# Wealth Holding and Financial Marketplace Participation in Black America

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## Introduction

In the literature on racial inequality, a strong emphasis has traditionally been placed on educational attainment, occupation, and income; these variables have been used to measure blacks' status relative to whites at any given point in time and to gauge progress made since the Civil Rights era. While each of these measures is an important indicator of where blacks stand, and of how much has been accomplished in the drive toward social justice, the measures fall short of providing an ideal index of blacks' well-being because they fail to capture the total amount of resources that are available to black and white families.

As noted by Oliver and Shapiro (1995), relative to income, wealth is a broader measure of the resources that a family or individual has available. Income measures the flow of resources into a household at a single point in time. Wealth captures all the existing resources that can be drawn on, primarily because it accounts for an accumulation of past savings out of income, the consequences of indebtedness, and the presence of inherited monies. If a family has assets, it possesses a store of purchasing power that can be put toward consumption or the pursuit of other goals, even if its present income is low or non-existent. This can be important during old age, when a family suffers an unexpected income loss such as that associated with a layoff, for responding to health shocks, and for making human capital investments or other lumpy expenditures.

Additionally, a study of wealth can reveal dynamics that might be overlooked otherwise (Oliver and Shapiro, 1995). A focus on wealth can highlight the inter-generational transmission of advantage and direct attention toward the length of time that an individual or household has benefited from a particular advantage. The purpose of this review is to: 1) summarize the findings of the literature on wealth; 2) indicate why financial assets in particular are important; 3) identify gaps in the existing literature on wealth; and 4) establish connections between wealth research and research questions that have been pursued elsewhere in the social sciences.

## The Presence and Magnitude of the Wealth Gap

Perhaps not surprisingly, wealth—like income—is unevenly distributed in the United States. There are substantial differences in wealth held when one divides the population along racial lines, and these differences remain even when variables that economic theory offers to explain wealth holding are accounted for. Data from the Survey of Income and Program Participation (SIPP) presented in Oliver and Shapiro (1995) indicate that, among all U.S. households, the average net worth of white families was about $96,000 in 1988 (meaning that whites held assets valued at $96,000 once their debts were netted out), while the average black family=s wealth stood at just under $24,000. This results in a wealth ratio of 0.25; indicating that, on average, for every dollar of wealth held by whites, blacks hold only twenty-five cents. This infers a bigger black-white wealth gap than the gap that presently exists between black and white earnings, as black-white income ratios hover around forty-eight percent (Wolff, 1998). Other studies using data from the National Longitudinal Survey of Youth (NLSY), the Survey of Consumer Finances (SCF), and the Panel Study of Income Dynamics (PSID) find similar results (see Blau and Graham, 1990; Wolff, 1998; and Hurst, Luoh and Stafford, 1998; respectively).

While these average differences fall when multivariate analysis is used to control for the influence of factors such as education, age, family size, marital status and permanent income, the differences do not vanish—race remains significant in such regressions (Oliver and Shapiro, 1995; Hurst, Luoh, and Stafford, 1998).

Research also indicates that there are race differences in the composition of black and white portfolios. Oliver and Shapiro (1995) note that among the wealth that is held, black families' holdings tend to be concentrated in consumable assets-namely, auto wealth and home equity-while white portfolios tend to exhibit more diversification. This finding resembles that found in the earlier research of Blau and Graham (1990), and Terrell (1971). In one of the first major studies of black and white wealth holdings, Terrell (1971) used data from the 1967 Survey of Economic Opportunity (SEO), and found that about 90 percent of black wealth was held in the form of physical assets while only about 10 percent was held in financial form. Over twenty years later, Oliver and Shapiro (1995) found a similar pattern of black portfolios being dominated by non-financial assets.

Economic and financial theory argues that portfolio allocation decisions (e.g. decisions about how much to invest in specific assets at any given level of wealth) will reflect the characteristics of individual assets-rate of return, riskiness, liquidity-and not the race of the holder, makeing it perplexing that race appears to matter so much in practice. Absent independent information to suggest that blacks and whites differ substantially in attitudes toward risk and liquidity, economic theory would not predict sharp differences in the structure of black and white portfolios.

