Study finds changes to retirement savings system may exacerbate economic inequality

August 23 2016

A shift to defined-contribution retirement plans, such as 401(k) plans, has led to an income and education gap in pension savings that could exacerbate future economic inequality, according to a study that will be presented at the 111th Annual Meeting of the American Sociological Association (ASA).

"The movement towards voluntary, contributory employer pensions has increased the influence of socioeconomic factors, such as education and income levels, on retirement fund accumulation," said study co-author ChangHwan Kim, an associate professor of sociology at the University of Kansas.

Unlike defined-benefit plans, which promise a fixed, pre-established monthly benefit for employees upon retirement, defined-contribution plans entail monthly contributions from employees, and sometimes employers, which are then invested on the employee's behalf. The final amount an employee receives upon retirement depends on total lifetime contribution to his or her account, plus investment gains or losses.

A key difference between defined-contribution plans, which have been growing in popularity since 1980, and defined-benefit plans is that workers may choose to opt out of participating in the former.

When defined-contribution plans are offered in workplaces, people with a bachelor's degree or higher are 1.2 times more likely to enroll in them than high school graduates even after controlling for the effect of annual

earnings, occupation, industry, firm size, and other characteristics, the study found. Furthermore, people with a bachelor's degree or higher save an average of 26 percent more annually to their defined-contribution retirement accounts than participating high school graduates even if both groups earn the same amount of annual income.

"These enrollment and savings decisions may not only be influenced by job factors such as a worker's earnings level, but also by non-labor market mechanisms that may include a person's amount of financial knowledge and his or her concern with planning for the future, of which less educated people may have lower levels," said Kim, who co-authored the study with Christopher Tamborini, a senior researcher for the U.S. Social Security Administration.

The researchers examined workforce data from the 2004 and 2008 waves of the Survey of Income and Program Participation, matched to W-2 tax records, as well as the Survey of Consumer Finances and found evidence of an income and education gap in pension savings.

"When you have options, sometimes bad things happen," Kim said. "You want to spend your money now, maybe to cover current necessities, but investing less for your retirement during your working years can have future costs that impact your retirement income security."

A disparity in retirement savings could exacerbate inequality during retirement, a time in life when income inequality has historically been less prominent, Kim said. "The findings suggest the importance of Social Security benefits moving forward, particularly for low earners," Kim explained.

More information: The paper, "Disadvantages of the Less Educated: Education and Contributory Pensions at Work," will be presented on Tuesday, Aug. 23, in Seattle at the American Sociological Association's

111th Annual Meeting.

Provided by American Sociological Association