Understanding Trends in Hispanic and African American Retirement Preparedness in the US

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Brief Summary of Major Findings

- **1. Expected retirement income is based on four components: (i) standard non-pension wealth holdings, (ii) defined contribution (DC) pension holdings, (iii) actual or expected defined benefit (DB) pension entitlements, and (iv) actual or expected Social Security benefits.**
- **2. The first two components are converted into an annuity. All the data (except rates of return) for these calculations are available from the Survey of Consumer Finances (SCF).**
- **3. Results indicate that both Black and Hispanic households made remarkable progress in terms of mean and median retirement income, poverty reduction, and replacement rates from 1989 to 2007 in both absolute terms and relative to whites.**

Summary (cont.)

- **4. However, for Black households, this was followed by a reversal of fortune from 2007 to 2019.**
- **5. Hispanics also experienced a setback in mean retirement income but continued progress in replacement rates and reducing poverty from 2007 to 2019.**

Literature Background

- **1. Measuring retirement adequacy is usually done by comparing predicted income at time of retirement with previous income (the so-called “replacement rate”). It should be noted that estimates of the replacement rate are quite sensitive to the choice of denominator. Some studies use family income at the time of the survey, others use a measure of permanent income, and still others use actual (or predicted) income as of the age just before retirement (as I do here).**
- **2. Calculations of retirement income adequacy typically relate retirement consumption to pre-retirement consumption in two possible ways. First, a household may be considered adequately prepared for retirement if it can maintain a similar real level of consumption as during its working years. Usually, 75 or 80 percent of pre-retirement income is thus considered adequate since the income needs of retirees are likely to be lower than those of workers (Aon Consulting 2001). Households no longer need to save for retirement, taxes are lower, work-related expenses disappear, the family size of retirees is smaller than that of workers, and households eventually pay off their debt (McGill, et al. 1996).**

Literature Review (cont.)

- **3. Selected studies on retirement adequacy: (a) Fisher et al. (2005) using the US Consumer Expenditure Survey; (b) Scholz and Seshadri (2009) using the HRS; (c) Gustman and Steinmeier (1998) find using the HRS; (d) Engen et al. (1999), using the SIPP and the SCF; (e) Moore and Mitchell (2000) using the 1992 HRS; (f) Wolff (2002) using the 1998 SCF; (g) Smith (2003) using the PSID and the CPS; (h) Sorokina et al. (2008), using data from the HRS; (i) Wolff (2011) on the basis of the 1989 and 2007 SCF; (j) Mitchell et al. (2021) using the HRS; (k) Center for Retirement Research CRR (2006), which develops what it calls "a new national retirement risk index" (NRRI) using the SCF; (l) Munnell et al. (2007 and 2021) using the SCF to calculate NRRI.**

Methodology

- **1. Net worth. The primary data sources used for this study are the 1989, 2001, 2007, and 2019 SCF. They are all expansionary years in the business cycle.**
- **2. DB pension benefits. For retirees, I use their actual reported DB benefit to compute retirement income. Among current workers, I use the actual formula reported in the SCF and projected earnings to year of retirement.**
- **3. Social Security benefits. For current Social Security beneficiaries, I use the Social Security benefit currently being received by the household as reported in the SCF. For current workers, on the basis of the person's earnings history, the person's Average Indexed Monthly Earnings (AIME) is computed. Then, on the basis of the rules current at the time of the survey year, the person's Primary Insurance Amount (PIA) is derived from AIME. The Social Security benefit is set to PIA.**

Methodology (cont.)

- **4. The Accounting Framework. The accounting framework becomes:**
- **(1) $DCEMP = DCEMP_a + DCEMP_b$**
- **where $DCEMP_a$ and $DCEMP_b$ are projections of the future stream of *employer* and *employee* contributions to DC accounts like 401(k) plans until the expected year of retirement. Total DC wealth is now given by:**
- **(2) $DCTOT = DCW + DCEMP_a + DCEMP_b$**
- **and "non-pension" wealth NWX as marketable household wealth minus DCW:**
- **(3) $NWX = NW - DCW$**
- **where DCW is current defined contribution plan wealth.**

Methodology (cont.)

