MICHIGAN RETIREMENT AND DISABILITY RESEARCH CENTER
UNIVERSITY OF MICHIGAN

Promoting research on retirement, disability, and Social Security policy

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

Taha Choukhmane, Jorge Colmenares, Cormac O'Dea, Jonathan Rothbaum, and Lawrence Schmidt*

Retirement saving is heavily subsidized in the United States. Two key types of subsidies, from employers and the federal government, are worth approximately 1.5% of GDP. Employers provide defined contribution (DC) accounts for a large segment of the workforce, and often "match" the contributions of their employees. In 2021, private sector employers paid more than $190 billion into employer-sponsored DC accounts, much of it in the form of matching contributions. The federal tax code supports deferred compensation, a tax-favored way to receive earnings and in which to save. In 2021, the federal government's tax expenditure on DC retirement accounts amounted to over $100 billion. In this paper, we study the distributional impact of these institutional supports for savers across the three largest racial and ethnic groups in the U.S. using a new data set covering millions of employees.

Large and persistent racial wealth inequality in the U.S. motivates this research. On average, white Americans possess six times the wealth as Black Americans. (Derenoncourt et al. 2022). Financial wealth held in tax-advantaged retirement accounts comprises the second largest household asset class (Federal Reserve Board 2021). Differences in retirement savings are a potentially important channel contributing to these wealth gaps. Brown (2021) argues that the retirement system favors activities more likely carried out by white Americans (e.g., saving) and penalizes activities more likely carried out by Black Americans (e.g., early withdrawals). We aim to measure the differences across racial groups in saving in employer-sponsored accounts and the distributional incidence of institutional subsidies for savers.

We form our unique data set by linking information on the saving behavior of employees to their employers' retirement plan rules. Our employee data comes from a Census Bureau link between the American Community Survey (ACS) and Form W-2, from which we obtain information on race, Hispanic origin, education, income, and retirement savings in employer-sponsored accounts. The employer

* **Taha Choukhmane** is an assistant professor of Finance at the MIT Sloan School of Management. **Jorge Colmenares** is a doctoral student in business economics at Harvard University. **Cormac O'Dea** is an assistant professor at Yale University. **Jonathan Rothbaum** is a research economist at the U.S. Census Bureau. **Lawrence Schmidt** is the Victor J. Menezes (1972) Career Development Assistant Professor of Finance at MIT's Sloan School of Management. This research brief is based on working paper MRDRC WP 2023-483, UM23-01.

data comes from hand-coding the plan details found in regulatory filings of firms who sponsor retirement plans. This combination of data allows us to observe, for millions of Americans, a) demographic characteristics, b) savings in employer-sponsored DC accounts, and c) the match subsidies (if any) that their employers offer.

We briefly summarize four of our main results.

- There are substantial differences in savings rates by race. Figure 1 shows, for workers with access to employer-sponsored DC accounts, average contributions as a percentage of earnings held in accounts. White workers save 1.8 (1.6) percentage points more of their earnings than Black (Hispanic) workers, respectively. These disparities engender differences in employer matches, amplifying these gaps. The more an employee saves, the more their employer contributes.
- The graphs described in Figure 1 do not adjust for other differences between races that associate with saving. Those who earn less save less, on average, and it has been well-documented that Black and Hispanic workers earn less, on average, than white workers. Figure 1, in isolation, could be reflective of these differences in income. Our second result investigates the extent to which age and income can account for these differences. Income and age differences between groups do indeed account for approximately 50% of the Black-white and Hispanic-white graphs. However, Black and Hispanic workers contribute, respectively, 0.8 percentage points and 0.7 percentage points of their earnings less than white workers in the same age and income group — and receive less in matching subsidies and favorable taxation as a result.
- Turning to drivers of racial disparities, evidence suggests that differential liquidity access and parental resources by race play critical roles. Employer-sponsored retirement accounts are partially illiquid before the age of 59.5; before then, withdrawals often trigger a tax penalty. Black retirement savers are substantially more likely to take an early withdrawal than are white retirement savers. We take this as evidence of differing liquidity needs and thus a differential ability to avail oneself of subsidized, but illiquid, retirement accounts. Furthermore, individuals with parents in the richest income decile save about half a percentage point of their earnings more than those with a parent in the poorest income decile, perhaps reflecting the fact that those with access to more wealth through their parents can save more in illiquid accounts.
- We show relationships between characteristics other than race and savings in employer-sponsored accounts. Holding income constant, those with more education, richer spouses, richer parents, and longer job tenure save more, receiving more in matching contributions.
- Finally we pair our data with a model of the federal tax code and Social Security system to i) evaluate the contributions of each of employee saving, employer matches, and favorable taxation to wealth on retirement for groups, and ii) study what would be the implications for wealth at retirement if the link between own saving choices and remuneration (through employer matches) or, alternatively, the federal tax expenditure on retirement accounts was broken.. By allocating current total subsidies (both through matching and through the tax expenditure) so that everyone receives a share proportional to their income independent of their savings amounts, workers in the lowest income quintile would benefit. The poorest 20% of Black, Hispanic, and white workers would receive additional retirement wealth worth approximately 150%, 135%, and 125%, respectively, of their annual average income.