Race differences in the tendency to hold financial assets can have important consequences. For example, the recent boom in the stock market during the late 1980s and early 1990s caused the returns to holding stock to rise dramatically relative to other assets, and capital gains were a great source of wealth growth for many white households as a result. The finding that black portfolios are dominated by physical assets, therefore, suggests a kind of stratification in asset markets that is akin to the stratification found in labor markets discussed and documented by Landry (1987). Much like the finding of black workers being stuck holding low rewarding jobs, it appears that, in asset markets, black families disproportionately hold assets with lower yields. Though the concept and consequences of asset market stratification have not been explored in detail by the existing literature, it is theoretically clear that differential patterns of holdings will have consequences for the growth rates of black and white portfolios, and for racial inequality. As long as initial wealth gaps exist and if blacks and whites experience sharply different returns in asset markets, there will be gaps between blacks and whites that cannot be narrowed simply by ensuring that blacks have access to education that will put them in a position to match whites' earnings in the labor market.

## Black Participation in the Financial Marketplace

Aside from the high monetary return associated with ownership of financial assets in recent years, financial assets offer the added benefit of being highly liquid. They can be readily converted into cash to meet emergencies (e.g. unexpected loss of employment) and life-cycle needs (i.e., the loss of labor income associated with retirement). Physical assets, such as cars and homes, are different because they are more difficult to use for such contingencies (though home equity is becoming more readily accessible due to recent advances in housing markets), and because they meet transportation and shelter needs that are likely to still be in place after job loss or retirement.

What do we know about blacks' participation in the financial marketplace? Two facts are apparent. First, black-white gaps in financial holdings are larger than the general wealth gaps, indicating that blacks are less represented in this market than whites (Wolff, 1998; and Oliver and Shapiro, 1995). Second, we know something about two individual financial assets. Research on stock holding and bank account ownership rates indicates that both are low in the African American community.

Much of what is presently known about stock ownership among African-American households comes from the PSID, which is the offspring of the SEO used in Terrell's (1971) seminal piece. Research by Hurst, Luoh, and Stafford (1998) indicates that only about 14 percent of black families own stock, while about 45 percent of white families do. Additionally, black families are found to be less likely to own stock even after the influence of other economic and demographic variables that would be expected to influence stock ownership are controlled for. It is not entirely apparent why blacks and whites differ in terms of stock holding. Oliver and Shapiro (1995) offer some guidance toward understanding the reasons for black-white differences in wealth, but their explanations relate largely to housing markets and entrepreneurship; and, while they do note the existence of favorable tax treatment for capital gains, this fiscal policy can explain growth in stock wealth for those who hold stock, but it cannot explain blacks' failure to own stock in the first place. Using inter-generational data from the PSID, Chiteji and Stafford (1998) address this issue by examining the role that learning about specific financial assets at home has on asset ownership. They find a relationship between parent's ownership of stock and children's ownership once the latter reach adulthood. This suggests that some of the race differences in stock ownership may be attributable partly to differences between blacks and whites in terms of their having been exposed to financial assets while they are growing up.

The news on the bank account ownership front is better than the news for stock ownership, with more black households holding this key financial asset than those that owned stocks. However, the gaps between black and white participation remain sizeable, with about 45 percent of black families holding a bank account compared to 85 percent of white families (Hurst, Luoh, and Stafford, 1998). Given the crucial role that bank-based money plays in our society, the high level of non-account ownership is surprising. Over the past 70 years, the United States has seen a dramatic increase in the use of checks by businesses and households desiring to make payments to other parties. Additionally, in recent years bank-based electronic transfers have been gaining popularity. The widespread reliance on bank-based money in our society raises questions about how households without bank accounts fare, for accounts at depository institutions have historically provided households with a crucial place to store wealth and they remain an important mechanism for making and processing payments.

