Who Benefits from Retirement Saving Incentives in the U.S.? Evidence on Racial Gaps in Retirement Wealth Accumulation

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Outline

1. Introduction
2. Data
3. Results
4. Distributional Impacts
5. Conclusion

Disclaimer

This report is released to inform interested parties of ongoing research and to encourage discussion. Any views expressed on statistical, methodological, technical, or operational issues are those of the authors and not necessarily those of the U.S. Census Bureau. The data in this paper has been cleared by the Census Bureau's Disclosure Review Board release authorization number CBDRB-FY22-SEHSD003-001, CBDRB-FY22-SEHSD003-017 and CBDRB-FY22-SEHSD003-033.

Introduction

- **1.5% of US GDP** dedicated to encouraging contributions to retirement savings plans
  - Employers: contribute $180bn to DC plans
  - Government: $120bn tax expenditure on DC plans
- This institutional design rewards those who can and do save more for retirement
- We use a new data set to study the distributional impact of these retirement saving incentives across racial groups.

Introduction

Racial wealth gaps are large and persistent (e.g. White-Black wealth gap is 6-to-1 since 1980) Derenoncourt et al, '21

Q: Do retirement incentives contribute to racial wealth inequality and why?

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Q: Do retirement incentives contribute to racial wealth inequality and why?

Important channel for wealth inequality:

- Retirement wealth is households' 2nd largest asset class (and largest for Blacks) - SCF '22
- One of the best investment going (avg. match $\approx 4\%$ annualized risk-free return) ...
- ... yet many employees do not take full advantage of the incentives

Main Findings

1. **There are large gaps in retirement saving across racial groups**
   - White workers contribute >40% more than Black and Hispanic workers
   - Individual characteristics (inc. income) only explain 1/3 of this gap

2. **Liquidity needs and family background help explain these gaps**
   - Black retirement savers twice as likely as Whites to take an early withdrawal
   - Controlling for differences in family structure and parents' resources reduces the gap

3. **Tax and employer matching incentives amplify these disparities**
   - System is regressive along multiple dimensions (race, education, family background, etc.)
   - Equalizing matching contributions can raise median black retirement wealth by 18%

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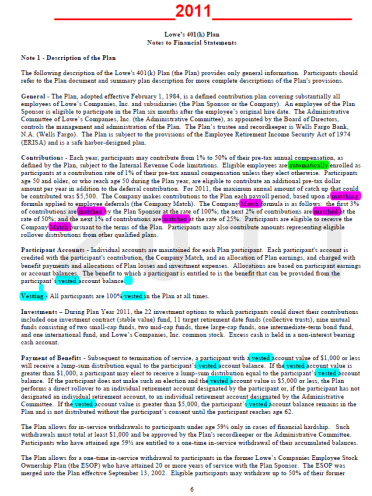
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Form 5500 has *narrative* descriptions of:

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- Matching schedule
- Vesting schedule
- Auto-features

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2011

Lowe's 401(k) Plan
Notes to Financial Statements

Note 1 - Description of the Plan

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General - The Plan, adopted effective February 1, 1984, is a defined contribution plan covering substantially all employees of Lowe's Companies, Inc. and subsidiaries (the Plan Sponsor or the Company). An employee of the Plan Sponsor is eligible to participate in the Plan six months after the employee's original hire date. The Administrative Committee of Lowe's Companies, Inc. (the Administrative Committee), as appointed by the Board of Directors, controls the management and administration of the Plan. The Plan's trustee and recordkeeper is Wells Fargo Bank, N.A. (Wells Fargo). The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and is a safe harbor-designed plan.

Contributions - Each year, participants may contribute from 1% to 50% of their pre-tax annual compensation, as defined by the Plan, subject to the Internal Revenue Code limitations. Eligible employees are automatically enrolled as participants at a contribution rate of 1% of their pre-tax annual compensation unless they elect otherwise. Participants age 50 and older, or who reach age 50 during the Plan year, are eligible to contribute an additional pre-tax dollar amount per year in addition to the deferral contribution. For 2011, the maximum annual amount of catch up that could be contributed was $5,500. The Company makes contributions to the Plan each payroll period, based upon matching formula applied to employee deferrals (the Company Match). The Company Match formula is as follows: the first 3% of contributions are matched by the Plan Sponsor at the rate of 100%; the next 2% of contributions are matched at the rate of 50%; and the next 1% of contributions are matched at the rate of 25%. Participants are eligible to receive the Company Match pursuant to the terms of the Plan. Participants may also contribute amounts representing eligible rollover distributions from other qualified plans.

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Investments – During Plan Year 2011, the 22 investment options to which participants could direct their contributions included one investment contract (stable value) fund, 11 target retirement date funds (collective trusts), nine mutual funds consisting of two small-cap funds, two mid-cap funds, three large-cap funds, one intermediate-term bond fund, and one international fund, and Lowe's Companies, Inc. common stock. Excess cash is held in a non-interest bearing cash account.