- **5. I then convert NWX and DCTOT into an annuity equivalent (ANN) based on the formula:**
- **(4)** $ANN_i = r_i \cdot Asset_i / [1 - (1 + r_i)^{-max(LERH,LERW)}]$
- **where r_i is the rate of return on asset i, LERH is the life expectancy of the husband at year of retirement, and LERW is the life expectancy of the wife at year of retirement. Life expectancies are available by gender. In 1989 and 2001, they are available for two racial categories: whites and non-whites. In 2007 and 2019, they are available for three categories: non-Hispanic whites, non-Hispanic Blacks, and Hispanics. I categorize Asian-Americans with whites. An annuity is calculated for each asset (and debt) class based on the historical rate of return on that asset.**
- **6. I then add to current non-pension wealth holdings (NWX) and defined contribution plan holdings the estimated amount of additional wealth accumulations up to the time of retirement. This is based on the historical real rate of return of each asset type. I also estimate the future gains on DCTOT.**

Results: Figure 1. Mean retirement income (in 1000s, 2019 dollars)

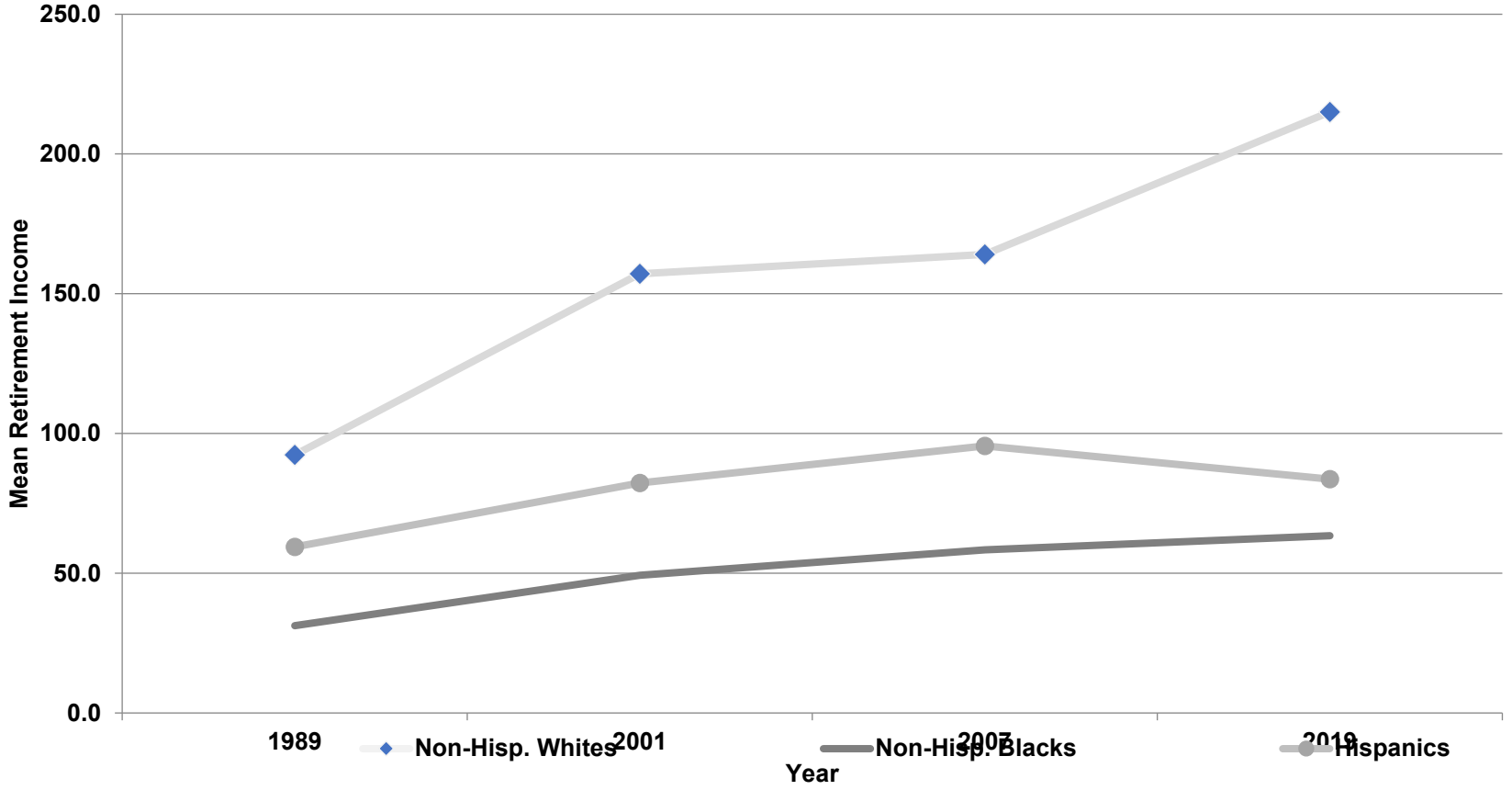

Figure 2. Median retirement income (in 1000s, 2019 dollars)

