



Mariahilfer Straße 97 A-1060 Vienna, Austria
Tel.: 43-1/798-9495 Fax: 43-1/798-0525
Internet: jvi@jvi.org

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Research Seminars in Macroeconomic and Structural Issues

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Wednesday, May 10, 2006
JVI Residence, Schmalzhofgasse 12

12:30 p.m.

Markus Knell

Oesterreichische Nationalbank

The Optimal Mix Between Funded and Unfunded Pension Systems When People Care About Relative Consumption

Abstract

In this paper we derive the optimal portfolio mix between a funded and an unfunded pension system when people care about their consumption relative to a reference group. Pay-as-you-go systems have the property that pension benefits are tied to future labor income. This lowers the uncertainty of individuals' future relative position and thus increases the attractiveness of unfunded systems. We show that the optimal share of funding decreases in the individuals' concern for relative standing. Using data for 14 countries and the period 1900–2000 we estimate that for the median country the optimal share should lie around 17 percent if people do not care about relative standing. It further decreases to values below 10 percent for reasonable assumptions about reference standards.

Please contact Clinton Shiells at 01/798 94 95 17 or cshiells@jvi.org, or see the JVI's website at www.jvi.org, for further information.