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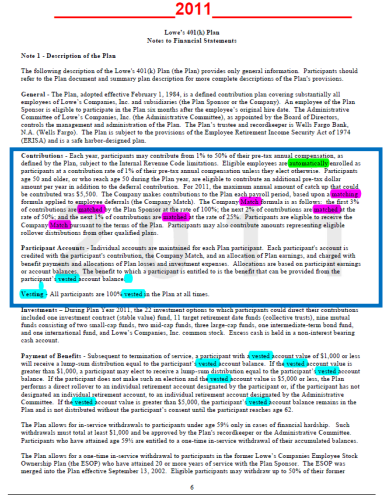
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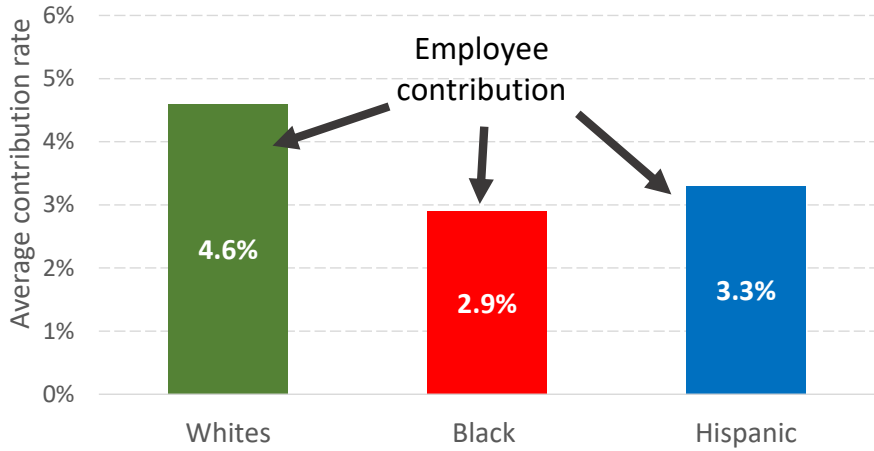
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2. Employer matching contributions amplify the effect on wealth of these gaps
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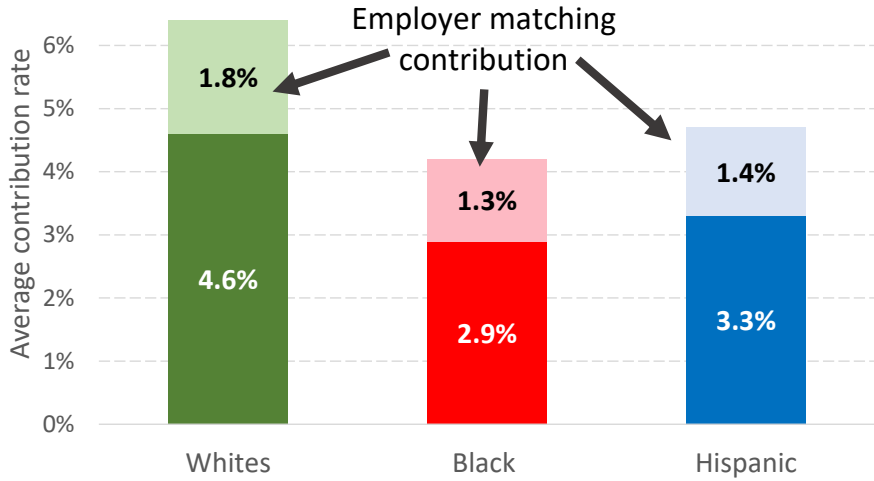
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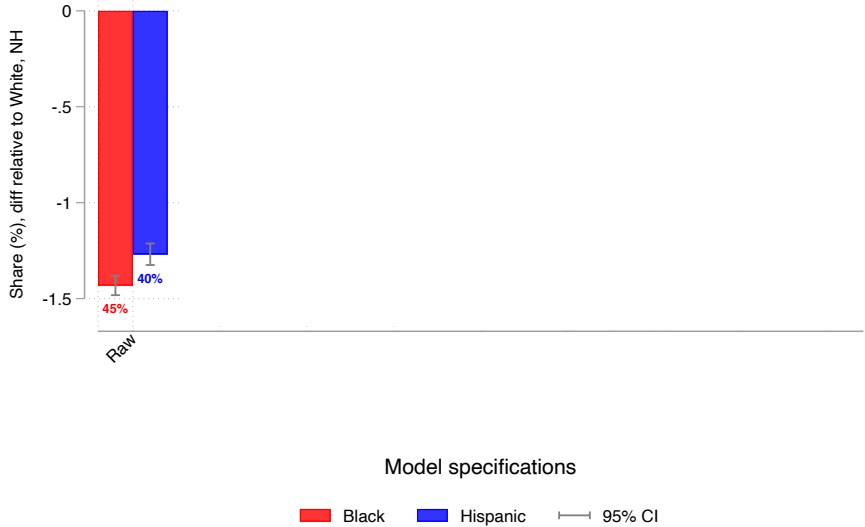
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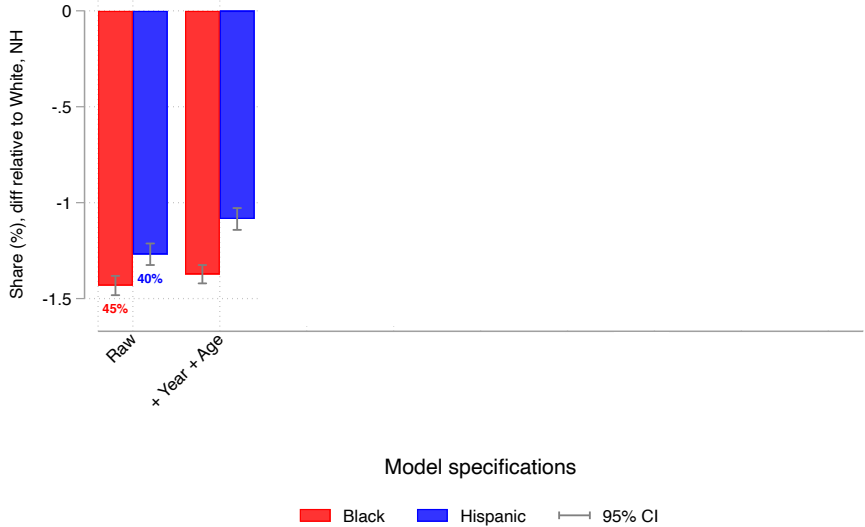
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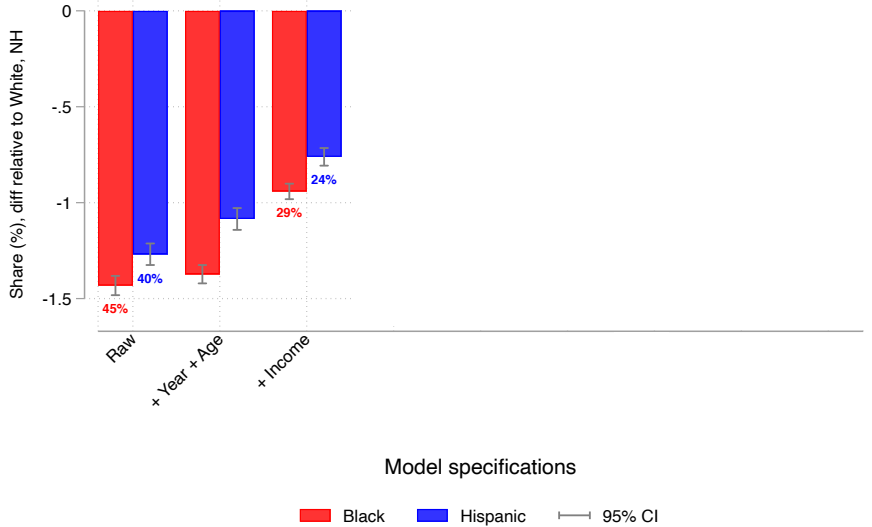
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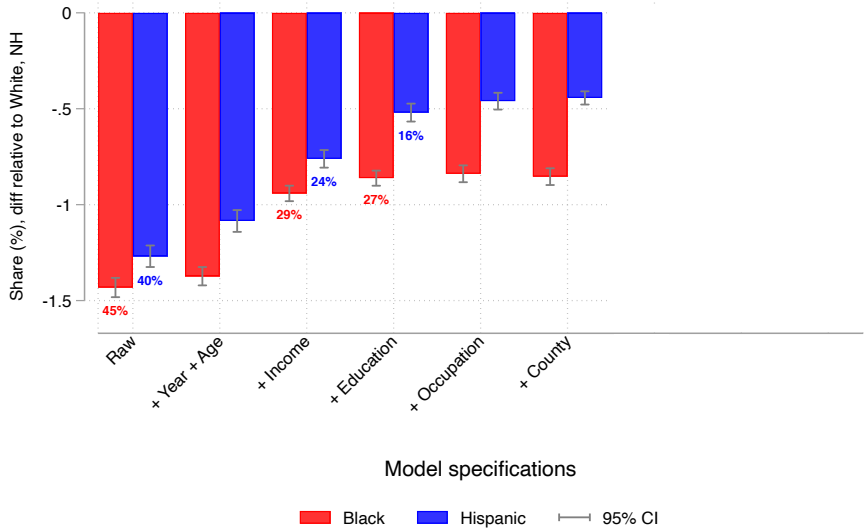
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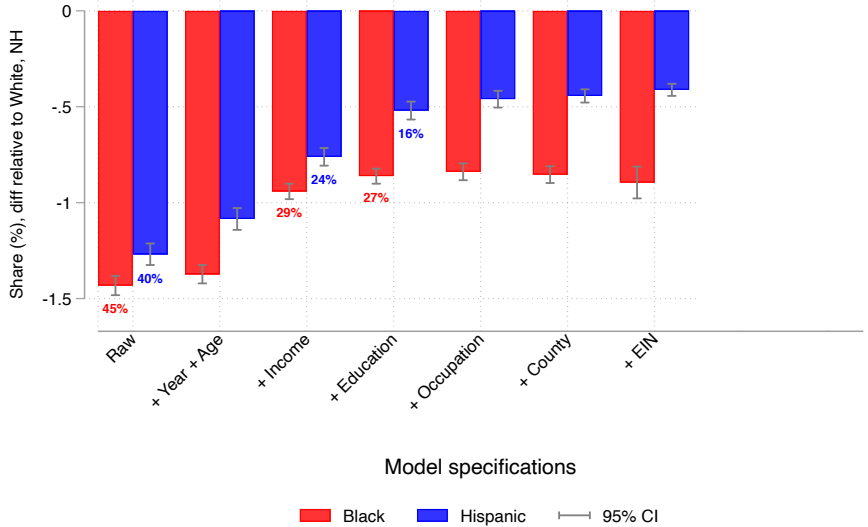
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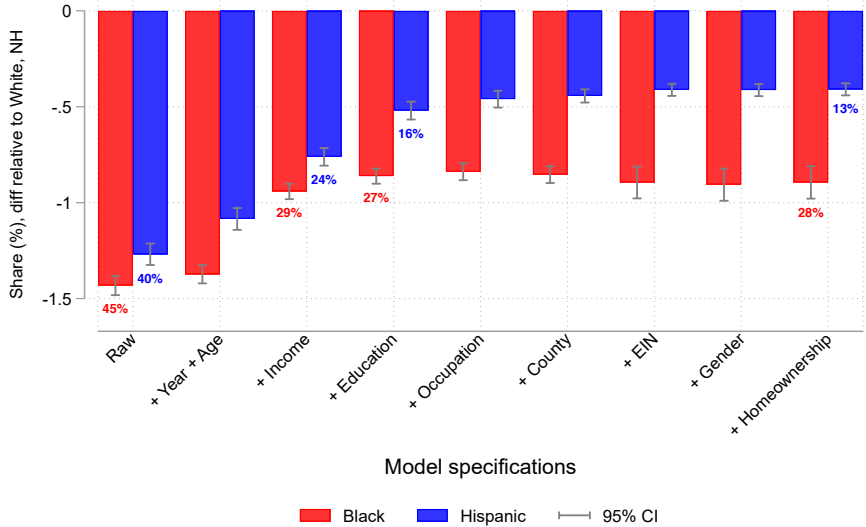
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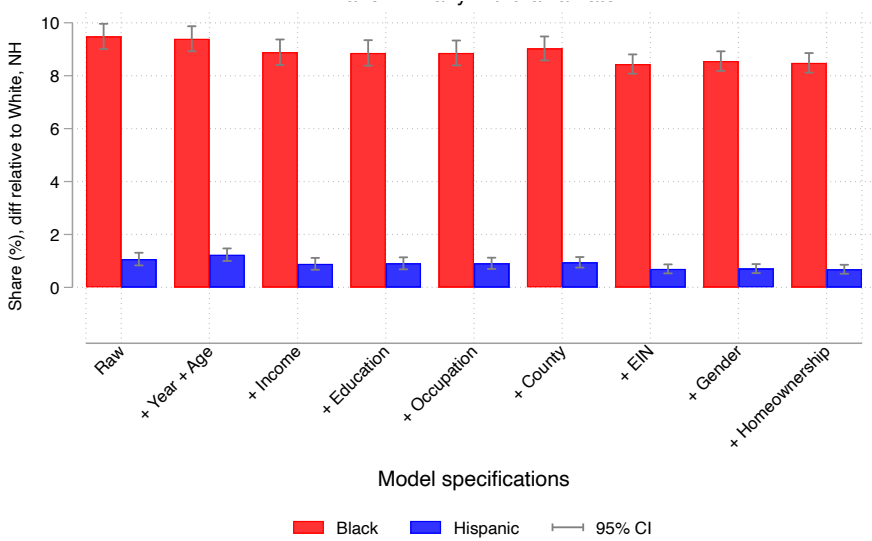