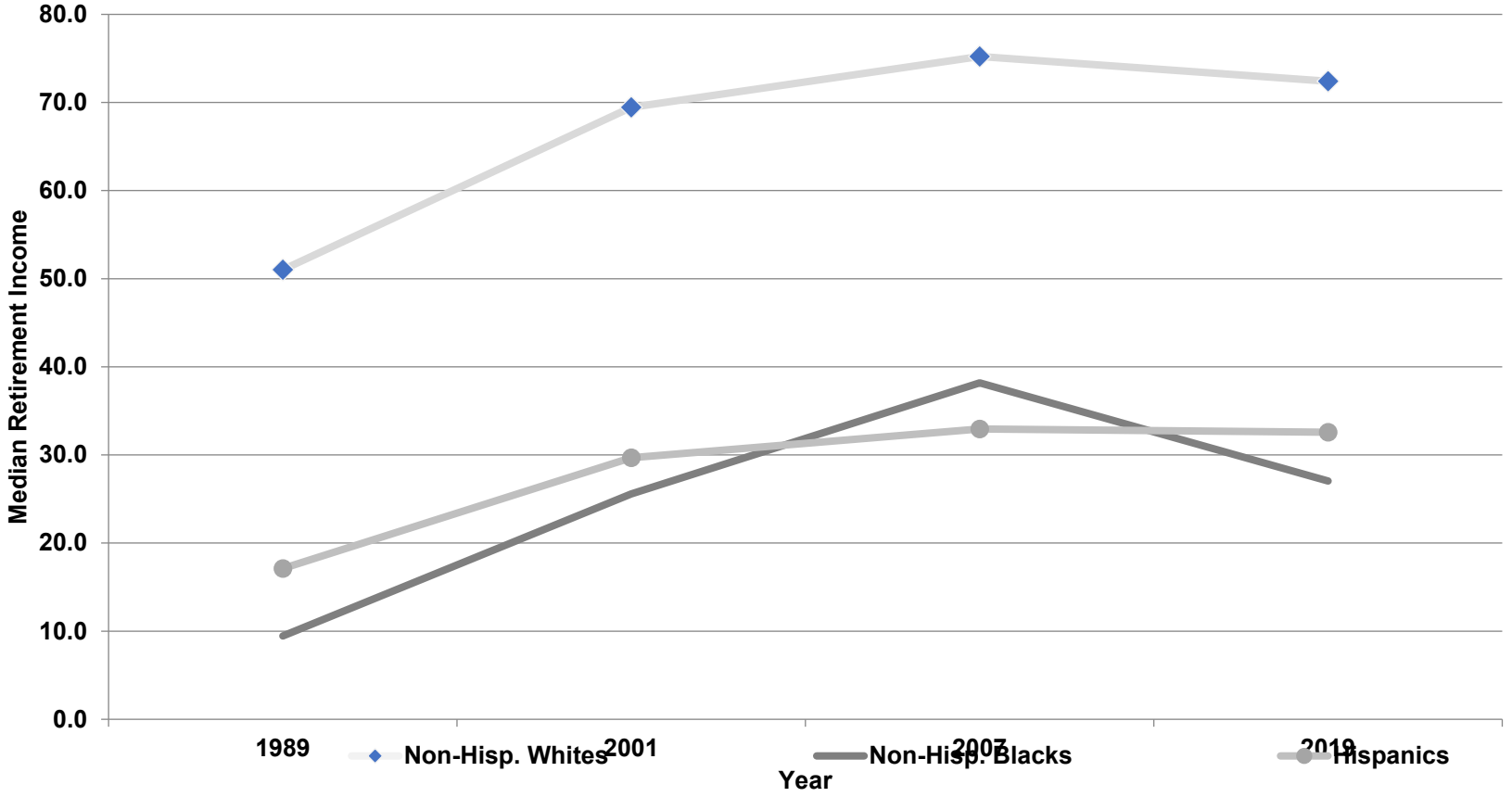

Table 1. Ratios of Mean and Median Retirement Income

	1989	2001	2007	2019
Ratio of mean retirement income				
1. Black / white households	**0.338**	**0.314**	**0.356**	**0.295**
2. Hispanic / white households	**0.644**	**0.524**	**0.582**	**0.389**
Ratio of median retirement income				
1. Black / white households	**0.185**	**0.368**	**0.508**	**0.374**
2. Hispanic / white households	**0.335**	**0.427**	**0.438**	**0.450**