With respect to the empirical evidence suggesting a lack of account ownership, two questions emerge for economists and scholars in other disciplines: (1) what are the reasons for lack of account ownership and (2) what are the consequences of not having a bank account? Several explanations have been offered to explain non-account ownership, but the debate about the causes of the low ownership rates in the black community is far from settled. The standard explanations focus either on demand-side factors or supply-side variables. On the demand side, low account ownership rates are attributed to some households' decision to forego accounts because the cost of an account does not match the value entailed by ownership. Research in this tradition has emphasized the deregulation that occurred in the banking industry and the declining incomes of low-income families during the 1980s, arguing that the subsequent decline in account ownership resulted from price increases for basic transaction services associated with deregulation (Caskey, 1994a). This literature views lack of account ownership as a decision to forego an account given the fee that is charged in order to cover banks' costs of providing the service. It hypothesizes that some households are "priced out of the market" for transaction services. A significant failing of this literature is that it does not provide any intuition as to why blacks should view the services associated with bank accounts differently from whites, and its regression analysis indicate that accounting for variables such as income and education do not eliminate the effect of race (see Caskey and Peterson, 1994).

Other research focuses on the supply side of the financial services market (Caskey, 1994b; Dymksi, 1996; and Avery, 1991). This research examines the relationship between lack of account ownership and bank representation in the urban areas in which many black families reside. For example, Caskey's (1994b) multi-city study finds that, on average, black neighborhoods have fewer banks than white neighborhoods and that the number of tracts without any bank representation is higher in the black community. Dymski's (1996) analysis of Los Angeles provides similar evidence, though he also notes that during periods in which banks have been closing branches in minority areas, alternative financial service providers, such as check cashing outlets, have been opening. This highlights the central quandary for the empirical literature on account ownership: how to reconcile apparent lack of demand for bank accounts with the evidence that is increasingly becoming available about the widespread use of check cashing outlets. There has been considerable growth in the check cashing industry in recent years and the scattered evidence that is available on fees charged by these institutions suggests that the services that they provide are not cheap (Caskey, 1994a; Squires and Connor, 1997). This literature clearly suggests another example of the way that space may shape opportunities, and it therefore serves as an interesting counterpart to the residential segregation literature and the literature on spatial mismatch in labor markets (Massey, 1990 and Wilson, 1996 for example).

Overall, it is unclear whether discrimination is fueling lack of account ownership by constraining inner-city blacks' access to financial services, whether there is something unique about black households' desired mix of financial services (such as an almost exclusive emphasis on check cashing privileges), or whether there is a reluctance to deal with banks that is rooted in historical experience. It is also possible that blacks have lower holdings of financial assets precisely because these assets are so liquid. There may be a connection between the presence of kin networks and informal social support in the black community as discussed by Stack (1974) and Lincoln (1998), and low bank balances in the black community, as the latter may reflect the fact that blacks frequently are called on to devote their savings toward meeting the needs of other family members or friends. Research by Pattillo and Heflin (1998), documenting the presence of more poor siblings in blacks= family trees than is the case for whites, is extremely suggestive, though more research needs to be done to determine precisely how the presence of informal and kin networks affect black households' financial behavior.

## Conclusion

The available empirical evidence indicates that black and white families hold vastly different amounts of wealth and distinctly different portfolios. This research also reveals that black households are less represented in financial markets than are white households. The reason for the differences that are observed between the races is unclear. Although the relevance of constraints posed by bank location decisions and the role of preferences have been explored separately in different places in the literature, these two competing explanations have not been tested in a single model and there is no consensus at present as to what explains the low account ownership rates by black families. On the stock ownership front, even less is understood about race differences.

The consequences of the differences in patterns of asset ownership, particularly in terms of the implications for the long-term well-being of black families and for racial inequality, also need to be better understood. The lack of financial marketplace participation has implications for the adequacy of preparation for emergencies and old age, and it may have further implications for African Americans' ability to cope with job loss and other life stressors, though such links have yet to be investigated by the literature. The low representation in the financial marketplace and low wealth holdings in general also warrant further investigation in order to determine whether policy intervention is appropriate to mitigate any potential consequences for child and adult outcomes and to stifle future growth in racial inequality.

Though the focus on wealth is new in research on racial inequality, it is important. The study of racial inequality is essentially an inquiry into the presence of differences between the opportunities that people of different races face in society. While traditionally viewed in a passive fashion (namely, as residual resources that accrue solely out of past saving from income), economists and other social scientists are beginning to recognize the fact that wealth plays an active role in people's lives. It is a variable that shapes the prospects or life chances of individuals and families.

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