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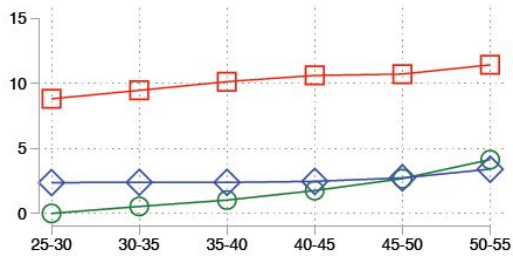
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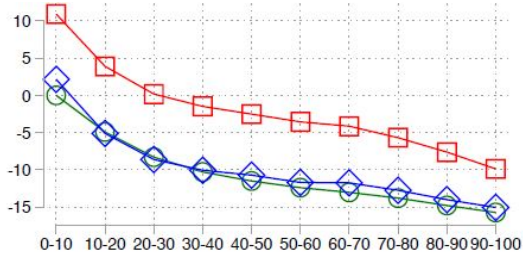
Probability of Early Withdrawal



Mechanism I: Liquidity constraints

Probability of Early Withdrawal, by Age and Income





White, Not Hispanic Black Hispanic

These figures present the implied age and income profiles of contributions for non-Hispanic White, Black, and Hispanic survey respondents. These numbers were obtained using the estimated coefficients from saturated models which include heterogeneous effects by income and race, as well as year, age, occupation, county, education, and EIN fixed effects.

▸ By Income Growth

Mechanism I: Liquidity constraints

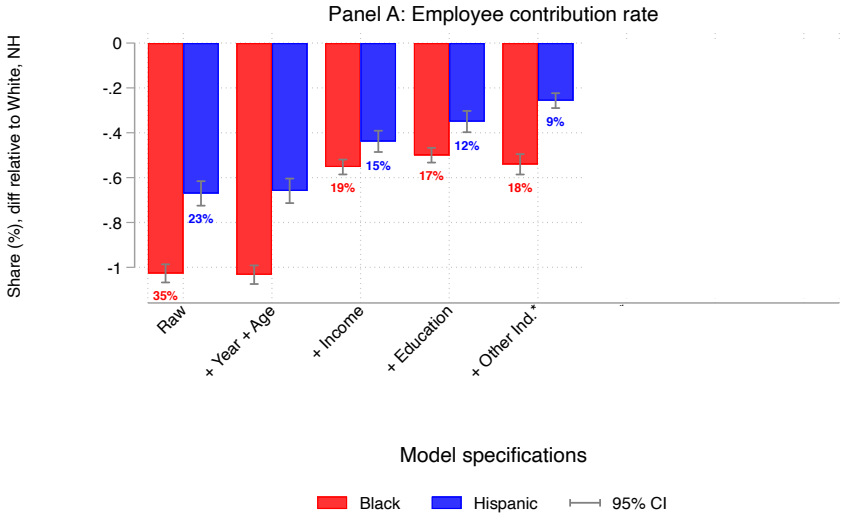
- Early withdrawal is costly over and above the cost of depletion of assets
  - Potential tax penalties
  - Six-month suspension (rule rescinded in 2020)
- Evidence of early withdrawals suggestive of liquidity constraints binding more for Black Americans than White and Hispanic Americans
  - This will (directly) reduce the accumulated balances at retirement
  - Also suggestive of one of the reasons for contribution gaps