Figure 3. Percentage of Households with Expected Retirement Income Less Than the Poverty Line

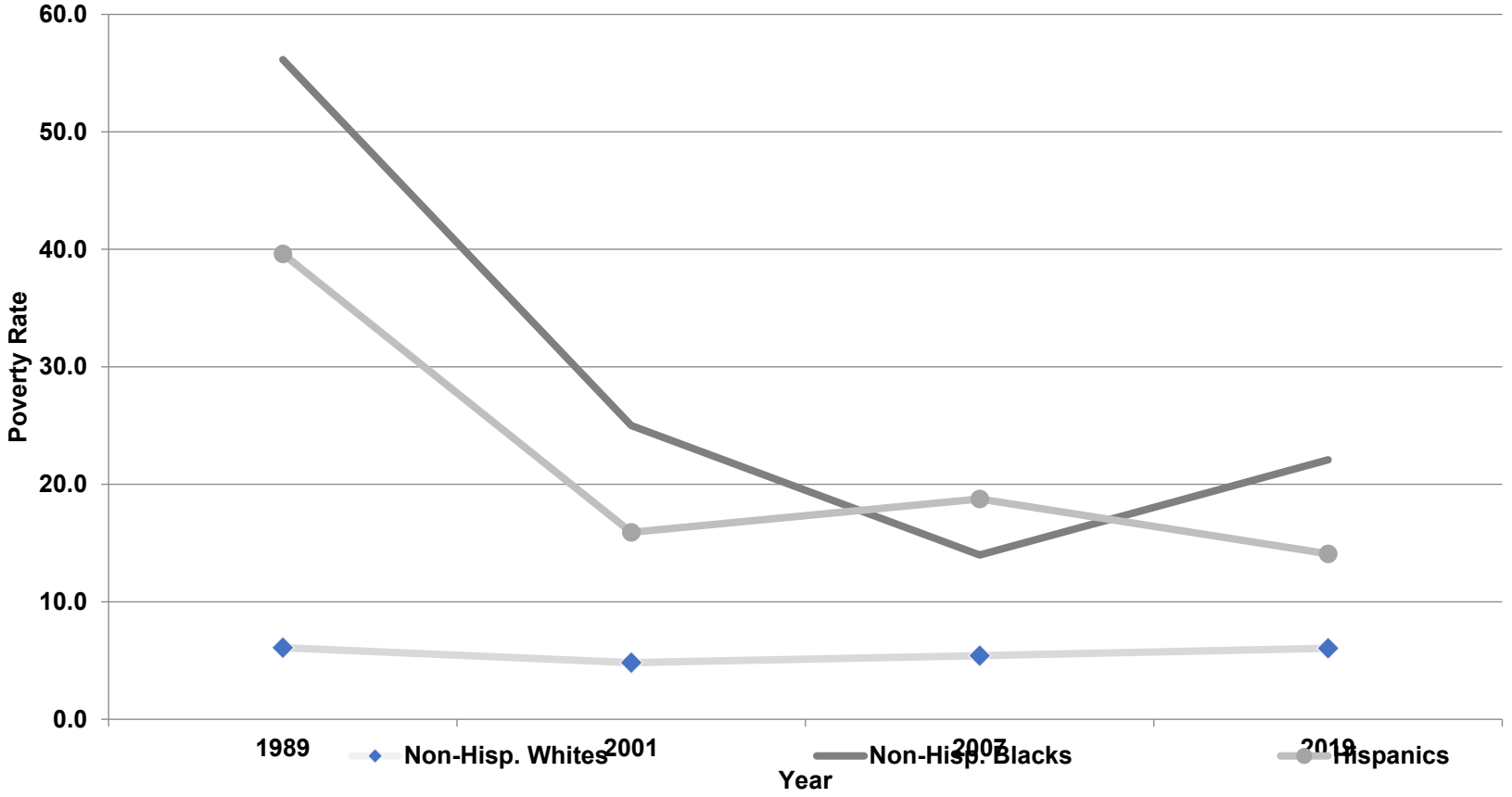

Table 5. Racial/ethnic differences in expected poverty rates

	1989	2001	2007	2019
Percent of Households with Expected Retirement Income Less Than the Poverty Line: Percentage point differences				
1. Black - white households	50.0	20.2	8.6	16.0
2. Hispanic - white households	33.5	11.1	13.3	8.0

