Reducing Retirement Inequality

Building Wealth and Old-Age Resilience

Edited by

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and
Nikolai Roussanov

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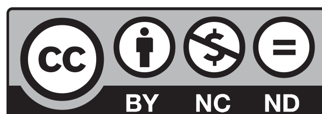

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Chapter 1

Diversity, Inclusion, and Inequality in Retirement Well-Being

An Overview

Olivia S. Mitchell and Nikolai Roussanov

Many older Americans today are poorly prepared to finance their retirement years, and such retirement underpreparedness is especially acute for members of disadvantaged racial and ethnic minority groups. For instance, Black and Hispanic families had only one-fourth of the amount of net private wealth (assets minus liabilities) compared to White families in 2022 (Kent et al. 2023). Moreover, racial wealth gaps have not shrunk much since 1980 (Derenoncourt 2022), in part because Whites tend to save more in and withdraw less from employer-sponsored retirement plans than do their Black and Hispanic counterparts. Employer saving matches in these plans tend to exacerbate these differences (Choukhmane et al. 2023).

This volume offers a range of perspectives on the causes and consequences of retirement wealth inequality, along with suggested opportunities to close the gaps. The researchers explore new datasets, analyze historical trends in income and wealth disparities, and evaluate alternative wealth and inequality measures. They also examine the roles of differential access to financial, housing, and human capital, and the role of the social security program. While the latter is a great equalizer, narrowing racial gaps considerably, the program faces insolvency and, without reform, it will be unable to pay full scheduled benefits within a decade. There are also key differences in wealth holdings and transfers between generations.

Contributors to this volume also offer a number of innovative policy alternatives that could narrow racial and ethnic differences in retirement well-being, options of relevance to employers, those who focus on real estate and educational markets, designers of tax and benefit programs, and much more.

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Racial Disparities in Retirement Preparedness

The chapter by Gustavo Suarez, Jeffrey Thompson, and Alice Henriques Volz (this volume) covers new ground with several novel datasets. The authors tap the Survey of Consumer Finances (SCF) for some of the best available data on family *market wealth* (total assets minus debts); then they add defined benefit (DB) pension data to arrive at *private wealth*; and finally, they include expected social security wealth to arrive at the *combined wealth* concept. This combined wealth metric is useful because DB pensions are a vital source for Black families and social security beneficiaries are disproportionately Black or Hispanic.

The evidence shows that White families have larger DB plan payments and defined contribution (DC) balances than do Black and Hispanic families, both at the mean and the median of the wealth distribution. Overall, both DB and DC pensions do help equalize wealth disparities, but private retirement savings are still distributed unequally by race. Two-thirds of White families (age 40–59) are covered by a defined contribution (DC) pension plan, compared to 43 percent of Black families and 32 percent of Hispanic families. The most evenly distributed form of wealth is that represented by the net present value of anticipated future social security benefits: in fact, social security is the most important asset for many families, exceeding total private wealth for a majority of White, Black, and Hispanic families.

As Karen Dynan and Douglas Elmendorf (this volume) report in their chapter, projected retirement-income replacement rates will be below 60 percent for many middle- and upper-income American families whose heads are today in their 50s. Moreover, the challenge of receiving adequate income in retirement will be particularly acute for older families with Black and Hispanic heads. Employing data from the Panel Study of Income Dynamics (PSID), which oversamples lower-income families and hence offers more precise estimates of the retirement preparedness of lower-income Black families, the authors report that *retirement replacement rates* (or the ratio of retiree benefits to pre-retirement incomes) are lower in real terms now than two decades ago, and disparities in retirement preparedness have widened over the years. For example, among families with heads in their 50s, the median real (inflation-adjusted) wealth for households with White heads fell from around $260,000 in 2000 to about $172,000 in 2019, while median wealth for those with Black heads dropped even more sharply—from about $72,000 to about $24,000. Real *money incomes* of White-headed families were also considerably higher than for Black-headed families (where money income is the sum of taxable income, transfer income, and social security income of all family members).

