“New Estimates on Generational Wealth and its Impact on the Racial Wealth Gap”

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Introduction

The persistence, and even expansion, of the racial wealth gap over the past 60 years has vexed numerous scholars. Some believe the wealth disparity results from "cultural" differences between White and Black households in their attitudes toward credit, risk-taking, and saving. Others point toward portfolio heterogeneity and disparate rates of return as the culprit. Still, others contend it's the momentum of generational wealth, an artefact of our country's long history of de jure discrimination. None of these arguments have proven to be wholly persuasive.

Simple facts do make the role of generational wealth a likely suspect. According to the Survey of Consumer Finances (SCF), White households hold 86 percent of household wealth and received 94 percent of the reported family transfers. While Black households account for 12 percent of the survey population, their shares of net worth and family transfers are 2 and 1 percent respectively. White households are nearly three times as likely to report receiving a past gift and their average gift is nearly 15 times larger than those reported by Black households. And the size of these intergenerational transfers is substantial. In a recent study, Feiveson and Sabelhaus (2018) estimate *among all households*, that somewhere between 26 and 51 percent of current household wealth could be traced to past gifts assuming real rates of return of 3 and 5 percent. In a subsequent article, Sabelhaus and Thompson (2023) conclude that family transfers comprise a larger portion of White wealth than Black wealth. All of this suggests that generational wealth should play a substantial role in explaining the racial wealth gap.

The evidence suggests otherwise. Early studies using the traditional Oaxaca-Blinder-Kitagawa (OBK) decomposition method find between 7 and 20 percent of the Black-White wealth gap is explained by family transfers. However, the OBK method suffers severe limitations (Barsky et al., 2002). Its required assumption of linearity is at odds with the nonlinear links

between wealth, income, and other covariates. Further, the OBK method can only examine differences at the mean making it vulnerable to outliers. An alternative decomposition approach, introduced by DiNardo, Fortin, and Lemieux (DFL) (1996) overcomes these limitations. Three recent studies using this method find agreement as they contend that family transfers explain as little as the 3 to 5 percent of the Black-White racial wealth gap.[1] Another paper (Sabelhaus & Thompson, 2022) does find that a broader measure of generational wealth can increase the explanatory role to 15 to 19 percent.[2] These estimates suggest that family transfers actually play a modest role in the persistence of the racial wealth gap.

The objective of this paper is to examine these issues with an expanded measure of generational wealth. I argue in vivo gifts and family bequests represent the *observable* portion of intergenerational transfers of family wealth. Like the iceberg, this visible portion is not largest share. To this end, I organize the paper as follows. I offer a summary of the ways that generational wealth is transferred across generations. Then, I introduce the decomposition method, data source, and key covariates. I share the results and finish with a discussion.

Benefits of Generational Wealth

Families transfer their generational wealth in ways other than well-timed gifts and inheritances triggered by death. Perhaps, most importantly they invest in the human capital of their children. Throughout childhood, family wealth can assure ample and nutritious food, safe and stable housing, and other critical needs are met. Adequate wealth allows parents to locate in neighborhoods with well-resourced schools or send their children to elite, private schools. Well-prepared for the academic rigors of college, their children gain admission and successfully

[1] They are Petach & Tavani, 2022; Toney, Addo, & Hamilton, 2023; and Sablehaus & Thompson, 2023.
[2] They include the expectation of a future inheritance as well as whether one inherited a real asset like a home or business.

graduate from top-level universities. Family resources permit their children leave college with a diploma but without burdensome debt. Well-positioned, they can expect to secure professional jobs that offer ample salary, generous benefits, and advancement opportunities.

Family wealth can offer valuable help even as their adult children are embarking on their careers. Some parents have the option of offering employment in the family business. Most parents can share their extensive professional network to enable their kids obtain desirable jobs and advance within their careers. Ample parental resources can provide a form of insurance. The potential of cash assistance or even moving back home temporarily enables their children to wait for an attractive employment offer or overcome career setbacks. This safety net allows some children the flexibility to invest in further education or engage in a high-risk, high-reward, self-employment opportunity. Parents of means can transfer real assets to their children including homes, rental properties, and businesses. Their illiquidity may preclude squandering that can arise with cash transfers. Generational wealth can be used to improve access to credit as parents can co-sign loans or offer nonrepayment "loans" to help with down payments. Lastly, generational wealth protects the younger generation from becoming a magnet to other family members seeking financial help. All of this help simply supplements what is given in the form of conventional, family transfers.

