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SCHWARTZ CENTER FOR ECONOMIC POLICY ANALYSIS

POLICYNOTE

EXTREME RETIREMENT INEQUALITY PERSISTS, EVEN AMONG THOSE WITH SIMILAR EARNINGS

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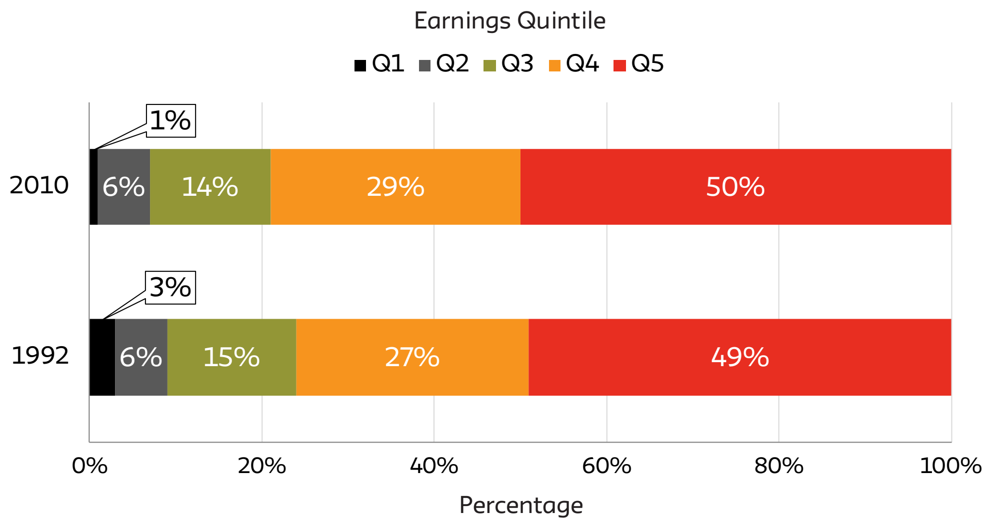
ELEVATOR PITCH

A first-of-its-kind analysis reveals sharp and persistent inequalities in retirement wealth. Using survey data matched with tax records, this study finds striking levels of retirement inequality within lifetime earnings groups as well as growing disparities between earnings quintiles. Retirement inequality mainly reflects the plight of low to moderate earners, rather than the outsize accumulations of the wealthy few. Measures to address retirement inequality should focus on those most disadvantaged by the failings of the U.S. retirement system.

KEY FINDINGS

- In both 1992 and 2010, workers in the top 20% of the earnings distribution held about half of all retirement wealth, whereas the bottom group's share fell from 3% to 1%.
- Among workers in the bottom fifth of the earnings distribution, the share of those with no retirement wealth increased from 45% to 51% between 1992 and 2010.
- Wealth-to-earnings ratios of the lowest earnings quintile fell between 1992 and 2010. Although wealth-to-earnings ratios grew for higher-earning workers, these gains are insufficient to offset rising health costs and increases in longevity.
- Retirement wealth is highly unequally distributed even among people with similar lifetime earnings, reflecting a retirement system that fails both low and high earners.

Figure 1: The Top 20% of Earners Held Over Half of Retirement Wealth in 1992 and 2010



Source: Authors' calculations using 1992 and 2010 Health and Retirement Study (HRS) data

Notes: HRS sample weights. Sample comprises employees ages 51-56 in 1992 and 2010 and is sorted into earnings quintiles based on lifetime labor market earnings. Retirement wealth includes balances in IRA and defined contribution (DC) plans (including profit sharing and stock purchase plans) and the expected present value of anticipated income from defined benefit (DB) plans, from current and past jobs, discounted to the present and pro-rated to past and anticipated service.

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MEASURING RETIREMENT INEQUALITY

Studies outlining the contours of wealth and income inequality have captured public attention in recent years. The SCEPA study links administrative tax data to nationally representative surveys, reconciling inconsistencies in the data and correcting flaws in prior studies. The linked data produce a more fine-grained analysis of retirement wealth inequality and, for the first time, permit an analysis of retirement wealth inequality among workers with similar lifetime earnings.

