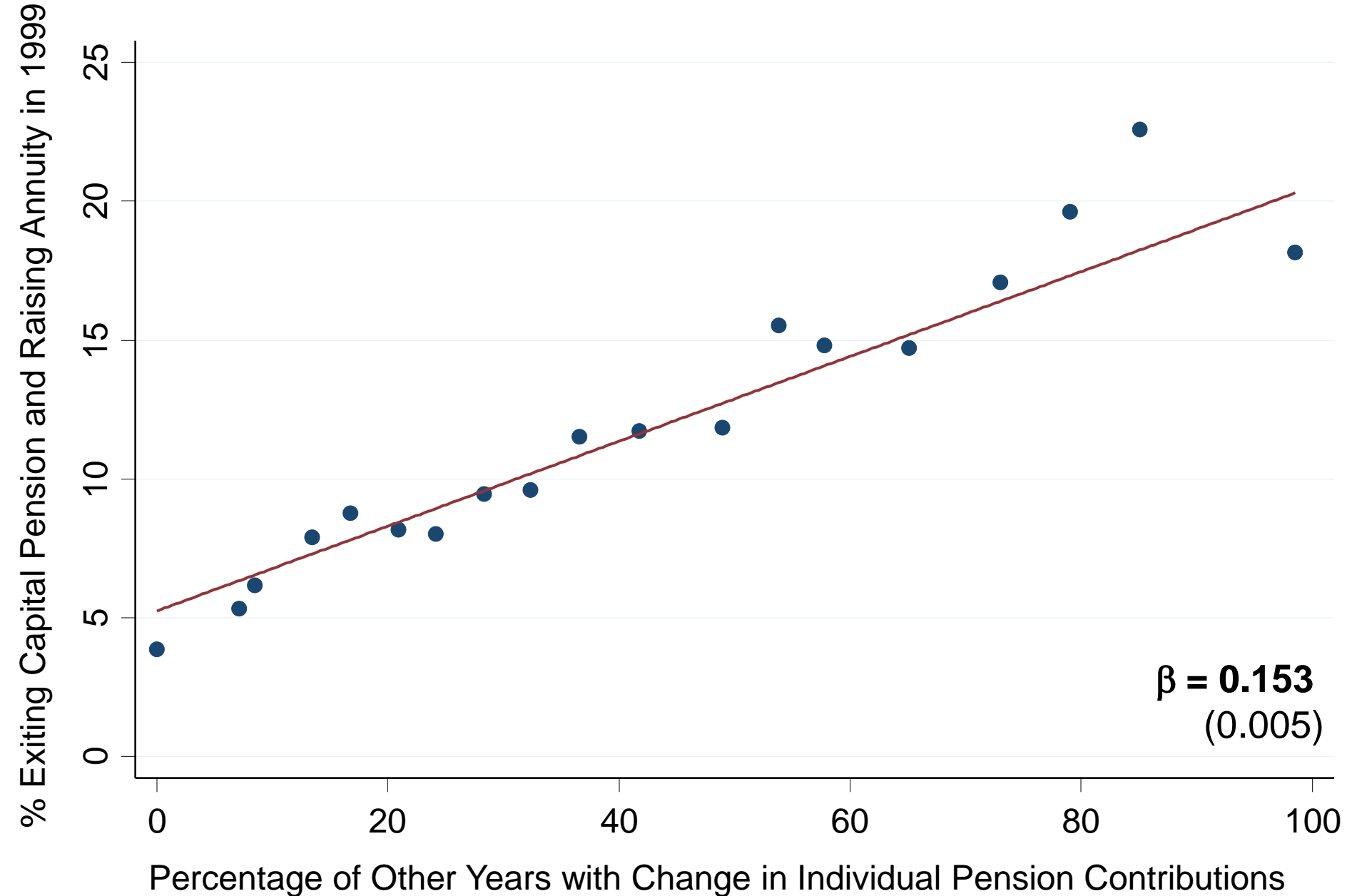
Impact of Subsidy Change: Old vs. New Contributors



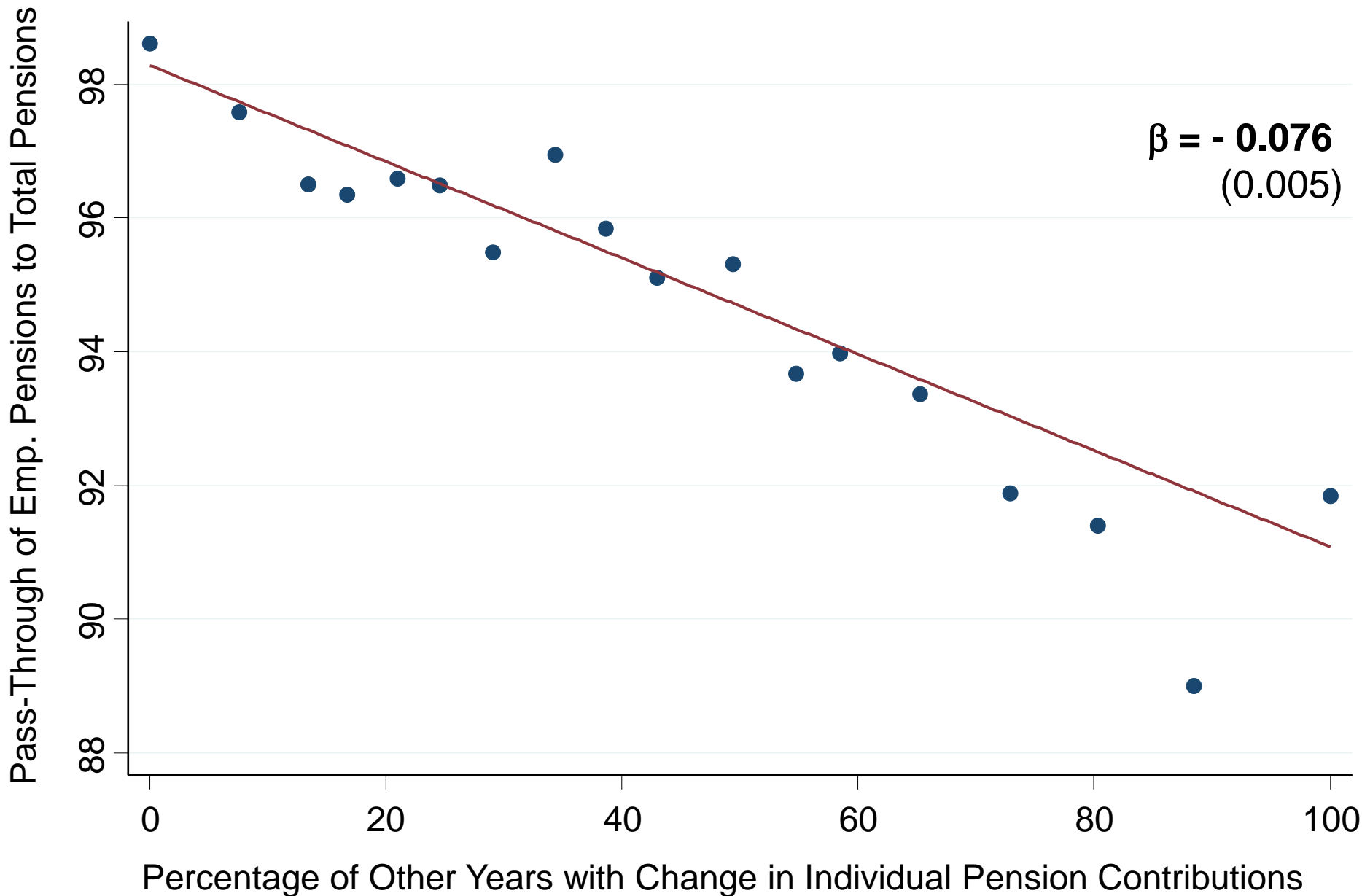
Impact of Subsidy Change: Old vs. New Contributors



