The Retirement Security Project

Strategies to Increase the Retirement Savings of African American Households[1]

Ngina Chiteji and Lina Walker

N° 2008-4

The Retirement Security Project

Common sense reforms, real world results

www.retirementsecurityproject.org

Advisory Board

Bruce Bartlett
Washington Times Columnist

Michael Graetz
Justus S. Hotchkiss Professor of Law, Yale Law School

Daniel Halperin
Stanley S. Surrey Professor of Law, Harvard Law School

Nancy Killefer
Director, McKinsey & Co.

Robert Rubin
Director, Chairman of the Executive Committee and Member of the Office of the Chairman, Citigroup Inc.

John Shoven
Charles R. Schwab Professor of Economics and Director, Stanford Institute for Economic Policy Research, Stanford University

C. Eugene Steuerle
Senior Fellow, The Urban Institute

The Retirement Security Project is supported by The Pew Charitable Trusts in partnership with Georgetown University's Public Policy Institute and the Brookings Institution.

1775 Massachusetts Ave., NW, Washington, DC 20036 • p: 202.741.6524 • www.retirementsecurityproject.org

I. Introduction

Concerns about whether African Americans are sufficiently prepared for retirement have been raised in academic circles, in the policy arena, and in the popular press.[2] The voices of the African American citizens tell a story that suggests current levels of saving are a concern for this minority population. A quarter of African American survey respondents expressed reservations about having enough resources to simply take care of basic expenses during retirement and about one-fifth reported that they expect to struggle during the first five years of retirement. By comparison, only one-tenth of all U.S. workers had this latter concern.[3]

In this report, we highlight differences in retirement resources between African Americans and other U.S. households, discuss their implications with respect to retirement preparedness and examine underlying reasons for these differences. The goal of the paper is to move beyond simple comparisons of savings between groups to measures that provide a better assessment of whether African Americans are saving adequately for retirement and how they compare relative to other households. Thus, this analysis enables us to assess the extent to which the concerns voiced by African Americans are validated, evaluate the underlying reasons for racial differences in retirement preparedness and identify policy options that would improve the retirement security of African American households.

The primary finding is that African American households are less prepared for retirement than white households. They have saved smaller sums, which is largely due to differences in labor market experience and saving decisions. When one accounts for differences in income (which are driven by differences in labor market experience), the savings gap narrows but persists.

Retirement resources, however, also include claims to Social Security and defined benefit (DB) pensions and when these are accounted for, on average, African Americans have adequate resources for retirement. However, African Americans continue to lag behind whites in that they have lower income replacement rates than white retirees and a disproportionate fraction of African Americans have replacement rates that would be inadequate to support their retirement consumption. Part of the racial differences in retirement resources may be due to differences in family structure and networks but also due to discrimination in labor and credit markets.

Given these differences in retirement preparedness, this report focuses on private-market solutions that would differentially improve the retirement security of African American families. The policy proposals emphasize

remedying information gaps, making it easier to save and improving incentives to save, particularly for moderate- and low-income households. Specifically:

- Provide an ongoing financial mentoring program for children, starting at very young ages, to level the playing field for children who are not born into families with financial market expertise or who have limited opportunity to learn about financial management from related adults. A long-term financial mentoring program could be built upon existing financial education programs that target children but do not typically offer ongoing, sustained mentoring opportunities.

- Make it easier to save by increasing the adoption of automatic features in 401(k) plans. This includes changing the default options in 401(k) plans so workers are automatically enrolled, and their contributions are automatically increased over time and invested in professionally managed, balanced funds – unless they actively chose not to participate. Additionally, when workers change jobs, automatically rollover assets in 401(k)-type plans into an IRA or another retirement plan offered by the new employer to keep the funds in the retirement system.

- Help millions of workers who currently do not have access to 401(k) plans save for retirement by creating a system whereby these workers can contribute automatically to a low-cost, diversified individual retirement account (IRA) through direct payroll deposits.

- Expand, simplify and make refundable the Saver's Credit so that the incentives for saving are clearer and more rewarding and those most in need of the credit could qualify – even if they do not owe taxes.

- Reform the asset tests for federal means-tested programs so that lower-income families and those in need of public assistance are not penalized for accumulating retirement assets.

In the following section we compare the retirement resources of African American families to the average U.S. family and discuss some of the underlying reasons for the differences. Section III then refines the comparison by controlling for income differences. Section IV accounts for claims to Social Security and DB benefits and assesses the adequacy of retirement saving. The report ends with a discussion of additional factors that contribute to the racial wealth gap (family structure and discrimination) and offers several promising policy initiatives that are designed to help blacks better prepare for retirement (sections V and VI).

II. Differences in Retirement Top

Table 1. Savings of Pre-retired and Retired Households

Panel A. Pre-retired household (age 51-64)		
Mean values [Median values]	African American households	All US households
Net worth	$123,400 [$27,500]	$399,800 [$142,300]
Net worth minus housing wealth	$77,800 [$4,000]	$277,700 [$49,000]
Financial Assets	$16,300 [$200]	$101,700 [$7,500]
DC/IRA	$39,900 [$0]	74,100 [$0]
Panel B. Retired households (age 70 and older)		
Net worth	$84,400 [$36,900]	$409,600 [$165,000]
Net worth minus housing equity	$34,700 [$2,000]	$281,200 [$61,000]
Financial Assets	$14,000 [$300]	$145,300 [$20,000]

Notes: Mean values, with medians reported in parenthesis.
Financial assets includes stocks, bonds, certificates of deposits and balance in checking and savings accounts
Networth includes financial assets, housing equity, value of transportation, value of business, farm and real estate, IRA, assets in trusts and other assets.
Source: Authors' calculations using data from the 2004 Health and Retirement Survey

Increment Resources

Many studies have documented that the average African American family has lower savings than the average U.S. family. Table 1 illustrates the extent of the racial savings gap, measured by net worth, among working-aged households approaching retirement (ages 51-64).[4] The median net worth of African Americans is only around $28,000 compared to $140,000 for the median household nationwide.[5] The difference in savings between black and other households is even larger if one excludes the value of housing equity.[6] The value of non-housing assets for the median black family is one-twelfth that of the typical American family, compared to one-fifth when housing equity is counted (Table 1).[7]

Racial differences in retirement resources are also apparent among current retirees. The median African American family aged 70 and older has a net worth of $36,900, which is markedly lower (one-forth) than the net worth of the median U.S. household (Table 1). In addition, sources of income also differ between black and white retirees (Table 2). Retired African American households are more likely to rely on income from pension plans and earnings than other

Table 2. Sources of Income Among Retired Households (age 70 and older)

	All U.S. households	African Americans
Retirement (pension) income	16.0%	17.5%
Social Security benefits	34.9%	33.1%
Public assistance	2.0%	3.1%
Assets/other income	14.2%	8.4%
Earnings	32.7%	38.0%

Notes: Social security benefits include workers, disability insurance and survivor's benefits
Public assistance includes SSI, unemployment and worker's compensation, veteran's payments, welfare payments such as AFDC and TANF
Assets/other income includes interest and rental income, income from dividends, educational assistance, financial assistance, alimony and child support
Earnings include wages and salary, self employment and farm income
Source: Authors' calculations using data from the Current Population Survey

retirees. Furthermore, income from assets represents a much smaller portion of total household income for African Americans than for other households (almost half as large).

In what follows, we discuss some of the reasons for the observed racial differences in retirement resources. To a large extent, these differences are attributable to racial differences in labor market experience, such as a higher unemployment rate and more part-time work.[8] These differences lead to lower average earnings than white persons and differential access to employer-sponsored retirement plans.[9] Some of the differences in retirement resources, however, are also attributable to racial differences in saving decisions. For instance, 401(k) participation and contribution rates are lower among black workers than white workers, and investment choices are sometimes different.[10] In most (although not all) instances, these differences in labor market experience and saving choices adversely affect African Americans' retirement security.

A. Differences in labor market experience

African Americans are more likely to be unemployed than white persons. Unemployment rates are 50 percent higher among African Americans than white persons (Table 3). In fact, higher unemployment rates among African Americans are apparent across all education groups, including among college graduates who, as a group, tend to have the lowest unemployment rate among all workers.[11]

Even among those who are employed, labor market outcomes between African American and white workers differ. A larger fraction of black workers are employed in low-wage occupations than other workers: 15 percent of low-wage workers are African Americans, yet African Americans comprise only 11 percent of

Table 3. Labor Market Outcomes by Race and Gender

	All Men	White Men	Black Men	All women	White women	Black women
All workers						
share of all workers[1]	53.2%	44.5%	5.3%	46.9%	37.5%	6.2%
share working part-time[1]	12.3%	12.3%	13.2%	27.1%	28.5%	20.1%
share working in public sector[7]	16.0%		20.4%	16.0%		20.4%
job tenure: percent with 20+ years (at current job)[4]	na	10.8	8.9	na	8.7	7.7
All workers						
median hourly wage[2]	$15.04	$16.82	$12.23	$12.18	$12.94	$11.14
annual earnings[3]	$42,210	$47,814	$34,480	$32,649	$34,133	$30,398
All persons						
employment rate[1]	73.3%	74.7%	63.6%	60.7%	60.7%	61.6%
unemployment rate[6]	4.7%	4.2%	6.1%	4.5%	4.0%	7.5%
labor force participation rate[5]	73.5%	74.3%	67.0%	59.4%	59.0%	61.7%

Source notes: (1) Authors' calculations based on 2006 data from Table PINC-05 from the 2007 March CPS (now called the "Annual Social and Economic Supplement").
(2) Median hourly wage info comes from 04/05 SOWA, pp. 166 and 167. The data are for 2003.
(3) Median annual earnings for 2006 (in 2006$) from Table 7, p. 6 of Census Bureau's Income, Earnings, and Poverty Data, American Community Survey, 2006.
(4) Source is Table 593 "Distribution of workers by tenure at current employer" from 2007 Stats Abstract. 9.4% is the national average (across all sexes and races).
(5) 2006 data from Table 570 of the 2007 Stats Abstract.
(6) From www.bls.gov/cps/cpsaat3.pdf--"Employment status of the civilian non-institutionalized population by age, sex and race."
(7) Figures listed are for workers regardless of gender based on authors' calculations using data from 2007 Current Population Survey.

the total workforce.[12] In addition, among men, African Americans are more likely to work part-time than whites: 13.2 percent of black men work part-time compared to 12.3 percent of white men.[13]

Lower earnings

As a result of these labor market differences, black families tend to have lower earnings than white families. As a group, black men earn about 72 percent of what white men earn and black women earn 86 percent what white women earn (Table 3).