Methods

Although similar to the DFL decomposition method mentioned earlier, this paper uses the updated method (FFL) as explained in Firpo, Fortin, and Lemieux (2018). Like the DFL, this method creates one counterfactual in which the distribution of key traits from one group are assigned to the other. It employs a reweighting strategy that better reflects commonly observed values and limits the influence of outliers that have no common support in the other group. It

avoids requiring an assumption of linearity and allows one to examine differences along the full distribution. The FFL method updates this by incorporating a two-stage, Recentered Influence Function to examine how marginal changes in the covariates affect the outcome variable. Instead of simply estimating the composition (explained) from the structure (unexplained) effect, this two-stage method separates each effect into a "pure" portion and an error term. The reweighting error estimates how well the reweighting matches the two groups while the specification error measures how well the model describes the interactions among the covariates and the outcome variable. In both cases, the errors should go to zero as the sample gets larger.

The SCF serves as the data source for this analysis. The SCF is a single-wave, cross-sectional survey that asks households detailed questions regarding their assets, debt, and wealth transfers as its primary focus every three years. Its range and depth of questions regarding household balance sheets makes it a peerless source of household wealth. Two thirds of the survey sample are randomly drawn while the remaining respondents are collected through an oversample of very affluent households. As a tiny percent of households hold nearly half of the nation's wealth, this sampling design offers greater assurance that this group is represented in the survey (Bricker, et al., 2016). As the SCF only started asking questions regarding financial literacy in 2016, this paper only includes that and the two subsequent surveys.

I use the following covariates as part of the explanatory model. Regarding generational wealth, I start with a measure of past bequests and gifts received. Knowing the reported value and year the transfer was received, I adjust the nominal values for inflation.[3] I include a dichotomous variable on whether the household received a (real) asset gift to determine whether such transfers are stickier. To measure less visible benefits of generational wealth, I use the value

[3] Interestingly, making adjustments for any real appreciation of these past gifts has a negligible impact on the results.

of whatever future inheritance is expected. I couple an educational attainment variable along with a dichotomous variable for the existence of student loan debt to measure parental human capital investment in their children. Presumably, parents with means will limit the amount of debt incurred seeking additional education and training.

I include several other variables to capture indirect benefits of generational wealth. To discern whether parents can help with access to credit, I include whether the respondent has had a denial of a credit request in the past year. I use a variable that reflects parental education attainment to see whether such education alone offers tangible benefits. To capture the possibility of parental safety net assistance, I develop a dichotomous variable on whether the respondent could get $3,000 from “friends or family” in an emergency. As this question could reflect the respondent’s attainment of social status rather than family resources, it should be interpreted with some caution. Lastly, I include a variable that reflects whether the respondent gave assistance in the past year to siblings, parents, or grandparents. Children raised in affluent families are less likely to receive and respond to such requests.

I include other covariates in the model as well. I include standard demographic variables like the respondent’s age, gender, marital status, and the number of dependent children in the household. To capture household capacity for current saving, I use a reported value of normal income along with whether the full household is covered by private health insurance or experienced unemployment within the past year. To test financial attitudes and behaviors, I incorporate a number of variables. To discern the contribution of household saving, I use whether they report some form of regular saving (intent) as well as whether they were actually able to save (capability) in the prior year. I add whether they engage in longer-term planning, believe saving to leave a legacy is important, view themselves as a risk-taker as well as their attitude

toward taking credit in order to fund a vacation. I include variables that measure how much of their adult lives they've worked full-time and whether they've experienced past due payments. Lastly, I use the survey questions to create a financial literacy measure.

Results

Below are the results from the FFL decomposition regarding the aggregate categories. The four categories of Attitudes, Capacity, Family Wealth, and Demographics explain most of the racial wealth gap, with the exception of the bottom tail. With this exception again, generational wealth accounts for more than a third of the Black-White wealth gap, a far larger share than has been reported recently. The remaining three categories mostly explain the residual in largely equal proportions. Almost without exception, each of the areas are statistically significant to at least a 0.05 level.

FFL Decomposition Aggregate Categories					
	Family Wealth	Attitudes	Capacity	Demographics	Explained
Mean	29%***	11%***	20%**	19%***	79%***
10th Percentile	1%	0%*	2%***	1%***	4%***
30th Percentile	33%***	16%***	27%**	21%***	96%***
50th Percentile	30%***	15%***	26%**	17%***	88%***
70th Percentile	34%***	15%***	22%**	21%***	92%***
90th Percentile	38%***	13%***	13%***	9%***	73%***
P-values: * < .10; ** <0.05; *** < 0.01					

Next, let's examine variables included in the aggregate categories, starting with the family wealth variables. By far, the most important variable in explaining the racial wealth gap is the absence of student loan debt. At the mean, it explains 15% of the racial wealth gap and has a significant impact across the wealth spectrum, even at the bottom tail. Of next importance is the existence of a safety net that contributes 7 percent of the gap at the mean and even greater amounts across most of the spectrum. That its impact is negligible at the bottom tail does suggest

it reflects somewhat the social network one has attained. The expectation of future inheritances explains 6 percent at the mean and as much as 15 percent at the upper tail. Almost without exception, inheriting a real asset like a home or business offers a greater contribution to the wealth gap than does whatever value one has inherited. Having inherited a real asset explains 3 percent of the gap at the mean and plays a discernible role across the wealth spectrum. The educational attainment variable is a negative 2 percent at the mean, but plays a significant role among the upper half of the wealth distribution. Parental education attainment offers very modest explanation as does the need to help one's siblings or parents. Parental help with household credit appears to have no role in explaining the wealth gap.