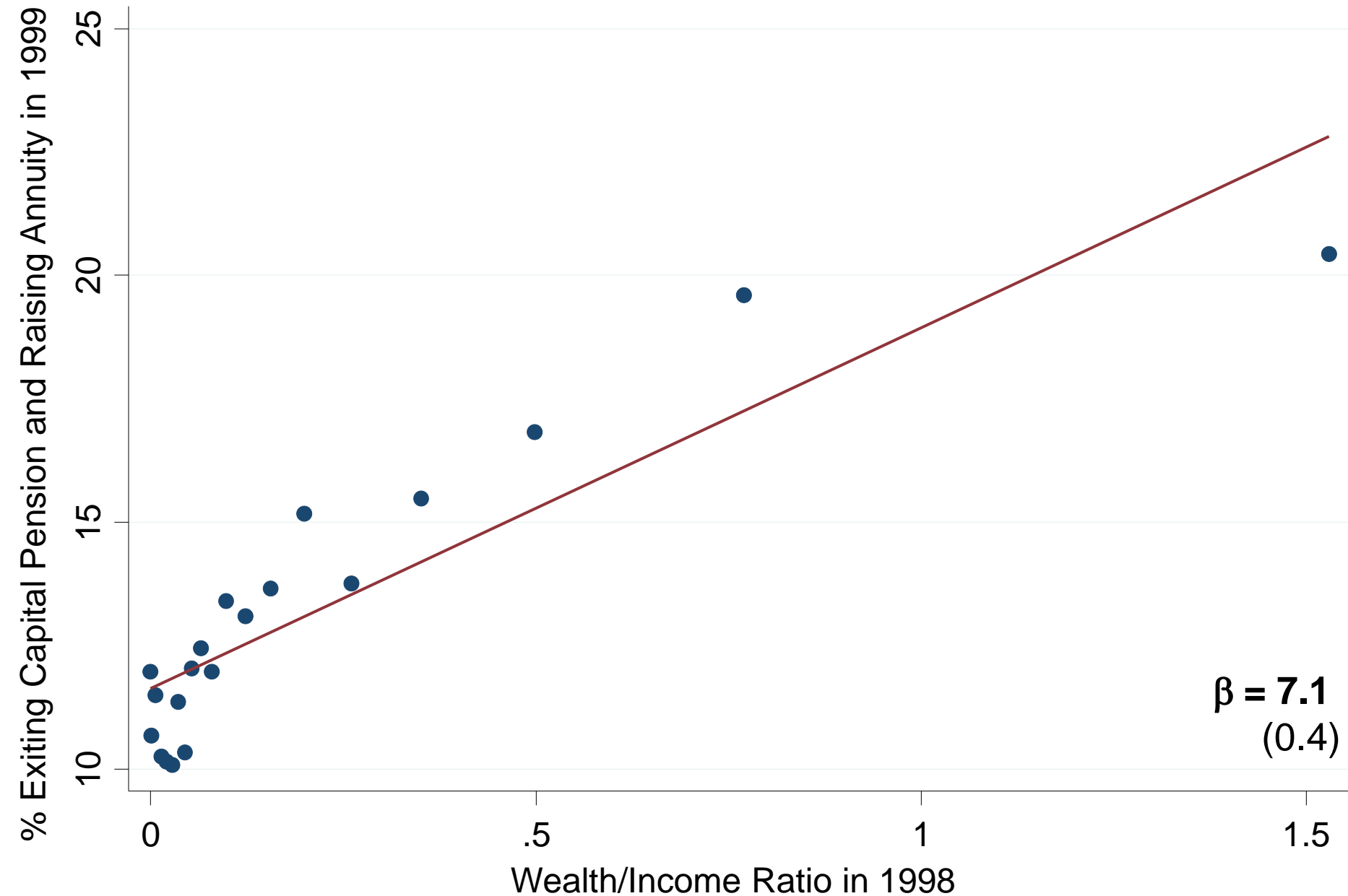
Percent Responding to Capital Pension Subsidy Change in 1999 by Frequency of Active Changes in Other Years



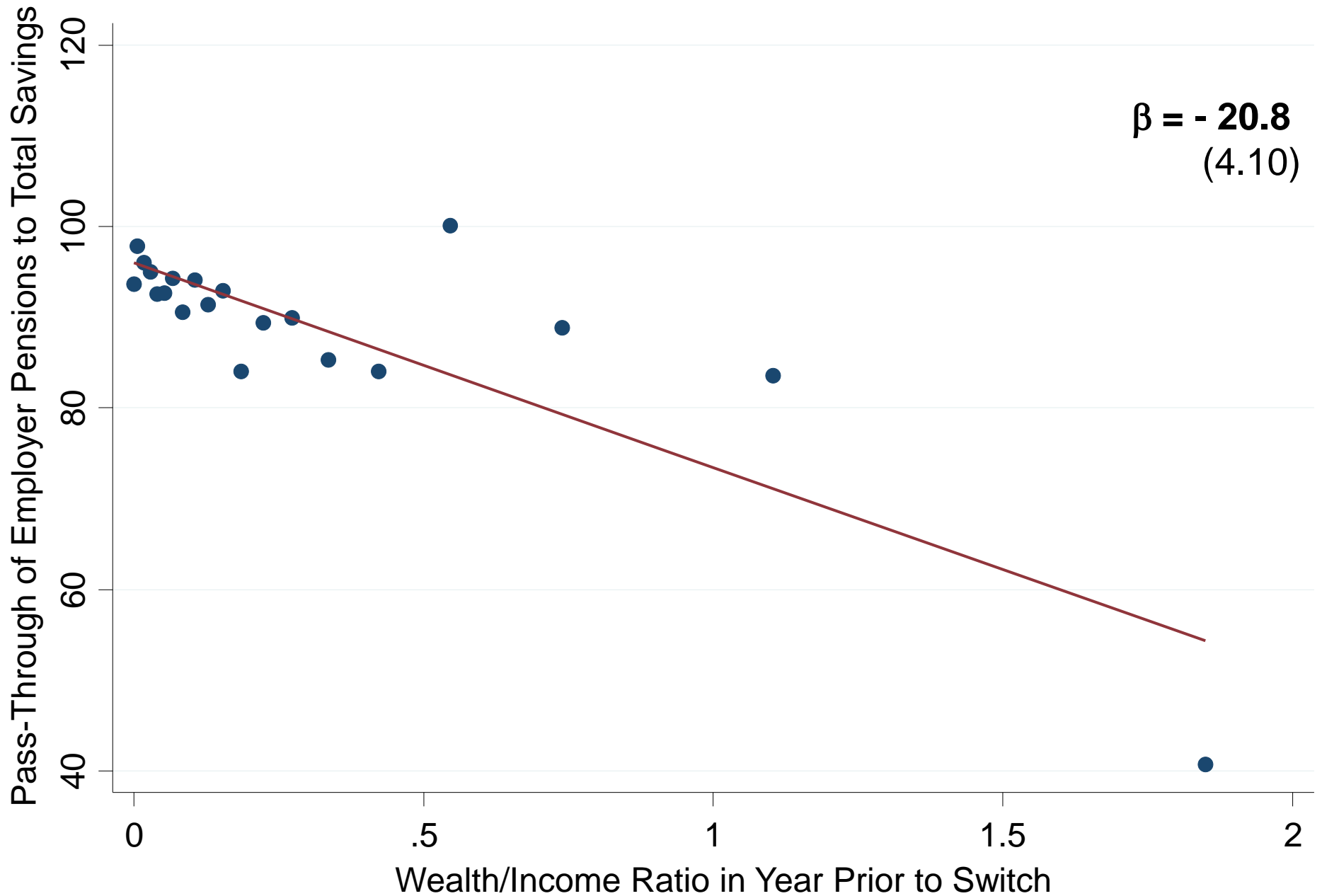
Pass-Through of Employer Pension Changes for Firm-Switchers by Frequency of Active Changes in Other Years