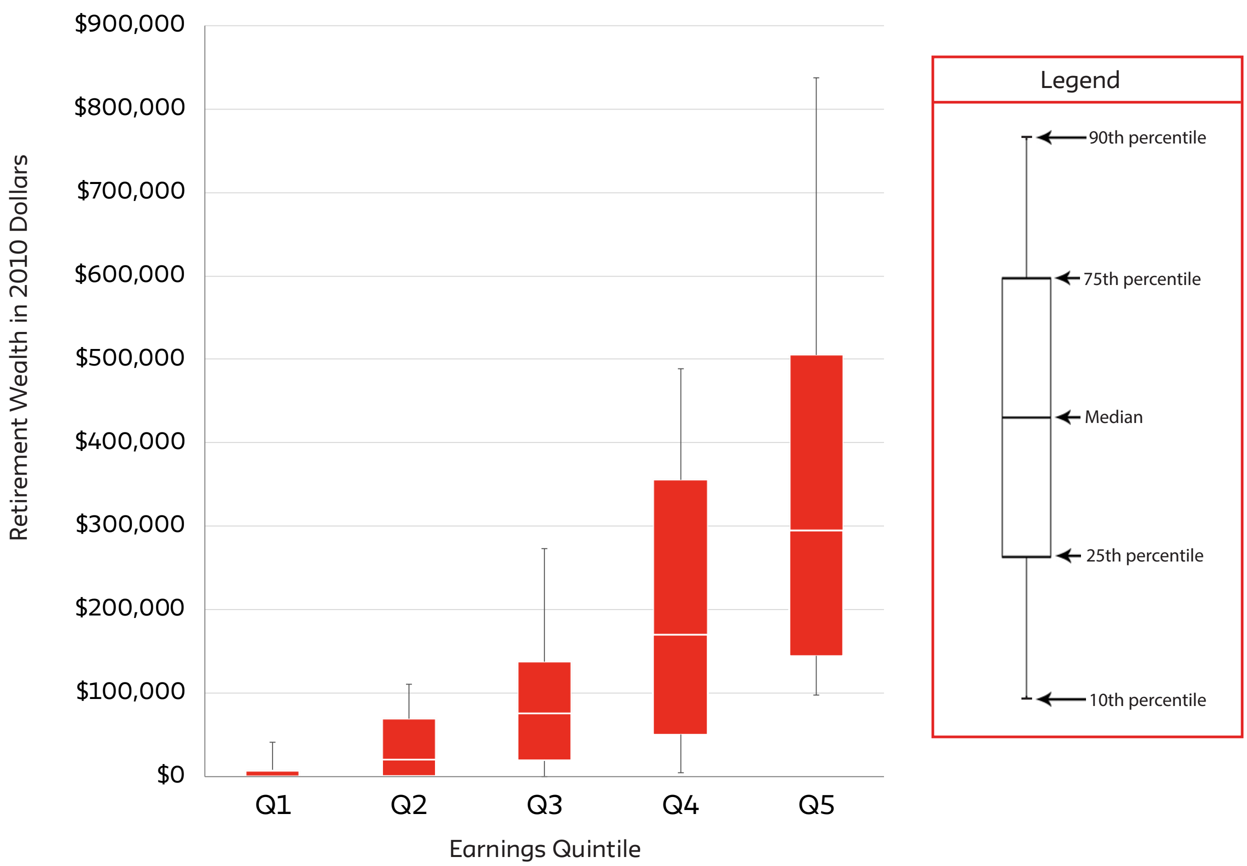
The data used in the study come from the nationally representative Health and Retirement Study, linked to W-2 tax records and retirement plan summary plan descriptions. The sample covers the period from 1992 to 2010 (the most recent year for which tax-linked records were available), straddling the displacement of defined benefit (DB) by defined contribution (DC) plans in the private sector.

EXTREME RETIREMENT INEQUALITY PERSISTS

This analysis reveals steep and sustained inequalities in retirement wealth of workers ages 51-56 and nearing retirement. To analyze how retirement wealth is distributed, this study grouped workers into five tiers of lifetime earnings. The share of total retirement wealth held by the top fifth of earners held steady from 1992 to 2010 at around half of all retirement assets. The lowest-earning quintile, meanwhile, held only 1 percent of retirement wealth in 2010.

Sharp inequalities have also persisted within earnings groups. In the top two lifetime earnings quintiles, the top 10 percent of savers held 10 to 20 times the retirement wealth of the bottom 10 percent of savers. In the lower three quintiles, the bottom 10 percent of savers had nothing. The retirement system produces a vast range of retirement wealth outcomes, even for those with similar lifetime earnings.

Figure 2: Retirement Wealth Inequality Pervasive Among Those With Similar Earnings



Source: Authors' calculations using 1992 and 2010 Health and Retirement Study (HRS) data
Notes: See Figure 1.

