Do pension participants want the freedom to choose or the freedom to snooze?

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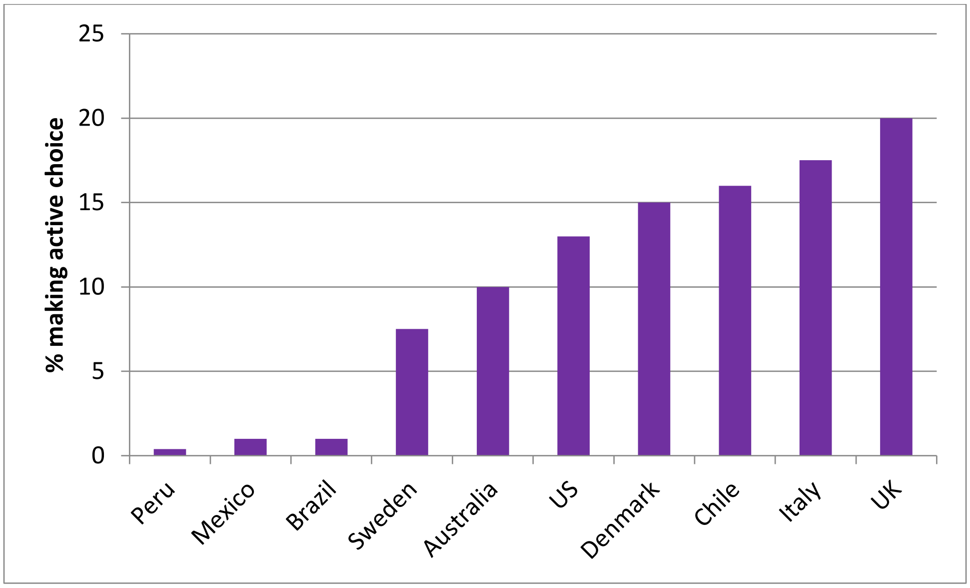
Individual freedom of choice is a much heralded and cherished principle in democracies. Milton Friedman and colleagues at his alma mater, the University of Chicago, made this a cornerstone of their belief (Friedman & Friedman, 1990). The freedom of choice is the antidote to excessive government interference and an instrument which enables people to realize their goals and discipline agents and organizations. The call for freedom is getting louder as individualization of every life is becoming more and more visible and trust in institutions is eroding. Numerous sociologists of name and fame (Beck, 2002; Putnam, 2001) have documented this trend and predicted its dire consequences. Policy makers have translated this trend into privatizing tasks and services which were financed or provided on a collective scale. Of course, the question remains: do people really want to take the fate of their lives in their own hands? For simple products and services freedom can be safely entrusted to individuals, but for complex services with long lasting consequences freedom of choice may not be in the interest of citizens at all. This question will probably be at the forefront in debates about many reforms in social security, health care, pensions as governments are shifting risks from collective levels to the level of the individual.

One particular debate in which the freedom of choice is clearly visible concerns the current reforms of pension systems (Whiteford & Whitehouse, 2006). Governments are considering more options for pension participants to make choices to suit their preferences. Indeed, the UK government has made this explicit in allowing people with defined contribution pension arrangements, as of April 2015, the freedom to take up their savings from the age of 55. The combination of free choice, competition and regulation is in the UK government's view serving the interest of consumers (see (Treasury, 2014)). However, experience has shown that by and large most people do not take charge of their pension wealth (Tapia &Yermo, 2007). E.g., the percentage of participants who fit the mold of active chooser with respect to investing their pension savings (see Figure 1) is small: from barely 1 percent in Peru to 20 percent in the UK. Faced with a choice, most people are led by defaults or when defaults do not exist, they do nothing or procrastinate.

Figure 1: Percentage of pension participants making active choices with respect to pension investments within pension system allowing choice



Sources country data: Agnew, Balduzzi, &Sunden, 2003; Byrne, 2007; Chetty, Friedman, Leth-Petersen, Nielsen, & Olsen, 2014; Fuentes, Searle, &Villatoro, 2013; IOPS, 2012; Rozinka& Tapia, 2007; Tapia &Yermo, 2007.

Of course, economists with a critical bent of mind (Choi, Laibson, Madrian, &Metrick, 2002; Kahneman & Tversky, 2000; Orszag & Stiglitz, 2001) are well aware that increasing choice is fraught with pitfalls. As the pension expert Barr (2002) stated years ago about pension reforms: “the possibility that increased choice is welfare improving is a myth” (p. 13).