Declining retirement preparedness has resulted from several factors, including the decline of DB pensions and the rise of DC accounts; changes in family structure and the rising cost of living (including the cost of long-term care and medical expenses not covered by insurance); and the many macroeconomic shocks of the past few decades such as the Global Financial Crisis of 2008–2009 and the COVID-19 pandemic of 2021–2023. Dynan and Elmendorf emphasize that retiree financial well-being in the future will therefore rely even more heavily on social security for adequate income in retirement, compared to the past.

In his chapter, Edward N. Wolff (this volume) defines *retirement adequacy* as the ability of retirement income to replace 75–80 percent of pre-retirement income. Relying on several datasets from the SCF, he shows that Black and Hispanic households have seen their retirement preparedness swing in both directions over the past few decades. Thus, from 1989 to 2007, Black and Hispanic households made substantial progress in terms of mean and median retirement income, poverty reduction, and replacement rates, in both absolute terms and relative to Whites. Yet between 2007 and 2019, Black household fortunes reversed. Hispanic mean retirement incomes also fell, but this group continued to make progress in replacement rates and reducing poverty in that period. Black and Hispanic families also fared worse than White families during the Great Recession of 2008–2009. Overall, Wolff concludes—along with other authors in this volume—that social security plays a far more important role in retirement income for minorities than for Whites.

As noted in their chapter, Jean-Pierre Aubry, Alicia H. Munnell, and Gal Wettstein (this volume) report that inheriting some wealth can also have a huge impact on older households' financial security. Drawing on the Health and Retirement Study (HRS), the authors calculate racial and ethnic differences in the likelihood of receiving an inheritance, planning to leave a bequest, having a will, and leaving actual bequests. They find that Black and Hispanic decedents are less likely to pass down meaningful estates, in large part because they are less likely to have a will than non-Hispanic Whites. This is particularly true for people with modest estates, where the main asset is their home. Moreover, having multiple heirs can lead to the fractionalization of the property. Assets of those who pass away lacking a will and a clear title to assets are often dispersed, leaving families to lose these assets instead of building up wealth over the generations. Indeed, the authors report that Black, Hispanic, and other minority respondents are significantly less likely to report ever having received an inheritance compared to Whites.

One reason that people fail to draw up a will is that they may be unwilling to confront their own mortality; another is that they perceive the will-writing

process to be too onerous or costly. Nevertheless, not having a will can result in the wrong outcome, particularly if the intended beneficiaries are not related by blood, marriage, or adoption. Conversely, people who themselves have received an inheritance, who have children of their own, and who are better educated, are more likely to have a will and also expect to leave bequests of their own.

Differences in the rates of accumulation of retirement wealth could thus be partially attributed to differential access to appropriate vehicles (e.g., DC plans with an employer match), but also to differences in consumption and saving behaviors over the course of the working life. For example, Blacks and Hispanics might experience more social pressure to engage in outwardly visible consumption expenditures, making it potentially more difficult to save (Charles et al. 2009). Most of the subsequent chapters in this volume explore other potential causes of these differences, and ways of ameliorating them.

The Roles of Housing, Expectations, and Social Security

Larry Santucci (this volume) in his chapter on US home ownership and housing wealth, concludes that most Americans have a significant chunk of their life savings in the form of home equity. Accordingly, inequities in home ownership can have far-reaching consequences for household wealth and retirement preparedness. His work focuses particularly on racially restrictive covenants, originally intended as a means of regulating land use.

The author shows how these regulations were historically tilted in favor of White Americans, and in turn, contributed to the current wealth inequalities. Specifically, the covenants made it difficult if not impossible for Black families to acquire homes, as well as affecting the prices paid for them, and depressing their returns to home ownership in several US cities. For instance, in Philadelphia, Blacks paid roughly 28 percent more than Whites to buy new homes, but as their blocks became Black-dominated, their home prices lost about 10 percent in value. These historical patterns have long-running adverse economic consequences. In Philadelphia today, home values remain lower, and rates of unemployment higher, in neighborhoods having higher concentrations of Black residents.

