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Racial Wealth Disparities
Is the Gap Closing?

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A vast literature has examined the economic progress of African Americans during the 20th century. Most of these studies have focused on income-or even narrower measures of economic well-being, such as earnings-and have sought to assess the extent to which any gains that were made relative to other racial groups can be attributed to factors such as affirmative action policies, declining race discrimination, changes in industrial composition, and a narrowing of the gap between the educational levels of African Americans and the rest of the population.[(1)] Much less is known, however, about how African Americans have fared in terms of wealth, an important measure of economic well-being that is more informative in many respects than those derived from income flows during a particular year.

While studies of earnings and income are important for assessing the extent to which labor market discrimination exists and the ability of African Americans to move closer to whites in terms of acquiring the skills and connections that are currently rewarded by the markets, they provide what is clearly an incomplete picture.[(2)] The economic positions of two families with the same incomes but widely different wealth levels are not identical. The wealthier family is likely to be better able to provide for its children's educational and health needs, live in a neighborhood characterized by more amenities and lower levels of crime, have greater resources that can be called upon in times of economic hardship, and have more influence in political life.

While the ratios measuring the relative income and earnings positions of African Americans tend to show they remain substantially behind whites, the gaps are small compared to the staggering chasm in wealth levels. I estimated the ratio of mean net worth for non-Hispanic African Americans to non-Hispanic whites to be 0.17 in 1995, and even lower (0.12) when measured in terms of medians (Wolff 1998). To put these numbers in perspective, the ratio of both the mean and median income of African American households to those of whites was 0.64 in 1997 (U.S. Census Bureau 2000).[(3)] Though the data needed to examine trends in wealth ratios over long periods of time are scarce, there is little evidence to suggest that they have risen substantially from even lower levels, at least over the past decade or so. For instance, in 1983 the mean and median ratios stood at 0.19 and 0.07, respectively.[(4)]

The handful of recent studies on racial differences in wealth have focused almost exclusively on gaps in wealth *levels* and have paid much less attention to patterns in wealth *accumulation.* [(5)] The typical approach followed has been to employ a Blinder-Oaxaca means-coefficient analysis (see Blinder, 1973), using regressions estimated separately by race, to calculate how much of the gap can be attributed to differences in characteristics associated with wealth accumulation, such as family income and education (Blau and Graham 1990, Oliver and Shapiro 1995, Menchik and Jianakoplos 1997, Avery and Rendall 1997, Conley 1999). The resulting estimates vary widely depending on whether coefficients are used from the regression equation estimated for whites or that for African Americans. That is, because the wealth of whites rises more steeply than that of African Americans with increases in such characteristics as income and education, the lower mean levels of these characteristics for African Americans "explain" much more when coefficients for whites are used.

The fact that the explanatory power of this exercise depends on the coefficients used is less than satisfying. A more complete understanding of the forces behind the racial wealth gap and the efficacy of public policies designed to narrow it hinges on what causes the wealth functions to differ so much by race in the first place. That is, do white families have higher levels of wealth than African American families at comparable age levels because they have received greater inheritances and other intergenerational transfers, because they devote higher percentages of income to saving, or because they earn higher rates of return on assets? Unfortunately, with data on family wealth for only one point in time, it is difficult to do more than speculate as to which of these three categories holds the key to racial wealth inequality.

Making use of the supplements on household wealth carried out by the Panel Study of Income Dynamics (PSID) in 1984, 1989, and 1994, this study follows a different tack. By following families over time, it is possible to reconstruct the path of wealth accumulation and attribute observed increases in wealth to intergenerational transfers, saving out of income, or the appreciation of existing assets. Comparing patterns between racial groups enables the question of the sources of the differences in wealth levels to be addressed more directly.

As expected, inheritances play a much greater role in the wealth accumulation of whites than that of African Americans. Perhaps surprisingly, however, there is no consistent evidence that the share of wealth accumulation attributable to capital gains is greater for whites than for African Americans, though, of course, the absolute amount from this source is much greater for the former.