Low-earning households save less (in levels) than high-earning households because they have a lower base from which to save. In addition, there is some empirical evidence that suggests that households with low incomes tend to save a smaller fraction of their incomes than high-income households.[14] Thus, the combination of a lower base for saving and lower savings rate partly explains the racial gap in net worth.

Differences in earnings also have implications for retirement resources because retirement balances and pension payments often are tied to earnings.

Under a DC retirement plan, such as a 401(k) plan, the employer's contribution to the plan typically is a fixed percentage of the worker's earnings. Consequently, African American workers with lower earnings would receive lower levels of employer contributions than other workers with higher earnings.

Likewise, DB plans typically compute pension payments based on earnings and years on the job. Accordingly, workers with lower earnings accrue lower pension benefits than higher-earning workers and, workers with shorter tenure on the job accrue lower pension benefits than those with longer tenure. On average, African American workers have lower earnings and they have shorter job tenure than other workers (Table 2); which means they are more likely to accrue lower pension benefits in DB plans than other workers.

Differences in private-sector employer-sponsored retirement coverage rates

Racial differences in labor market experience also lead to differential access to employer sponsored retirement coverage. In the private sector, black workers are less likely to be offered retirement coverage than other workers because they are more likely to work in part-time and lower-wage jobs, which typically do not offer coverage. The private-sector coverage rate for African Americans is about 3 percentage points lower than the national average.[15] Compared to white workers, the gap is even greater: 50 percent of white workers in the private sector are covered by an employer-sponsored retirement plan compared to only 42 percent of African American workers.[16]

Furthermore, private-sector African American workers may become increasingly less likely to have coverage relative to other private-sector workers. Between 1979 and 2004, coverage rates in private-sector employment fell by about 10 percentage points among workers with a high school education (to about 40 percent), but stayed stable at about 60 percent for college-educated workers.[17] Since a higher proportion of African American workers have a high school education or less, to the extent that the trend continues, the gap in coverage rates between African American workers and white workers in the private sector may increase.[18]

Differences in public-sector employment

Black workers, however, are more likely to be employed in the public sector than other workers.[19] This difference in public sector employment places black workers on a more favorable footing for retirement than other workers because most public sector employers offer pension coverage and the coverage is typically in the form of a DB plan.[20] One of the advantages of DB plans over 401(k)-like plans is that workers generally are not responsible for making participation and contribution decisions: they are automatically enrolled in the plan if they are eligible, contribution rates are pre-determined and the assets are

Table 4. Wealth and Asset Holdings of Pre-retired Households, by Income Group

	Below the poverty line		Median Income Groups		Top Income Decline Group		Top Black
Mean values (Median values)	Black	All Households	Black	All Households	Black	All Households	Income Decile Group
Wealth (net worth)	$30,100 [$0]	$80,100 [$10,000]	$79,000 [$47,000]	$199,500 [$95,000]	$978,400 [$450,400]	$1,559,000 [$708,000]	$556,200 [$257,500]
Wealth less housing equity (net worth less housing)	$5,000 [$0]	$36,800 [$1,000]	$38,000 [$11,000]	$119,700 [$32,800]	$839,500 [$250,400]	$1,239,100 [$479,500]	$426,000 [$120,100]
Financial Assets	$3,100 [$0]	$15,900 [$0]	$10,800 [$1,000]	$42,300 [$4,500]	$127,700 [$13,000]	$474,400 [$90,000]	$70,700 [$11,500]
IRA/DC	$3,900 [$0]	$14,300 [$0]	$32,600 [$0]	$56,700 [$0]	$198,000* [$21,000]	$169,300 [$50,000	$152,500 [$15,000]
Number of Observations	257	800	256	1,457	30	484	88

Notes: Mean values, with medians reported in parenthesis.
** Because of the small sample size, the mean value for IRA/DC balances is skewed upwards by the presence of a single black household with a very sizeable DC account balance.*
Financial assets includes stocks, bonds, certificates of deposits and balance in checking and savings accounts
Networth includes financial assets, housing equity, value of transportation, value of business, farm and real estate, IRA, assets in trusts and other assets.
Source: Authors' calculations using data from the 2004 Health and Retirement Survey

professionally managed. Generally, these features are beneficial to all workers (because inertia can prevent or delay a worker from participating) but they are particularly beneficial to low income African Americans who, as a group, tend to have less financial market experience and lower financial literacy than other workers.[21]

The other advantage of DB coverage over DC coverage is that benefits from a DB plan are payable for life (that is, as an annuity); whereas, the majority of DC plans do not even offer the option to annuitize plan balances. Retirees in DC plans, therefore, must manage their assets to last their lifetime and face the possibility of outliving their resources should they live longer than expected. Thus, African American retirees who, on average, have greater access to DB pensions are better protected from the risk of outliving their resources than workers with DC-type retirement coverage.

B. Differences in saving decisions

While racial differences in earnings and access to employer-sponsored retirement plans lead to racial differences in retirement account balances, the choices that black workers make regarding retirement saving may further amplify these differences. Even when black workers are offered employer-sponsored retirement coverage through 401(k)-type plans, they make choices about (i) whether to participate in 401(k) plans, (ii) how much to contribute, and (iii) how to invest their saving, that lead to lower relative savings in these retirement accounts.

For example, among workers who have access to 401(k)-type plans, black workers are less likely to participate in these plans than white workers. One study found that in 2004 only 50 percent of eligible black private sector workers participated in their employer's retirement plan compared to over 59 percent of white workers.[22] By not participating,

workers are also losing any employer-matching contributions they might have received had they contributed to their 401(k) plan and the tax advantages that come with saving in these employer-sponsored retirement accounts.

There also is some evidence that 401(k) contribution rates among African Americans with DC plans are smaller than those of other households.[23] Estimates suggest that among workers who participate in a 401(k) plan, the average 401(k) contribution rate for African Americans is 4.2 percent, while it is 5.5 percent for whites and 5.4 percent across all DC plan participants regardless of race. This same study reveals that more than half of African Americans contribute 4 percent or less of their salary to their 401(k) account.[24]

Additionally, African Americans appear to be less likely than white workers to invest in and hold high-yielding assets, such as stocks, than the average U.S. family.[25] To the extent that investment returns are lower as a result, the accumulated savings over time for a black worker would be lower than that of a white worker, on average. This difference in investment choices may partly explain the difference in accumulated assets between retired African Americans and comparably-aged households. At the median, African American households age 70 or older hold about $300 in financial assets compared to $13,000 held by the median retired household nationwide.

III. Income-Adjusted Differences in Retirement Resources

It is important to note that the comparisons of net worth and other retirement resources discussed in the previous section have been between groups with potentially very different income. As noted earlier, the earnings of black and white workers differ. Moreover, Black families have lower income than other families, on average, and a disproportionately higher fraction of black families are in the nation's lowest income group. The median income for African American families nationwide is about two-thirds that of the typical U.S. household ($32,000 for blacks compared to $48,000 for the typical U.S. household).[26] In addition, 17 percent of African American families are poor compared to 7 percent of white families and the national average of 8 percent.[27]

In order to assess the relative retirement preparedness of African American families, therefore, it is useful to juxtapose families with comparable incomes. The key question then becomes whether African American households will have comparable retirement resources as other households with similar income. In this section we examine wealth levels of households, controlling for income. This income-adjusted comparison of wealth also would illuminate whether there are factors beyond income that differentially affect black and white households' retirement security. A cursory comparison of

income ratios (two-thirds) to wealth ratios (ranging from one-twelfth to one-quarter) suggest that other factors may play a role.[28]

Table 4 presents data covering near-retired households who are in the lowest income group (living below the poverty line), those who are middle income, and those who are among the top 10 percent of the richest U.S. households.[29] As shown in Table 4, the wealth gap persists when comparisons are restricted to households with similar income. This result is consistent with findings from other studies.[30] The gap is narrower for households in the highest income group (at the median, the wealth ratio is between one-half and two-thirds) but is wider for households in the lowest income group.