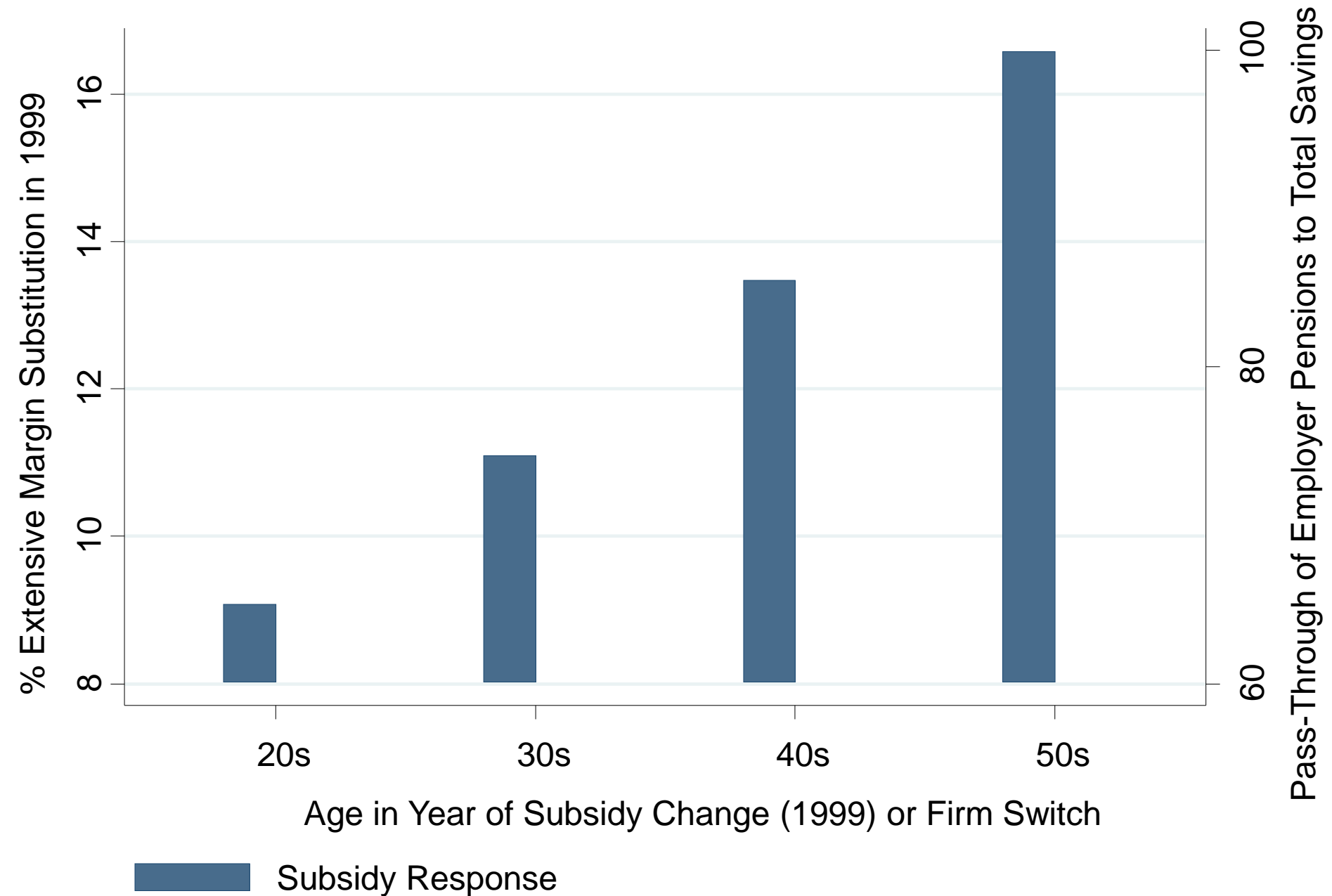
Heterogeneity in Response to Capital Pension Subsidy by Wealth/Income Ratio