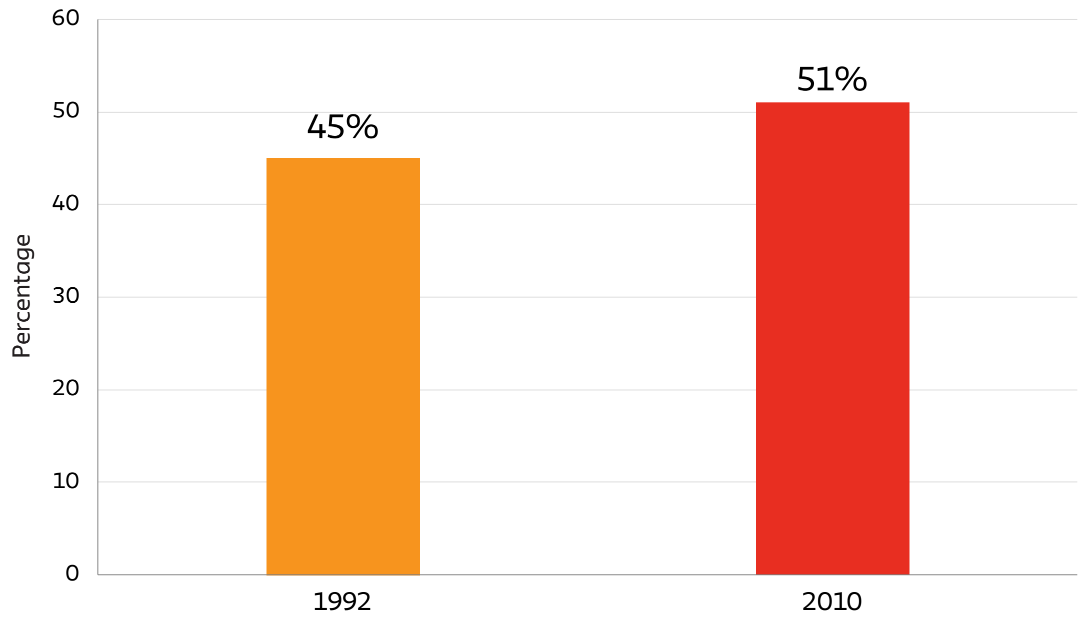
Underlying the broader trend in retirement inequality are widening disparities in wealth accumulation between lifetime earnings groups. As discussed further below, wealth-to-earnings ratios fell for lower earners while rising for higher earners. At the same time, the lowest-earning quintile saw a rise in the share of those with no retirement wealth whatsoever.

The data also illuminate disparities in inequality measures between different types of retirement plans. Inequality is high and rising for those with only DC plans—such as 401(k)s—and lower for those with traditional DB plans. Inequality is lowest among those with both DB and DC plans.

THE RETIREMENT SYSTEM FAILS BOTH THE POOR AND WELL-OFF

For those in the lowest tier of lifetime earners, the bottom 20 percent, the share of those with zero retirement assets was 51 percent in 2010, up from 45 percent in 1992. However, inadequate retirement savings are not limited to the lowest quintile, but characterize workers across the earnings distribution. Median retirement wealth falls 84 percent short of what people would accumulate if they saved 6 percent of every paycheck with a 50 percent employer match and no leakages. At the bottom of the earnings distribution, the shortfall is even starker. The median worker in the bottom earnings quintile would have saved $154,200, compared with the zero wealth they have now.

Figure 3: Low Earners With No Retirement Wealth Increases to Over Half



Source: Authors' calculations using 1992 and 2010 Health and Retirement Study (HRS) data

Notes: See Figure 1. We treat workers as hving zero retirement wealth if they have zero DB, DC, or IRA wealth from current or past jobs.