As noted in Table 4, the typical (or median) poor African American household has virtually no savings (zero IRA/DC balances, financial assets, and net worth); whereas, the typical poor U.S. family has accumulated a small amount of wealth (primarily from equity in their home).[31] Among middle-income households, the typical African American household still has lower savings than other households. The net worth of a typical pre-retired middle-class black family is only about half of the net worth of a typical pre-retired middle-class household in the population at-large ($47,000 compared to $95,000 respectively), indicating that even middle-class blacks will be entering retirement with fewer resources than other Americans.

Similarly, black households in the top 10 percent of income have lower net worth than comparable households.[32] While the typical rich household in the United States has accumulated about $50,000 in retirement savings in IRA/DC accounts and about $90,000 in financial assets, the typical African American household in the nation's top income group has an IRA/DC balance of just $21,000 and financial asset holdings valued only at $13,000.[33] Blacks therefore have a resource deficit even when one considers the most well-to-do Americans.

Few black households, however, have incomes that place them in the top 10 percent of all Americans. In fact, black households that are in the top 10 percent of income among other black households have substantially lower income and lower net worth than those in the 10 percent of the U.S. population ($257,500 compared to $708,000). Comparing liquid wealth, such as financial assets, the typical black household at the top of the African American income distribution has no more than one-eighth the assets of typical rich household (Table 4). Accordingly, African Americans who may very well consider themselves rich relative to their peers still lag far behind many other U.S. households when entering retirement.

IV. Retirement Adequacy

The analysis to this point has focused on household net worth primarily, which includes the value of home equity, financial assets, and savings in tax-deferred retirement accounts, such as IRAs and 401(k)s. The measure of net worth, however, does not include expected claims to future benefits from Social Security and DB pensions. As we noted earlier, the importance of Social Security and pension benefits vary across households and, for some, these benefits can account for a substantial portion of retirement income. Because Social Security benefits are progressive, in that benefits replace a higher portion of earnings for low income workers than for high-income workers, and because black households on average have lower income than other households, the omission of Social Security benefits from household resources would tend to overstate the differences in retirement preparedness between black and white households. Similarly, to the extent that black workers are more likely to receive DB benefits than white workers, the omission of DB payments would overstate racial differences in retirement resources.

Income replacement rates

A more appropriate comparison of relative preparedness of those not yet retired therefore would account for these expected sources of funding, in addition to accumulated assets.[34] One common approach is to evaluate whether and to what extent a household's expected retirement resources (including all saving, Social Security and DB benefits) are sufficient to maintain their pre-retirement standard of living throughout retirement. That is to say, what percentage of the household's income before retirement can be replaced by accumulated savings and claims to benefits in retirement (the income replacement rate). It is generally thought that an income replacement rate of 75 to 80 percent would be needed to finance consumption during retirement and maintain pre-retirement standards of living.[35]

Estimates of expected mean retirement income of African American and white families suggest that the average African American family could expect to have a replacement rate of 73 percent of pre-retirement income, whereas the average white family could expect to replace 83 percent of their pre-retirement income, when pension wealth and social security are included.[36] Thus, even after accounting for expected Social Security and DB benefits, a gap still exists in the degree to which African Americans and white families are prepared for retirement: African Americans lie near the lower end of the range deemed adequate to maintain their living standards while whites are slightly above the top of the range.[37]

Moreover, a recent study that examines families below the adequate range reveals that 40 percent of African Americans could expect to have a replacement rate that is lower than 50 percent; whereas only about one-quarter of white households had estimated replacement rates in that range.[38] Thus, a significant minority of households will

not be financially prepared for retirement and a disproportionate number of those households are expected to be African Americans.

V. Other Explanations for the Income-Adjusted Racial Wealth Gap

In this section, we review some possible reasons for the observed wealth gap between black and other families with comparable income. We focus on differences in family ties and networks, which result in differences in family risk-sharing, financial transfers, and financial literacy.

It is common to view household saving as a process governed solely by factors affecting the nuclear household however, there is increasing evidence to suggest that relationships with extended family members may affect the way that individuals prepare for retirement. Sharing resources, such as housing, may help older households meet some of their retirement needs and help some families accumulate wealth. At the same time, intra-family transfers to support poorer kin members also may depress younger generations' ability to save for their own retirement. Furthermore, knowledge and skills about saving could be shared within the family, so young African Americans from lower-income families may not have the same learning opportunities as those from higher-income families.

Family Networks

Economists have argued that families can do almost as well as insurance markets in protecting against adverse events if family members pool risks and resources.[39] Choosing to pool risks and resources within the family can allow an individual who suffers a loss of income to rely on other family members to help finance consumption when he or she experiences the loss in income, which mitigates the need to save and shore up contingency reserves for the situation.

It is well-documented that minority families, including African American families, are more likely to live in extended households than non-Hispanic white families.[40] Nearly one in four African Americans lives in an extended household compared with only one in ten non-Hispanic white persons.[41] Furthermore, these racial differences in extended family living arrangements remain even after controlling for economic characteristics. One study finds that blacks and Hispanic households are 14 percent more likely than non-Hispanic white households to be extended.[42]

To the extent that families that live together are more likely to help each other financially, the higher presence of extended households among African American families than non-Hispanic white families may explain part of the racial difference in wealth among those who are near retirement. Potentially, individuals may decide they do not need to save large sums independently because they believe they can rely on other family members for assistance.

Evidence suggests that among single elderly women, co-residence with other family members appears to alleviate poverty for nearly one out of every seven household, for example.[43] Similarly, single women benefit from co-residing with other family members – regardless of their racial background. However, because elderly African American women are 1.5 times more likely to be single than elderly non-Hispanic white women and a greater proportion of younger single mothers are African American than white, extended kin networks may represent a more important resource for both young and old black women than white women.[44]

Even individuals or families that do not reside together may choose to share resources and to pool risks. Some studies suggest that African Americans are highly embedded in kin networks.[45] If individuals who are accustomed to turning to relatives in times of financial need can expect to rely on such family assistance during retirement, they would have less incentive to save independently for this life stage.

Financial transfers between family members

While family structure and participation in kin networks can provide a barrier against poverty and act as a kind of retirement resource for the old, other studies suggest that African Americans' entrenchment in family networks actually may depress their ability to save while they are young. In particular, two studies find that middle class African American adults are more likely to have poor relatives than other middle class individuals, and that the presence of poor relatives throughout the family tree is negatively correlated with an individual's wealth.[46] The authors argue that the total amount of savings that a middle class African American household is able to accumulate during its working years is reduced because of the need to assist poor parents through financial transfers.

Financial transfers from older family members to younger members, on the other hand, can be beneficial for building wealth. In the empirical research that examines the effect of bequests and inter-vivos transfers on wealth accumulation there is general agreement that the receipt of financial transfers can positively affect the recipient's ability to accumulate wealth. Financial assistance to pay for schooling, for example, will improve an adult child's future earning opportunities; and a down payment gift to facilitate the purchase of a home will reduce the amount of debt that one's offspring has to take on to purchase a home. Thus, transfers can help younger generation family members build wealth earlier than they otherwise would. The literature has shown that African Americans are less likely to receive these types of transfers, even after controlling for the economic resources of the adult child.[47] Most studies agree that this implies that young black families are at a disadvantage relative to other families that do receive financial assistance (at least in theory). There is less agreement, however, about the volume of transfers that occur, and

whether they have large effects on children's saving behavior, and the exact extent to which they create a sizeable gap between the wealth held by African American and other households.[48]

Financial Literacy

Another possible consequence of African Americans' greater likelihood of having poor relatives throughout the family tree is that blacks are subsequently less likely than those with wealthier kin networks to acquire knowledge, skills and opportunities related to saving and perhaps more basic understanding of financial matters. Research suggests that attitudes about saving, risk preferences and investment choices may be learned or mimicked from parents.[49] These wealth-enhancing "traits" are more likely to be transferred to children by wealthy parents, who have greater understanding, access to, and knowledge about financial markets, than low-wealth parents.[50] There is also increasing evidence that financial illiteracy is widespread among the U.S. population but it is particularly acute among specific demographic groups, such as those with low education, women, African-Americans, and Hispanics.[51]

Financial literacy can have a significant effect on retirement outcomes. Studies show that those with greater financial literacy are more likely to plan for retirement and planners are more likely to approach retirement with higher wealth levels than non-planners.[52] Evidence also suggests that those who have low financial literacy are significantly less likely to invest in stocks.[53] Thus, differences in financial literacy and financial market experience between African Americans and whites could explain part of the wealth gap.

What is less clear, however, is whether these differences in financial literacy and financial market experience remain after controlling for income differences. In any event, because middle class African Americans are more likely to have poor parents than white middle class families and to the extent that poor parents are less likely to be financially literate, middle-class African Americans may be less financially literate than middle-class white families.

VI. Policies

The paper has documented lower retirement resources among African American households than other households, even after controlling for differences in income. The previous sections have highlighted several key elements that differentially affect African Americans' saving levels; in particular, differences in labor market experience, differences in saving decisions, and differences in family structure and networks. Most of these differences adversely affect African Americans' retirement security; although some (such as greater public sector employment and family risk sharing) provide them with better protection from certain risks in retirement than what is available to other households.