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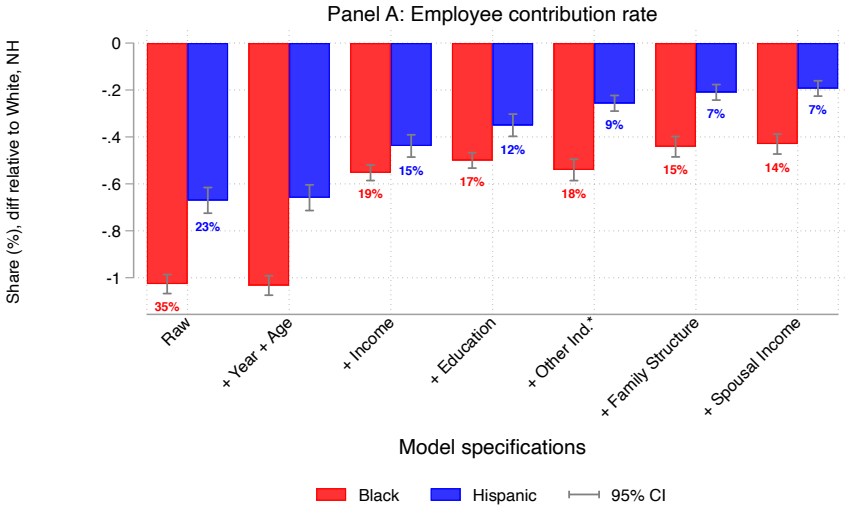
Cohorts born after 1978



Other Ind.* (i.e., Other Individual Controls):
occupation, county of residence, EIN, gender, and homeownership

5. Household and extended family characteristics

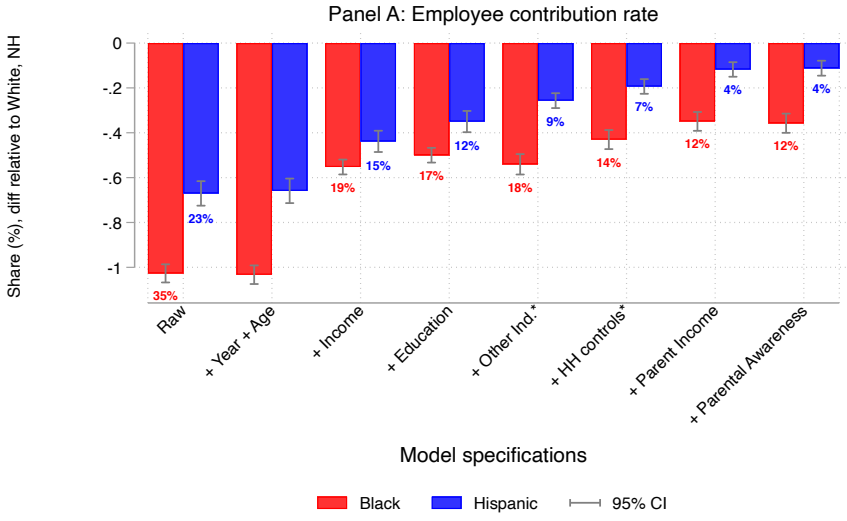
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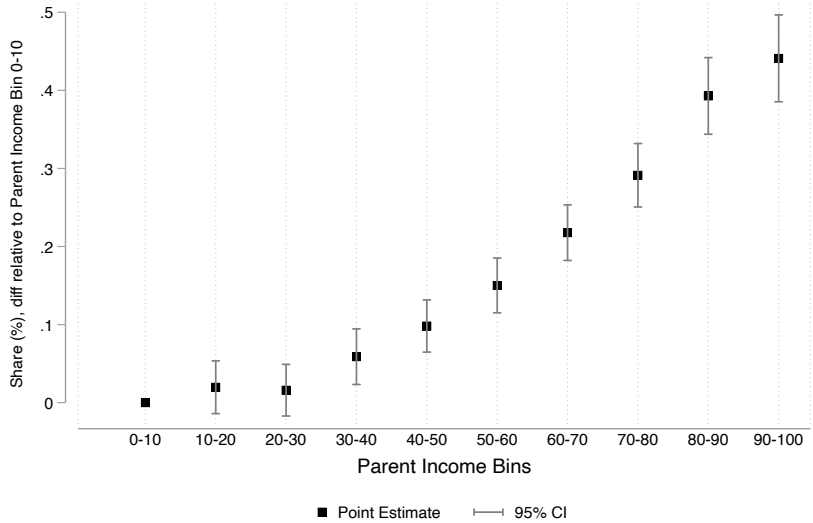


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HH controls*:
family structuare and spousal income

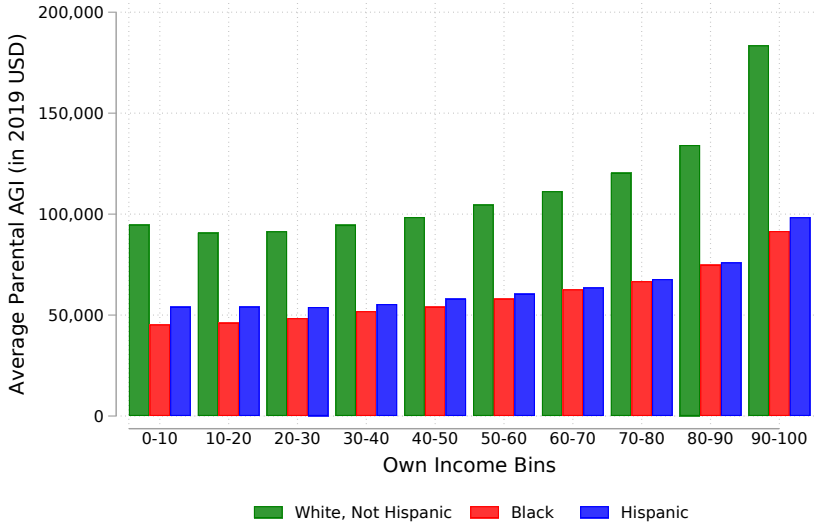
The role of parental income

Holding own-characteristics constant, those with richer parents save more



The role of parental income

Conditional on own-income, White Americans have richer parents than Black or Hispanic Americans



Family Structure and Parental Income

- Family structure and parental income together explain approximately between one third and half of the gap in saving remaining after controlling for individual characteristics
- This adds to evidence that immediate needs/liquidity constraints are driving some of the gaps that we document

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Magnitudes and Broader Distributional Features

Long tradition of optimal policy/distributional analysis of the U.S. retirement system
(Diamond, '77; Kotlikoff et al., '82; Moser and Olea de Souza '19)

Regressive subsidies for private saving ...