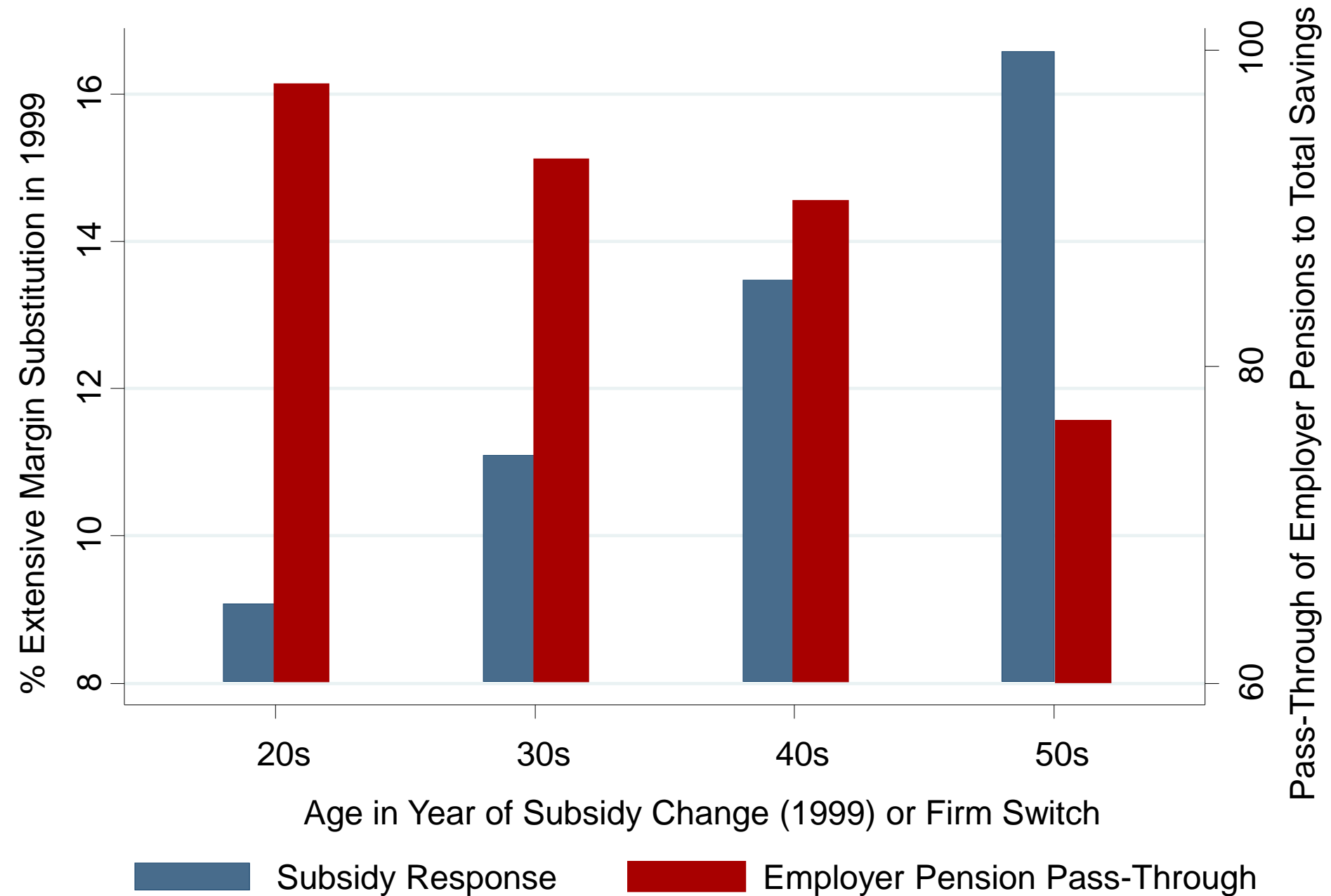
Heterogeneity in Pass-Through of Employer Pensions by Wealth/Income Ratio



Heterogeneity in Responses to Subsidies and Employer Pensions by Age



Heterogeneity in Responses to Subsidies and Employer Pensions by Age



Observable Heterogeneity in Response to 1999 Subsidy Reduction

Dep. Var.:	Exits Capital Pension and Increases Annuity Contribution in 1999?					
	(1)	(2)	(3)	(4)	(5)	(6)
W / Y Ratio	0.071 (0.004)		0.062 (0.004)	0.060 (0.004)	0.057 (0.004)	0.053 (0.004)
Age		0.002 (0.0001)	0.002 (0.0001)	0.002 (0.0001)	0.002 (0.0001)	0.002 (0.0001)
College				0.030 (0.004)	0.027 (0.003)	0.015 (0.004)
Economics Education					0.072 (0.007)	0.055 (0.007)
Controls						X
No. of Obs.	62,641	62,641	62,641	62,641	62,641	62,641

Mean of Dependent Variable: 11.6%

Dit årlige overblik over dine pensioner hos ATP

Du har to pensioner hos ATP - ATP Ratepension (også kaldet SP-opsparing) og ATP Livslang Pension. Pensionerne kan du tidligst få udbetalt, fra du fylder 65 år. I brevet her kan du bl.a. se, hvad der er indbetalt for dig.

Din ATP Ratepension

Værdi pr. 1. januar 2004	6.722,59 kr.
Afkast i 2004	750,49 kr.
Pensionsafkastskat i 2004	-93,56 kr.
Omkøstninger i 2004	-37,92 kr.
Indbetalt i 2003*	3.349,00 kr.
Nettoafkast af din indbetaling**	66,89 kr.
Værdi pr. 1. januar 2005	10.757,49 kr.

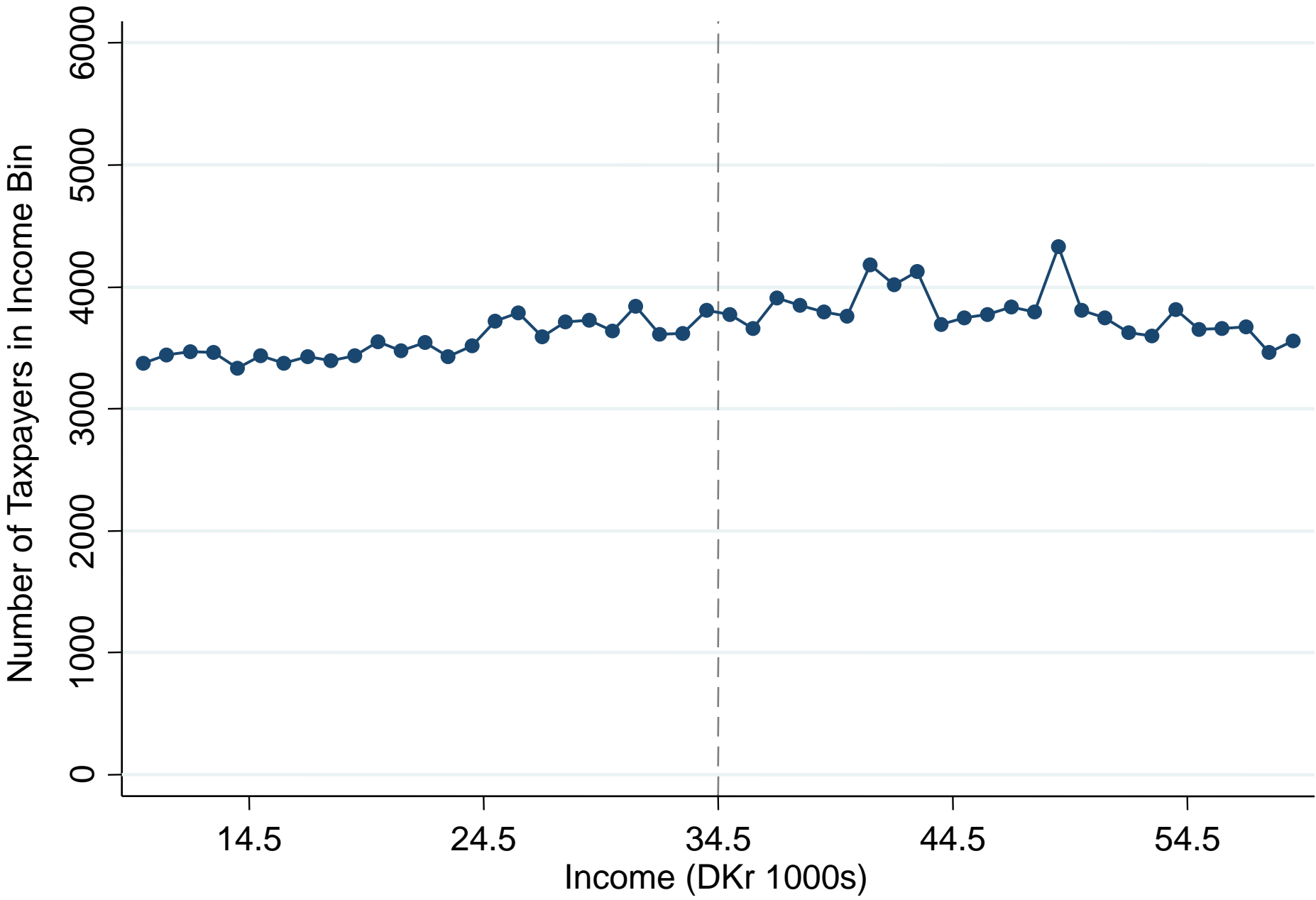
Fra 1. januar 2005 fik du 3 valgmuligheder for din ATP Ratepension (SP-opsparing). Du kan vælge at flytte pengene til et andet selskab, at investere dem selv på ATP's Folkebørs eller lade ATP fortsætte med at investere dem for dig.