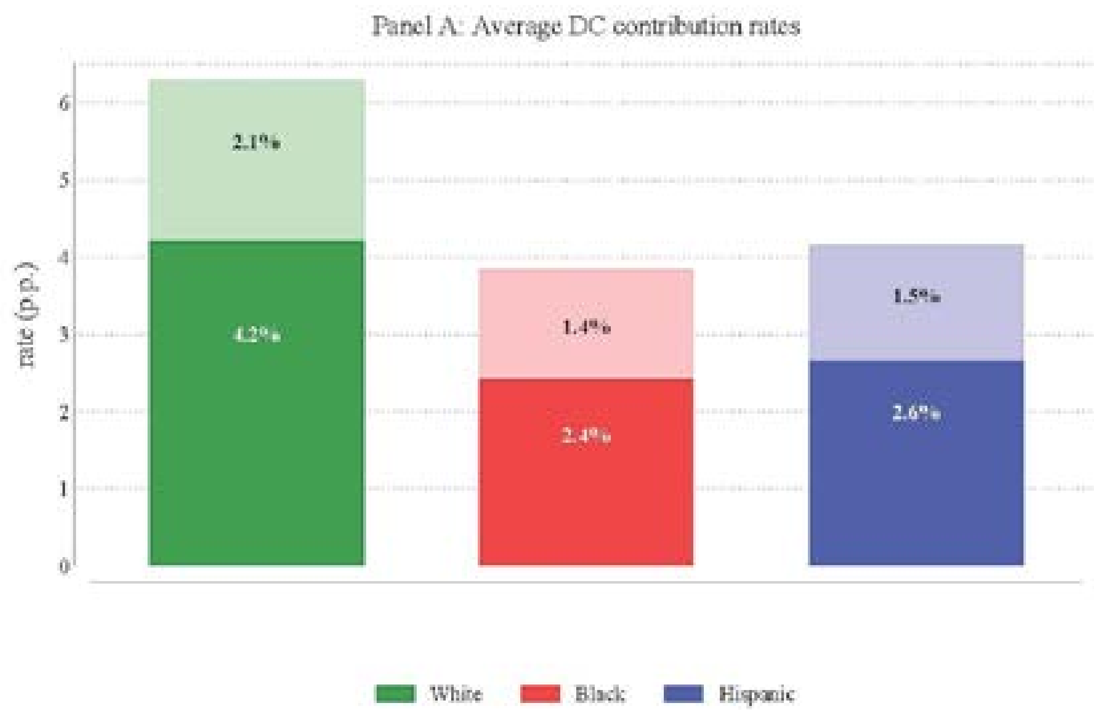
References

Brown, D. A. (2022). The whiteness of wealth: How the tax system impoverishes Black Americans--and how we can fix it. Crown.

Derenoncourt, E., Kim, C. H., Kuhn, M., & Schularick, M. (2022). Wealth of two nations: The US racial wealth gap, 1860-2020 (No. w30101). National Bureau of Economic Research.

Federal Reserve Board (2021), Distributional Financial Accounts, https://www.federalreserve.gov/releases/z1/dataviz/dfa/distribute/chart/ ❖

Figure 1: Average employee (dark) and employer (light) contributions, by race



Michigan Retirement and Disability Research Center
Institute for Social Research
426 Thompson Street, Room 3026
Ann Arbor, MI 48104-2321
Fax: (734) 615-2180
mrdrcumich@umich.edu www.mrdrc.isr.umich.edu

Sponsor information: The research reported herein was performed pursuant to grant RDR18000002 from the U.S. Social Security Administration (SSA) through the Michigan Retirement and Disability Research Center (MRDRC). The findings and conclusions expressed are solely those of the author(s) and do not represent the views of SSA, any agency of the federal government, or the MRDRC.