Two concepts of freedom

The key to understanding the difficulties in giving consumers sovereignty in pension affairs can be found in philosophy. Worldly philosophers have pointed out that freedom is not a one-dimensional concept. Both Berlin (1958) and Sen (1988) have brought to the fore that freedom can be of two sorts: positive freedom, referring to the desire to take control of one’s own life and exercise choice to attain own goals, and negative freedom, referring to the absence of force or constraints imposed by others. Economists like Friedman are often tacitly ascribing to the concept of freedom as being of a positive kind, whereas citizens may be thinking about the negative freedom concept and refrain from making choices.

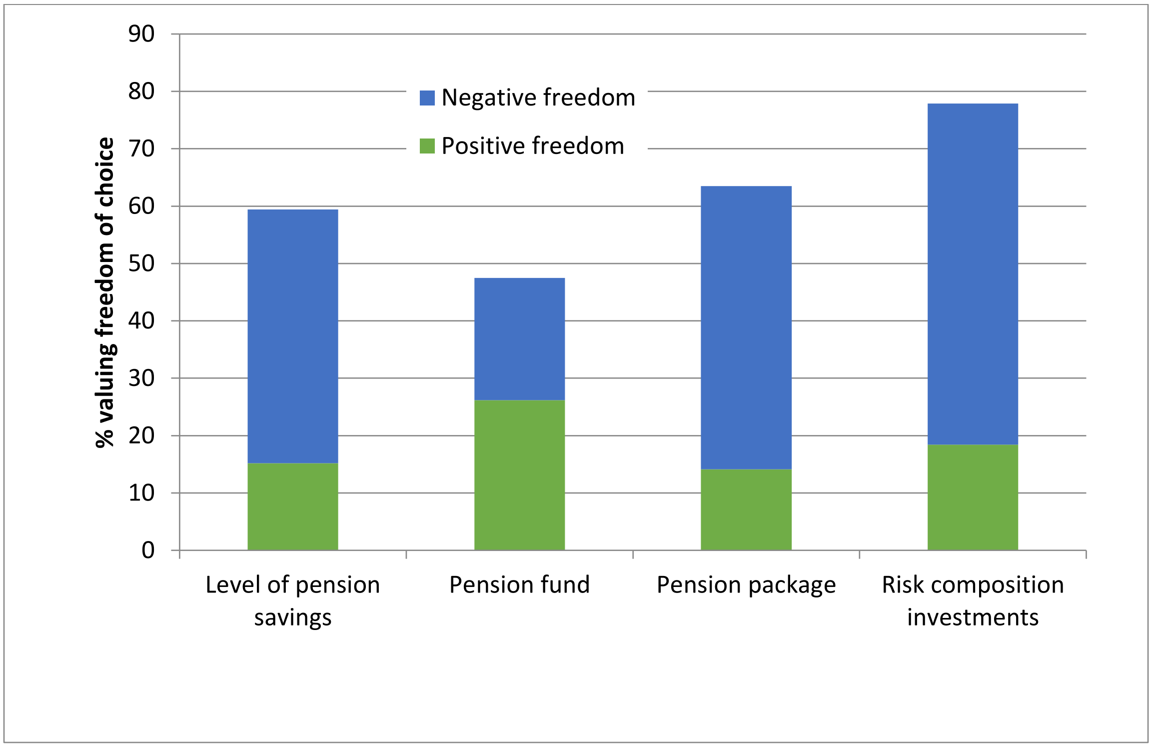
To disentangle the two concepts is virtually impossible by examining actual behavior, but by properly designing a survey one may be able to shed some light on the actual desire of people wanting positive freedom in the domain of pensions. The present article focuses on the case of the Netherlands, but we venture that this type of study can be replicated in any field or any country.

The Dutch government is the process of reforming its pension system to adapt to changing age structure, changing labor market. For years the Dutch pension system has been seen and evaluated by peers for years as a system that belongs to the top-3 of the world (Mercer, 2015). Especially the supplementary pension system is praised. It is traditionally organized and governed by collective pension funds offering pensions guaranteeing a relatively high benefit. Risk of poverty among old aged in the Netherlands is the lowest in the world. Every employee is on a mandatory basis connected to the pension fund of the employer.
In planning for reform governments are also keen to cater to the needs of a society which calls for individualization. In 2014 the Dutch government initiated a poll among the general public about the future of pensions in which 60 percent of the Dutch wanted to choose their own investment portfolio, 58 percent wanted to choose the level of their pension savings, and 45 percent wanted to choose their own pension fund. Of course, these figures need to be treated with caution. Asking individuals to value the freedom to choose is bound to trigger associations which are undoubtedly positive.