Ved dødsfald udbetaler vi værdien af din ATP Ratepension til dødsboet, efter der er betalt afgift til staten på 40%.

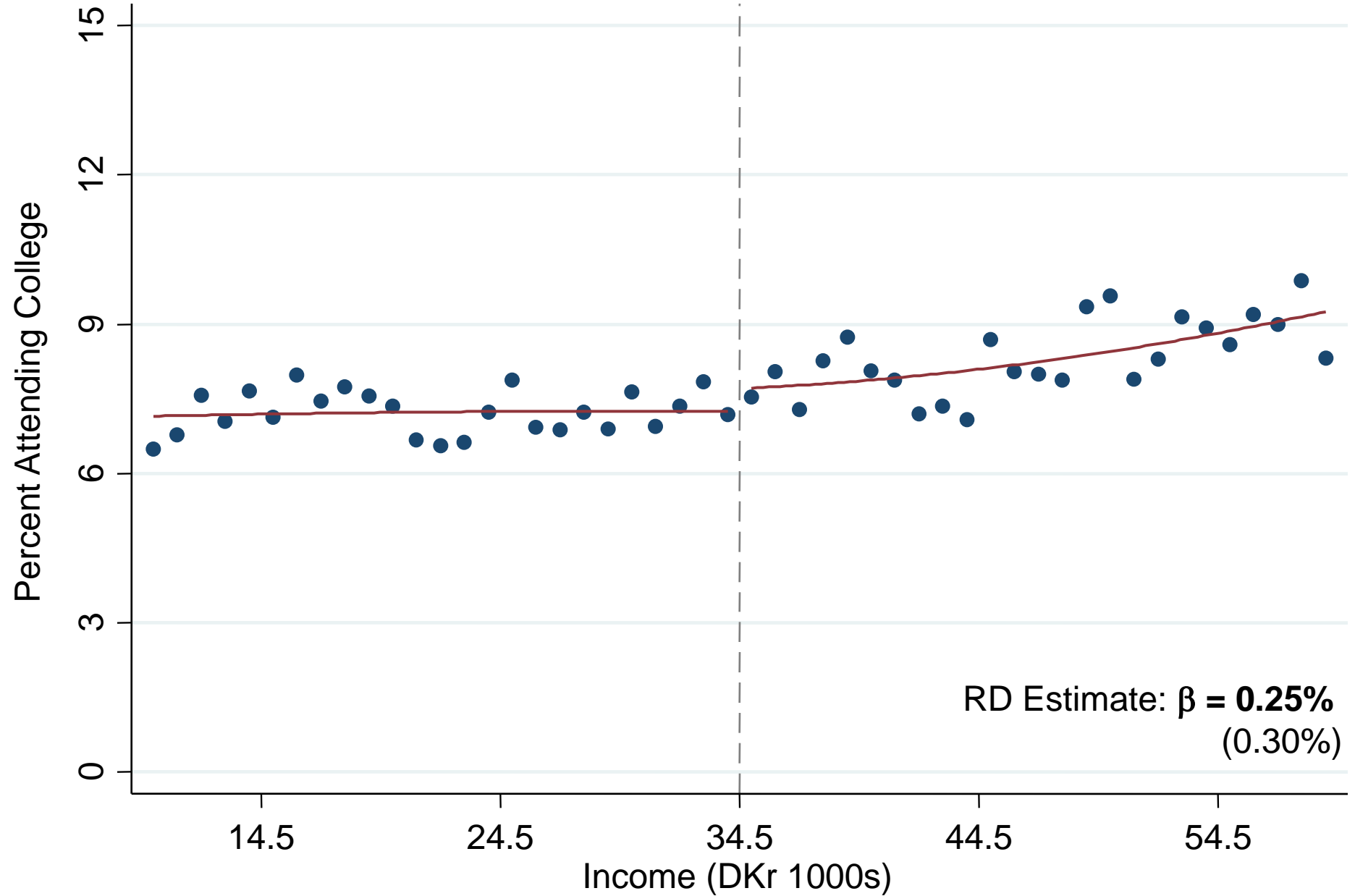
Your ATP rate pension [MSP]

Value as of Jan 1. 2004	6,722.59 Dkr.
Return in 2004	750.49 Dkr.
Tax on return in 2004	-93.56 Dkr.
Administrative costs in 2004	-37.92 Dkr.
Contribution in 2003	3,349.00 Dkr.
Net return on your contribution	66.89 Dkr.
Value as of Jan 1. 2005	10,757.49 Dkr.

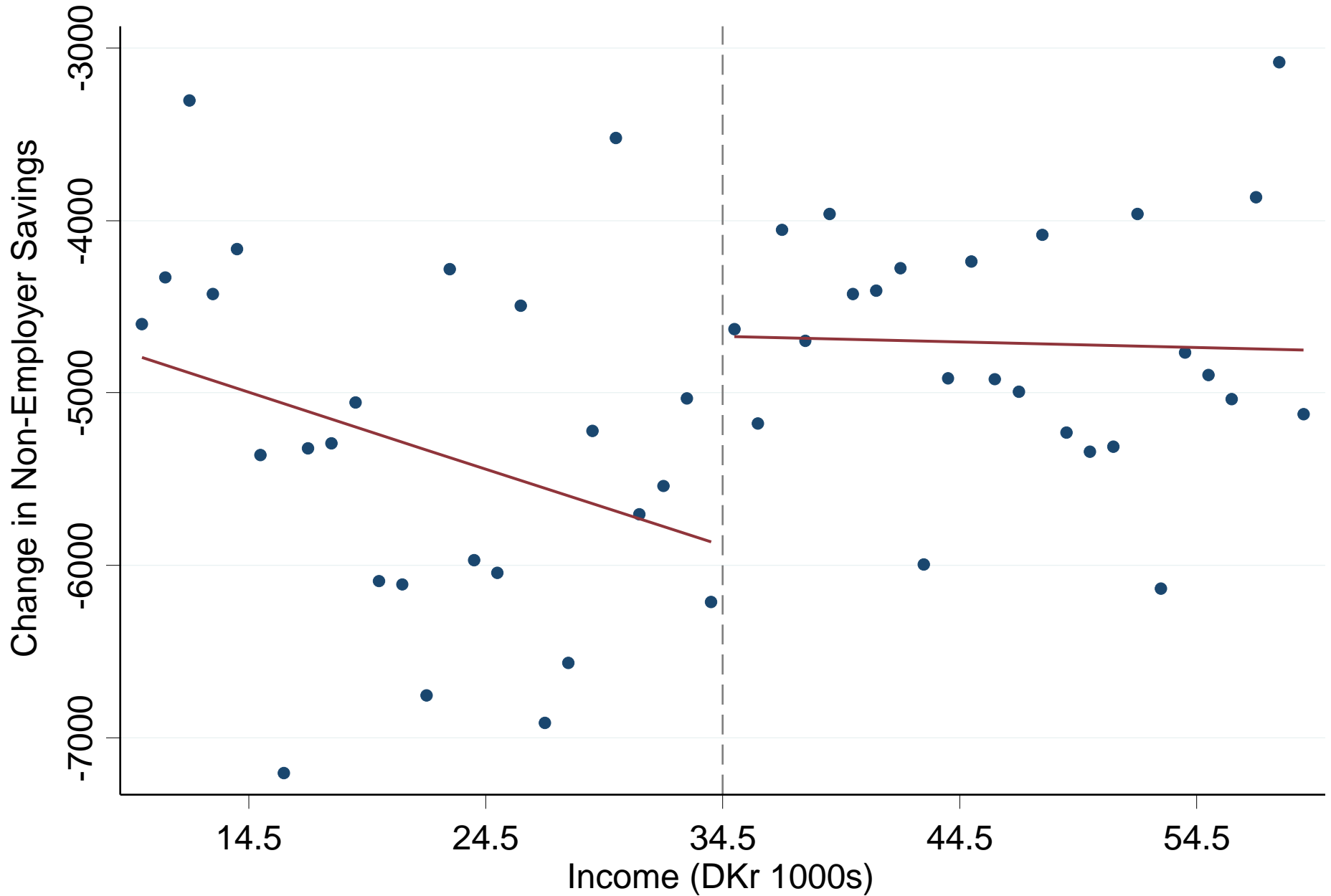
Balance Test 1: Income Distribution Around Eligibility Threshold



