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Mismeasurement of Pensions Before and After Retirement: The Mystery of the Disappearing Pensions with Implications for the Importance of Social Security as a Source of Retirement Support

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We aim to increase understanding of (1) the importance of pensions and Social Security as sources of income and wealth in retirement, and (2) pension dynamics as covered individuals proceed from employment through retirement, either collecting or transforming their pensions.

We begin by focusing on the apparent discrepancies between published data documenting pension coverage and plan value between surveys of current workers and surveys of retirees. Consider, for example, the following simple comparisons: The widely read Social Security publication "Income of the Population Over 55, 2008," p. 37, suggests that 39.2 percent of units (couple or single member households) with at least one member aged 65 to 69 received pension or other retirement benefits beyond their Social Security. In contrast, data from the Health and Retirement Study (HRS) suggest that about three fourths of households from that same cohort had a pension from a current, last or previous job when they were ages 51 to 56 (Gustman, Steinmeier and Tabatabai, 2010a, Table 5.12), and 52.7 percent of respondents (not households) had a live pension from a current or previous job (Table 5.11).

There are analogous differences in plan values. For example, pensions appear to be much more important relative to Social Security when measured for those approaching retirement in the HRS than when they are measured among retirees by the Social Security Administration using CPS data. For those ages 65 to 69, the CPS suggests *income* from pensions is about 59 percent as large as income from Social Security. In contrast, for a similar population HRS data suggest the present value of expected pensions is 67 percent of the present value of their future Social Security payments. Adding the values of pensions and IRAs, as CPS income data does, in HRS wealth data, the value of pensions and IRAs together is 90 percent of the value of Social Security (Gustman, Steinmeier and Tabatabai, 2010a, Table 12.1A).

A review of the literature suggests that when pension values are measured by the wealth equivalent of promised DB pension benefits and DC balances for those approaching retirement, pensions account for more support in retirement than is suggested when their contribution is measured by incomes received directly

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from pension plans by those who have already retired. Our empirical analysis has attempted to account for these differences in the contributions of pensions as measured in income and wealth data.

A number of factors cause the contribution of pensions to be understated in retirement income data.

1. One factor is a difference in methodology between surveys affecting what is included in pension income, especially in the CPS, which ignores irregular payments from pensions.
2. Some pension wealth "disappears" at retirement because respondents change their pension into other forms that are not counted as pension income in surveys of income. Altogether, 16 percent of pension wealth was transformed into some other form at the time of disposition. For those who had a defined benefit pension just before termination, at termination 12 percent of the respondents had their plans transformed into a state that would not count as pension income after retirement.
3. For those who received benefits soon after termination, there is a 3.5 percent reduction in DB pension value at termination compared to the year before termination. One reason may be the form of annuitization that is chosen. This is another difference contributing to the explanation of why pension values measured among retirees are smaller than the pension values measured among those on the job.

Our findings suggest a number of caveats. Clearly, reporting errors or inconsistent reporting by respondents play a role in affecting the decline in the relative value of pensions reported as individuals age. Thus there are differences between pension coverage reported before vs. after retirement that appear to lead to exaggeration in the value of pensions before retirement. Altogether, 242 of 2,515 respondents who reported pension coverage as of Wave 1 of the HRS denied having pension coverage when they left their job. Misreporting of plan type also plays a role. Of the 1,602 respondents who reported a defined benefit pension in Wave 1, and who remained throughout the period of analysis, among those who had terminated their job by Wave 8, 1,150 also reported having a defined benefit pension at termination. Thus 452 (1,602 – 1,150) members of the survey declared having a pension in Wave 1 and that their pension was a DB plan, but did not declare having a DB pension at the time they terminated their employment on the pension job.

The bottom line is that CPS data on pension incomes received in retirement understate the full contribution pensions make to supporting retirees. Pension income and wealth measures vary when they are measured for the same person, and for the same pension, at different times in the life cycle. Although part of the difference is due to the well-known discrepancy between expectations and realizations, the documented transitions in pensions over the life cycle are consistent with pensions providing a larger share of support in retirement than is suggested by CPS pension income data.

Understanding the reasons for these differences is important for public policy. The discrepancies between the measures based on income after retirement vs. those based on wealth expected before retirement will lead to an incorrect understanding of how much pensions contribute to supporting families in retirement. Because the contribution of pensions to supporting retirees is understated in CPS income data, both the need for additional support in retirement and the potential contribution of pensions to retirement support may be misunderstood. Errors in measuring the value of pensions in turn lead to errors in the reported share of retirement income due to Social Security. Because pension values are understated, such errors will suggest that retirees are more highly dependent on Social Security for their retirement incomes than they in fact are, and that too large a share of the population of retirees is solely dependent on Social Security.

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