



Simulating How Progressive Proposals Affect the Racial Wealth Gap

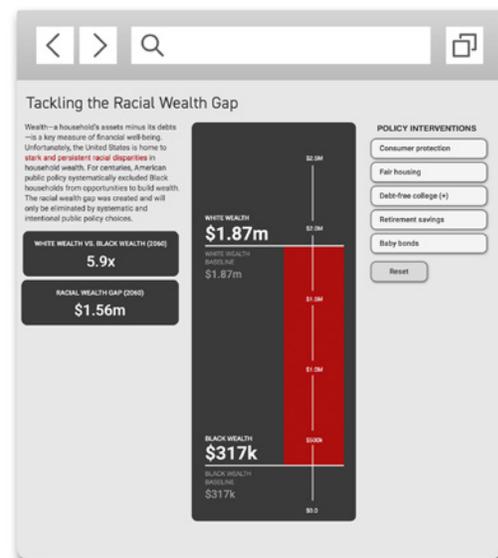
By Christian E. Weller, Connor Maxwell, and Danyelle Solomon August 7, 2019

Authors' note: CAP uses “Black” and “African American” interchangeably throughout many of our products. We chose to capitalize “Black” in order to reflect that we are discussing a group of people and to be consistent with the capitalization of “African American.”

Wealth—a household’s assets minus its debts—is a key measure of financial well-being. Unfortunately, the United States is home to stark and persistent racial disparities in household wealth. While various proposals exist with the aim of shrinking the racial wealth gap, estimates of their long-term effects are limited. A new simulation developed by the Center for American Progress demonstrates how separate proposals implemented today, in combination or in isolation, would reduce racial disparities in average wealth—total wealth divided by the number of households in the United States—by 2060. The simulation specifically tracks white and Black couples who are currently beginning their careers and starting to accumulate wealth and compares their total projected household wealth as they near retirement.

The racial wealth gap

Wealth eases the transition between jobs and neighborhoods and provides a cushion in response to emergencies and during retirement. Wealth is also transferrable and allows households to finance their descendants’ futures by helping cover the costs of education, a health emergency, or even a down payment on a home. However, in 2016, the median white household held \$171,000 in wealth—almost 10 times more than the median Black household’s wealth of \$17,600.¹ The median racial wealth gap of more than \$150,000 may understate the extent of the disparity between Black and white households. The average net worth of a white household was \$919,000 in 2016.² In contrast, the average net worth of a Black household was just \$139,000, showing a much larger difference of \$780,000.³ Regardless of the method of measuring wealth, the evidence is clear: A considerable wealth disparity exists between white and Black households.



This image is a static preview of an interactive showing the current state of the Black-white wealth gap. To view the interactive and to see the impact of different policy interventions, please visit <https://www.americanprogress.org/?p=473117>.

Racial disparities in wealth are not a result of individual or family choices but rather the result of structural racism in American public policy. Many government programs designed to expand access to homeownership, higher education, fair wages, and union protections have largely benefited white households, allowing them to build and transfer wealth across generations, while Black households were systematically excluded.⁴ As a result, the racial wealth gap persists, even after controlling for educational attainment, marital status, age, and income level.⁵ In fact, college-educated Black households have 30 percent less wealth at the median than noncollege-educated white households.⁶ Without intervention, these disparities are expected to persist for at least another 200 years.⁷ The Black-white wealth gap was created and will only be eliminated by systematic and intentional public policy choices.

Why a racial wealth gap simulation?

The racial wealth gap has received increased attention from progressive lawmakers and other policy experts in recent years. The growing consensus on wealth inequality as a critical issue has produced myriad proposals to reduce wealth disparities, such as eliminating student loan debt and making college debt free; providing seed capital for America's youth based on parental income or wealth; and strengthening civil rights statutes and enforcement. Although experts have proposed a variety of interventions, estimates of their long-term effects are few and far between. The simulation developed by CAP begins to fill this gap in contemporary analyses by demonstrating how discrete proposals, implemented in combination or in isolation, would reduce the racial wealth gap over the next four decades.

The simulation's scenario

This simulation cannot estimate what the current wealth gap would be if various policies had come into effect at some point in the past, as the relevant data for a backward-looking exercise do not exist on a consistent basis. Instead, the authors created a forward-looking exercise to simulate the effects of five distinct interventions on the racial wealth gap over the next generation. In short, the simulations show what would happen over the coming 40 years if the relevant policies were enacted immediately. The specific proposals in this simulation include:

1. Combat predatory lending and exploitative financial service fees by strengthening the Consumer Financial Protection Bureau.
2. Fully enforce civil rights statutes prohibiting housing discrimination, and strengthen the oversight and enforcement of financial institutions to eliminate systematic differences in mortgage markets.
3. Cancel student loans and offer debt-free college.
4. Bolster retirement incomes by establishing a national savings plan for workers who do not have retirement benefits through their employer.
5. Provide seed capital for America's youth in the form of a national baby bonds program.