... balanced by **progressive social security**
& income-based **non-discrimination testing**

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... balanced by **progressive social security**
& income-based **non-discrimination testing**

Problem: focus only on income may **underestimate the system's regressivity**
Other dimensions matter for subsidies take-up and are not undone by Social Security

Magnitudes and Distributional Features

Coefficient estimates from the fully saturated model (inc. income, race, EIN, individual and family characteristics)

Traditional focus:

Moving from 2nd to 9th decile of labor income $= +1.1\%$ higher total contrib.

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Taking matching into account and **controlling for income**:

- **Race:** Black (Hispanic) workers contribute 1.1% (0.4%) less than Whites
- **Education:** College degree $= +1.4\%$ higher contrib.
- **Family Structure:** Two-person households save anywhere between 0.39% to 0.84% more, and couples (singles) without kids save up to 0.93% (0.52%) more.
- **Spousal Support:** spouse in top decile of labor income $= +2.9\%$
- **Parental Support:** parents previously in top decile of labor income $= +0.44\%$ contrib

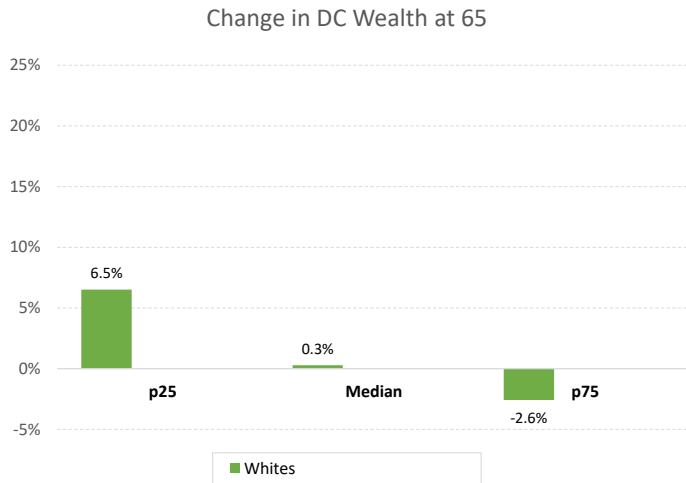
Policy counterfactuals

Reallocate **matching and tax** incentives assuming **no behavioral response**

- **Counterfactual I: Within-firm redistribution**
  Equalizing employer contributions (as % of salary) across all employees in each DC plan
- **Counterfactual II: Across-firms redistribution**
  Equalizing employer matching contributions (as % of salary) in the population
- **Counterfactual III: Tax equalization**
  Equalizing net tax benefit for contributions (deferred taxation + exemption from capital earnings taxation)

Counterfactual I: Within-firm Redistribution

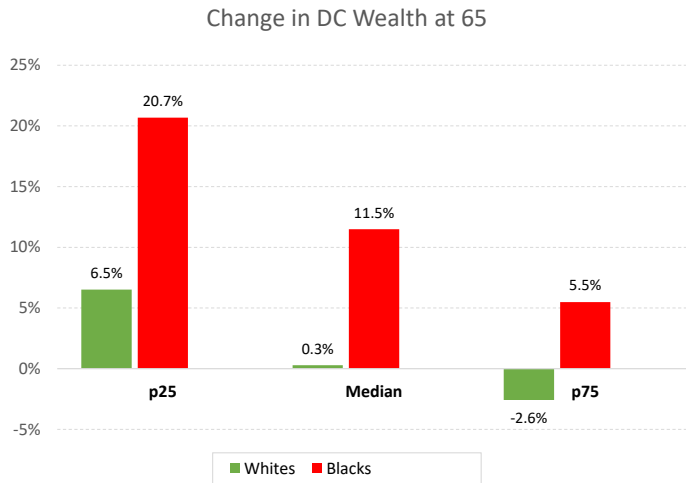
Equalizing employer contributions (as % of salary) across all employees in each DC plan



▸ w/ Social Security wealth

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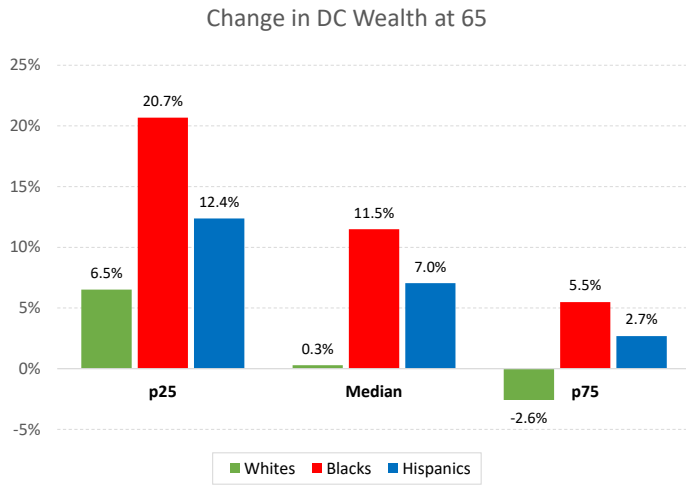
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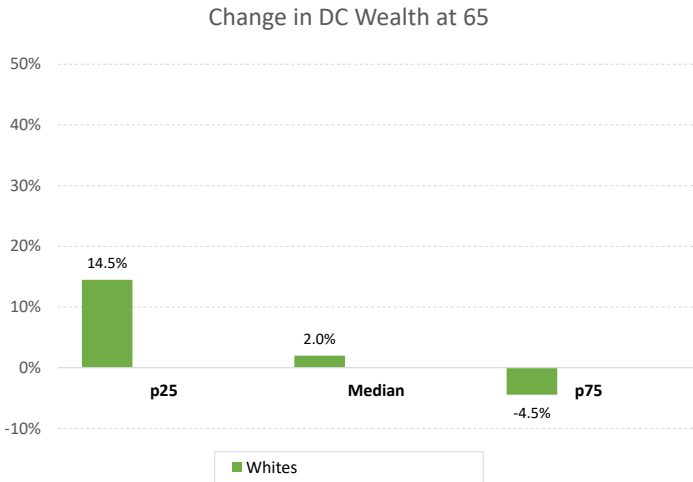
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Counterfactual II: Across-firms Redistribution