Balance Test 2: Fraction Attending College Around Threshold



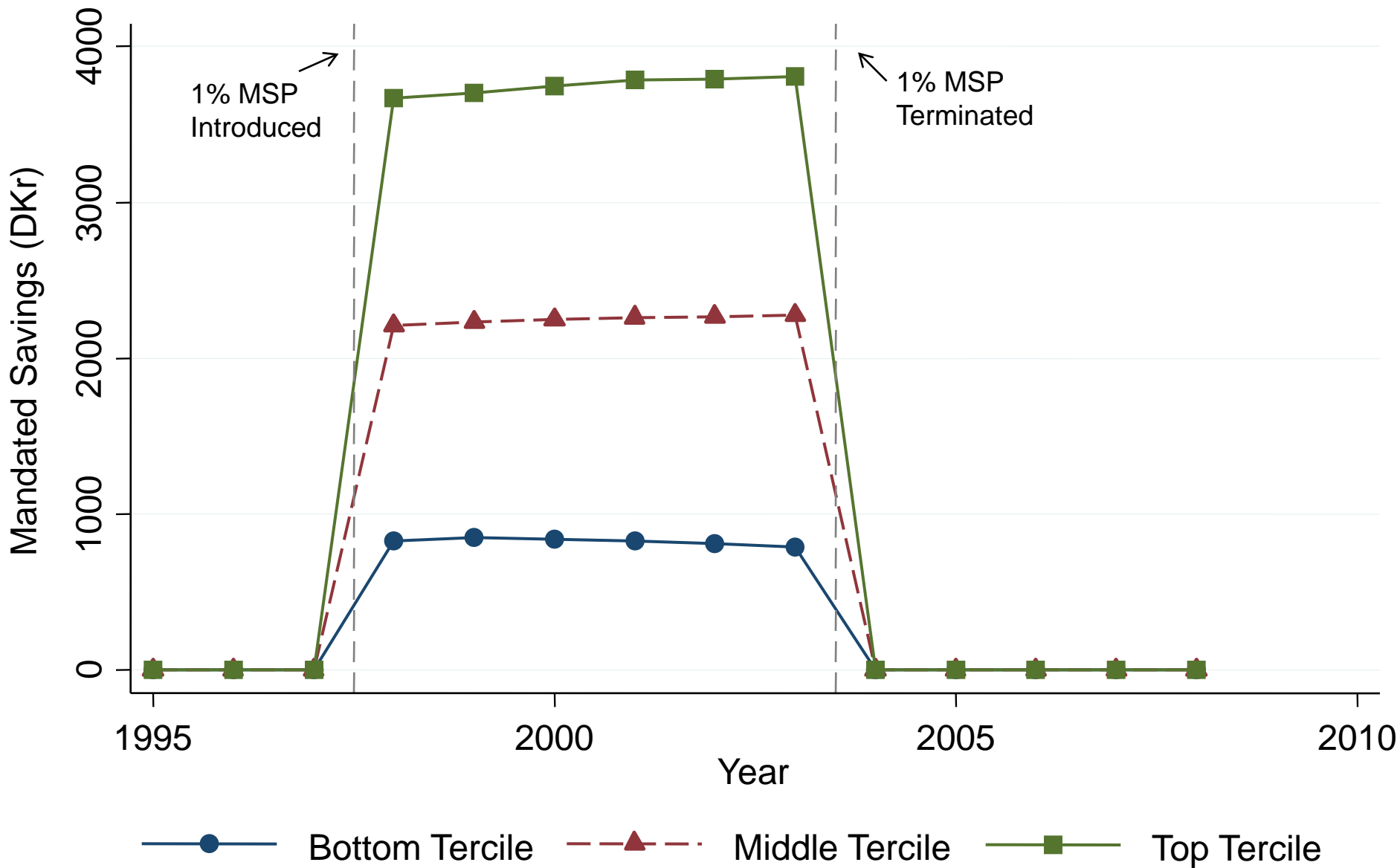
Total Non-Employer Savings Around Eligibility Cutoff in 1998