The simulation begins with two hypothetical households: one Black and one white in 2020. The households consist of two 25-year-old individuals of the same race. One of the two members of each household earns an annual income based on a 40-hour workweek. The other does not earn an income.

The authors simulate each household's wealth at the end of the individuals' working age. For the purpose of this exercise, the end of working age is 65 in 2060. Taking a snapshot of total wealth earlier than during the householders' mid-60s would bias the simulations toward interventions that have their largest effects early in people's lives, such as baby bonds.

The simulation's baseline estimates

The authors used weighted averages to establish baseline earnings, college completion and savings rates, rates of return, and inheritances for the two hypothetical households in the racial wealth gap simulation.

Earnings

Earnings for 25-year-old workers with and without a college degree are based on the 2013-2017 American Community Survey 5-year estimates, which report that the typical incomes for a 25- to 29-year-old worker with and without a college degree are \$42,118 and \$21,387, respectively.⁸ To avoid providing a false sense of accuracy—i.e., presenting estimates about the future in an implausibly precise manner—the authors rounded these estimates to \$45,000 and \$25,000, respectively. Nominal earnings are simulated to increase by 1 percent per year for productivity growth and are adjusted for inflation based on an assumption of 2 percent inflation per year over the next 40 years.

College completion rates

Average college completion rates are based on estimates from the National Center for Education Statistics, which reports that 22.8 percent of 25- to 29-year-old Black Americans and 42.1 percent of 25- to 29-year-old white Americans have a bachelor's degree or higher.⁹ To avoid providing a false sense of accuracy, the authors rounded these estimates to 25 percent and 45 percent, respectively, for 25-year-old Americans in 2020.

Student loan borrowing rates

Average borrowing rates are based on analyses from Demos and the American Council on Education (ACE). The 2015 Demos analysis found that 81 percent of Black graduates from publicly funded colleges and universities borrowed to finance their educations, compared with just 63 percent of white graduates.¹⁰ The 2019 ACE analysis found that 86 percent of Black bachelor's degree recipients in 2016 had borrowed to finance their educations, compared with just 70 percent of white recipients.¹¹ To avoid providing a false sense of accuracy, the authors rounded these estimates to 80 percent and 60 percent, respectively, for 25-year-old Americans in 2020.

Savings rates

The authors assume a baseline savings rate of 4 percent for workers without a college degree and 8 percent for workers with a college degree. This largely is based on the assumption that workers with a college degree have a higher earnings profile than workers without a college degree, allowing them to save a greater portion of their income over time.

Rates of return

The authors also assume a baseline real rate of return of 2.5 percent for Black households and 3 percent for white households. The 50 basis-point gap in rate of return is based on several studies demonstrating that Black and white borrowers and investors experience different interest rates, even after controlling for various protective factors.¹²

Large gifts and inheritances

As noted at the beginning of this issue brief, white households have more than \$150,000 more in wealth than Black households at the median and \$780,000 more in wealth than Black households on average. For the purpose of this exercise, the authors assume a baseline amount of \$200,000 in large financial gifts and other forms of familial inheritance for the simulation's two-person white household and a baseline of \$0 for the two-person Black household. This figure is designed to capture skewed inheritances, including the acquisition of property from past generations, such as a house that is owned outright; formal and informal gifts that may not be considered a traditional inheritance, such as familial assistance with rent or a down payment on a house; and benefits from social networks and other resources to which white households have disproportionate access.

Studies show that white households are more likely to receive an inheritance and that the inheritance is higher, on average, than the inheritance received by their Black counterparts.¹³ According to the Federal Reserve, 22.9 percent of white households with a head of household age 30 to 59 in 2015 received an inheritance, and the average inheritance was \$236,495.¹⁴ Furthermore, 18.8 percent of these households anticipated receiving an additional inheritance at some point in the future.¹⁵ In contrast, just 10.6 percent of Black heads of household in the same age range in 2015 received an inheritance, and the average inheritance was just \$55,207.¹⁶ Additionally, only 5.9 percent of these households anticipated receiving an additional inheritance at some point in the future.¹⁷

According to research from the Urban Institute, white families are five times more likely than Black families to receive large gifts and inheritances, even after controlling for income and other factors.¹⁸ White families also receive approximately \$5,000 more than Black families in large gifts and inheritances as measured over a two-year period.¹⁹ The study's authors note that these average differences add up to substantial amounts over time. In fact, between 1997 and 2007, the accumulative effect of large gifts and inheritances accounted for an estimated 12 percent of the difference in wealth between white and Black families.²⁰

There are also substantial intangible benefits transferred to white households from their families, communities, and society that are not captured in this analysis, such as access to social networks.