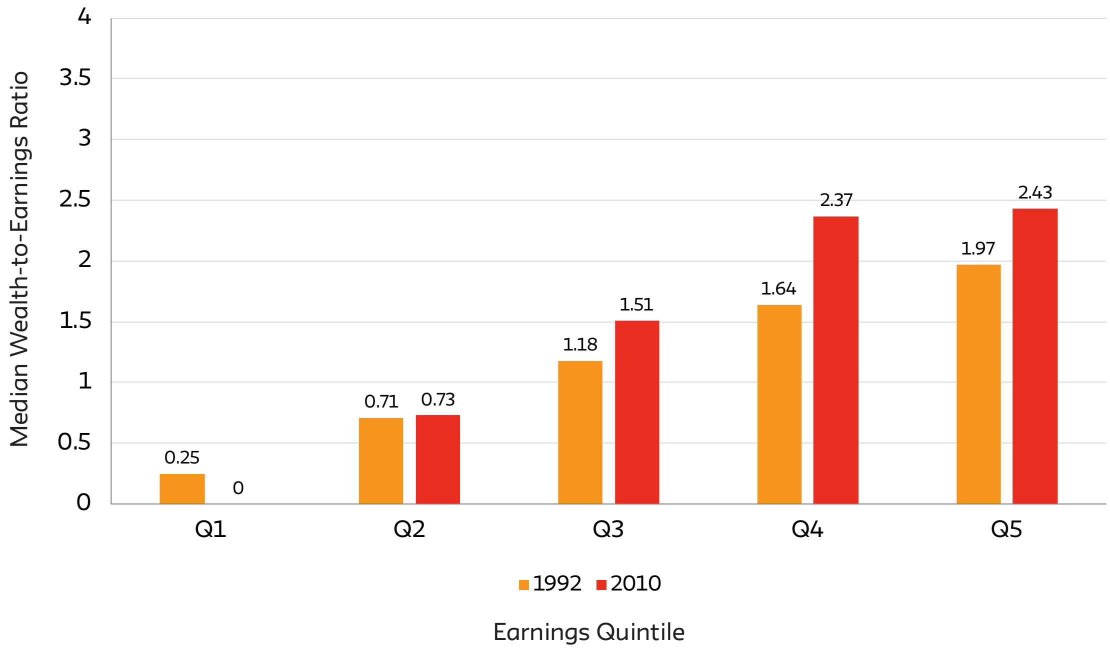
THE FLOOR FOR RETIREMENT WEALTH IS COLLAPSING

Retirement inequality mainly reflects the floor collapsing under the many rather than the soaring fortunes of a few. Some 40 percent of older workers and their spouses face downward mobility in retirement[1] and less well-off savers are particularly vulnerable to negative economic shocks.[2] To determine financial preparedness for retirement, the study measured wealth-to-earnings ratios across the earnings distribution.

Experts debate how much retirement savings the typical worker needs to accumulate relative to income to maintain their standard of living in retirement. Financial institutions advise that workers at age 50 accumulate savings equal to six times their earnings.[3] Some studies argue this may be excessive for many,[4] whereas others point to rising health care costs and increasing longevity as reasons for workers to save even more.[5]

The typical worker in our sample has a wealth-to-earnings ratio below 2, a third of industry recommendations and well below reasonable estimates of adequate retirement savings. Wealth-to-earnings ratios fell among those in the lowest earnings quintile over the sample period. Even within the top quintile of lifetime earners, over a quarter of workers have wealth-to-earnings ratios below 2.

Figure 4: Typical Workers at All Earnings Levels Unprepared for Retirement



Source: Authors' calculations using 1992 and 2010 Health and Retirement Study (HRS) data
Notes: See Figure 1.

POLICY RECOMMENDATIONS

The American retirement system has always been highly unequal and, for most, highly inadequate. While the generational shifts in the retirement system have yet to produce any sharp increases in aggregate inequality, this could very well change as the share of those with remaining DB plans falls off, to be replaced with those who have only DC savings or none at all.

Retirement inequality reflects the common plight of low to moderate earners, not the outsize accumulations of the few. Thus, measures to address retirement inequality should focus on those who are most disadvantaged by the shortcomings of the individualized, do-it-yourself U.S. retirement system. Lawmakers should bolster Social Security as a crucial backstop for those who have been unable to accumulate sufficient savings for old age.

But Social Security is only a start. The dearth of retirement assets for the lowest earners and the inadequacy of those in the middle call for a more ambitious solution to the retirement crisis. Guaranteed Retirement Accounts (GRAs) are individual accounts requiring employers and employees to contribute with a fair and effective refundable tax credit provided by the government. GRAs provide a safe, effective vehicle for workers to accumulate personal retirement savings over their working lives.[6]

ENDNOTES

1. Ghilarducci, Papadopoulos, and Webb (2018).

2. Ghilarducci, Radpour, and Webb (2018).

3. Fidelity (2018).

4. Skinner (2007).

5. Munnell, Soto, Webb, Golub-Sass, and Muldoon (2008).

6. Ghilarducci and James (2018).

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