

Retirement Savings, Financial Literacy and Time Preferences in Germany

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In Germany 75% of retirement income is pay-as-you-go financed (BMAS 2008). Old age provision in Germany is composed of three pillars: the statutory pay-as-you go pension, company pension, and private pension. Until the pension reform in 2001 most Germans relied almost solely on their statutory pension entitlements. In light of population aging, many scholars projected rising contribution rates. Two pension reforms have taken place in order to distribute the burden more equally amongst the generations.

For the first time, many German households are now responsible for ensuring that they are able to maintain their standard of living when old. Promptly after the reforms were passed, insurance companies and banks reacted by offering a variety of retirement savings plans. In order to make optimal decisions about retirement plans, however, an appropriate level of financial knowledge and understanding is necessary.

In 2007 questions to assess financial literacy have been implemented into the German SAVE-Survey which is a panel study focusing on household finances and savings decisions. The three questions added were the same as the ones previously added to many other surveys like the American Health and Retirement Study and the Dutch DNB Household Panel (Lusardi and Mitchell 2006, Rooij, Lusardi, and Alessie 2007). The distribution of financial literacy among the Germans is as poor as it is in other countries.

It will be examined how the saving behavior of the population changed after the reforms. Moreover, the characteristics which might influence the decision to engage in supplemental retirement savings will be investigated. The main interest, however, is to analyze the effects of financial literacy and time preferences on the probability of expecting income from private retirement plans or capital life insurance. Previous research has shown that retirement savings decisions are not only influenced by each of the two single variables but also through an interaction between financial literacy and time preferences (Howlett, Kees, and Kemp 2008).

An empirical analysis of the SAVE-Survey 2008 shows a positive relationship between time preferences and the probability to contribute to a private retirement plan. For financially literate consumers time preferences rarely influence the probability of expecting income from private retirement plans. It is important to acknowledge that financial literate individuals seem to be more likely to save for retirement than the less literate consumers even if they discount the future more heavily. Hence financial education compensates for a high discount rate as described in the Model of Becker and Mulligan (1997). In order to motivate individuals to save for retirement, it seems to be important to remind them that there is a life beyond the working life, in Beckers' and Mulligans' term, to increase their future orientated capital. There are several ways, like newspapers or television to achieve this goal. Last but not least it is financial education which helps individuals to optimize their savings decisions.