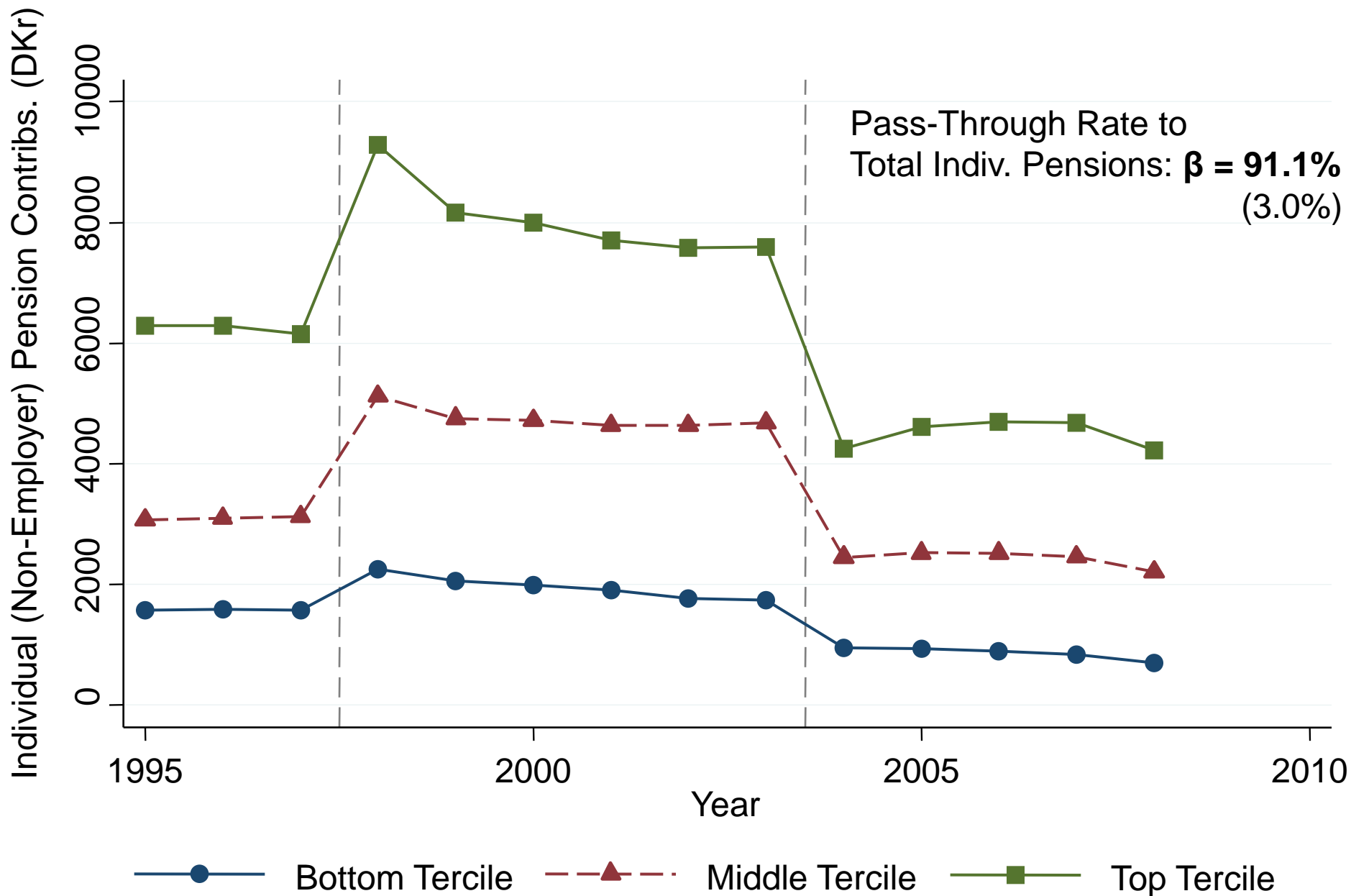
Government Mandated Savings Plan

- RD estimates only apply to a low-income group of individuals
- Now show that similar results are obtained throughout income distribution using a difference-in-differences design
 - Note that MSP was terminated in 2004

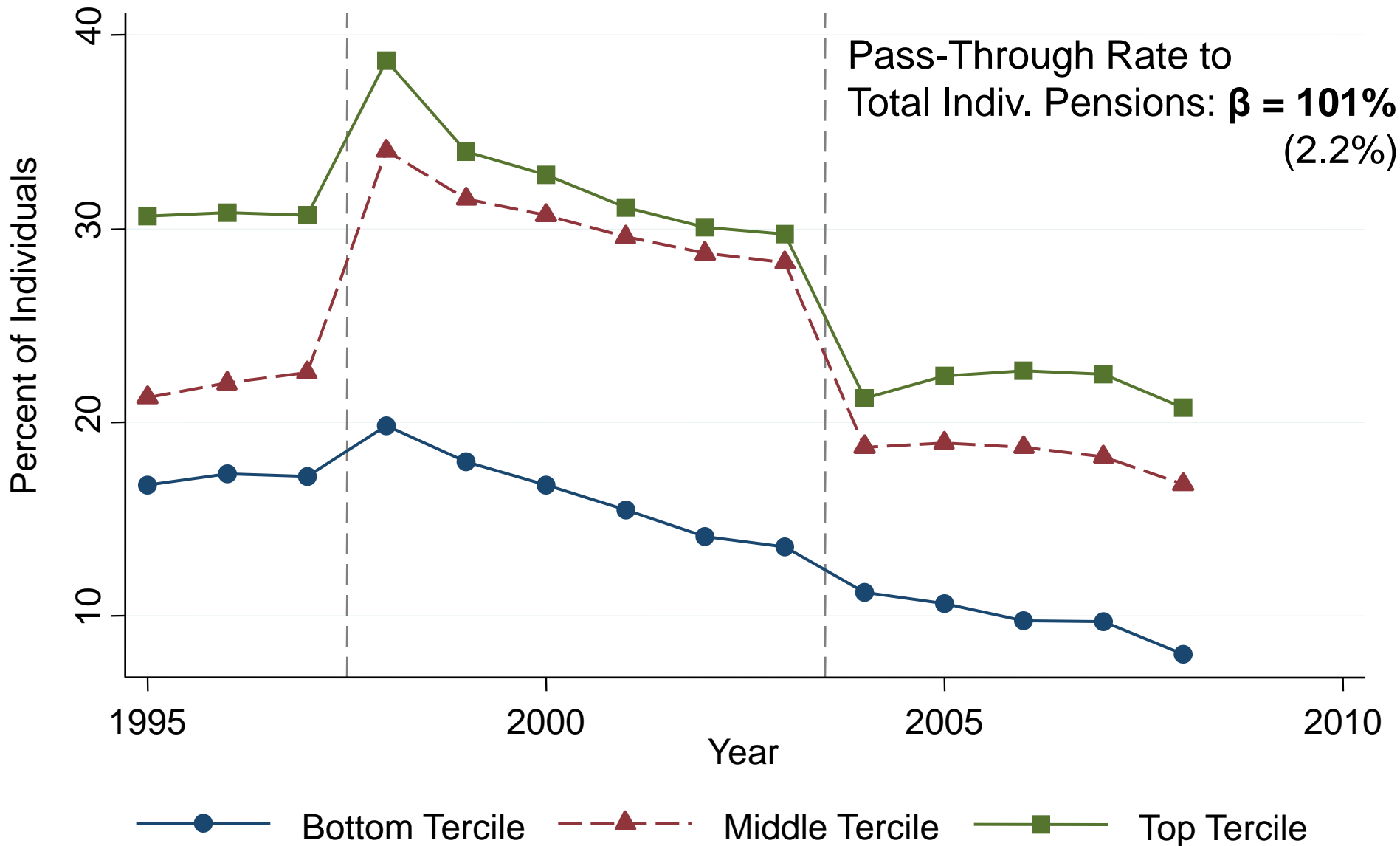
Mandatory Pension Contributions (M) by Income Group