In addition to inequities in home ownership, the ability of households to take advantage of its benefits also varies across groups. For example, Gerardi et al. (2023) show that Black and Hispanic homeowners pay significantly higher mortgage interest rates than do White and Asian homeowners, largely because the latter are much more likely to exploit periods of falling interest rates by refinancing their mortgages, with these propensities not

accounted for by differences in credit scores, home equity, and income. More broadly, wealth inequality is traceable to how households plan and save. In the chapter by Abigail Hurwitz, Olivia S. Mitchell, and Orly Sade (this volume), the authors show that people's subjective expectation of how long they will live can lead to suboptimal financial decisions with long-term consequences, including under-saving prior to retirement and overspending in retirement. Using two online surveys fielded before and during the COVID-19 pandemic, the authors show that overall life expectancy declined during the pandemic. Nevertheless, people who had previously underestimated their survival chances prior to the pandemic were more likely to recommend saving more, and more likely to recommend annuitization. Black respondents, in particular, were most likely to recommend saving more and annuitizing.

An implication of this work is that Hispanic and Black households could benefit from information better explaining the nature of and consequences of longevity risk. Prompting people to think about long-term financial decisions can illuminate ways to encourage people to make better financial decisions essential for later life.

Sylvain Catherine and Natasha Sarin (this volume) turn to an examination of the gap between Black and Hispanic household incomes and their marketable wealth. Although the median Black household earns 24 percent less per adult than the median White household, the latter has six times more *marketable wealth* than the former (marketable wealth includes stocks and private businesses, disproportionally held by those at the top of the wealth distribution). Their chapter shows that, once *social security wealth* (i.e., the expected present value of social security payments) is taken into account, the overall wealth gap between Black and White Americans is much closer to the income gap. Moreover, the authors note that this gap has narrowed over the last 30 years. They reach similar conclusions when comparing White and Hispanic households. For this reason, others' focus on *private marketable wealth* (which excludes social security wealth) paints an incomplete picture of the level and trends in racial wealth inequality.

Because social security benefit payments are progressive, the program dramatically narrows wealth inequality. In 2019, for instance, the median Black and Hispanic family held 55 and 53 percent of the total wealth of White Americans, respectively, up from 29 and 44 percentage points over the past three decades. Driving this was a large increase in social security wealth over time, from $3.4 trillion in 1989 to $37.2 trillion in 2019. Overall, social security wealth now represents nearly 61 percent and 59 percent of Black and Hispanic household wealth, versus 21 percent and 9 percent three decades ago. For this reason, social security plays an outsized role in the wealth of Black and Hispanic households. Nevertheless, since it is illiquid, it cannot be used to absorb shocks that occur prior to retirement,

or to finance large projects like an entrepreneurial venture or a home purchase. Accordingly, without program reforms to address its looming funds shortfall, it will not meet its obligations: with concomitant consequences.

Differential Access to Financial and Human Capital Markets

The chapter by Vicki L. Bogan (this volume) turns to retirement preparedness, arguing that barriers to engaging with financial institutions, employer-sponsored retirement plans, and financial planning/advisory services significantly hinder households' ability to save and plan for retirement. Using the SCF data, she studies the impact of financial inclusion on household retirement saving and wealth creation by focusing on three primary sources of retirement funds: social security, employer-sponsored retirement plans, and other assets and investments.

The author concludes that financial inclusion is a crucial lever for facilitating retirement preparedness. In addition, many who fail to plan for retirement are not offered any type of retirement plan. Moreover, low retirement plan participation is not simply a matter of inadequate income but also a function of financial inclusion and financial illiteracy. In addition, racial differences in retirement preparedness are exacerbated by differences in intergenerational wealth transfers, especially inheritances and large gifts.