Our proposals to improve retirement security for African Americans focus on three areas in which African Americans differ from white household and for which there are demonstrable effective policy interventions. First, we focus on reducing information gaps and improving financial literacy of African Americans, which studies suggest would improve planning and investment choices by African Americans and, ultimately, could increase accumulated balances in retirement accounts. Second, we propose wider adoption of automatic features in 401(k) plans and IRAs, which would circumvent underlying reasons for the racial disparity in saving choices and improve participation and contribution rates, as well as investment outcomes, for African Americans. And, third, we propose improving saving incentives that specifically target lower- and moderate-income workers, who are disproportionately African Americans in part because of racial differences in labor market experience.

We do not present proposals to alter family structure differences that were analyzed above since there are both advantages and disadvantages to these family networks.[54] Neither do we offer proposals aimed at correcting labor market differences between blacks and whites. We note, however, that the labor market differences discussed above undoubtedly are attributable to several causes: differences in levels of education, differences in geographic proximity to "good" jobs, differences in social networks, or employer discrimination for example. Labor market discrimination, in particular, could lead to lower wages, jobs with lower benefits (such as lower or no retirement coverage) or even difficulty securing a job.[55] Some studies estimate that racial discrimination reduces the earnings of black workers by about 12 to 15 percent of white workers, even after other factors that affect wages are controlled for.[56] However, there is still little consensus over the magnitude of racial discrimination that prevails in labor markets.[57]

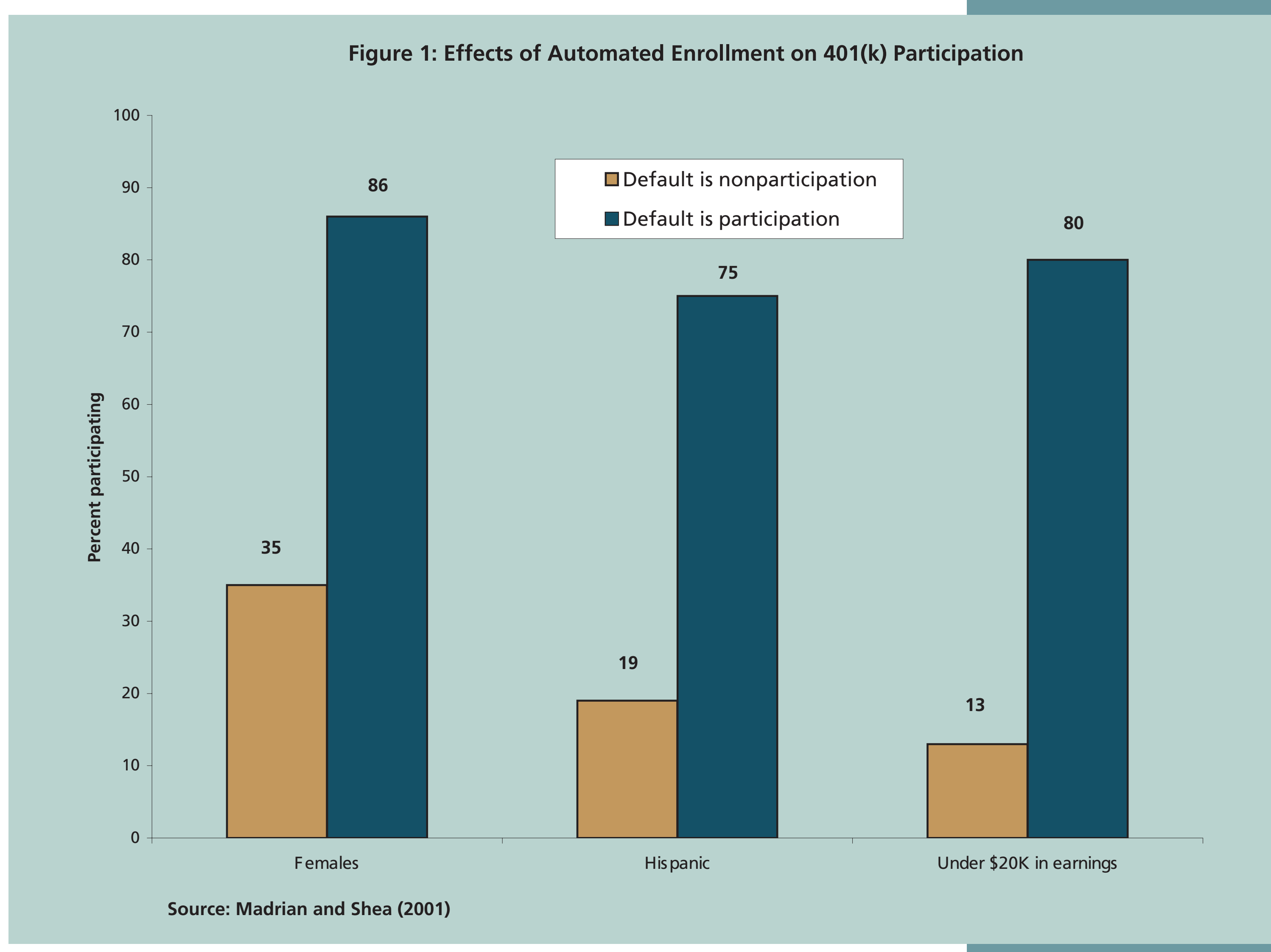
In addition, discrimination outside the labor market can influence households' total wealth by creating barriers to fair and reasonable rates of interest on loans, and by reducing homeownership. Since homeownership is one of the primary mechanisms through which individuals build wealth, discrimination against African Americans in housing markets or lending practices could lead to sizeable racial differences in wealth. Studies have found evidence of racial discrimination in housing markets — in seeking a home and in securing a mortgage.[58] Other research also suggests that when African Americans do succeed in purchasing homes, residential segregation in housing markets may lead to situations in which the homes that blacks acquire tend to appreciate less than those of other families.[59] While all these issues are pertinent to African American retirement security, addressing discriminatory access to labor, housing and credit markets, however, are outside the scope of this paper.

A. Financial Mentoring

The research discussed in Section III suggests that attitudes about saving and investment choices may be learned from parents or mimicked and, thus, would be important for the accumulation of savings – but children from moderate- and low-income African American families lack access to this source of information. This suggests that one possible strategy to increase retirement saving and investment outcomes among African American families would be to design policies that remedy these information gaps. Then, individuals who are born into homes with limited information would be able to save as effectively as those born into families with financial market expertise.

Attitudes about saving are likely formed from an early age. Habits learned from when one is young tend to carry into adulthood. If children are encouraged at a young age to start saving and notions of budgeting are integrated into their daily lives, it may instill a positive attitude towards saving over their adult years. Furthermore,

Figure 1: Effects of Automated Enrollment on 401(k) Participation



Source: Madrian and Shea (2001)

if children are introduced to financial institutions and financial terminology and given an opportunity to make financial decisions, it may help overcome barriers (either informational or psychological) that have previously inhibited participation in financial markets.

One approach, therefore, might be to develop a mentoring program targeted at very young children. The approach might couple young children with a financial institution that provides ongoing financial mentoring to the child over a period of time. The mentoring would begin at a very young age – as early as age 6 – and continue until the child reaches age 18. At very early ages, children would be given simple financial goals, such as opening a savings account. As they get older and become more familiar and comfortable with money management, the mentoring would include discussions about saving with a target or for a particular outcome, long-term versus short-term saving goals, access to credit and paying down debt, and, if account balances are large enough (for older children), diversifying funds. It also could include discussion of realistic expectations about retirement and sources of retirement income.[60]

Such a mentoring program might be operated with the partnership of a financial institution and through the public schools. Mentors from financial institutions would make regular and periodic visits to schools. At these visits, the mentor would talk about financial matters – in the way that families may talk about their finances. The mentor would discuss saving goals (such as preparing for college expenses, saving for Christmas), how an economic up- or down-turn might affect a personal saving goal (such as working through the effect of a gas price increase or an increase in public transportation costs on a personal budget), or how changes in interest rates or equity returns might affect saving goals. The type of discussion and the frequency of these visits would vary with the age of the audience.

When designing such a proposal, it may be important to create a sense of ownership over the account and funds in the account. Children would be encouraged to open a saving account and contribute to that account. Their account balance will likely be low but small account balance would be less of an issue to children; rather a tangible reminder of its presence may be more satisfying to them. One possibility might be to have the financial institution issue a Passbook for the savings account. A Passbook would simply be a book that logs all transactions and remaining balance in the savings account. However, because the Passbook is owned by the child, maintained by the child and is a tangible and visual reminder of their savings, it may generate a stronger sense of ownership and achievement. The Passbook would likely have a more meaningful effect at younger ages or among those with less access or facility with online banking options, and its appeal may diminish with age or access. However, its may still serve to inculcate a pro-saving attitude among very young children and its benefits might be expected to survive beyond the functional usefulness.

There are a number of existing programs that provide financial education and literacy training to children and adults.[61] Many of the programs that target children tend to focus on high-school age children.[62] A small number of programs focus on those younger than high school but these tend to be short-term education programs and they do not offer long-term financial mentoring.[63] Children from families with financial market experience, however, learn from multiple and ongoing interactions regarding money management from their parents. Financial goals and needs change with age and circumstance, and the skills to adjust with these changes can only be acquired through a gradual but sustained mentoring program and none of the existing programs currently offer an ongoing, sustained mentoring opportunity.