Counterfactual experiments suggest that African Americans would have gained significant ground relative to whites during the period under study had they inherited similar amounts, had comparable levels of family income and, more speculatively, had similar portfolio compositions. In addition, the wealth gap would have narrowed had the share of income that African Americans devoted to saving been as high as that for whites; however, much of this difference is attributable to the fact that (average) saving rates rise with income and African Americans have lower incomes than whites, rather than whites having a higher saving rate conditional on income level.

As shown in Table 1, the gap in wealth levels between African Americans and whites is staggeringly wide, regardless of whether it is measured in terms of mean or median holdings. In 1994, the average African American family had a net worth of $32,426, less than one-fifth of the average net worth of $180,720 for white families.(6) Perhaps even more jolting is the comparison in terms of medians. In 1994, the median African American family had a net worth of $1,100, barely positive and just one-fiftieth of the $57,200 median wealth for whites.

Examining wealth by age, we find that the profile for whites has the traditional hump shape, with wealth increasing through the prime earnings years and then tailing off, while that for African Americans shows a greater tendency to be monotonic with age.(7) The upshot is that the ratio of African American to white wealth is highest for the elderly group, though at about 0.30 it is clearly not high in any absolute sense. It is striking to see how wide these gaps are even at young ages. As the median value of wealth for African Americans does not climb above zero until the age group 45-54, the median ratio stays at zero up to that age group.

Table 1 Wealth by Characteristics of Head and Family Income, 1994

	Mean Values			Median Values		
	Whites	**African Americans**	**Ratio**	**Whites**	**African Americans**	**Ratio**
All families	180.7	32.4	0.18	57.2	1.1	0.02
Age of head						
Less than 25	18.4	4.1	0.22	22.0	0.0	0.00
25-34	69.2	13.1	0.19	8.8	0.0	0.00
35-44	131.5	22.0	0.17	42.9	0.0	0.00
45-54	252.4	51.2	0.20	97.9	21.7	0.22
55-64	313.7	45.7	0.15	160.6	22.4	0.14
65+	254.7	76.5	0.30	112.2	33.0	0.29
Education of head						
Less than high school	99.6	21.8	0.22	27.5	0.0	0.00
High school graduate	122.4	28.6	0.23	48.8	0.7	0.01
Some college	164.8	36.3	0.22	59.4	9.2	0.16
College graduate	329.4	75.9	0.23	108.9	13.8	0.12
Marital status of head						

Married	252.8	64.4	0.25	95.9	18.7	0.19
Not married	93.4	22.1	0.24	17.6	0.0	0.00
Income quartile						
First	68.8	17.9	0.26	7.7	0.0	0.00
Second	95.3	33.4	0.35	35.7	3.3	0.09
Third	135.5	38.6	0.28	61.5	14.5	0.24
Fourth	412.2	98.7	0.24	171.6	36.7	0.21

Notes: Wealth is measured in thousands of 1998 dollars. Calculations use the cross-sectional samples (for details, see Appendix A). About 2 percent of families are excluded from the calculations by the education of the head for each year and about 7 percent for those by income quartile because of missing data. Sample sizes: 7,415 (4,804 whites, 2,611 African Americans).

Even as measured by mean ratios, the ratio for young household heads, those under the age of 25, is only 0.22. This wide gap at an early age, even before a household head has had time to accumulate assets through saving from his or her own income, hints at the importance of intergenerational transfers in causing young white and African American household heads to start off on an unequal footing.

The pattern of racial wealth differences changes little when education is controlled for. The mean ratios within the four education groups shown in Table 1 are in the neighborhood of 0.2. As this is little higher than the 0.18 for all families, it is clear that the racial wealth gap is primarily attributable to large differences at the same educational level, rather than to there being a smaller portion of African Americans relative to whites in the wealthier, higher-education groups. Nor has marital status or income class much explanatory power, as the racial wealth gaps are primarily attributable to differences within groups defined by these variables.

The ratios shown in Table 2 indicate little change between 1984 and 1994 in the relative distance between white and African American wealth holdings, with the proportions for means staying in the neighborhood of 0.18-0.19 and those for the medians around 0.02-0.03.[(8)] Though the amount of wealth is substantially higher in Wolff (1998), the mean ratios shown here are within a few hundredths of a point of those in the earlier study for the ratio of non-Hispanic whites to non-Hispanic blacks, calculated for nearly identical years (1983, 1989, and 1995) using the Survey of Consumer Finances. The levels and trends of the median ratios are a bit different using that source, going from 0.07 in 1983 down to 0.03 in 1989 and back up to 0.12 in 1995.