Amir Kermani and Francis Wong (this volume) follow US households surveyed in the Panel Study of Income Dynamics (PSID) over the period 1999–2017, to measure home ownership status, race, and food consumption. The authors report that racial gaps in housing returns are driven by minorities' higher chance of undergoing a distressed home sale (i.e., foreclosure and short sale). In particular, experiencing a home foreclosure results in a range of adverse outcomes for homeowners, including more financial distress, higher divorce rates, lower subsequent rates of home ownership, and migration to lower-quality neighborhoods.

Their analysis documents several interesting findings, including the fact that White homeowners tend to experience significantly less consumption volatility than renters, whereas Black households exhibit no reduction in consumption volatility upon transition to home ownership. This is likely due to minorities' greater income volatility and lower financial liquidity. Moreover, minorities realize lower returns on the sale of their homes, often because they are more likely to be financially distressed (rather than because their homes appreciate at slower rates). This reality makes it difficult to make remedial interventions, while the authors favor policies that target

disparities prior to retirement. Closing the gap in housing returns would cut the Black–White gap in primary housing wealth at retirement in half.

A related topic taken up by Mingli Zhong and Jennifer Andre (this volume) is rising debt levels among older households. Their study uses credit bureau data on debt delinquency to document that having high delinquent debt indicates insufficient income and retirement insecurity. The authors conclude that older adults living in majority non-White communities are more likely to have delinquent debt and carry a higher level of delinquent debt than those in majority-White areas. Much of this is medical debt in collections, as well as student loan and credit card debt.

The highest homeower delinquency rates are in Texas, Louisiana, South Carolina, West Virginia, and Georgia, and disparities in the ratio of delinquency rates between older adults in non-majority-White vs majority-White areas are large. The authors find that the largest racial delinquency rate disparities are in the Dakotas, Wyoming, Wisconsin, and the District of Columbia (between 3.1 and 3.5 times).

To measure people's knowledge and understanding of the factors leading to sound financial decision-making and effective management of personal finances, Annamaria Lusardi, Olivia S. Mitchell, Alessia Sconti, and Andrea Sticha (this volume) deploy two surveys: the National Financial Capability Study (NFCS), a nationally representative survey of American adults' financial sophistication, and the TIAA Institute-GLFEC Personal Finance Index (P-Fin Index). The authors differentiate results across Asian, Black, Hispanic, and White respondents regarding their financial resilience, measured as respondents' confidence levels in being able to cover an emergency expense of $2,000 within 30 days. Overall, the evidence shows that Blacks and Hispanics are similar in terms of their vulnerability indicators, and they are significantly more financially fragile than are Whites and Asians. Moreover, only 13 percent of Asians say they are constrained by their debt, versus 27 percent of Blacks and 36 percent of Hispanics; and only 11 percent say they cannot pay all bills in full and on time, versus 35 percent of Blacks and 22 percent of Hispanics.

A similar set of conclusions arises from a composite vulnerability score, which can then be associated with respondent background characteristics. The evidence shows that very high rates of costly money management practices, such as payday loans and not repaying credit card balances in full, are more prevalent among Blacks and Hispanics, relative to Whites and Asians. Additionally, differences in financial literacy also account for a substantial amount of the racial/ethnic gaps in financial vulnerability. Finally, the more financially vulnerable are also less likely to have participated in financial education programs, and this relationship is particularly pronounced among Blacks and Whites.

Narrowing the Gaps

In their piece, Carl Davis and Brakeyshia Samms (this volume) argue that retirement savings tax exemptions in the US favor mainly upper-income White households, concluding that a tax reform has the potential to reduce racial retirement wealth inequality. Specifically, they note that a typical White household nearing retirement has accumulated five times more non-social security retirement wealth ($176,900) than the typical Hispanic household ($35,000), and seven times more than the typical Black household ($24,300). Several factors accentuate the racial gap, including the reality that Black households often need to support extended family members, and people of color are also less likely to receive inheritances. Accordingly, there is less money to draw on for making a down payment on a home. As well, the authors mention that disparities favoring wealthier Whites begin young, with better public education, jobs, and home ownership.