Some of the existing programs may offer opportunities or platforms for providing long-term financial mentoring from a very young age, however. These include the Personal Economics Program offered by the American Bankers' Association that puts banks together with educators to teach people, including children, about banking services and financial management.[64] Additionally, many of the 12 Federal Reserve District banks work with local organizations to provide 'teach the teacher' or 'train the teacher' programs in an attempt to ensure that educators have the knowledge and resources that they need to teach financial and economic topics in an effective manner. Finally, Banking on Our Future is a program that links volunteer banker-teachers with neighborhood schools, community groups, and beacon programs. The youth are taught the basics of checking and savings accounts and the impact that credit and investment can have on their lives.

B. Automatic Saving

Financial mentoring alone, however, would be insufficient to ensure retirement security for many Americans. Many individuals, even those who are financially savvy, are at times too busy to take the time or the effort to sort through complicated financial decisions. As a result, they either postpone making these decisions or rely on simple rules of thumb that sometimes do not result in prudent investment choices.

For instance, many workers are offered the opportunity to save through their employer's 401(k) plan, yet many do not participate in the plan. In many 401(k) plans, workers must make an active decision to participate in the plan. However, participating involves more than simply filling out a form (either paper or electronic). Workers must decide how much to contribute and which investment option provided by their employer to select. These decisions are complicated and make the 401(k) enrollment decision daunting, particularly for workers who have limited investment experience. As such, many workers postpone or avoid making the enrollment decision.

Non-participation is particularly high among lower-income and minority workers.[65] It is also higher for African Americans than white workers (as noted previously). By not participating in the

401(k) plan, African American workers miss the opportunity to benefit from any employer matching contributions and the tax savings from contributing to a 401(k). Furthermore, by delaying participation, they lose the opportunity of letting compounding returns grow their assets over time.

Automatic Enrollment

A strategy that has proven successful at getting workers to participate in their 401(k) plan is to change the default option from an opt-in system to an opt-out system. Under an opt-out system, workers are automatically enrolled into their company's 401(k) plan, unless the worker affirmatively chooses not to participate. With automatic enrollment, the employer selects a default contribution level and at each pay-period, that portion of the worker's paycheck is directed into a default investment fund.

Automatic enrollment in 401(k) plans has been shown to increase participation significantly: in firms that implemented automatic enrollment, participation rates increased from 75 percent to as high as 95 percent among new hires.[66] The effect was even more dramatic among women, minority and low-income workers – increasing participation rates from 35 percent to 86 percent for women and from 13 percent to 80 percent for workers earning under $20,000 a year (Figure 1).

With automatic enrollment in 401(k)s, workers who are unable or unwilling to make decisions about their 401(k) participation (because it is too complicated or they do not have the time) would still be able to participate in the plan. Automatic enrollment harnesses the power of inertia so that individuals save even if they make no effort. For African Americans who are eligible but do not participate in their 401(k) plan, automatic enrollment may "turn the tide" for them and help them save earlier than they otherwise would have and earn investment returns over a longer period of time.

Automatic enrollment in 401(k) plans is most effective when it is combined with other automatic features. These include automatic enrollment with automatic increases in contribution rates over time, automatic investment in prudent and diversified funds, and automatic rollover of 401(k) assets when the worker leaves a job. Plans with these enhanced automatic features ("second generation" plans) would help workers gradually save more over time, improve investment returns in their portfolios and retain assets in the retirement system when they change jobs.

Automatic Escalation

Many "first generation" plans typically enroll only new workers at a 3 percent contribution rate and do not increase contribution rates over time. The typical default 3 percent rate, however, is less than half the average pre-tax contribution rate of 7 percent of pay among participants in non-automatic 401(k) plans.[67] Furthermore, the majority of participants who are enrolled under automatic enrollment tend to remain at the initial

contribution rate if the company does not automatically increase their contribution rate over time.[68] Inertia keeps workers from saving more over time.

Building in annual increases in contribution rates (automatic escalation) would help workers gradually save more over time with virtually no effort. Contribution rates could be increased by one percent per year, unless the participant opted-out of those increases. Additionally, a "second generation" plan might enroll new and current non-participating workers at a higher initial contribution rate, such as 5 or 6 percent.

These enhancements would help workers save more and take advantage of any additional employer matching contributions which they may have previously missed. Currently, about one quarter of employers that offer automatic enrollment also automatically escalate contributions.[69] Wider adoption of automatic escalation would, over time, improve the financial position of many lower-income families, particularly African American families, who tend to have lower saving rates than higher income households (as discussed earlier).

Automatic Investment

Research shows that many 401(k) participants tend to make poor investment choices: they over-invest in company stock, are too conservative in their investment choices or seldom rebalance their portfolios as they age. Whether because of limited time or expertise, these choices either expose them to too much risk or to low investment returns over time. We also noted earlier that African Americans, on average, are less likely to hold stocks than white households. The result of this differential investment choice is that investment returns for African American households, on average, are lower than that of white households.

Many "first generation" automatic 401(k) plans typically default contributions into a stable value or money market fund. These tend to have lower investment returns than more diversified equity funds, such as life-cycle funds. However, recently promulgated regulations provide employers and plan sponsors some degree of fiduciary relief if they offer qualified default investment alternatives (QDIAs) that are professionally managed or balanced (such as life-cycle funds). These QDIAs not only provide higher investment returns than stable value funds, the portfolio is rebalanced over time to reflect changing retirement expectations and risk exposure. The default investment options would benefit all workers with DC coverage but they would be particularly valuable to African American participants by offering the potential for higher investment returns over time than might be achieved otherwise.

Adoption of Automatic 401(k)s

Recently enacted legislation through the 2006 Pension Protection Act (PPA) addressed several employer concerns regarding automatic 401(k)s and provided new incentives to encourage

more employers to adopt automatic 401(k)s.[70] Since the enactment of PPA 2006, the number of employers offering automatic 401(k)s has increased. In 2007, 44 percent of surveyed employers reported using automatic enrollment, an increase from 26 percent in 2006. The number offering automatic 401(k) is expected to increase further over time as other incentives offered by the PPA (such as, enhanced safe harbor plans, which offer automatic enrollment, escalation and investment) become effective.

Automatic Rollover

Under automatic rollover, when an employee changes jobs, the funds in her 401(k)-type account would be automatically rolled over into an IRA or another retirement plan offered by the new employer. The worker, however, can affirmatively choose not to roll over her funds. Many workers, particularly those with small account balances, tend to cash out their accounts when they leave a job; thereby, losing the value of the tax-preferred saving and leaving them with less retirement saving. Recent empirical evidence suggests that simply changing the frame within which workers evaluate their options for pre-retirement distributions can retain assets in a tax-preferred retirement accounts and prevent "leakage" from the retirement system.[71] In this way, automatic rollovers help to keep retirement funds in the retirement system when workers change jobs by making rollovers the default option.

These strategies discussed above will benefit all workers with access to employer-sponsored retirement plans. However, they will be particularly beneficial for African American workers who, on average, have lower earnings, tend to invest in lower return assets, and face higher risk of job disruptions than white workers.

Automatic IRAs

A significant minority of African American persons, however, do not have access to employer-sponsored retirement plans because they are employed in low-wage or part-time jobs. These workers would not benefit from the automatic 401(k). However, a new proposal would create a system whereby workers without access to employer-sponsored retirement plans can contribute automatically to a low-cost, diversified IRA through direct payroll deposits. Because IRAs are portable and are not tied to a particular employer, employees would be able to continue contributing to the IRAs even when they switch jobs.[72]

Under this proposal, workers would be enrolled in an IRA and deposits to the IRA will be made automatically at each pay period, unless the employee actively chooses not to participate in the program. A firm that is not ready to adopt a 401(k) or other retirement plan would offer its employees the ability to save in an IRA every payday by payroll deposit, which is currently available to millions of employees. Once payroll

deposits begin, they continue automatically unless the worker later opts out. Employers above a certain size (e.g., 10 employees) that have been in business for at least two years and do not sponsor any retirement plan for their employees would be required to offer employees this payroll-deduction saving opportunity.

The automatic IRA would involve no contributions or other outlays by employers. Employers would merely offer their payroll system as a conduit that employees could use to save part of their own wages in an IRA. Participating employers would receive temporary tax credits, would be required to obtain a written waiver from any employee who does not participate, would be encouraged to use automatic enrollment and would be able to protect themselves from fiduciary liability. Employees, or the employer, could designate the IRA to receive the savings, including, as a fallback for those unable or unwilling to choose, a national platform IRA that could be based on the federal employees' Thrift Savings Plan accounts. The default investment for the automatic IRA would be a diversified, low-cost life cycle fund, with other choices available.[73] The self-employed would be encouraged to save by extending payroll deposit to independent contractors, facilitating direct deposit of income tax refunds, and expanding access to automatic debit arrangements linked to IRAs, including on-line and traditional means of access through professional and trade associations. Thus, for many workers without access to 401(k)-type plans through their employer, including African American workers, the automatic IRA will make it easier for them to save in a tax-preferred environment. Additionally for African Americans, the automatic IRA with a default investment fund, such as a life-cycle fund, may provide higher returns than they otherwise would earn.

C. Saver's Credit

While 401(k)s and IRAs represent effective instruments for saving for retirement because of their tax-preferred status, for many low income families, including some African American families, the incentives to save in a tax-preferred retirement account may be small. Contributions to tax-preferred retirement accounts reduce the saver's taxable income; thus, they generally benefit those with higher marginal tax rates more than those with lower marginal tax rates. Low income families tend to face low marginal tax rates or to pay no taxes at all. They therefore stand to benefit less than other workers from tax incentives that reduce taxable income, or not at all.

