Discussion of “Household Saving Behavior and Social Security Privatization” by Alisdair McKay

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The views expressed herein are those of the author and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.

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- Use calibrated model to calculate welfare before/after reform.
- Imperfect financial decisions reduce welfare after privatization.

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- And a big-picture comment on methodology.

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- Very nicely executed model of that problem.
- Many potential applications to development economics.
- But are we persuaded that "search for low-cost intermediary" is best way to model imperfect decisions?

Mechanics of the model

- Finite-lived household faces a standard life-cycle problem:
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    - More search time $\Rightarrow$ better chance of finding a good offer.
    - Result 1: distribution of offers is not degenerate in equilibrium.
    - Result 2: all else equal, households with more to invest will search more, get better returns $\Rightarrow$ adds skewness to the wealth distribution.

Calibration

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  - Labor productivity: AR(1).
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  - Tax rates, Social Security system based on existing system.
- Search efficiency: Calibrate $\Pr(j \text{ offers} | \text{time searching } = s)$ so that model equilibrium matches two moments from data:
  - Average time spent on "household financial management" and "banking and using financial services" (3 minutes/day).
  - Median fee on S&P 500 index funds (64 basis points/year).

Checking the calibration

- Compare model to data on:
  - Time spent managing finances over the life cycle.
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- Model does pretty well.
- But is matching these moments enough to persuade us that "search for a low-cost intermediary" is the right way to model imperfect decisions?

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- Model is set up so it costs only 64 basis points (on average) to make rather lazy decisions (take the first offer).
    - Behavioral biases could be *much* more costly than that (e.g., investing mainly in employer stock).

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- De-emphasize index fund fees, look at other aspects of financial decisions.

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- Model also rules out many aspects of imperfect decisions.
- Need a richer model to understand how important imperfect decisions are relative to other factors.

Connecting macro methods and development questions

- How would a (stereotypical) development economist answer this paper's questions?
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- Policy experiment: What happens after an actual privatization?

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  - Calibrate to data on observed choices.
  - Then see what happens when search costs are lower.
- How confident would we be in the results?
  - What if there are other reasons for suboptimal choices?
  - What does it mean to lower search costs?

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- Macroeconomists and development economists agree on at least one idea:
  - Do X only when benefit(X)>cost(X).
- The case for macro methods is stronger when GE effects are more important.

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