

Closing The Racial Retirement Gap

Black and Hispanic Americans are less financially prepared for retirement than their white counterparts. Research presented at an annual Wharton symposium examined underlying causes and suggested reforms.

MOST AMERICANS HAVE a significant chunk of their life savings in the form of home equity, so inequities in homeownership could have vast consequences for household wealth and retirement preparedness. But home equity isn't the only factor contributing to retirement inequality in the U.S. The 2023 Pension Research Council Symposium delved into those factors and potential policy reforms to address them. Titled "Diversity, Inclusion, and Inequality: Implications for Retirement Income Security and Policy," the conference was hosted this spring by Wharton's Pension Research Council. "To understand and overcome retirement inequality, one needs a combination of finance, economics, psychology, sociology, demography, and ethics," business economics and public policy professor Olivia Mitchell, the council's executive director, said during the conference.

"Business schools in particular, and higher education more broadly, are important factors in creating the knowledge base that's necessary to secure people's retirement and then to go on to create generational wealth and close the wealth gap," Wharton Dean Erika James declared in a conversation with Surya Kolluri WG92, head of the TIAA Institute. Insights from featured academics, business leaders, and civil servants offer important takeaways on key issues surrounding the retirement racial wealth gap.

"To overcome retirement inequality, one needs finance, economics, psychology, sociology, demography, and ethics," said Olivia Mitchell.

The Latest Research

Inadequate Retirement Preparedness: "Retirement adequacy" is often defined as the ability to replace retirement income that is equivalent to 75 to 80 percent of pre-retirement income. For many households, retirement is mostly financed from pension accumulations, Social Security benefits, and non-retirement assets. Retirement-income replacement rates appear to be under 60 percent for many middle- and upper-income families with heads in their 50s, according to conference speakers Karen Dynan and Doug Elmendorf, both Harvard University professors. "The challenge of receiving adequate income in retirement is especially acute for many families with Black heads," they stated.

For families with heads in their 50s, the median real wealth for those with white heads fell from roughly \$260,000 around the start of the century to roughly \$172,000 in 2019, the professors noted. But median real wealth for those with Black heads dropped even more sharply—from about \$72,000 to about \$24,000 over the same period.

To explain this shift, Dynan and Elmendorf pointed to sharp declines in the shares of families with defined-benefit pensions. These plans are funded by employers and have increasingly been replaced by defined-contribution plans, where employees make contributions for retirement, often with employer matches. "One might hope that families without [defined-benefit] pensions would save more themselves, but that is not the case," they noted. "The challenge of receiving adequate income in retirement is especially acute for many families with Black heads, as Black-headed families ... are notably less likely to have defined-benefit pensions."

Hurdles to Building Housing Wealth: Historical inequities have limited the ability of Black Americans to build their housing wealth, which has resulted in a wealth distribution that is skewed toward white Americans, according to Larry Santucci, senior advisor and research fellow at the Federal Reserve Bank of Philadelphia. His research points to restrictive housing regulations that were historically tilted in favor of white Americans as a factor that exacerbated the racial wealth gap. Santucci cited a 2016 survey that showed that 73 percent of white families owned their homes, with an average net housing wealth after deducting unpaid mortgage balances of about \$216,000. In contrast, just 45 percent of Black families owned a home, with an average net housing wealth of \$94,400.

Housing wealth comprises two-fifths of the net wealth of retirement-age Americans, according to Amir Kermani, associate professor of finance and real estate at the University of California, Berkeley, and Francis Wong, assistant economics professor at the Ludwig-Maximilians University of Munich.

\$10K

Seventy-one percent of people without a retirement plan reported having less than this amount in savings and investments in a new survey by the Employee Benefit Research Institute and Greenwald Research.



"About half of the Black-white gap can be explained by higher rates of distressed sales among Black homeowners," the researchers noted. Closing the gap in housing returns would cut the Black-white gap in primary housing wealth at retirement in half.

Debt Burdens: One factor undermining older Americans' ability to prepare financially for retirement is the debt burden they carry. Increasingly, adults are carrying debt into retirement, according to Mingli Zhong GRW20, research associate, and Jennifer Andre, data scientist at the Urban Institute, who tracked some 4.8 million adults aged 50-plus who had credit bureau records. They found that the median debt amount for older households with debt was about three times higher in 2016, at \$55,300, than in 1989, at \$18,900 in real 2016 dollars. The researchers also reported racial disparities in debt levels. Compared to an older adult in a majority-white community, a typical older adult in a community of color is more likely to have any type of delinquent debt, carry a higher balance of total delinquent debt, and have a higher balance of medical debt in collections. The older adult living in a majority-white area has a higher balance of delinquent student loan debt and delinquent credit card debt, they also found.