Figure 4. Percentage of Households Meeting 75% Replacement Rate

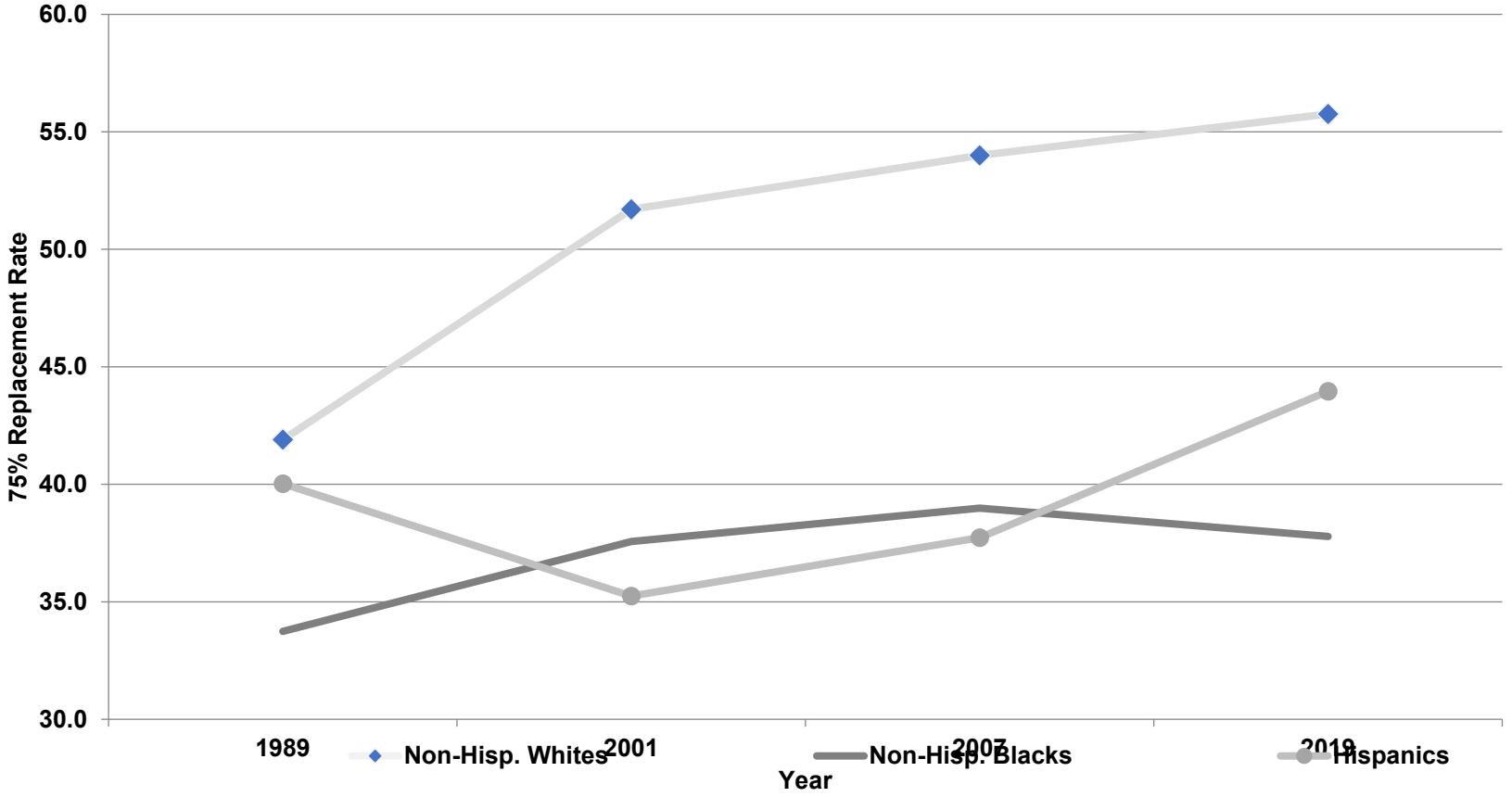

Table 5 (cont.). Racial/ethnic differences in percentage of households meeting 75% replacement rate

	1989	2001	2007	2019
Percentage of Households Meeting 75% Replacement Rate: Percentage point differences				
1. White - black households	8.2	14.1	15.0	18.0
2. White - Hispanic households	1.9	16.5	16.3	11.8