Tax credits, however, can be used to create strong incentives for low- and moderate income households. For example, the Saver's Credit, which specifically targets moderate- and lower-income families, was enacted in 2001 to give taxpayers earning less than $52,000 a tax credit

for contributions to 401(k) plans, IRAs, and similar retirement saving vehicles.[74] Depending on the taxpayer's income, households can receive a credit of 10, 20, or 50 percent of their contributions to a retirement account. Because African American families tend to have lower income than then the average American family, they would disproportionately benefit from the Saver's Credit.

The Saver's Credit, however, is currently nonrefundable: it merely offsets a taxpayer's tax liability. Therefore, it provides no saving incentive for almost 50 million lower-income households that have no income tax liability. Making the Saver's Credit refundable would provide an important incentive to these households to save, which would improve retirement security for those families with the lowest incomes. This might have the added benefit of making them less dependent on Social Security income and means-tested government programs during their retirement years. There is also some evidence that restructuring the credit as a matching contribution that is automatically deposited into an IRA could further increase the incentive to save.[75]

The Saver's Credit also could be simplified with a single 50 percent credit rate, phased out smoothly above the income eligibility limit. It could be improved to reach a larger group of families by expanding the eligibility limit to include households with income of up to $70,000 per year. This would increase the incentive to save and help moderate and lower-income Americans, which includes many African American families, save for a secure retirement.

D. Updating Asset Test Rules

One final way that policymakers can introduce reforms that improve the incentive to save is by modifying the rules for eligibility for public assistance program. Outdated asset tests in means-tested public assistance programs (such as Supplemental Security Income (SSI), Temporary Assistance for Needy Families (TANF) and Medicaid) penalize lower- and moderate-income households that save.[76] There programs help individuals in times of unexpected hardships or illness, or who may not have had a full working history and rely on these sources of public assistance to supplement their retirement needs. Beneficiaries of many of these programs are disproportionately African Americans.[77]

To be eligible for these programs, applicants generally must meet an asset test as well as an income test. While the asset tests usually do not count accrued benefits under a defined benefit plan as assets, many states often count 401(k) or IRA balances or both. This has the effect of a steep implicit tax on 401(k) and IRA saving. As a result, pre-retired families with incomes low enough to qualify for a means-tested program under the income test might respond by saving less. Similarly, families that suddenly experience a temporary disruption in employment would be required to nearly deplete their retirement savings before becoming eligible for the public assistance.

Although some state programs have eliminated asset tests, or at least aligned the treatment of defined contribution plans with that of defined benefit plans, many have not. The recently enacted 2008 Farm Bill addresses the inconsistent treatment of assets in tax preferred retirement accounts in the food stamp program by excluding those assets from the asset tests. However, asset tests in other public programs, such as SSI and Medicaid, continue to treat retirement saving in a confusing and seemingly arbitrary manner, with different restrictions state-by-state and account-by-account.

Congress and the states should therefore eliminate the implicit tax on retirement saving in these programs by mandating that retirement accounts such as 401(k)s and IRAs be disregarded for eligibility and benefit determinations in federal and state means-tested programs.[78] Changing the law to exempt retirement accounts from being considered in means-tested programs would treat retirement savings fairly and consistently and would send an important signal to families that rely or might need to rely on means-tested programs in the future: you will not be penalized for saving for retirement.

Eliminating asset rules for retirement savings will have some short-term costs as additional lower-income households will qualify for and use means-tested benefit programs. However, these costs should be modest; and if moderate- and low-income households can save for a more secure retirement, fewer people will have to rely on public benefits in old age.

V. Conclusion

Many African Americans have low absolute levels of retirement savings, and blacks' savings are low relative to the population at-large. Because private savings and employer-sponsored pensions are key components of the retirement system in the United States, the observations that personal savings, pension coverage rates, and pension balances are all low present cause for concern, raising questions about how blacks will fare in retirement and whether anything can be done to enhance their preparedness for this life course event. There are several policy options that are promising. Policies to boost retirement savings by remedying information gaps, by making it easier to save, by expanding access to opportunities to save on the job, and by raising the return to saving are likely to affect blacks positively, helping to ensure that African Americans are financially secure during the twilight years.

Endnotes

1 We thank Bill Gale and anonymous referees for very helpful comments.

2 Jonathan Skinner, "Are you saving enough for retirement?" *Journal of Economic Perspectives*, 21 no. 3 (2007): 59-80, provides a summary of the savings adequacy debate. Several recent studies argue that many U.S. households do save enough for retirement; these include John Karl Scholz, Ananth Sheshadri and Surachai Khitatrakun, "Are Households Saving Optimally for Retirement?" *Journal of Political Economy*, 114, no. 14 (2006): 607-643; and Mark Aguiar and Erik Hurst, "Consumption versus Expenditure, " *Journal of Political Economy*, 113(October, 2005): 919-948. Eric Engen, William Gale and Cori Uccello, "Lifetime Earnings, Social Security Benefits, and the Adequacy of Retirement Wealth Accumulation," *Social Security Bulletin*, 66, no. 1(2005) finds that minority status is associated with less than adequate retirement wealth.

3 Employee Benefit Research Institute, 2007 Minority survey available at *www.ebri.org/surveys/mrcs/*.

4 Net worth includes housing equity, financial and non-financial assets less debts. Net worth does not include claims from expected Social Security and DB pensions.

5 Another way to think of this difference is to think of it in annuity terms. If a newly-retired person were to purchase a single-life annuity with $28,000, it would yield only about $220 in income each month; whereas, an identical person with $140,000 would receive $1,100 in income each month. (*www.annuity.com* for 5% and 15 years)

6 It is sometimes assumed that housing equity is not used to support consumption since many elderly households are house-rich but income-poor yet few tap into their housing equity (by selling and renting or downsizing, or through a reverse mortgage) to increase their non-medical consumption (Steven F. Venti and David A. Wise, "Aging and Housing Equity: Another Look" NBER Working Paper No. W8608 (Cambridge, MA: NBER, November 2001). However, there is some evidence that housing equity may be used to finance late-life out-of-pocket medical expenses. Also, there has been recent growth in the market for reverse mortgages (which is a means to draw down housing equity without having to move); however, demand remains very low for this product (see Thomas Davidoff and Gerd Welke, "Selection and Moral Hazard in the Reverse Mortgage Market," Haas School of Business, University of California Berkeley working paper (October 2005).

7 There is also a difference in the amount of financial assets held. Generally, holdings of financial assets, such as stocks and bonds, for the typical U.S. household are low but they are much lower for African American households ($7,500 versus $200). All data are from the 2004 Health and Retirement Survey (authors' calculation).

8 Joseph Altonji and Rebecca Blank, "Race and Gender in the Labor Market," in Handbook of Labor Economics, Volume 3, eds. Orley Ashenfelter and David Card (Elsevier Press, 1999) discusses differences in labor market outcomes extensively.

9 Because most of the literature on racial differences in labor market outcomes compares blacks to whites, much of our subsequent discussion will use whites as the reference point, even though the earlier sections of this paper compared blacks to the population at large.

10 Blacks and whites also differ in life expectancy, which would affect the amount of saving for retirement. However, although racial difference in life expectancy at birth is large for those born in 1950 and are close to retirement today (around 8.3 years), the difference narrows significantly with age (among 65 year olds, the difference is only 1.6 years and by age 75, the difference is only 0.5 years) and with time (difference in life expectancy among those born in 2004 is 5.2 years). Data are for 2004, from the Center for Disease Control, "Table 27: Life expectancy at birth, at 65 years of age and at 75 years of age by race and sex" at *www.cdc.gov/nchs/data/hus/hus06.pdf#027*

11 See Lawrence Mishel, Jared Bernstein and Sylvia Allegretto, State of Working America 2004/2005 (Washington, DC: Economic Policy Institute, 2005).

12 See Mishel, Bernstein and Allegretto (2006/2007).

13 Some fraction of part-time workers may be those who were unable to find full-time employment.

14 Karen E. Dynan, Jonathan Skinner and Stephen P. Zeldes, "Do the Rich Save More?," *Journal of Political Economy*, 112, no. 2 (April 2004): 397-444.

15 Economic Policy Institute Datazone at *www.epi.org*; and Lawrence Mishel, Jared

Bernstein and Sylvia Allegretto, State of Working America 2004/2005 (Washington, DC: Economic Policy Institute, 2005).

16 The difference between how blacks fare relative to the national average and how they look when compared to white workers emerges largely because the population average includes the coverage rates for Latinos, which are very low. See Peter Orszag and Eric Rodriguez, "Retirement Security for Latinos," Retirement Security Project Issue Brief, No. 2005-7; available at *www.retirementsecurityproject.org*.

17 Economic Policy Institute Datazone "Change in private sector employer-provided pension insurance coverage, 1979-2004" (available at *http://www.epi.org/datazone/06/pension_ins.xls*); and Table 3.15 of Lawrence Mishel, Jared Bernstein and Sylvia Allegretto, State of Working America 2004/2005 (Washington, DC: Economic Policy Institute, 2005).

