University of Michigan Retirement Research Center

Imperfect Knowledge, Retirement and Saving

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Executive Summary

The standard economic model of retirement and saving suggests that people are well-informed and forward-looking in deciding on their labor market and saving behavior. A key consideration is the standard of living they will enjoy once they have retired, and how it relates to their standard of living when at work. This Issue Brief describes an exploratory investigation that suggests people are not very well informed about their pensions and social security, but that their retirement and saving behavior is not very much affected by whether they have been overly optimistic or pessimistic. Even as they approach retirement age, they do not correct their saving or revise their retirement to better attain their desired consumption in retirement. Among those who have overestimated their benefits, rather than save more or retire later, they are content to accept whatever consumption their saving will permit in retirement, leaving their behavior as planned using misinformation.

This *Issue in Brief* uses data from the University of Michigan Health and Retirement Study (HRS) linked with Social Security records and employer provided information about pensions to develop direct measures of the level of knowledge and misinformation about Social Security and pensions. We begin by examining the general level of knowledge about retirement benefits and see whether this is different for various demographic groups. We relate these measures of knowledge to activities undertaken to plan for retirement. Next, we examine the effects of knowledge and retirement planning activities on retirement outcomes, including on retirement plans, retirement behavior, revisions in re-

tirement as one approaches retirement age, and the estimated relation between Social Security and pension incentives and retirement. Lastly, we conduct preliminary analyses to see what relationship knowledge has to wealth accumulated for retirement.

The Data

The Health and Retirement Study (HRS) is a longitudinal, nationally representative study of older Americans. This NIA supported survey began in 1992 with an initial cohort of 12,652 individuals from 7,702 households, with at least one household member born from 1931 to 1941. Social security earnings histories were linked for 9,472 respondents, or about 75 percent of the respondents to the survey.

Detailed descriptions of employer pension plans were obtained for two-thirds of respondents with plans on their current jobs and for those with a plan on their last jobs if not currently working, and for about a third of the pensions from jobs held before the current or last job. It is important to note that, for a number of reasons, measurement of pension values is less precise than the measurement of Social Security benefits.

From the HRS survey, we obtain the following measures of respondents' knowledge of Social Security: Do you expect to receive Social Security benefits in the future? At what age? How much will the benefits be in today's dollars? Similar questions are asked about pensions, along with additional questions about the specific features of the respondents' pension plans. Retirement planning activities include things like talking about retirement with one's spouse or friends or relatives, thinking about retirement, and attending employer-sponsored retirement meeting

Summary of Major Findings

Knowledge of Social Security and Pensions Knowledge of Social Security and Pensions

- Only half of the respondents who expect Social Security benefits are able to say what they expect their benefit to be. Regarding pension, 41% say they don't know what their pensions are worth.
- Comparing what people expect to receive with what they actually receive, we find that 27 percent of respondents estimate their Social Security benefits within 25% of their actual benefit amount. Of respondents who make a guess that is less accurate, 14% are too pessimistic and underestimate their benefits, and 10% are too optimistic and overestimate their benefits. The numbers are a little worse for pensions with 16% accurate within 25%, and of those who are less accurate, 25% understate their likely benefits and 17% overstate them.
- Demographic comparison reveal that women do a poorer job of estimating their Social Security benefits than men; whites do better than Hispanics and blacks; married people are better informed as are those with more schooling. Respondents in the oldest cohorts (closer to retiring) do better than younger, and those in the lowest income and wealth deciles do worse than those in the highest. A similar pattern is revealed for knowledge of pensions.
- Those for whom Social Security represents a larger proportion of their total wealth--are more dependent on it--

are less likely to know what their benefits will be than those for whom it is a smaller proportion. The opposite is true for pensions: those who are more dependent on pensions are likely to know more about them.

- Retirement planning activities seem to increase knowledge for both types of benefits, although only modestly. One exception is that respondents who report having asked the Social Security Administration for a calculation of their benefits are much more likely to say they know what those benefits will be.

The Relation of Knowledge of Social Security Benefits and Pensions to Retirement Outcomes

- Overall, there is only modest support for the expectation that those who have engaged in retirement planning activities are likely to retire earlier.
- Individuals who over estimate their Social Security and pension benefits are likely to retire later than planned, but the effects are very weak.
- Respondents who said they did not know what their benefits would be were less likely to be retiring in the near future.
- Adding measures of knowledge of Social Security and pension benefits to standard retirement models has little impact on the predicted effects of Social Security and pension variables on retirement.

The Relation of Knowledge of Social Security Benefits and Pensions to Other Wealth·

- Measures of knowledge are only weakly related to measures of non Social Security and non-pension wealth.
- Among the retirement planning measures, talking with one's spouse about retirement is associated with slightly higher wealth. Overall, retirement planning has modest but statistically significant effects on non Social Security and non-pension wealth.
- Adding measures of Social Security and pension knowledge to models of saving has little impact on the estimated effects of Social Security and pension variables on saving.

Conclusion

As seen in this study, there is a great deal of misinformation about Social Security and pension benefits and rules. Those who are most dependent on Social Security benefits are least well informed about them. We find the opposite for pensions: those who are most dependent on pensions are most well informed about their pension benefits. Women and minorities are less well informed about both types of retirement benefits.

Overall, there is only a modest relationship between measures of information and retirement planning activities--those who plan are somewhat better informed than those who do not. However, we find that having requested a report from the SSA is strongly related to knowledge of one's Social Security benefits, suggesting that providing information on request is a helpful policy. However, people who request reports are likely to have more information in the first place. Future work should attempt to evaluate the SSA's current policy of providing the report of personal earnings record and projected retirement benefits to all recipients. Lastly, we find a modest relationship of knowledge and planning activities to planned and actual retirement and to non Social Security and non-pension wealth, and little effect of including knowledge variables in retirement and saving equations.

Although this investigation yielded some suggestive results, the puzzle is far from solved. In economic research, a common assumption is that people are well informed and forward-looking in their behavior. Yet we find many who are not well informed about their future retirement benefits, and they seem to behave no differently from those who are well informed with regard to saving and retirement. Moreover, despite being misinformed, they do not adjust their behavior as they approach retirement age and become aware of the true situation.

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