Life Expectancy and Financial Literacy: Research by Wharton's Olivia Mitchell and the Hebrew University of Jerusalem's Abigail Hurwitz and Orly Sade finds that people's perceptions of how long they will live determines how they plan

their retirement savings and draw down retirement funds. "Inaccurate perceptions regarding life expectancy can lead to suboptimal financial decisions with long-term consequences, including under-saving prior to, and overspending during, retirement," according to the researchers. In surveys conducted for their research, Blacks and Hispanics overestimated their anticipated longevity; in fact, they anticipated living longer than whites. The researchers also sought to answer whether providing people with more accurate information on longevity influences their recommendations for saving and buying annuities. They found that people who underestimated their survival chances were more likely to recommend saving and annuitization when they saw more accurate information on longevity risk.

Wills and Inheritances: Vicki Bogan WG95, finance professor at the Cornell SC Johnson College of Business, argued that low financial literacy and insufficient access to savings products are largely responsible for inadequacies in retirement preparedness. Her work suggests that barriers to engaging with financial institutions, the lack of employer-sponsored retirement plans, and the inability to access financial advice can significantly hinder one's ability to save for retirement. Additionally, health issues hinder savings.

Differences in retirement preparedness are exacerbated by intergenerational wealth transfers, according to Bogan, who pointed to research showing that over 42 percent of white households near



retirement had either already received an inheritance or a large financial gift or expected to get one. In contrast, fewer than 14 percent of Black households and 12 percent of Hispanic/Latino households had received or expected to receive one.

Jean-Pierre Aubry, Alicia Munnell, and Gal Wettstein of the Center for Retirement Research at Boston College also highlighted racial differences in inheritances and wills. “Black and Hispanic decedents are less likely to pass down meaningful estates because they are far less likely to have a will,” according to the researchers.

Social Security and the Racial Wealth Gap:

Although the median Black household earns 24 percent less per adult than the median white household, the latter has six times more marketable wealth—such as stocks, housing equity, and bank accounts. Yet after accounting for Social Security wealth (the present value of Social Security payments), the Black-white wealth gap is far smaller, according to Wharton assistant finance professor Sylvain Catherine and Yale Law School associate professor Natasha Sarin. Accordingly, inequality scholars who ignore Social Security benefits have missed the rising value of government promises of relatively generous future annuities.

The researchers noted that Social Security wealth currently comprises 61 percent and 59 percent of Black and Hispanic households’ assets, up from just 21 percent and nine percent three decades ago. This is because the progressive Social Security benefit formula pays relatively higher benefits to lower-earning, vs. higher-paid, workers. They warned that unless policymakers reform Social Security to address its looming insolvency, lower-income retirees and particularly Black and Hispanic households will confront larger racial wealth gaps.

Potential Policy Reforms

Financial Wellness Programs: Symposium speakers identified several ways in which racial retirement wealth gaps can be narrowed. Jamie Kalamarides, CEO of Bear North LLC, a financial services advisory firm, suggested that retirement preparedness can be boosted with employee financial wellness programs, legislation, and innovations from financial services providers. “Beyond altruism, employers want happier workers; they want them to be more loyal,” he said. “We’ve seen that workers who are less financially stressed are more productive, and that they are more present, or they have fewer absences along the way.”

Baby Bonds: Racial wealth inequality could also be reduced with novel developments such as baby bonds, helping parents set aside money for their children’s education, according to Naomi Zewde,

assistant professor at the UCLA Fielding School of Public Health. Several states and municipalities have launched their own versions of baby bonds or are seeking to introduce these publicly funded accounts, often with more generous financing for lower-income families. Zewde pegged the cost of a federally funded program, which would establish a fund for every newborn in the U.S., at \$80 billion annually, divided among about four million children born every year, for an average payout of \$20,000.

Rethinking Tax Policies: Retirement-friendly tax policies could also help alleviate racial wealth inequality, according to Carl Davis and Brakeyshia Samms at the Institute on Taxation and Economic Policy. Their research found that among those nearing retirement, the typical white household has about five times more non-Social Security retirement wealth (\$176,900) than the typical Hispanic household (\$35,000) and about seven times more than the typical Black household (\$24,300). Retirement savings exemptions predominantly favor upper-income white households, and tax reform has great potential to reduce racial retirement wealth inequality, according to Davis and Samms. The researchers believe that racial inequities can be addressed by reorienting retirement savings incentives toward moderate-income families, taxing retirement income streams more equitably at the state level, and ensuring taxation of real estate wealth in retirement. Tackling Social Security would also be important.