18 See Kurt J. Bauman and Nikki L. Graf, "Education Attainment 2000: Census 2000 Brief (Washington, DC: U.S. Census Bureau: August 2003).

19 20.4 percent of black workers are employed in the public sector; whereas, nationally, only 16 percent of workers are employed by the public sector (authors' calculations using the March 2005 Current Population Survey data).

20 Some state and local governments are offering DC plans, either wholly or partially, however the majority of state and local governments continue to offer DB coverage. See Alicia Munnell, Alex Golub-Sass, Kelly Haverstick, Mauricio Soto, and Gregory Wiles "Why Have Some States Introduced Defined Benefit Contribution Plans?" Center for Retirement Research at Boston Brief No. 3 (Boston, MA: January 2008), for changes at the state and local level; and Alicia Munnell, Kelly Haverstick and Jean-Pierre Aubry, "Why Does Funding Status Vary Among State and Local Plans?" Center for Retirement Research at Boston Brief No. 6, (Boston, MA: May 2008), for the health of these pension funds.

21 We discuss this issue in greater detail later in the paper.

22 Patrick Purcell "Pension Sponsorship and Participation: Summary of Recent Trends," CRS Report for Congress (September 6, 2007).

23 Karen Smith, Richard Johnson and Leslie Muller, "Deferring Income in Employer-Sponsored Retirement Plans: The Dynamics of Participant Contributions," Boston College Center for Retirement Research Working Paper No. 20 (Boston, MA: August 2004). Since the average African American has lower lifetime income, this result is consistent with earlier studies that show lower saving rate among lower-income households.

24 The lower contribution rate may reflect, in part, lower savings rate among workers with lower earnings, as noted earlier.

25 Kerwin Charles and Erik Hurst, "The Correlation in Wealth Across Generations," Journal of Political Economy, 111, no. 6 (2003): 1155 - 1182; and Ariel Mutual Funds and Charles Schwab, "The Ariel-Schwab Black Paper: A Decade of Research on African American Wealth Building and Retirement Planning" (Chicago, IL: Ariel Mutual Funds, October 2007).

26 United States Census Bureau, 2008 Statistical Abstract of the United States, Table 674 available online at *www.census.gov*.

27 Data from March 2007 Current Population Survey (CPS), ages 51-64 only using single race or two race categories.

28 The income ratio compares the median black income to the median U.S. income and the wealth ratio compares the median black net worth (or, net worth less housing equity) to the median U.S. net worth (or, net worth less housing equity).

29 Household income is sorted into 10 income groups (deciles). Highest income households are those whose incomes are in the top decile group. Middle-income is defined as being in the fourth, fifth or sixth decile of the national distribution of income.

30 See, for instance, Robert Barsky, John Bound, Kerwin Charles and Joseph Lupton, "Accounting for the Black-White Wealth Gap: A Nonparametric Approach," NBER Working Papers 8466 (Boston, MA: NBER, 2001). who find that only two-thirds of the wealth differential between whites and blacks is explained by differences in earnings.

31 The group averages are higher. On average, poor African American households hold about $4,000 in an IRA or DC account, about $3,100 in financial assets, and about $30,000 in total wealth. However, because mean values are strongly influenced by the highest and lowest values, the median values present a more reliable portrait of a typical household's situation.

32 The sample size for blacks is small enough to require the results to be interpreted with caution.

33 Authors' calculation using the 2004 Health and Retirement Study.

34 Particularly since Social Security benefits are more likely to replace a higher proportion of pre-retirement earnings for African Americans than higher-income households and African Americans are more likely to receive DB benefits than other households because they are more likely to work in the public sector.

35 Because families are no longer working and incurring work-related expenses, the amount they need in retirement to maintain their standard of living is lower, according to the replacement rate perspective.

36 These estimates include personal savings, savings in tax-preferred retirement accounts, expected pension benefits and expected social security benefits. Mean retirement income derived from these three sources of savings is estimated at $28,100 for African Americans and $80,800 for whites (in 2001 dollars). The data are from Christian Weller and Edward Wolff, "Retirement Income," Report for the Economic Policy Institute (Washington, DC: EPI, 2005) available at *www.epi.org/content.cfm/issueguides_retirement_security*. The study examines households age 47-64, using data from 2001. The results reported above are computed using data from Tables 2, 13, 18 and 20.

37 Although the range only provides an estimate of what a family would need, it nevertheless demonstrates racial differences in saving adequacy.

38 Weller and Wolff (2005).

39 Kotlikoff and Spivak, "The Family as an Incomplete Annuities Market", *Journal of Political Economy*, 89, No. 2 (April 1981): 372-91.

40 Extended households can include grandparents, grandchildren, siblings and other related family members. Racial differences in family living arrangements were apparent even in the first half of the twentieth century . (See Steve Ruggles, "The Origins of African-American Family Structure," *American Sociological Review*, 59, no. 1 (February 1994): 136-15. The difference between black and white living arrangements is larger today than it was 50 years ago. (See Table 2 in Yoshinori Kamo, "Racial and Ethnic Differences in Extended Family Households." Sociological Perspectives, 43, no. 2 (Summer 2000): 211-229).

41 Kamo (2000). Data used in this source are from the 1990 Census.

42 See Ronald Angel and Marta Tienda, "Determinants of extended household structure: Cultural pattern or economic need?" *American Journal of Sociology*, 87 (1982): 1360-1383. The authors control for income-poverty ratio, education, foreign birth, employment and female headship.

43 Chenoa Flippen and Marta Tienda, "Family Structure and Economic Well-Being of Black, Hispanic, and White Pre-Retirement Adults," Center on Demography and Economics of Aging, (Chicago, IL: University of Chicago, September 1998).

44 Not all co-residence arrangements are beneficial to elderly family members, however. There is evidence to suggest that some households – particularly single elderly men from black or Hispanic households – are worse off when other kin members co-reside with them because the new residents contribute very little financially to the household. Nearly 11 percent of single black and single Hispanic elderly men transition into poverty as family size increases. (For this statistic see Flippen and Tienda (1998).

45 Examples include Carol Stack, All Our Kin (Basic Books, 1997); and Robert Taylor, Linda Chatters and Vickie Mays, "Parents, Children, Siblings, In-laws, and Non-kin as Sources of Emergency Assistance to Black Americans." Family Relations, 37, (1988): 298–304.

46 Ngina Chiteji and Darrick Hamilton , "Kin Networks and Asset Accumulation," in Inclusion in the American Dream: Assets, Poverty, and Public Policy, ed. Michael Sherraden, (Oxford University Press, 2005); and Mary Pattillo and Colleen Heflin,"Poverty in the Family: Race, Siblings and Socioeconomic Heterogenity," Social Science Research, 35, no. 4 (2006): 804-822.

47 Paul Menchik and Nancy Jianakoplos, "Black-White Wealth Inequality: Is Inheritance the reason?" Economic Inquiry, 35, no. 2, (April 1997): 428-442, controls for incomes and other factors that which contribute to racial wealth differences and finds that inheritances could account for between 10 and 20 percent of the average difference in black-white household wealth. Kerwin Charles and Erik Hurst, "The Transition to Homeownership and the Black-White Wealth Gap," Review of Economic Statistics, 84, no.2, (May 2002): 281-297,find suggestive evidence that black homeownership rates may be lower than white homeownership rates (even controlling for similar income and

wealth levels) because whites are more likely to receive financial assistance with the downpayment than blacks.

48 This macroeconomic debate is discussed in Laurence Kotlikoff and Lawrence H. Summers "The Role of Intergenerational Transfers in Aggregate Capital Accumulation," *Journal of Political Economy*, 99, no. 4, (August 1981):706-732 Laurence Kotlikoff, "Intergenerational Transfers and Savings," Journal of Economic Perspectives, 2, no. 2, (Spring 1988): 41-58; and William G. Gale and John Karl Scholz, "Intergenerational Transfers and the Accumulation of Wealth," *Journal of Economic Perspectives*, 8, no. 4, (Autumn 1994): 145-160.

49 Research on ways that parents model behavior for their children abounds in the psychology literature— for example, Walter Mischel, Yuichi Shoda and Monica Rodriguez, "Delay of Gratification in Children," Science, 244, no. 4907, (May 1989): 933-938. Within the economics discipline, empirical studies of intergenerational correlation in behavior include, John Knowles and Andrew Postelwaite, "Do Children Learn to Save from their Parents," University of Pennsylvania (2005) available at *www.econ.upenn.edu/~jknowles/Research/KP.htm*; Thomas Dohmen, Armin Falk, David Huffman, and Uwe Sunde,"The Intergenerational Transmission of Risk and Trust Attitudes." IZA Discussion Paper 2380 (Germany: IZA, 2006); Kerwin Charles and Erik Hurst, "The Correlation of Wealth Across Generations," *Journal of Political Economy*, 111, no. 6, (December 2003): 1155-1182; and Mark Wilhelm, Eleanor Brown, Patrick Rooney, and Richard Steinberg , "Tracking Giving Across Generations," New Directions for Philanthropic Fundraising, no 42, (Summer, 2004): 71-82.

50 Melvin Oliver and Thomas Shapiro, Black Wealth/White Wealth: A New Perspective on Racial Inequality, (New York, NY: Routledge, 2006); Ngina Chiteji and Frank Stafford, "Portfolio Choices of Parents and Their Children as Young Adults," *American Economic Review*, 89, no. 2, (May 1999): 377-380, and Charles and Hurst (2003).