In contrast to the existing literature, this study finds that whites have a higher (active) saving rate than African Americans-8.0 percent of family income over the 1984-1994 period versus 4.1 percent.[(9)] This, combined with white families' much higher family income over the period, leads to substantially greater saving in absolute terms, though not in relative terms. Inheritances and gifts were more important for whites both in absolute terms and as a share of the change in wealth over the period. The research indicates that they were also more important for this group as a proportion of initial wealth.

Using a series of counterfactual experiments, a measure was calculated of the racial wealth gap in 1994 had the behavior of African Americans been identical to that of whites with respect to portfolio allocation, rate of return on capital, saving as a share of income, family income, inheritances, and inflows from changes in household composition. For example, one simulation substitutes the average rate of saving for white families with that for African Americans. However, because average saving rates tend to rise with income (Huggett and Ventura 2000), it is also of interest to specify them as a function of income, and then to replace the saving rate for African Americans with the rate that would be predicted for whites with the same average income as African Americans. It is desirable to allow portfolio composition to depend on income as well.

Table 2 Net Worth, 1984, 1989, and 1994

	Mean Values			Median Values		
	Whites	**African Americans**	**Ratio**	**Whites**	**African Americans**	**Ratio**
All families						
1984	139.8	25.2	0.18	51.8	0.8	0.02
1989	179.0	34.2	0.19	52.6	1.3	0.03
1994	180.7	32.4	0.18	57.2	1.1	0.02

Notes: Net worth is measured in thousands of 1998 dollars. Calculations use the cross-sectional samples (for details, see Appendix A). Sample sizes: *1984:* 6,911 (4,336 whites, 2,575 African Americans); *1989:* 7,114 (4,505 whites, 2,609 African Americans); and *1994:* 7,415 (4,804 whites, 2,611 African Americans).

Each simulation recalculates changes in wealth for African Americans after substituting a white parameter (such as the saving rate) for the corresponding African American parameter, and for whites after substituting the African American parameter. The two calculations tend to give similar results, though in some cases the difference between the counterfactual and the actual is smaller when the white wealth accumulation process is recalculated. Part of this is due to the fact that a ratio of less than one is affected more by an additive change to the numerator than by a change to the denominator of the same magnitude but opposite sign.

A number of interesting findings emerge from the research. First, the results for the entire period make clear that decades would be required for the wealth gap to close or even for the wealth ratio to approach the income ratio. Indeed, even with the dramatic changes in behavior implied by these experiments (changes that no policy could easily accomplish), simulated African American wealth levels remain at just a fraction of those of whites. Second, keeping in mind that calculations making use of asset-specific returns should be interpreted with caution, one finds that if African American families in 1994 had had the same portfolio composition as white families, the wealth gap would have been narrower by six to eight percentage points. This simulated closure results mainly from the higher share of stocks in white portfolios.[(10)]

Third, given the relatively small racial difference in the overall rate of return on capital, substituting the white rate of return for the African American had very little effect on the racial wealth gap. This result, however, may be peculiar to the period under study. In particular, the increase in the stock market since 1994 probably pushed up the overall rate of return on capital for whites relative to African Americans because of the greater weight of stocks in the former group's portfolios.

Fourth, substituting the (unconditional) white saving rate for the African American saving rate narrowed the 1994 racial wealth gap by about eight percentage points. By contrast, substituting the white saving *function* for the African American saving function narrowed the racial wealth gap by only one point. The difference in results is due to the fact that white saving rates conditional on income are only slightly higher than those of African Americans. However, raising African American incomes to the level of those of white families (and making saving a function of income) would cause the racial wealth ratio to jump by as much as 10 percentage points.

Fifth, increasing African American inheritances and transfers to the amount received by white families would result in a five-percentage-point increase in the racial wealth ratio. Finally, standardizing for wealth inflows related to household composition shifts would have little effect on the racial wealth gap.

