Comment

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The topic of long-standing US racial inequality is experiencing a revival in mainstream economics literature. Numerous studies released in recent years document the prevalence and persistence of racial gaps across several economic domains, analyze the heterogeneous impact of policies across racial groups, or develop new theoretical frameworks for understanding racial gaps. This paper makes a timely intervention in this last literature, focusing on one of the most striking forms of racial inequality, the Black-white wealth gap.

This paper models the persistence of racial wealth inequality as arising from endogenous beliefs about returns on risky assets. In the authors’ model, beliefs update through learning, which is assumed to occur solely through participation in the market for risky assets (an assumption that is later relaxed to allow for learning through social networks). In the model set up, Black and white households hold equally pessimistic initial beliefs. During slavery, capital returns were very high—high enough that the expected gains exceeded that of eschewing investment even when beliefs were pessimistic. Under these circumstances, white households participated in risky asset markets and thus learned more about the true distribution of good and bad outcomes after investment. But because slavery barred Black Americans from participation in labor and capital markets, only white households were able to experiment and thus update their beliefs about returns. After slavery, Black Americans could in theory participate, but by then, returns had fallen and were no longer sufficiently high to overcome expected low returns due to pessimistic beliefs. The long-run result of this is that there are no Black capitalists today.

The model is well able to match the fact that risky assets are an important driver of today’s racial wealth gap. The policy implications of the model are that investment subsidies have the power to close the racial wealth gap in the infinite time horizon, while transfers like one-time reparations payments do not close the racial wealth gap in the long run, as they do not affect beliefs. Indeed, relative to a world with wage equalization, which reduces the racial wealth gap through low-risk asset building, reparations have no additional impact on the long-run racial wealth gap.

There is much to admire in this paper. First, the authors take the history of racial oppression seriously and carefully develop a model that highlights one way the past can cast a long shadow on racial wealth inequality today. They formalize capital and labor market exclusion under slavery as well as racial wage gaps in the Jim Crow era. These exclusions combined with the historical dynamics of capital returns give rise to a situation where Black households opt for safe returns over risky ones, generation after generation, leading to low wealth levels today. Second, the model reproduces several key facts about racial inequality. For example, the model matches the average racial wealth gap today as well as the intergenerational mobility gap in the past and present. Additionally, model matches the contribution of risky assets to the racial wealth gap overall. Finally, racial differences in beliefs about risky asset returns in the model are corroborated by consumer survey evidence.

I focus my commentary on three questions. First, one of the contributions of the paper is to incorporate endogenous beliefs about risky asset returns as drivers of the racial wealth gap. In the
paper, such differences arise from Black Americans not updating their beliefs. What if racial differences in beliefs about risky asset returns stem from actual differences in the returns themselves?

A substantial literature documents that there are racial differences in returns on assets of various types. This raises the question of whether Black beliefs are not so much pessimistic as simply reflective of reality. In illustrating the model’s mechanisms, the authors give the example of Henry Boyd, a former slave who purchases his freedom and attempts to run a business. Though Boyd is able to secure initial capital to start his business by partnering with a white business partner (as Boyd himself is legally and socially barred from borrowing money), but his shop is burned down so many times by white supremacists that he eventually closes his business altogether. Far from being an example of exclusion that prevents further learning, the case seems to exemplify learning itself, thus changing the interpretation of the key mechanism for persistent gaps.

After slavery, there were many further instances of the destruction of Black wealth, from the burning of Black homes in white neighborhoods to the very salient example of the destruction of the Greenwood district in Tulsa, Oklahoma in 1921. Albright et al. (2021) find that the Tulsa Massacre had long-run effects on the local Black community, with increased labor force participation by women and suppressed rates of homeownership. The authors further find that news of Tulsa sent a chill throughout the Black community, with reductions in homeownership in those places connected to the massacre through newspaper coverage. Kroeger and Wright (2021) find that Black-owned businesses have lower survival rates than white-owned ones, and business closure is associated with downward economic mobility. Thus, focusing solely on the entry margin — encouraging business ownership by Black Americans — may not lead to lower racial wealth gaps if Black businesses have a lower success rate. To be effective at reducing racial gaps in business wealth, policies fostering entrepreneurship must address the sources of racial differences in success.