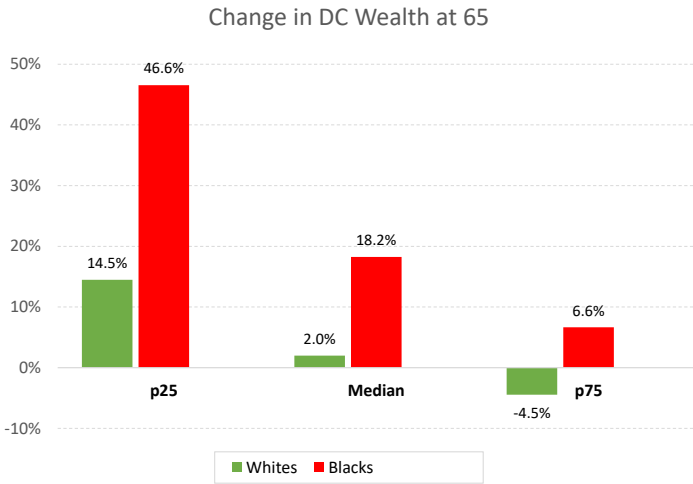
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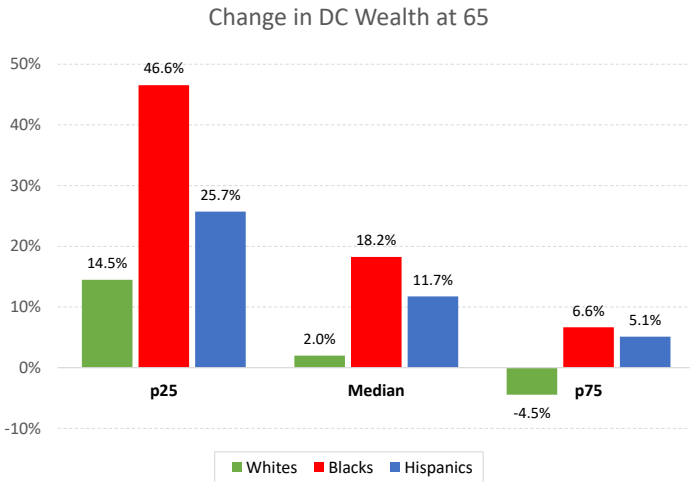
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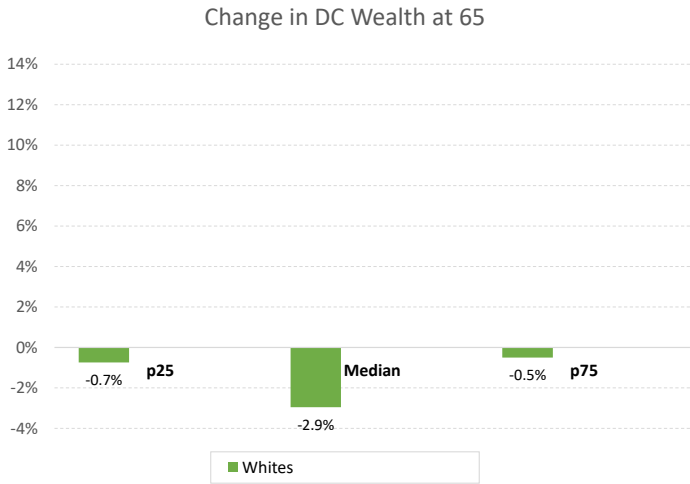
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Equalizing employer matching contributions (as % of salary) in the population



Counterfactual III: Tax Benefits Equalization

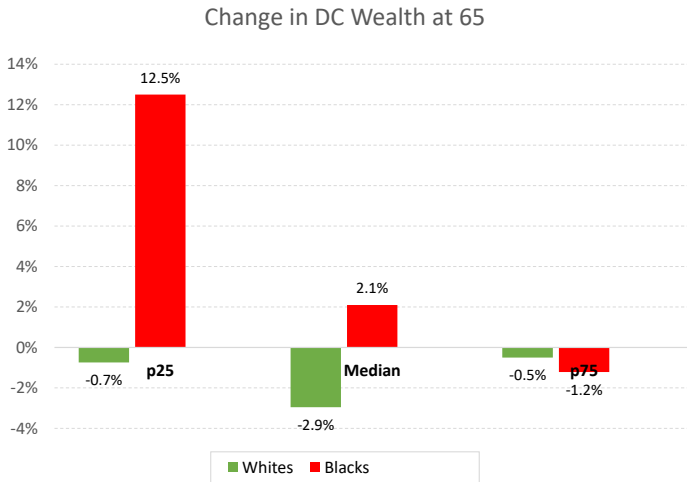
Equalizing net tax benefit for contributions (as % of lifetime income) in the population



w/ Social Security wealth

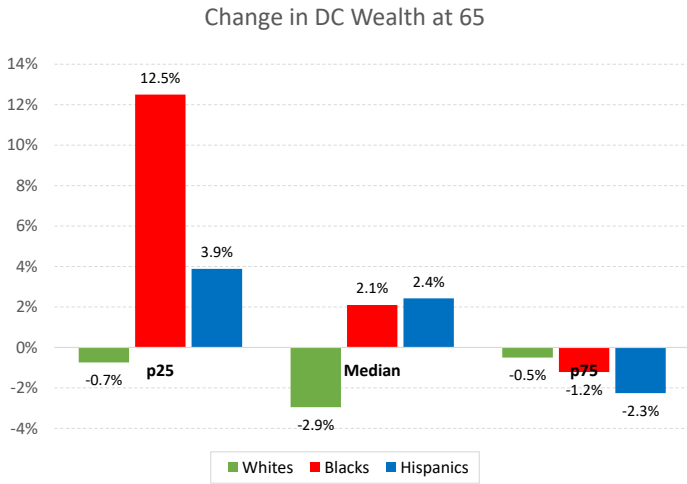
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Main Findings

1. **There are large gaps in retirement saving across racial groups**
   - White workers contribute >40% more than Black and Hispanic workers
   - Individual characteristics (inc. income) only explain 1/3 of this gap

2. **Liquidity needs and family background help explain these gaps**
   - Black retirement savers twice as likely as Whites to take an early withdrawal
   - Controlling for differences in family structure and parents' resources reduces the gap

3. **Tax and employer matching incentives amplify these disparities**
   - System is regressive along multiple dimensions (race, education, family background, etc.)
   - Equalizing matching contributions can raise median black retirement wealth by 18%

Conclusion

- Current system relies on **incentives** for saving and **disincentives** for early withdrawals
  - Limited evidence that these incentives work as intended (Choi, 2015; Friedman, 2016)

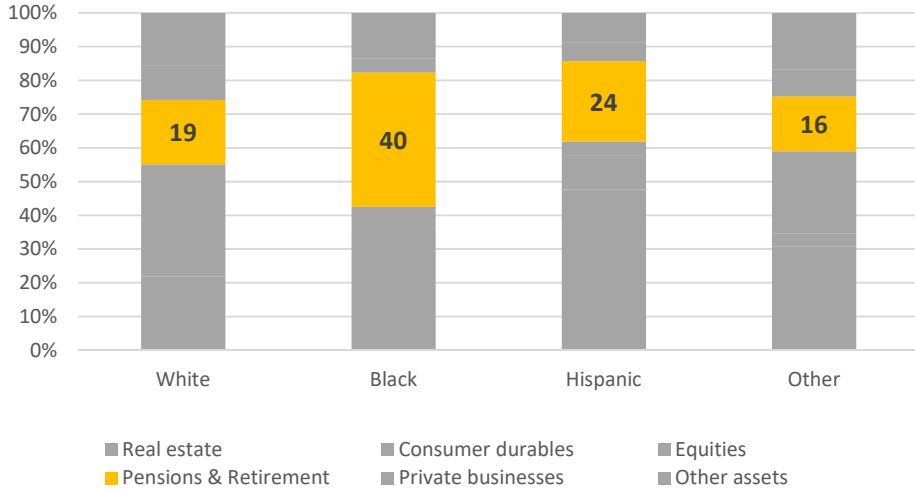
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  - differences across **income groups understate system's regressivity:** disparities remain (after controlling for income) by race, parents background, family structure, education, etc.
  - **system amplifies racial wealth gaps** and intergenerational persistence

