Understanding the Racial Wealth Gap

BY BRANDON FULLER

The nationwide protests against racial injustices and the uneven effects of the COVID-19 pandemic have led to a recent increase in dialogue about racial economic inequality. But the disparities themselves are not new developments. According to the Fed's Survey of Consumer Finances, since 1989, the pre-tax income of the median white family has been 1.7 to 2.5 times greater than that of the median black family. While the black-white income gap is considerable, at $28,510 in 2019, it is dwarfed by the black-white wealth gap. In 1989, the median wealth gap between black and white families was $135,010 in 2019 dollars — the median white family had $143,560 in wealth while the median black family had only $8,550. Over the next 30 years, the median white family would continue to have seven to 10 times as much wealth as the median black family. Despite the occasional narrowing of the gap and both white and black families experiencing an increase in wealth throughout the period, the black-white median wealth gap by 2019 was even larger at $165,000.

Many economists are concerned with understanding the factors that drive such large, persistent disparities in wealth. Economic intuition suggests potential contributors to the gap, such as differences in income, education, inheritances, and family structure; testing these hypotheses empirically is another matter.

Studies that investigate the racial wealth gap often attempt to do this through what is known as a "regression decomposition" approach. Typically, this involves using regression techniques to estimate the relationship between wealth and its related factors for black and white households separately. These estimated equations can then be used to quantify the contribution that observable differences between racial or ethnic groups make to the racial wealth gap. Studies using these techniques often find, however, that results differ depending on which equation is used, thus making it difficult to establish a consensus on the importance of contributors to the wealth gap.

At the Richmond Fed, a team of economists — John Bailey Jones, Urvi Neelakantan, Grey Gordon, and Kartik Athreya — has been conducting research on the black-white wealth gap for several years. They are taking a novel approach that draws on their expertise in "heterogeneous agent" macroeconomic models to investigate the gap. That means they are developing a model of saving decisions and wealth accumulation that incorporates elements of the differences between black and white households observed in the real-world data (such as earnings, education, and family structure). Compared with previous studies using regression techniques to decompose the racial wealth gap, they believe this will enable them to better isolate and identify the effects of contributors to the wealth gap.

Gordon explains that their model allows them to "toggle on and off" differences between black and white households. Simulating the model will enable an investigation of how the racial wealth gap varies with the absence or presence of differences in, say, earnings or education between black and white households. This, in turn, could help the researchers evaluate policy proposals to reduce the gap.

While the model will incorporate many of the factors that previous studies have emphasized, the economists hope that their work will illuminate a few contributors to the wealth gap that are particularly important. "We were wondering if the racial wealth gap is a story of everything," Neelakantan says. "Does each of these factors add a bit to the total gap, or are we going to find a key contributor?"

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One possible contributor the researchers are paying particular attention to is incarceration. "Incorporating incarceration into our model of earnings processes is one thing that's new about our paper," Neelakantan explains. "There are many technical papers in economics about how to model earnings over time. It becomes even more important when you are going to feed that earnings process into a bigger model. If you miss something, you could amplify problems when it is an input into another model."

As incarceration can have long-lasting effects on one's labor market outcomes, better incorporating the labor market disruptions caused by incarceration into a model of wealth accumulation may further economists' understanding of how earnings differences between racial groups contribute to the racial wealth gap.

Why is the study of the racial wealth gap important? Neelakantan says that appeals to justice and the historical context within which the black-white wealth gap has developed in the United States are compelling in and of themselves. Beyond that, she says, the underlying reasons for the gap matter from an economic perspective. "If people face barriers that prevent them from reaching their goals, then I think we want to know what those are so we can apply the right tools to dismantle them." **EF**

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