Turning to policies that can help narrow the racial retirement wealth gap, they discuss subsidies for accumulating retirement wealth in tax-preferred accounts, including tax credits. They also note the importance of reforming social security to ensure it can help those most in need, as well as helping to reduce retirees' costs.

There is now a suite of financial wellness programs (EFWPs) available at the workplace, offering employees the opportunity to close racial wealth gaps, notes John J. Kalamarides (this volume) in his chapter. Specifically, the 2019 and 2022 Setting Every Community Up for Retirement Enhancement (SECURE) Acts, state-based auto-IRAs, and paid family medical leave (PFML) programs, along with innovations by financial services providers, now give firms a chance to greatly enhance workers' financial wellness. According to Kalamarides, there is a real business case for firms to offer financial wellness programs. He noted that benefits administration is often an underappreciated component of employee financial wellness programs, yet this is where much of the relevant innovation is occurring. Employers should, in principle, be interested in having happier, more loyal, and less financially stressed employees who turn over less. Moreover, employees also have much to gain from implementing financial wellness programs offered at their workplaces. Instead of trying to set aside savings on their own, they could have their retirement plan contributions automatically deducted from payroll. Moreover, many workers receive company matches incentivizing them to save for retirement, along with tax incentives and the benefits of pooled purchasing power.

Notwithstanding all those support mechanisms, EFWPs are insufficient to close the racial wealth disparity gap, Kalamarides acknowledges. Those programs tend to include full-time covered workers at medium to large institutions, but they often do not include workers at small businesses, the

self-employed, or part-time workers. They also do not help with housing or access to capital that can be invested in entrepreneurship. Additionally, Blacks and Hispanics tend to lack access to asset-building, risk management, and decision support benefits, because they are disproportionally in jobs that pay low wages and in essential services, they are sole proprietors, their small business employers lack benefits, or they are not eligible for benefits. Accordingly, Kalamarides calls for universal enrollment of workers in DC plans, as well as universal, sustainable state and/or federal paid family medical leave programs. He also advocates that state insurance regulators enable small businesses to pool risk through associations that can expand workplace-based coverage at affordable prices.

David C. John, J. Mark Iwry, and William G. Gale (this volume) also outline policies that can help reduce inequities and boost retirement preparedness, especially for minorities. Their chapter notes that almost 57 million Americans lack access to a payroll deduction workplace retirement savings plan, and 53 percent of Blacks and 64 percent of Hispanics are thus disadvantaged, compared to 42 percent of White workers. The authors argue that providing emergency savings accounts available at the workplace could play a key role in rectifying this shortfall. Factors making these attractive include workers' ability to access their money immediately, the freedom to start and stop contributions at will, and the ability to take their accounts with them when they change jobs. The SECURE 2.0 bill passed in 2022 has moved in many of these directions, but the authors propose that additional steps will be needed to enhance retirement wealth inequality.

In her chapter, Naomi Zewde (this volume) proposes a federally funded trust fund as one way to help close the retirement wealth gap. In particular, she posits that baby bonds would be used to seed newborns' accounts for an amount between $500 and $50,000, which then would be invested on the infants' behalf until young adulthood. Since the initial seed amounts would vary inversely with household wealth at birth, the program seeks to redress generational inequality in access to capital, giving young people a chance to build wealth into their later lives. Yet she admits that their effect on retirement wealth is uncertain, if older recipients lacking access to familial transfers sought to consume their trust fund to meet immediate needs. At the same time, the cash from the bonds may ease inequality over the life course.