Davis and Samms have proposed that policymakers give preference to tax credits over exemptions, primarily because tax credits are more equitable. Because high-income families are more likely to be white, the bias embedded in existing tax exemptions tends to worsen racial differences. The researchers have also noted that income and asset limits could improve the effectiveness of retirement tax subsidies. The bulk of those subsidies are enjoyed by upper-income families who use retirement accounts as lucrative tax shelters, in their view.

Emergency Savings Accounts and More: David John, senior strategic policy advisor at the AARP Public Policy Institute, and J. Mark Iwry and William Gale, senior fellows at the Brookings Institution, said that racial inequities can also be reduced via dedicated emergency savings accounts, expanded access to retirement programs, easier portability of retirement balances from employer to employer, and an improved Saver’s Credit program, which provides tax credits for contributions to retirement plans. Having an emergency savings account and auto-enrollment in pensions are especially important for enhancing retirement preparedness. —Shankar Parameshwaran

28%

Estimated percentage of Black retirees’ incomes in 2019 that were drawn from Social Security benefits, compared to almost 32 percent for Hispanics and 12 percent for whites. These figures were from New York University professor Edward N. Wolff’s symposium presentation “Understanding Trends in Hispanic and African American Retirement Preparedness in the U.S.”

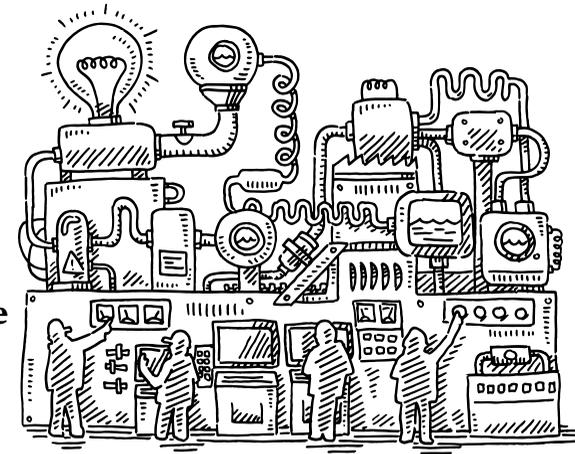


Bringing More Predictive Power To Economic Forecasts

Innovative ways of crunching big data are advancing our ability to make accurate predictions about key aspects of the economy, including GDP growth, employment, and interest-rate decisions. A new forecasting model from Wharton Nippon Life Professor in Finance Jules van Binsbergen and other researchers captures changing economic sentiment in the U.S. over 170 years to make these predictions. The researchers explain their model in the paper “(Almost) 200 Years of News-Based Economic Sentiment.”

1 THE MODEL

The researchers customized a machine learning technique to analyze roughly one billion articles across 200 million pages of 13,000 U.S. local newspapers dating back to 1850, to measure economic sentiment granularly at the city, county, and state levels.

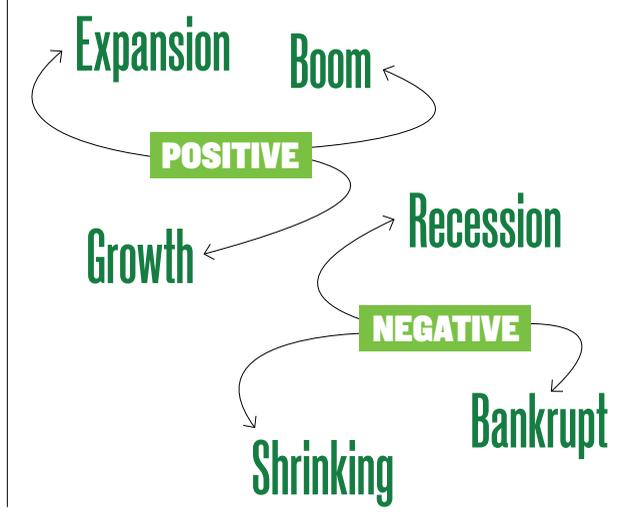


2 THE MOTIVE

“If you want to better understand the role that sentiment has on economic activity, GDP growth, labor market decisions, and other fundamentals, it’s always better to have more granular and longer time series data,” says van Binsbergen. “We show this sentiment has predictive power for economic activity over and above the standard predictors.”

3 THE METHOD

The AI model looks at the context in which a word or phrase is used in a given sentence. It classifies words and phrases related to the economy as positive or negative and measures the intensity of their sentiment.



FRANKRAMSPOTT

4 MOVING THE NEEDLE

Using this algorithm to capture sentiment in the future is possible, despite challenges in determining the right mix of media sources. Van Binsbergen is happy their study has advanced predictive techniques: “There are people that forecast GDP for a living. ... It seems that our sentiment measure leads their forecasts, meaning that it seems to run more information than what professional forecasters seem to be using.”