While it is difficult to state with precision the exact difference in financial gifts and inheritances received by Black and white American households, the authors believe that an average difference of \$200,000 is a conservative estimate.

The policy interventions

While there are many proposals that aim to shrink the racial wealth gap, the authors restricted the simulation to five interventions: combat predatory lending by strengthening the Consumer Financial Protection Bureau; fully enforce existing civil rights statutes prohibiting housing discrimination; cancel student loan debt and make college debt free; bolster retirement incomes by establishing a national savings plan; and provide seed capital for America's youth in the form of a national baby bonds program.

1. Combat predatory lending by strengthening the Consumer Financial Protection Bureau

The Consumer Financial Protection Bureau (CFPB) is charged with protecting consumers from fraud, discrimination, and abuse in the U.S. financial marketplace. In the eight years since its inception, the agency has targeted discriminatory lending in the auto loan, home loan, and credit card industries and cracked down on payday lending companies.²¹ However, the Trump administration and congressional Republicans have engaged in repeated efforts to weaken the CFPB, jeopardizing the financial well-being of many Americans, especially people of color.²² Strengthening the CFPB would involve expanding its resources, capacity, and authority to combat malfeasance in the financial marketplace.

While difficult to measure with precision, the authors predict significant reductions in predatory lending and other discriminatory financial practices in communities of color—especially in Black communities—with the advent of a fully empowered CFPB. This effect is simulated as a 50 basis-point increase in the real rate of return for Black households.

2. Fully enforce civil rights statutes prohibiting housing discrimination

Despite the presence of existing civil rights statutes, evidence demonstrates that racial discrimination remains rampant in the American housing system. In fact, 45 percent of African Americans report experiencing discrimination when trying to rent or buy housing, compared with just 5 percent of white Americans.²³ According to recent estimates, homes in Black neighborhoods are also undervalued by \$48,000, on average, due to racial bias alone, resulting in \$156 billion in cumulative losses for Black homeowners nationwide.²⁴ This proposal would promote access to wealth building by significantly expanding the resources and authority of federal, state, and local agencies charged with addressing housing discrimination.

While the authors recognize that it would be difficult—if not impossible—to legislate away racial bias, preventing housing discrimination and holding bad actors accountable could result in substantial savings for Black households. First, the authors estimate that this intervention would increase the Black homeownership rate from 42.3 percent—rounded down to 40 percent in the simulation—to 60 percent.²⁵ Second, this intervention would likely reduce residential segregation and the devaluation of property in Black neighborhoods. The simulation’s best-case scenario for this proposal is fully enforcing civil rights statutes prohibiting housing discrimination, which would result in additional net savings of \$48,000 in 2016 dollars per Black household in which members are age 45 discounted to age 40—the approximate average age of Black homeowners based on the authors’ analysis of 2016 data from the Federal Reserve Board’s Survey of Consumer Finances.²⁶

3. Cancel student loan debt and make college debt free

More than 40 million American adults currently carry a balance of federal student loan debt. In aggregate, this debt now exceeds \$1.5 trillion.²⁷ While not every student borrower is in serious financial distress, student loan debt does have an acute effect on a substantial portion of borrowers—especially borrowers of color—and undermines wealth accumulation over time. This policy proposal would cancel all student loan debt and offer comprehensive federal tuition subsidies based on a household’s ability to finance higher education.

This simulation estimates that canceling student loan debt and making college debt free for all Americans will increase the savings rates of otherwise indebted college attendees and the incomes of individuals who would otherwise forgo college attendance due to cost.