While none of the individual Attitudinal variables explain more than 3 percent of the gap at the mean, they do reveal some striking patterns when one considers their impact across the wealth distribution. Two of the variables, whether households actually saved or not and financial literacy make their greatest contribution in the upper tail. The Did Save variable explains up to 6 percent of the gap while the financial literacy variable never exceeds 4 percent. Having a full-time work history reaches its peak of 7 percent at the 30th percentile and remains significant through much of the upper end. Being a regular saver and having a longer-term planning horizon offers some modest contribution throughout the middle of the wealth continuum, but not at the two tails. Risk-taking behavior never exceeds a 1 percent contribution to the wealth gap. Strikingly, payment discipline as well as attitudes toward credit or leaving a legacy have no discernible impact on the wealth gap.

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FFL Decomposition – Individual Variables							
Family Wealth	Mean		10th	30th	50th	70th	90th
Past Transfers	0%		-1%***	-1%	2%	5%***	2%
Expect to Inherit	6%***		1%***	4%**	3%**	3%*	15%***
Inherited Asset	3%**		0%**	3%**	4%**	2%**	1%*
Educ. Attainment	-2%***		-1%***	0%	5%***	7%***	4%***
Student Loan Debt	15%***		2%***	14%***	5%***	4%***	3%***
Parent Education	0%		0%***	0%	0%	1%*	2%***
Safety Net	7%***		0%	11%***	10%***	10%***	9%***
Helped Others	0%		0%	1%*	1%*	1%*	1%*
Restricted Credit	0%		0%	0%	0%	0%	0%
Attitudes							
Did Save	3%***		0%***	2%***	3%***	6%***	6%***
Regular Saver	3%***		0%***	3%***	3%***	1%**	0%
LR Plan Horizon	2%**		0%***	2%**	1%**	2%**	0%
Risk Taker	1%**		0%***	1%**	1%*	1%*	1%*
Legacy Import.	0%		0%***	0%	0%	0%	1%
Late Payments	0%		0%	0%	0%	0%	0%
Credit Ok	0%		0%	0%	0%	0%	0%
FT Work History	2%***		0%	7%***	4%***	1%	2%***
Financial Literacy	1%		0%	0%	3%***	4%***	4%***
Capacity							
Normal Income	15%***		2%***	17%***	16%***	18%***	12%**
Private Health Cov.	4%***		0%	8%***	8%***	5%***	1%
Unemployed	1%***		0%	2%***	2%***	-1%*	0%
Demographics							
Age	17%***		1%	17%***	24%***	21%***	6%*
Age Squared	-12%***		0%	-13%**	-17%***	-13%***	-1%
Married	7%***		1%***	9%***	8%***	8%***	4%***
Male	7%***		0%	7%***	2%	5%***	1%
No. of Children	0%		0%	0%	0%	0%	0%
Specification Error	-0.37		-16.0***	0.14	0.18	0.25	0.14
Reweighting Error	-0.38		-1.71	-0.11	-0.08	-0.18	-0.29
P-values: * <0.10; ** < 0.05; ***<0.01.							

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In contrast, differences in household capacity play an important role. Normal income offers a substantial explanation across the wealth distribution, even at the bottom tail. Having private health insurance coverage contributes substantially although not at the upper and lower tails. Bouts of unemployment have a modest role to play. The Demographic variables follow a similar pattern of explaining moderate portions of the wealth gap through the middle of wealth distribution, but not so much in both tails. The age variables reveal the expected pattern while both the marriage and gender variables offer substantial explanation through the middle of the distribution. Curiously, the number of children has no apparent impact.

The error terms mostly corroborate the model's soundness with the exception of the specification error in the bottom tail. It simply reinforces the model's challenge with understanding what is happening at the bottom tail of the wealth distribution.

Conclusion

Offering an expanded view of generational wealth and its many benefits clearly demonstrates its significant role in explaining the racial wealth gap. In contrast to recent estimates, it appears to explain one third of the gap. The evidence clearly shows the formal financial transfers are the visible, but relatively unimportant benefit of generational wealth. Instead, the intergenerational transfer of human capital in the form of educational attainment without the baggage of student loan debt is the most important factor. Several reasons may

explain this. Likely more families are capable of providing this form of generational support than are able to make significant financial gifts. Additionally, the timing of inheritances – occurring later in the recipient's life – limits their value. In contrast, family help with college tuition occurs early in the recipient's life; its benefits can be leveraged over one's whole adult life. Moreover, the racial benefits of such help are clearly skewed as substantial evidence elsewhere demonstrates how White graduates earn much salaries than their Black peers.

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