Though the data have been treated with as much care as possible in these exercises, a certain amount of skepticism may be warranted, given that the division of wealth accumulation into its component parts relies on the ability of respondents to reconstruct accurately their financial transactions of the preceding five years. Even those who have played pivotal roles in the development of the data acknowledge that the separation of wealth accumulation into active and passive savings components on the basis of PSID data is "quite crude" (Juster, Smith, and Stafford 1999, 32). Kennickell and Starr-McCluer (1997) also raise concerns about the quality of retrospective reporting of household wealth.

The calculations in this study are based in part on recall over a five-year period. To check these against the more reliable information reported at the time of each wave, some experiments were reconstructed through a regression-based method that used only the more reliable cross-sectional data.[(11)] (A detailed explanation is given in the full Public Policy Brief 66.)

Based on this analysis, it may take another two generations for the racial wealth gap to close, even if the income gap between African American and white households is eliminated immediately. How can we accelerate this process? Asset building for low-income families is a new and powerful idea. I believe that assets (or the lack of them) matter greatly in providing an economic cushion, enabling people to make investments in their futures and psychological orientations and enter the financial mainstream. Current public policy offers substantial, highly regressive subsidies for wealth and property accumulation (such as mortgage deductibility for homes and other real estate and tax sheltering of IRAs, 401(k) plans, and other forms of retirement assets), but this applies only to relatively well-off individuals. Tax sheltering makes sense only if a family has enough income to pay income taxes. By contrast, poverty policy has ignored asset building for resource-poor families. The challenge is to design policies to reach low-asset families who are willing to work and save.

The question of whether the poor can save is the root of much concern and confronts traditional economics. Sherraden (2001) provides new data analysis that demonstrates that the poor do, in fact, save when provided the opportunity and reasonable subsidies. Edin (2001) and Stern (2001) argue in favor of loosening credit so that the poor can borrow more easily and at lower costs. Should public policy encourage asset accumulation or make credit and borrowing easier? In the end, both approaches might be necessary.

In exploring how the American Dream of homeownership applies to the poor, Denton (2001) found that homes lead to other social assets, such as better schools and public services and more effective social networks. She notes that housing is not only a form of investment, but is also a component of lifestyle, providing direct amenities to the owner, and a vehicle for intergenerational transfers. She points out, however, that the rise in housing values from the 1950s to the 1970s that produced spectacular equity is not likely to occur again for the current generation of young homeowners. Homeownership in African American communities typically results in lower equity than it does in white communities, and does not provide the owner with access to richer educational environments or better public services.

The most heated debates around these policy initiatives contrast promoting new asset building policies with protecting and strengthening existing safety net programs for the poor. This brings the discussion back to connecting income and labor market policies to asset building strategies and finding the appropriate policy mix. For example, raiding individual asset building accounts to pay medical bills because of Medicaid cuts does not promote a brighter future; it only shifts the financial burden. Asset building accounts must be targeted at asset accumulation, not paying for ongoing expenses.

Beneficial outcomes of asset building have already been documented at neighborhood, household, and individual levels (see Shapiro and Wolff 2001). Homeownership, for example, is positively correlated to rising property values, educational attainment and achievement, decreased dropout rates, increased civic involvement, and residential stability. Research in other areas (marital stability, family health, children's well-being, domestic violence) is very encouraging.

There may be differences in how particular assets, such as social security wealth, private pension funds, 401(k)s, vehicles, and even homes affect well-being. Some are fungible and others are not. Some can help a person build a better life and future, while others are more important as safety cushions later in life. Indeed, an automobile purchase may be a "legitimate" use for subsidized asset accounts, since for many poor people a car is an absolute necessity for going to work and shopping (see, for example, Edin 2001).

In the public policy arena, events are already occurring very rapidly. The Assets for Independence Act of 1998 authorized $125 million for Individual Development Accounts (IDAs). IDAs, which are not taxed, allow amounts set aside by eligible low-income families to be partially matched by public funds, rather like the Universal Savings Accounts proposed by President Clinton in his 1999 State of the Union address. The accounts earn interest, and can be drawn upon to support schooling or training, purchase a home, or start a business. States can use IDAs as a part of welfare reform plans and welfare-to-work programs. The Savings for Working Families Act, introduced in early 2000, proposed about $5 billion in tax credits to financial institutions and private sector investors to set up, match, and support asset building for low-income persons. A Children's Savings Account Initiative is about to be launched. In at least 34 states, IDAs have either been authorized or the legislation is pending.