It is of crucial importance to get a more refined insight in the degree of desired choice. To this end we designed a survey asking Dutch employees about the importance they attach to freedom of choice within their collective pension arrangement, as well as the importance of delegating choices to the board of their pension fund (see supplement for details). Of course, so-called carry-over effects (De Leeuw, Hox, &Dillman, 2008) will be present in one single survey in case you ask respondents both the freedom of choice option and the option of delegating choice. Therefore, we split the total sample of pension participants into two randomly selected samples (A and B). Sample A received the question to evaluate the possibility of freedom of choice for a set of pension issues which are key for the buildup of pension wealth. For five elements of the collective pension contract we asked employees to judge the importance of having freedom of choice or the freedom from making a choice for : (1) the level of pension savings; (2) having the option to choose your own pension fund; (3)pension package - the number of risks covered by the pension contract (think of the level of old age pension income, invalidity pension, or a pension for your partner); and (4) the risk composition of investments.

The other group (sample B) was asked to evaluate the importance of letting all pension choices be determined by their pension fund. A half year later the follow-up survey was carried out in which the questions were switched for both groups. So, in the end, every individual independently judged the value of freedom of choice *and* the value of delegating choice. By using both independently measured preferences for choice *and* delegation of choice *per respondent* one is able to offer a more refined picture of choice preferences (see van Dalen and Henkens (2018) for full report): who is indifferent, who values delegation of choice, who values individual freedom of choice, and who values both delegation and free choice. The latter two categories enable us to unravel the two concepts of freedom Isiah Berlin was after. We identify supporters of *positive freedom* as those who consistently value freedom of choice higher than delegation of choice. And we define supporters of *negative freedom* as those who value both the freedom of choice and the delegation of choice. Based on this categorization one can construct the preference ordering as depicted in Figure 2.

Figure 2: Accounting for freedom (percentage of those who value freedom of choice in pension matters, by negative and positive freedom)



Negative freedom = people who favor both freedom and delegation of choice
Positive freedom = people who consistently favor freedom of choice over delegation of choice
Source: based on Van Dalen and Henkens (2018)

Three conclusions stand out. First, the percentage of participants who value positive freedom of choice varies from 14 to 26 percent. This is not a negligible number but certainly not the majority which must be in the back of the minds of policy makers when they introduce freedom of choice in pensions. Second, for the case of pension investment, the derived percentage of active choosers – 18 percent – falls well within the actual numbers as depicted in Figure 1. More so, when one realizes that a considerable number of people may overestimate their desire to make choices. Third, when we take a look at the valuation of negative freedom - as defined by our measures - it appears that for three of the four domains of pension finance negative freedom is the dominant view on freedom and for the remaining domain – pension fund choice– the negative-positive view of freedom is more or less evenly split.

Conclusions

Reforming pensions is a brain buster for governments now populations are aging and economic growth stagnates. The consensus view among policy makers is that credible pension plans can only be attained by shifting risks to citizens and lowering benefits. And this plan fits well with the view that societies are becoming more individualized. Granting individual freedom is a natural step to take. Let citizens decide. In making these judgements policy makers are sometimes informed by surveys and sometimes by the way they view the world. Both sources have their shortcomings. Economic reforms are often tacitly based on the idea that the one-dimensional idea that freedom is instrumentally important, whereas citizens may value freedom on its intrinsic merits. This view is reinforced by surveys which also take this same view. The reality is that people attach importance to both the freedom of choice as well as the freedom from making a choice. It is only by taking both concepts into account that one may come closer to the truth what people really appreciate. For the case of pensions only a minority seeks the ideal of having complete control over the decisions which help to attain one's goals in life. The history of pensions shows that people are financially illiterate, myopic, badly prepared for retirement and when they are offered choices they by and large refrain from making them (Tapia &Yermo, 2007). These problems were the very reason for establishing collective pension funds. Introducing or enlarging freedom of choice will certainly not solve these same problems.

*Read the full article here

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