The authors of this simulation assume that student loan cancellation will cause otherwise indebted college attendees to transform much of their now-cancelled student loan payments into additional savings. White Americans are far more likely to attend college, and thus are more likely to hold student loan debt than their Black counterparts. However, among college graduates, Black adults are more likely to borrow and are also more likely to hold higher balances—although balance estimates vary significantly depending on the source. For the purpose of this simulation, the authors rely on a 2016 Urban Institute analysis finding that among individuals with student loan debt, the average Black and white adult maintained balances of \$43,725 and \$31,357, respectively.²⁸ While there would likely be some immediate short-term effects from debt cancellation, this simulation deliberately assumes that debt cancellation will spread out savings over time rather than result in a substantial infusion at the front end.²⁹ The savings effect of student loan cancellation is simulated as a lower-bound estimate, with additional savings equal to 2016 balance estimates—rounded to \$45,000 and \$32,000, respectively—for Black and white borrowers. Given that education debt can take different forms, an assumed interest rate of 5 percent is used to treat all asset and debt returns in the same way, which is in line with standard economic models.

Evidence suggests that college attendance and completion rates will increase as the price of college decreases. Today, student attendance often depends on some external source of funding, such as grants or financial support from relatives, to provide a backstop to excess debt. However, not all Americans have equal access to these funding sources. The authors estimate that approximately 12 percent of Black and white high school graduates currently forgo college attendance because of such liquidity constraints.³⁰ In reality, debt-free college may have larger effects for nonwhite high school graduates.³¹ Assuming that their preferences for debt are similar to those who attend college—they may actually have lower preferences for debt—these individuals likely would have to go deeper into debt in order to finance their education because they do not have similar access to financial support as students who attend college.³² In other words, their hypothetical amount of debt is higher than the actual debt of individuals who ultimately attended college. Making college debt free eliminates liquidity constraints for would-be attendees who have less access to external sources of money to finance their education. The result of this policy would be attendance and completion rates that are 12 percentage points higher for Black and white students. These additional college graduates would consequently see higher earnings and increased savings.

4. Bolster retirement income by establishing a national savings plan

Retirement savings accounts, such as individual retirement accounts (IRAs) and 401(k) plans, help many American workers accumulate wealth over the course of their careers. Yet Black households are far less likely to have access to employment opportunities that come with retirement savings benefits. In fact, just 37.5 percent of working-age Black households have retirement savings accounts, compared with 65.9 percent of white households.³³ Even when Black households do have access to these plans, their balances are often lower than those held by their white counterparts.³⁴ A national savings plan (NSP) would expand access to retirement savings vehicles for workers who may not have an employer-sponsored plan.³⁵

The NSP would be modeled on the Thrift Savings Plan, a 401(k)-style retirement savings plan currently open to federal employees and members of Congress that is known for its low fees, sensible investment options, and simplicity.³⁶

The authors estimate that the creation of an NSP would increase average retirement program participation among Black households from 40 percent, rounded up from 37.5 percent in the simulation, to 70 percent. White households would also see a boost in program participation from 70 percent, rounded up from 65.9 percent in the simulation, to 80 percent. Savings rates for new participants with college degrees are estimated to increase by 2.5 percent, while participants without college degrees would experience a 5 percent increase in their annual savings rate.

5. Provide seed capital for America's youth in the form of a national baby bonds program

In recent decades, many young Americans—especially people of color—have struggled to gain a financial foothold due to wage stagnation, high debt, and limited assets.³⁷ These realities limit wealth-building opportunities and exacerbate inequality. This policy proposal would provide every young person in America with financial assets to ease the transition into adulthood.

A national baby bonds program would deposit an initial sum of money into a low-risk savings account for each newborn baby in the United States.³⁸ The U.S. Department of the Treasury would manage these accounts and make additional progressive contributions each year based on parental wealth—the annual measurements of parents' or guardians' total assets minus liabilities.³⁹ Minors whose parents or guardians have little or no wealth would receive greater contributions than minors whose parents or guardians have average or above-average wealth. Beneficiaries would gain access to their accounts at age 18 and could use these assets to help cover housing, education, or transportation expenses, among other things.⁴⁰

This simulation assumes that a baby bonds proposal would be enacted in 2020 and apply retroactively to all Americans ages 25 and younger. The authors estimate that this would translate to approximately \$79,170 in assets transferred to the typical Black household in which members are age 25 and \$39,585 for the typical white household in which members are age 25.

The racial wealth gap residual

Ample evidence demonstrates that wealth begets wealth and that compounding interest advantages individuals who are able to accumulate wealth earlier in their careers. Yet thousands of Black households have been systematically excluded from opportunities to build wealth. Therefore, the authors also included a racial wealth gap residual to capture the total amount needed to close the remainder of the wealth gap after none, some, or all of the other policies in this simulation are adopted. In other words, the residual, instituted in isolation or in combination with other proposals, will always equal 100 percent of the remaining racial wealth gap by 2060. This figure could represent the sum of myriad policies not included in this simulation or the transfer of a combination of liquid and illiquid assets equal to the size of the remaining wealth gap to every Black household in America.