The number of pieces of legislation is potentially misleading because they serve only a small fraction of families with few or no assets. Many of these programs are intended to test conceptual, design, practical, and political issues. Even if they are deemed effective and find public support, taking them to scale will engage another host of issues.

So what can be done now to promote asset development among poor people in general and poor African Americans in particular? Development of IDAs and related programs will stimulate saving by the poor and help to draw them into the financial mainstream. At present, private credit card companies are very reluctant to advance credit to the poor. By expanding credit opportunities in this sector-perhaps through a government-backed credit card system-low-income families will find it easier to purchase cars and pay educational expenses. The homeownership rate among African American families (and white families as well) has been virtually stagnant over the last two decades. A new government-subsidized mortgage loan, perhaps modeled on the postwar GI Bill, may be required to further expand homeownership in the coming decade.

As Melvin Oliver argued in the preface to Shapiro and Wolff (2001), asset-building strategies may provide longer-lasting remedies to deep-seated poverty than mere income replacement policies, which have been the hallmark of U.S. poverty policy over the last 65 years. Building up not only financial capital but human and social capital as well may provide a firmer foundation than monthly income transfers to overcome the deleterious effects of poverty.

Notes

1. For long-term perspectives on racial economic progress, see, for example, Smith and Welch (1989) and Reardon (1997). Of course, race economic differentials need not always be moving in the direction of relative economic progress for African Americans, as experience since the 1980s has demonstrated. For example, see Bound and Freeman (1992) for an analysis of the decline in the relative position of young black men in the 1980s.

2. For ease of exposition, the term &quote;whites" will be used throughout to include all those who are not African American.

3. Though the Census Bureau also reports data for families, a comparison is made using

data for households, since the definition of "family" in the Panel Study of Income Dynamics (PSID), the main dataset used in the analysis of this paper, includes "unrelated individuals" as separate families, and thus is closer to the Census Bureau definition of "household."

4. See Wolff (1994) for longer-term comparisons using both net worth and homeownership rates. Though entry into self-employment may be facilitated by the presence of wealth and the ownership of businesses may serve to increase wealth, the fact that the rate of self-employment of African American men relative to white men has remained constant at about one-third for this century (Fairlie and Meyer 1996) is consistent with little change in the wealth ratio.

5. The analysis of racial differences in wealth accumulation in Hurst, Luoh, and Stafford (1998) is an exception, though it is not the main focus of their paper.

6. All dollar amounts are converted into 1998 dollars using the Bureau of Labor Statistics's Consumer Price Index-All Urban Consumers (CPI-U).

7. Though the hump shape in a cross section can be consistent with the life-cycle model of wealth accumulation, it is evident that it cannot be taken as confirmation of it, given that period and cohort effects are also playing a role. See Wolff (1988) and Jianakoplos, Menchik, and Irvine (1989) for additional discussion.

8. When the value of vehicles is included in wealth, the results look somewhat different. Whites have a median wealth of 60.4 thousand dollars in 1984, 61.7 thousand in 1989, and 67.7 thousand in 1994. For African Americans, the corresponding values are 3.8 thousand, 6.6 thousand, and 8.2 thousand, resulting in the ratio of medians rising from 0.06 in 1984 to 0.11 in 1989 and then to 0.12 in 1994.

9. The finding that whites have a higher saving rate than African Americans is not sensitive to the choice of sample, though the gap narrows somewhat as extreme outliers in terms of changes in wealth are excluded from the sample.

10. Another contributing factor is that African American families had a higher rate of return on stocks than did white families. Obviously, it is not evident that with falling barriers to stock ownership among African Americans, their rate of return would remain so much higher than whites'.

11. The one exception is the continued use of information on reports of inheritances. Because these are rare events, it is easier to recall them than to be able to reconstruct, for example, the net amount put into stock.

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