51 Annamaria Lusardi, "Household Saving Behavior: The Role of Financial Literacy, Information, and Financial Education Programs," NBER Working Paper No. 13824 (Boston, MA: NBER, February 2008).

52 Annamaria Lusardi and Olivia S. Mitchell, "Baby Boomer retirement security: The roles of planning, financial literacy, and housing wealth," *Journal of Monetary Economics*, 54, no.1, (January 2007): 205-224.

53 Maarten van Rooij, Annamaria Lusardi and Rob Alessi, "Financial literacy and stock market participation," DNB Working Papers 146 (Netherlands Central Bank, Research Department, 2007).

54 Furthermore, doing so would require one to make normative judgments about ways that relatives choose to interact with one another. Instead, we remind readers interested in policy that families are structured differently and the choices of one generation often can affect the choices of its offspring, and the latter's fortunes.

55 For a detailed discussion of racial discrimination in labor markets Joseph Altonji and Rebecca Blank, "Race and Gender in the Labor Market," in Handbook of Labor Economics, Volume 3, eds. Orley Ashenfelter and David Card (Elsevier Press, 1999).

56 William Darity and Patrick Mason, "Evidence on Discrimination in Employment," *Journal of Economic Perspectives*, 12, (Spring 1998): 63-90; and James Heckman, "Detecting Discrimination," *Journal of Economic Perspectives*, 12, (Spring 1998): 101-116.

57 The controversy that exists in the empirical literature stems largely from the fact that assessing the effect of race, by itself, requires researchers to account for and net out differences in productivity-related characteristics that may vary by race. However, some researchers argue that productivity-related characteristics cannot be fully controlled for and, thus, wage differences may reflect these observed productivity differences. See, for instance, S.G. Sanders, D. Black, A. Haviland, and L. Taylor, "Why do Minority Men Earn Less? A Study of Wage Differentials Among the Highly Educated," Review of Economics and Statistics, 88, no. 2 (May, 2006): 300-313.

58 For instance, black applicants faced a higher probability of having an application for a home loan rejected, even when they were comparable to other applicants with respect to income and other risk characteristics. See Alicia Munnell, Geoffrey Tootell, Lynn Browne and James McEneany, "Mortgage Lending in Boston: Interpreting HMDA data," *American Economic*

Review, Volume 86, (March 1996): 25-53, for more details. See also Margery Austin Turner, Stephen L. Ross, George Galster, John Yinger, Discrimination in Metropolitan Housing Markets: National Results from Phase I of HDS2000 (Washington, DC: Urban Institute, November, 2002).

59 Oliver and Shapiro (2006) estimate that the "cost" to black households is lower average housing value appreciation of about $28,000. This estimate does not control for income, however many researchers argue that blacks face residential segregation regardless of their income level. Accordingly, if one were to control for income, it is likely that this cost would not vanish.

60 "Survey evidence suggests that some individuals may have potentially unrealistic retirement expectations." A survey by Ariel Mutual Funds and Charles Schwab, "The Ariel-Schwab Black Investor Survey: Saving and Investing Among Higher Income African Americans and White Americans, p. 28 (October 11, 2007) found that about half of African American households say they expect to live off of rental income during retirement and that 12 percent of African Americans expected to rely primarily on this type of income when financing consumption during retirement. Yet, a survey of current retirees indicates that fewer than 20 percent of African American retired households had any rental income (Ariel Mutual Funds and Charles Schwab, "The Ariel-Schwab Black Paper: A Decade of Research on African American Wealth Building and Retirement Planning," (October 2007): 10.)

61 Those targeted at adults tend to help with navigating complicated financial transactions, such as applying for a mortgage, or offer retirement planning tools, such as helping workers understand the time frame over which they must fund their retirement and what resources are available to them in retirement, including public programs, private saving and financial products.

62 Such as Financial Literacy 2010, a national campaign to increase the financial savvy of the average high school student.

63 In the U.S., Banking on a Future is a program that targets children ages 9 though 18. Internationally, Aflatoun is a program that targets children between ages 6 and 14.

64 See the American Bankers Association (ABA) Education Foundation, "Our National Programs" at *www.aba.com/consumer+connection/CNC-aboutef.htm*.

65 See Brigitte Madrain and Dennis F. Shea,"The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," The Quarterly Journal of Economics, 116, No. 4, (2001): 1149-1187, for additional details.

66 Madrian and Shea (2001).

67 42 percent of plans have a 3 percent default rate and 20 percent have a higher default rate. Hewitt Associates, Trends and Experiences in 401(k) Plans 2005 Survey, (Lincolnshire, IL: Hewitt Associates, LLC, 2005).

68 See James Choi, David Laibson, Brigitte Madrian and Andrew Metrick, "For Better or For Worse: Default Effects and 401(k) Savings Behavior," in Perspectives on the Economics of Aging, ed. by David Wise, pp.81-121 (Chicago, IL: University of Chicago Press, 2004).

69 According to a 2007 Wells Fargo Survey, 21 percent of employers that offer automatic enrollment also automatically escalate contributions. According to the Hewitt Trends and Experience in 401(k) Plans 2007 Survey, 28 percent of employers that automatically enroll participants also automatically escalate contributions.

70 See William G. Gale, J. Mark Iwry and Spencer Walters, "Retirement Saving for Middle- and Lower-Income Households: The Pension Protection Act of 2006 and the Unfinished Agenda" Retirement Security Project Policy Brief No. 2007-1 (January 2007) for additional details.

71 William G. Gale and Michael Dworsky, "Effects of Public Policies on the Disposition of Lump-Sum Distributions: Rational and Behavioral Influences," Center for Retirement Research Working Paper No. 2006-15, (August 2006).

72 See J. Mark Iwry and David C. John, "Pursuing Universal Retirement Security Through Automatic IRAs," Retirement Security Project Policy Brief No. 2007-2, (April 2007); J. Mark Iwry and David C. John, "Pursuing Universal Retirement Security Through Automatic IRAs," Testimony before the Senate Finance Committee (June 29, 2006). These and related publications are available at *www.retirementsecurityproject.org*.

73 For a detailed description of the automatic IRA, see J. Mark Iwry and David C. John, "Pursuing Universal Retirement Security

Through Automatic IRAs," Retirement Security Project Policy Brief No. 2007-2 (April 2007).

74 J. Mark Iwry, William G. Gale, and Peter R. Orszag, "The Saver's Credit," Retirement Security Project Policy Brief No. 2005-2 (March 2005); available at *www.retirementsecurityproject.org*; and J. Mark Iwry, William G. Gale, and Peter R. Orszag, "The Saver's Credit: Issues and Options," Tax Notes (May 3, 2004); available at *www.taxpolicycenter.org*.

75 The explicit 50 percent credit is an implicit 100 percent match. For an example, consider a couple earning $30,000 who contributes $2,000 to a 401(k) plan. The Saver's Credit reduces that couple's federal income tax liability by $1,000 (50 percent of $2,000). The net result is a $2,000 account balance that costs the couple only $1,000 after taxes (the $2,000 contribution minus the $1,000 tax credit). This is the same result that would occur if the net after-tax contribution of $1,000 were matched at a 100 percent rate: the couple and the government each effectively contribute $1,000 to the account. While taxpayers should respond the same to equivalent implicit and explicit matches, empirical research provides evidence to the contrary. For a detailed discussion, see Esther Duflo, William Gale, Jeffrey Liebman, Peter Orszag, and Emmanuel Saez, "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block," *Quarterly Journal of Economics*, 121, no. 4 (2006).

76 For a detailed discussion of this issue, see Zoë Neuberger, Robert Greenstein, and Eileen P. Sweeney, "Protecting Low-Income Families' Retirement Savings: How Retirement Accounts Are Treated in Means-Tested Programs and Steps to Remove Barriers to Retirement Saving," Retirement Security Project Policy Brief No. 2005-6 (June 2005); available at *www.retirementsecurityproject.org*.

77 For instance, nearly 30 percent of TANF and SSI recipients are black. See *http://www.urban.org/publications/411553.html* for characteristics of TANF recipients by race and *http://www.socialsecurity.gov/policy/docs/ssb/v65n2/v65n2p1.html* for characteristics of SSI recipients by race.

78 See forthcoming proposals by Robert Greenstein and Zoë Neuberger in "Removing Barriers to Retirement Saving in Medicaid and Supplemental Security Income" Retirement Security Project Policy Paper (forthcoming 2008).

Lina Walker is Director of Research at The Retirement Security Project and Research Professor at Georgetown University.

Ngina Chiteji is Associate Professor of Economics at Skidmore College and former Research Fellow at the Institute for Race and Wealth at Howard University.

The views in this paper are those of the authors alone and should not be attributed to the Brookings Institution, Georgetown University's Public Policy Institute, The Pew Charitable Trusts, or any other institutions with which the authors and the Retirement Security Project are affiliated.

Copyright © 2008 Georgetown University. All rights reserved.

Mission Statement

The Retirement Security Project is dedicated to promoting common sense solutions to improve the retirement income prospects of millions of American workers.

The goal of The Retirement Security Project is to work on a nonpartisan basis to make it easier and increase incentives for middle- and lower-income Americans to save for a financially secure retirement.

1775 Massachusetts Ave., NW
Washington, DC 20036
p: 202.741.6524
www.retirementsecurityproject.org