Factors not incorporated into the simulation

Several factors were intentionally left out of this simulation. These include the effects of recent household composition trends, changes in savings rates over time, dual-earner couples, and wage discrimination, as well as cost estimates for various proposals in this simulation.

This simulation does not incorporate marriage composition trends in the United States. In 2015, 17 percent of newlyweds were married to someone of a different race, up from 3 percent in 1967.⁴¹ More than 8 in 10 of these marriages included one white spouse.⁴² Recent trends in marriage composition could have some small effect on the racial wealth gap by 2060 if analyses continue to be based on the race of the householders. However, estimates measuring this effect are beyond the scope of this simulation.

The CAP simulation also does not incorporate any changes in the savings rate over the hypothetical householder's career. One could logically assume that as household income and wealth increases, savings rates will also increase. However, householders may also incur new expenses, such as child care and health problems associated with aging, over the course of their career. These factors are exceedingly difficult to measure, and thus were left out of this simulation.

Based on the authors' analysis of data from the 2016 Survey of Consumer Finances, the share of dual-earner couples is slightly higher than 50 percent among younger Americans and drops to less than 50 percent among Americans in their late 50s and early 60s.⁴³ Dual-earner status does change as educational attainment increases; the share of dual-earner couples with a college degree in recent years was 55 percent, compared with 48 percent for people without a college degree. However, these slight changes are exceedingly difficult to model. Therefore, the authors tested two different models to determine whether the relative racial wealth gap between two single-earner households would significantly differ from the relative gap between two dual-earner households. These models did not produce significantly different conclusions; therefore, the authors restricted this simulation to two single-earner couples.

An abundance of evidence demonstrates that wage discrimination remains a significant problem in the United States. In fact, 46 percent, or nearly half, of African Americans report experiencing discrimination in terms of equal pay or promotion considerations.⁴⁴ These inequities almost certainly have a negative effect on wealth accumulation over Black workers' careers. However, the effects of wage discrimination are difficult to measure and are beyond the scope of this simulation; therefore, they were not incorporated into the analysis.

Finally, the five proposals included in this simulation would undoubtedly vary in terms of cost. However, the authors did not score any of the proposals due to the presence of difficult-to-measure factors, such as how a reduction in the racial wealth gap would affect net Treasury revenue 40 years in the future.

Conclusion

While each of the proposals outlined in this brief succeeds in reducing the racial wealth gap, none of them alone or in combination fully eliminate the disparity. Without any intervention, the simulation's hypothetical Black household has a net worth of approximately \$316,000 by age 65 in 2060. In contrast, the simulation's white household has an estimated net worth of \$1.87 million. This means a ratio of almost 6-to-1 and a gap of approximately \$1.56 million.

Providing seed capital for America's youth in the form of a national baby bonds program has the single largest effect on the racial wealth gap. With this intervention, the net worth of the simulation's hypothetical Black household more than doubles, rising to almost \$800,000 by age 65. The simulation's hypothetical white household would also experience considerable gains in net worth, from \$1.87 million to \$2.17 million. The authors estimate that a national baby bonds program would shrink the Black-white wealth ratio to approximately 2.7-to-1 by 2060, or a gap of \$1.37 million.

Enacting the first five proposals in combination would substantially reduce, but not eliminate, the racial wealth gap. The authors simulate that combating predatory lending by strengthening the Consumer Financial Protection Bureau; fully enforcing civil rights statutes prohibiting housing discrimination; cancelling student loan debt and making college debt free; bolstering retirement incomes by establishing a national savings plan; and providing seed capital for America's youth in the form of a national baby bonds program would increase the net worth of the hypothetical Black household to \$1.28 million by age 65. The hypothetical white household would have a net worth of \$2.45 million as a result of these interventions. Collectively, the five proposals would reduce the Black-white wealth ratio to 1.9-to-1 by 2060, or a gap of approximately \$1.2 million.

While the first five proposals have merit, they will not be enough alone or in combination to fully eliminate the racial wealth gap. The wealth gap is the result of centuries of structural racism in American public policy. Closing it will require something bold and intentional, including but not limited to supporting and analyzing reparations as a viable policy solution to make amends for 400 years of injustice.

Christian E. Weller is a senior fellow at the Center for American Progress and a professor of public policy in the McCormack Graduate School of Policy and Global Studies at the University of Massachusetts Boston. Connor Maxwell is a policy analyst for Race and Ethnicity Policy at the Center. Danyelle Solomon is the vice president for Race and Ethnicity Policy at the Center.

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