

NBER WORKING PAPER SERIES

FINANCIAL LITERACY AND RETIREMENT PLANNING IN GERMANY

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Working Paper 17110
<http://www.nber.org/papers/w17110>

NATIONAL BUREAU OF ECONOMIC RESEARCH
1050 Massachusetts Avenue
Cambridge, MA 02138
June 2011

The research reported herein was conducted pursuant to a grant from Netspar. We would like to thank Axel Börsch-Supan, Elsa Fornero, Martin Gasche, Michael Haliassos, Mike Hurd, Alex Lefter, Chiara Monticone, Kathrin Nies and Guglielmo Weber for their helpful comments. We are grateful to seminar participants at the Mathematical and Statistical Methods for Actuarial Sciences and Finance conference in Ravello, Italy, April 2010, at the Netspar Pension Workshop in Zurich, Switzerland, 2010, and at the CeRP Workshop “Financial Literacy around the World” in Turin, Italy, December 2010. This paper was started while Tabea visited Dartmouth College in the fall of 2009 and CeRP in February 2010 and she thanks both institutions for their hospitality and CDSE for financial support. We are particularly grateful to the German Research Foundation (Deutsche Forschungsgemeinschaft) for financing the SAVE survey. The views expressed herein are those of the authors and do not necessarily reflect the views of the National Bureau of Economic Research.

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NBER Working Paper No. 17110
June 2011
JEL No. D14,D91

ABSTRACT

We examine financial literacy in Germany using data from the SAVE survey. We find that knowledge of basic financial concepts is lacking among women, the less educated, and those living in East Germany. In particular, those with low education and low income in East Germany have little financial literacy compared to their West German counterparts. Interestingly, there is no gender disparity in financial knowledge in the East. In order to investigate the nexus of causality between financial literacy and retirement planning, we develop an IV strategy by making use of regional variation in the financial knowledge of peers. We find a positive impact of financial knowledge on retirement planning.

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Have you and your partner ever tried to find out how much you would have to save today to reach a certain standard of living at old-age? Yes. / No.

This question is only asked of households in which at least one of the partners is not fully retired. Thus, the following analyses are based on a sample of 677 non-retired households.²⁷ Overall, just one-quarter of those surveyed (25.3%) responded that they have done some retirement planning. The majority of households (74.7%) have never tried to find out how much they should save to reach a certain standard of living in retirement. Thus, the share of planners in Germany seems rather low. Other surveys, mainly U.S. surveys on retirement planning, such as Ameriks et al. (2003), find that of samples of relatively well-educated, wealthy individuals below age 65, 27% did not have a financial plan. However, given that the German public pension system has been—and for many individuals still is—rather generous, the low level of retirement planning among German households is not so surprising. But given the pension reforms mentioned above, households are increasingly in charge of their financial well-being during retirement and some planning will be required. In particular younger individuals who will be fully affected by reductions in their pension income will need to plan for retirement.²⁸

3.4.2 Retirement Planning and Financial Literacy

Financial planning and financial literacy are positively correlated: Table 4 shows that households who have planned for retirement are more likely to give correct answers to all of the questions compared to households who have not planned. Overall, about 70% of the planners answered all three questions correctly versus only 54% of the non-planners. The non-planners are about twice as likely as the planners to have responded “do not know” to at least one question.

[Table 4 about here]

In order to simultaneously examine the relationship between financial planning, financial literacy, and socioeconomic characteristics we conduct multivariate analyses. As a first step, we implement a simple linear regression. The dependent variable is a dummy that indicates

²⁷ In our regressions only 647 households remain because of missing information on educational status.

²⁸ In SAVE 2010 we added a question about the confidence individuals place in the public pension system. More specifically, we asked if individuals expected to get a sufficiently high pension from the public system. Surprisingly the planners, on average, are more likely to agree with the statement that their state pension will be high enough. The non-planners are, on average, significantly more pessimistic.

Table 3: Financial Literacy in East and West Germany (N=1,059)

This table displays the proportion of households who correctly answer the interest, inflation, and risk question, respectively in East and West Germany. The last two columns display the percentage of respondents with three correct answers in East and West Germany.

	interest		inflation		risk		3 correct	
	West	East	West	East	West	East	West	East
<i>Age</i>								
35 and younger	86.1	81.0	78.6	48.6	71.7	51.5	63.2	37.0
35 to 50	88.3	75.5	83.9	76.1	73.2	61.6	65.5	50.8
51 to 65	87.7	77.1	84.6	72.7	69.1	57.6	58.4	46.6
older than 65	77.6	79.1	79.8	81.6	51.1	43.4	44.4	40.0
<i>Gender</i>								
Men	87.4	75.8	87.1	74.5	72.6	56.4	64.8	48.0
women	82.3	79.2	76.6	70.4	59.7	52.3	51.1	42.0
<i>Education (ISCED 1997 classification)</i>								
lower secondary	63.9	35.6	58.2	36.4	38.1	18.0	26.8	3.4
upper secondary	86.6	76.9	83.6	69.0	64.4	52.7	57.6	41.5
postsec. non-tert.	90.1	87.0	89.9	87.0	84.0	61.0	72.8	61.0
tertiary	89.7	90.6	92.6	89.5	84.0	69.2	78.5	65.3
other	94.6	82.7	76.6	34.0	75.2	43.2	58.5	20.6
GDR	86.3	80.1	89.0	78.1	74.9	61.9	67.2	51.7
Non GDR	84.7	73.1	81.0	59.8	65.2	37.8	56.9	29.7
<i>Labor Market Status</i>								
not employed	83.0	68.7	76.7	58.2	61.1	44.7	52.9	34.1
employed	89.7	83.5	84.0	73.0	73.3	64.5	65.5	52.9
Self-employed	88.6	83.8	90.0	82.5	84.5	69.8	76.5	50.2
retired	78.1	76.3	80.0	78.5	55.6	45.6	46.7	40.6

Source: SAVE 2009, own calculation, data is weighted.

Table 4: Retirement Planning and Financial Literacy (N=677)

This table shows the proportion of households who correctly answer and who do not know the answer to the respective financial literacy questions across planning and not planning for retirement. Only households who have not yet retired are included in the sample.

	planning	not planning
<i>Interest</i>		
correct	90.9	82.5
do not know	44.4	11.4
<i>Inflation</i>		
correct	88.4	75.4
do not know	6.7	19.2
<i>Risk</i>		
correct	77.4	64.0
do not know	16.4	32.0
<i>Overall</i>		
inflation and interest		
correct	82.9	69.6
all correct	69.1	53.8
at least 1 dk	19.5	37.5

Source: Own calculation on the basis of SAVE 2009; data is weighted.