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  - **system amplifies racial wealth gaps** and intergenerational persistence
- Broader take-away for retirement policy reform:
  - detaching subsidies from contribution amounts can narrow the racial wealth gap
  - more broadly, distributional policy analysis should look beyond income

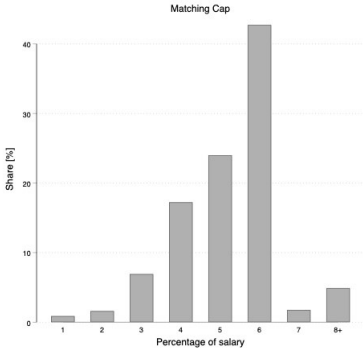
Retirement accounts are a large share of household wealth

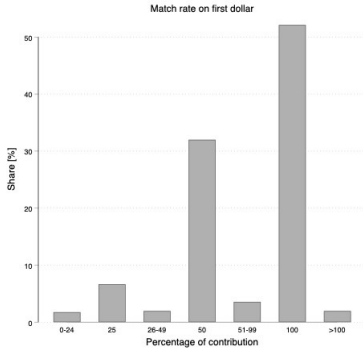


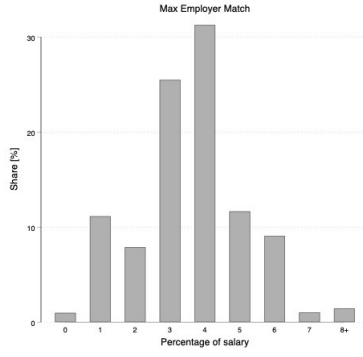
Source: Federal Reserve Board (2022), Distributional Accounts

Back

Distribution of Matches



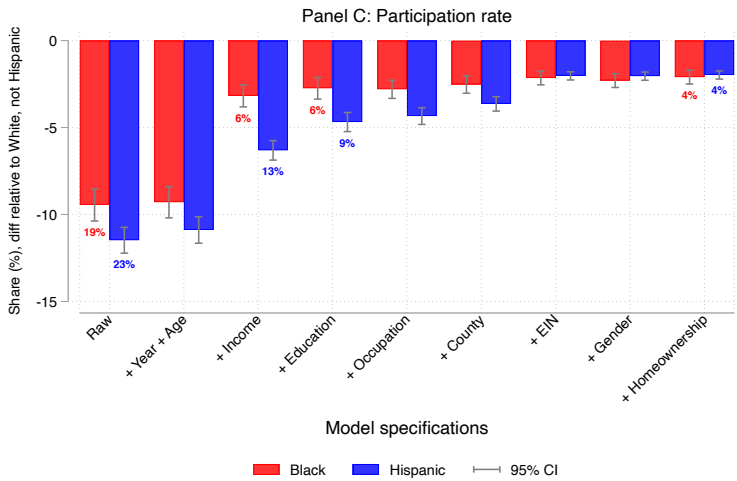




Back

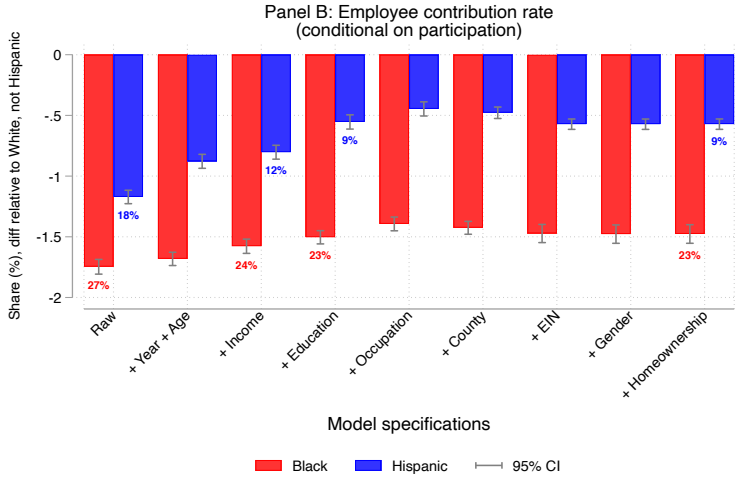
3. Gaps remain after controlling for individual characteristics

Participation



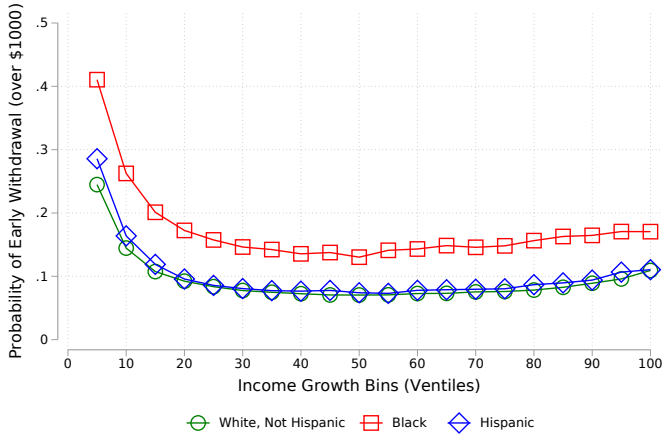
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Contributions conditional on participating