The author pegs the cost of the plan at $80 billion annually, noting that this is in line with other federal programs such as the $73 billion per year Supplemental Nutrition Assistance Program, commonly referred to as food stamps. The $80 billion would be divided across the approximately four million new US-born babies each year, for an average payout of $20,000. Interestingly, in some locales, a version of baby bonds already exists. For

instance, the District of Columbia passed legislation enabling baby bonds in 2021, creating accounts for each newborn in a family whose household income was under three times the poverty level ($65,880 for a family of three in that year). This program seeds an initial $500 into the account, and an additional $1,000 per year for each year the household's income remains below the threshold, until the child attains age 18. In Pennsylvania, the funds may be used for higher education, while in Connecticut, the state defines four potential avenues: buying a house, starting a business, or going to higher education (all within Connecticut), or rolling the funds over into an Individual Retirement Account. Connecticut's program has been stalled, although it has passed through the legislature and has been signed by the governor.

Many other efforts to provide access to retirement saving are also underway in several US states, as well as in numerous countries around the world. To date, nine US states have rolled out state-mandated retirement programs, and many more have such programs on the books at last tally (Reed 2023). These are typically post-tax state-run savings accounts, into which workers are defaulted if their employer does not offer a retirement savings vehicle. Evidence to date indicates that, since such employees are generally lower-paid and experience high turnover, they frequently opt out; even when they do not, they tend to accumulate only small amounts that are not likely to be sufficient to support a generous retirement benefit (Chalmers et al. 2022).

Internationally, retirement plan contributions have been mandated in the United Kingdom (Gov.UK nd) as well as many former British colonies including Singapore, Hong Kong, and Australia, and in Latin America where the most famous system is in Chile (Kay and Sinha 2008). Many of these programs have successfully gathered substantial assets, particularly for (formal) private sector workers, since the self-employed and public sector workers tend to be excluded (OECD 2023). However, during the COVID-19 pandemic, many governments permitted workers to take early withdrawals from their plans, implying substantial cuts in anticipated retiree benefits (Fuentes et al. 2023). Moreover, policy regarding pension access has become increasingly controversial, as many countries permit retirees to withdraw all or most of their assets at retirement, hence exposing them to the risk of running out of money in later life. An alternative approach deserving further research would be to default savers into deferred annuities with a portion of their retirement assets, so that they would be better protected against longevity risk (Horneff et al. 2019). Additionally, there is growing interest in ways of helping mobile workers consolidate their retirement savings into a single account, rather than having to track, manage, and oversee multiple employer-based plans accumulated over their careers (Mitchell et al. 2023). Not only could this reduce account fees and prove

easier for individuals to manage payouts, but it can also help protect retirees whose plan sponsor continues to bear fiduciary liability for the retirement assets.

Conclusions

In the modern era, ensuring retirement preparedness is becoming increasingly important in the face of rising longevity risk. Moreover, inequality of retirement wealth is also receiving more attention, prompted by aggregate shocks, rising healthcare costs, substantial debt burdens, and financial illiteracy. Our volume tackles these important topics by focusing on the causes, consequences, and policy challenges of inequality between distinct members of the minority and majority populations in the US.

We first document the size of the retirement wealth and income gaps and outline the major factors driving it. Next, we show how access to housing, social security benefits, and distinct longevity expectations play a role. The roles of differential access to financial and human capital markets are also treated, highlighting financial inclusion and debt patterns. The discussion culminates with a discussion of policies to narrow the gap, including tax policy, workplace financial wellness, baby bonds, and emergency as well as retirement saving accounts.

We close by emphasizing the fact that helping people to plan, save, and manage their retirement payouts is inherently a very difficult topic. Indeed, as Nobel Laureate William Sharpe has noted (Ritholz 2017), avoiding running out of money in old age is 'the nastiest, hardest problem in finance,' requiring that people do a good job both at investing and at forecasting their lifetimes. The fact that the US social security system is facing severe shortfalls (CBO 2023) makes this challenge even more fraught for the average person, and especially so for large segments of Black, Hispanic, and other disadvantaged groups of retirees who rely on these benefits to help them make ends meet. The chapters in this volume underscore that there is little time to lose, particularly as families' retirement preparedness has declined in the last decade, rather than improved.

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