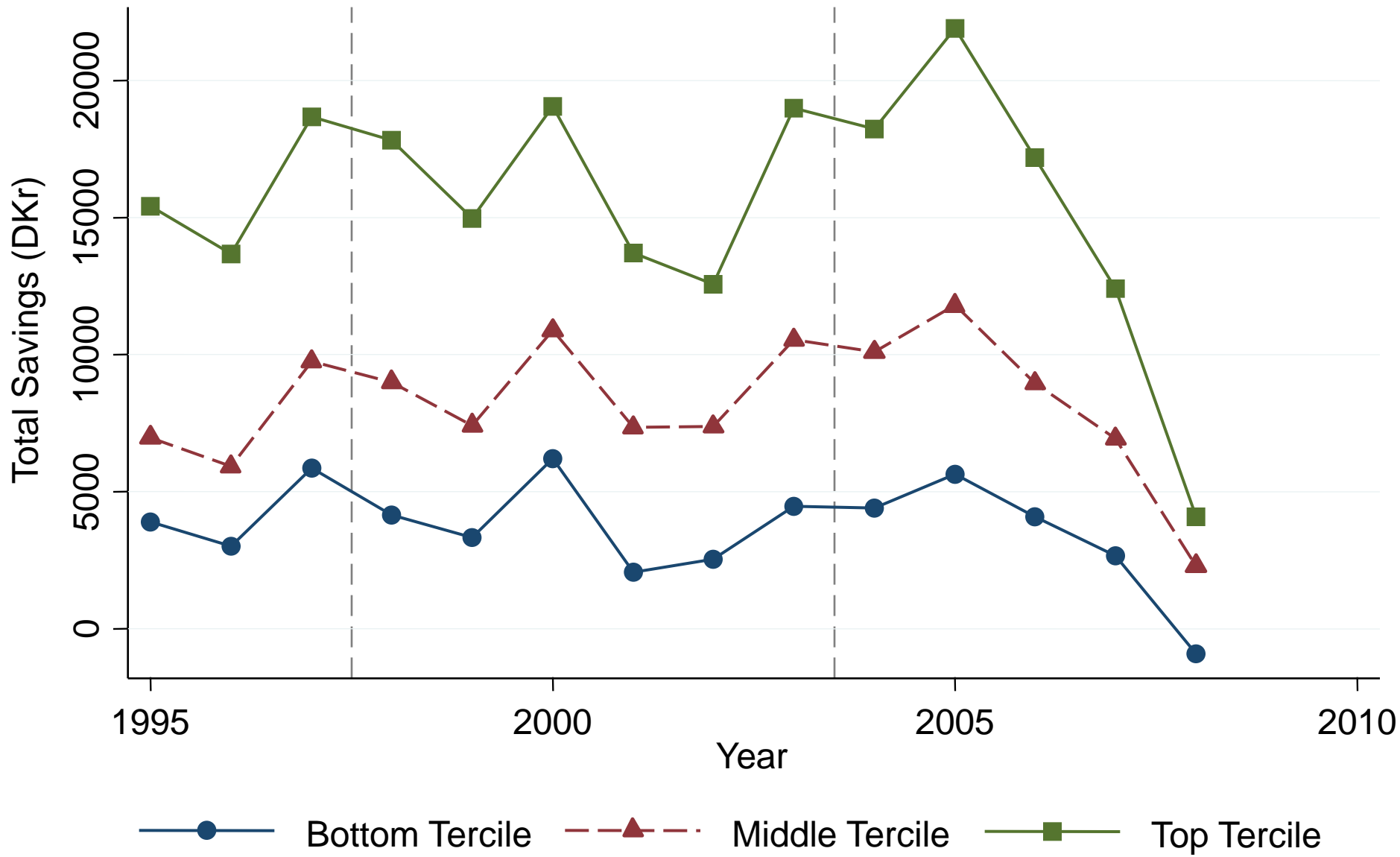
Total Non-Employer Pension Contributions by Income Group



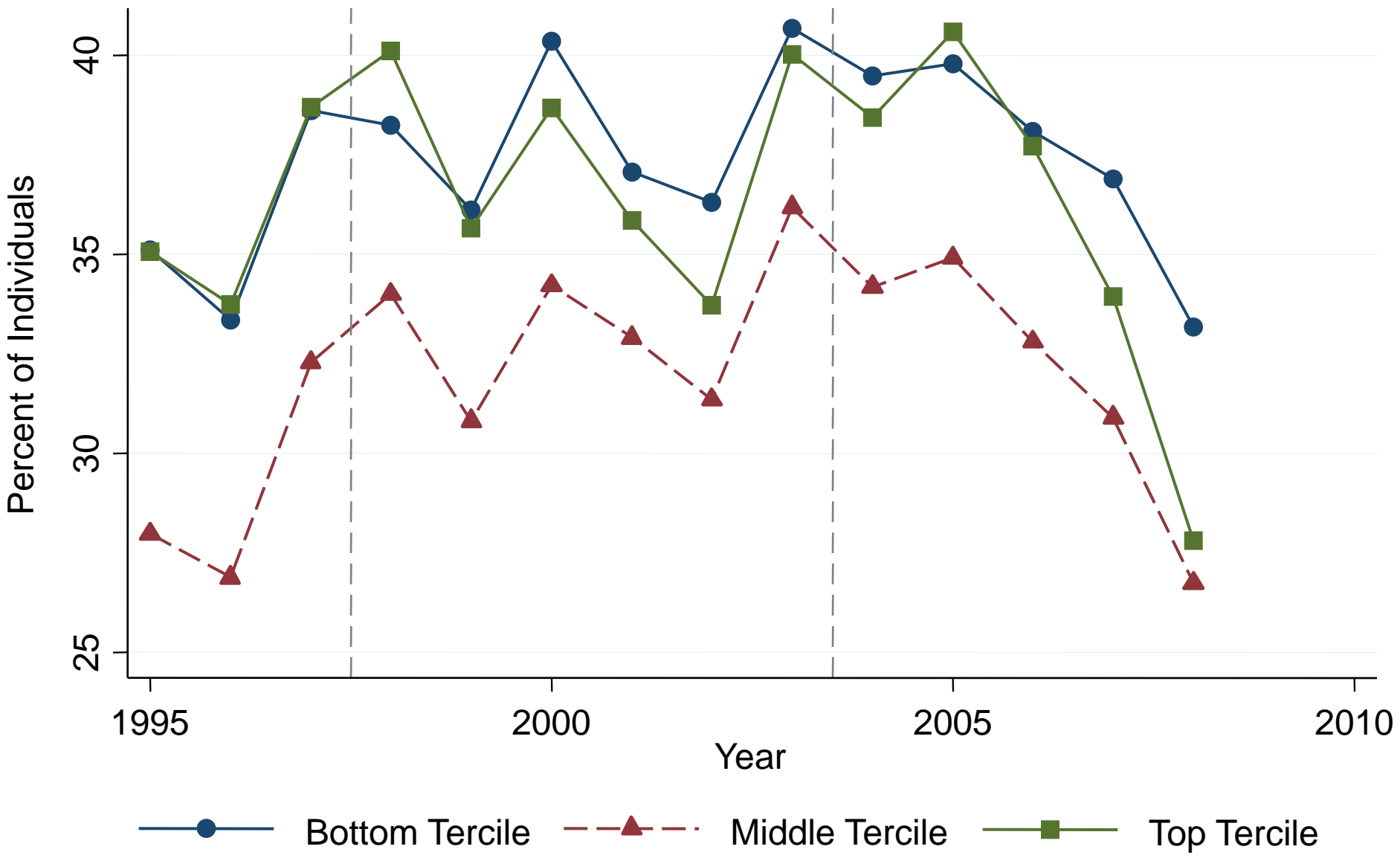
Percent of Individuals Contributing More than 1.5% of Income to Pensions



Total Savings by Income Group



Effect of Mandate on Fraction of Individuals with Total Non-Employer Savings > 4%



Threshold-Based Analysis of Effect of Employer Provided Pension on Total Savings Rates