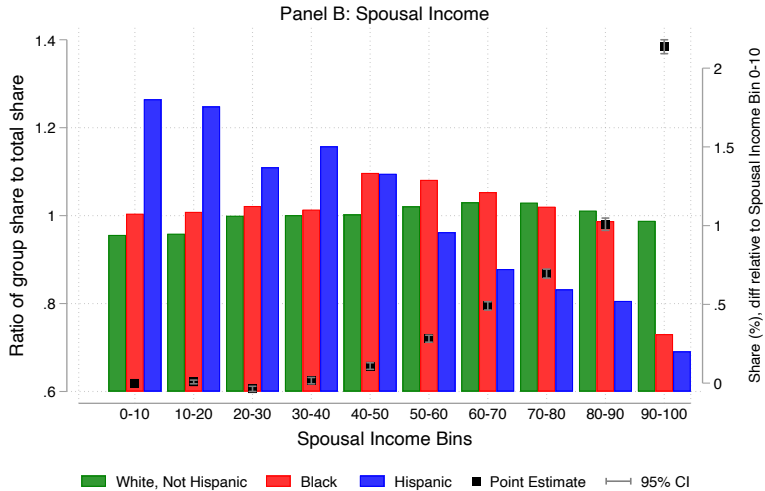
Mechanism I: Liquidity constraints

Probability of Early Withdrawal, by income growth

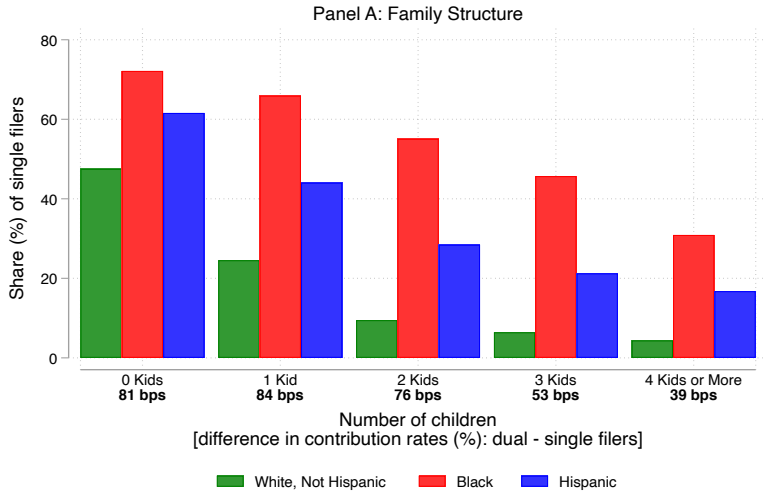


Notes: These figures plot the fraction of workers, by race and 20 ventile bins formed on contemporaneous arc income growth rates from year $t-1$ to t. Sample is restricted to the subset of individuals who had contributed at least **$**1,000 to DC accounts prior to year t.

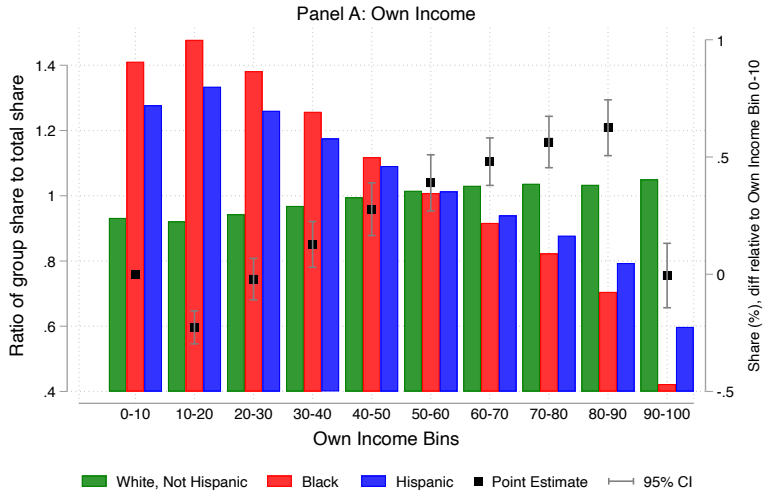
Spousal Income



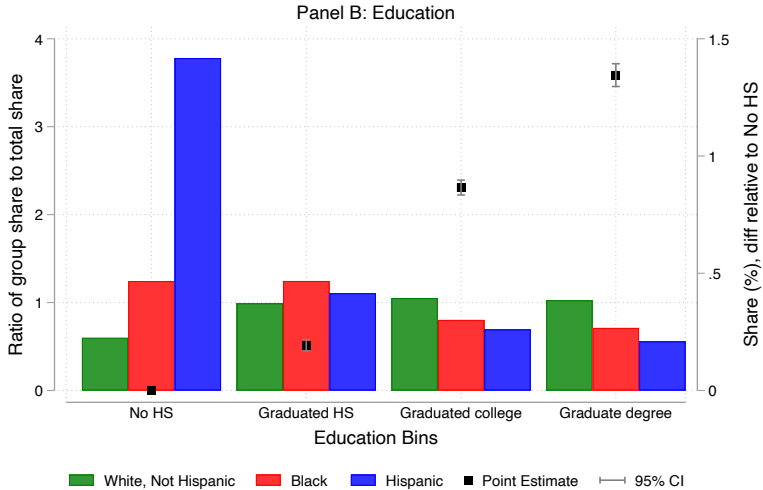
Family Structure



Own Income

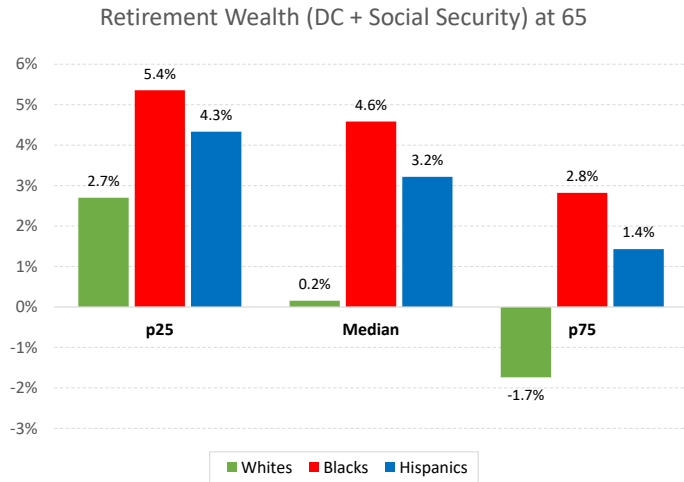

Panel A: Own Income
Ratio of group share to total share
1.4
1.2
1
.8
.6
.4
Share (%), diff relative to Own Income Bin 0-10
1
.5
0
-.5
0-10
10-20
20-30
30-40
40-50
50-60
60-70
70-80
80-90
90-100
Own Income Bins
White, Not Hispanic
Black
Hispanic
Point Estimate
95% CI

Education


Panel B: Education
Ratio of group share to total share
Share (%), diff relative to No HS
0
1
2
3
4
0
.5
1
1.5
No HS
Graduated HS
Graduated college
Graduate degree
Education Bins
White, Not Hispanic
Black
Hispanic
Point Estimate
95% CI

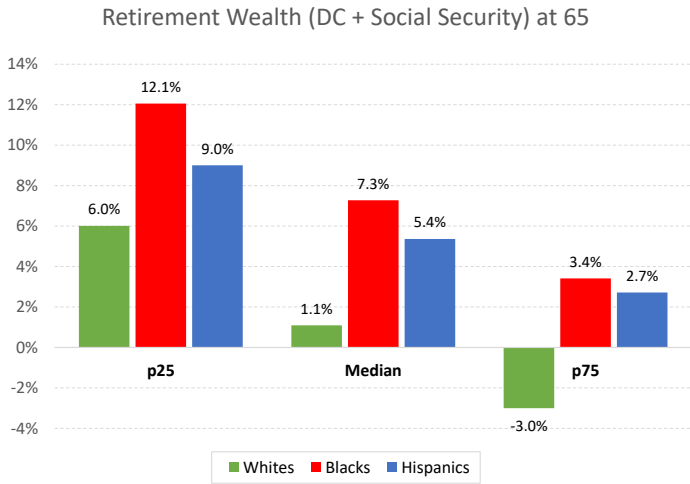
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Equalizing employer contributions (as % of salary) across all employees in each DC plan



Counterfactual II: Across-firms Redistribution

Equalizing employer matching contributions (as % of salary) in the population



Counterfactual III: Tax Benefits Equalization

Equalizing net tax benefit for contributions (as % of lifetime income) in the population

