It is widely documented that a large wealth gap exists between White and Black households. Using the newest Survey of Consumer Finance (SCF) data, Bhutta et al. (2020) report that both the median and mean wealth of Black families are each less than 15% of those of White families. In addition, Kent and Ricketts (2021) use the same SCF data and further point out that Black families are much less likely to own various assets, such as homes, businesses, and financial and retirement assets, which implies that the participation rates for various financial vehicles could vary significantly across races.

Many factors potentially contribute to the large wealth gap. By a simple accounting concept, heterogeneity in individuals’ saving rates and portfolio choices results in different rates of wealth accumulation. Thus, intuitively, a higher level of wealth must be caused by higher saving and/or a higher rate of return on a portfolio. A better understanding of the underlying factors of the wealth gap is the first step to improving the quality and efficacy of government policy intended to create a more equitable society.

This essay investigates the difference in the stock market participation rate between White and Black households, which is an important contributing factor to the wealth gap caused by heterogeneous portfolios. From 1928 to 2016, the average annual stock return was about 8 percentage points higher than the return on 3-month Treasury bills. This difference leads to sizable return gaps over time. Hence, stock market participation could play an important role in explaining the large wealth gap observed in the data.

We use the 2018 Survey of Income and Program Participation (SIPP) data to investigate this issue. We define a household as participating in the stock market if the value of the household’s stocks and mutual funds was greater than zero. The stock market participation rate is defined as the proportion of households who report having a stock or mutual fund value greater than zero.
greater than zero at any point during the year 2017 (the reference period for the 2018 SIPP).2

The results show a sizable difference between the stock market participation rates of White and Black households: 24% of White households report owning stock or mutual funds, while less than 8% of Black households do.3

Past research has found that stock market participation is highly correlated with income level. Low-income households cannot afford to save and hence do not hold many assets, such as stocks. Because the average household income is higher among White households than Black households, one might intuit that income disparities are driving the difference in the stock market participation rate.

However, this is not the whole story. When controlling for household income level, the large gap between participation rates prevails. The figure shows the participation rates for White households (blue bars) and Black households (orange bars) across different income groups. The gap remains large for each group and even appears to widen for higher-income brackets, indicating that household income level does not account entirely for the differences in participation rates between Black and White households.

To further show that the income gap is not the major determinant of the wide gaps in the stock market participation rates in the figure, we consider the following thought experiment: How much would the gap in the stock market participation rate close if the income distribution of Black households was equal to that of White households? That is, let us assume that the percentage of Black households that fall into an income group in the figure is the same as the percentage of White households that fall into that income group.4 When we equalize the income distribution and keep the Black household participation rate the same for each income group, the total Black household stock market participation rate rises from 8% to approximately 11.4%, which remains substantially below the White household participation rate of 24%.

After controlling for income, it is difficult to argue that the cost of stock participation, such as transaction fees, is able to explain the wide participation gap between White and Black households. While there could be several underlying factors, and narrowing down what they are is beyond the scope of this essay, one factor could be peer influence on financial decisionmaking. For example, households may be more likely to invest in the stock market if their friends and family are doing so.5

Investment decisions matter for the welfare of households and their ability to accumulate wealth. Therefore, understanding the different financial asset participation decisions made by Black and White households is an important step in understanding the racial wealth gap. Further attention should be paid to understanding the underlying causes of the difference in stock market participation rates between White and Black households as well as other contributing factors to the racial wealth gap, such as differences in retirement saving. ■

Notes
1 $100 investments in stocks and in bonds in 1928 would have yielded nearly $329,000 and $2,000, respectively, 88 years later. See Damodaran (2016) for the detailed numbers. The return gap remains sizable even if one considers 10-year bonds instead of 3-month Treasury bills.
2 Our stock market participation does not include stock positions in retirement accounts, such as 401Ks.
3 These rates are similar to those reported in the 2019 SCF’s Summary Extract Public Data based on the variable HSTOCKS, which indicates whether a household’s stock has a value greater than zero.
4 Note that there are two additional income groups included in aggregate stock market participation rate calculations but not pictured in the figure due to small sample size: $500,000 to $999,999, and $1,000,000+
5 See Hung (2021). In academic literature, the peer effect on financial decisions is supported by several studies such as Duflo and Saez (2002) and Hong, Kubik, and Stein (2004).

References