The second question has to do with the time to convergence. I would argue that it too must be considered when evaluating policies that purport to close racial wealth gaps. Reparations may be insufficient for closing racial wealth gaps in the infinite time horizon, yet this type of policy closes the gap by construction, once implemented. This is an important outcome in and of itself because the full evolution of the racial wealth gap suggests that a long convergence path is itself a legacy of slavery and initial conditions in the wealth gap.

In Derenoncourt et al. (2022), we provide a new time series of the racial wealth gap since 1860. We build the time series by combining census data from 1860 and 1870 with southern state tax reports from the 1860s to the 1910s, statistical reports on Black economic progress, household survey data, the censuses of population and agriculture, and finally historical and modern waves of the survey of consumer finances. This time series is illustrative as it shows that the biggest reductions in racial wealth inequality occurred in the first 50 years after Emancipation. Over the past 160 years, the wealth gap exhibits a “hockey-stick” shape over time that aligns with standard wealth accumulation frameworks where savings, capital gains, and income growth are the determinants of wealth for Black and white Americans. Even under equal parameters for wealth accumulation in terms of savings rates and capital gains, and under observed income
convergence, the wealth gap would remain sizable today (a gap of 3 to 1) and would not converge, even in the next near 200 years. Given observed differences in savings and capital-gains-induced wealth accumulation across the two groups, convergence is indeed no longer in sight. In fact, the past few decades show the wealth gap widening again, not closing.

This long-run perspective puts today’s wealth gap in context. It would take large advantages in savings rates, capital gains, or income growth rates to bring about racial wealth convergence in a short time frame. Policies like reparations in the amount of the wealth gap bring the wealth ratio to one at the time the transfer is made. While it is true that the wealth gap would re-emerge if such a transfer does not change the parameters of wealth accumulation, such as returns or savings (whether stemming from differences in behavior or not), there may be reason for considering the time to convergence in the design of wealth equalization policies.

The final strand of this discussion focuses on the determinants of beliefs in the model. In the authors’ baseline model, beliefs depend first on direct participation in the market. Historical institutions and the dynamics of capital returns mean that Black Americans never believe it is worth it to become capitalists. The authors then relax this assumption and allow social networks to influence beliefs. However, they note that segregated social networks mean that beliefs can remain relatively pessimistic even with a large number of ties, if networks are segregated by race. They find that including even just one white “friend” in the network can eliminate the wealth gap in the infinite time horizon.

However, it would be interesting for future research to consider other ways beliefs might be influenced. For example, it is possible that a policy like reparations and the type of society in which such a policy is realized would also affect Black beliefs about returns. Historical abuses that erode trust in institutions can dampen economic convergence. Whether or not policies such as reparations can restore that trust is a difficult question to answer empirically. But one case study may be illustrative. Miller (2020) studies land and capital redistribution in the Cherokee Nation after the Civil War. The Cherokee Nation joined the Confederacy during the Civil War. Afterwards, the Nation signed a treaty with the US federal government that gave freed Black persons in the Cherokee Nation citizenship of the Nation and the right to claim land. New landowners were allocated equipment to assist in farming. Studying the impact of this policy, the author found that racial wealth gaps fell in the Nation relative to the rest of the South. Furthermore, the author found that human capital investment in the next generation increased, and that Black farmers in the Nation planted fruit trees as opposed to staple crops only.

This change in investment choices may signify updated beliefs on the returns to a relatively riskier investment. Fruit trees have a long gestational period compared to staples and are only remunerative if landowners believe their property rights to be secure. Thus, this evidence raises the question of whether certain forms of reparations policy can also change beliefs. This would then allow reparations to have a more lasting effect on the racial wealth gap relative to a world in which reparations do not affect beliefs.