SECTION VIII

Growing Wealth, Growing the Economy

Our last three essays focus on how addressing wealth gaps will also generate substantial benefits for the economy. One essay describes the specific channels—investments in children, business formation, and family financial stability—through which building family wealth promotes sustained economic growth. Another essay examines the significant boosts to GDP by closing large racial and ethnic wealth gaps—and some specific ways that can be achieved. A final essay calls for the creation of a "Citizens Wealth Fund"—a novel variation of a sovereign wealth fund—that would grow the wealth of households as the economy grows by, among other things, leveraging the upside of a financial downturn.

In short, we can do well for our families and do well for our economies at the same time.

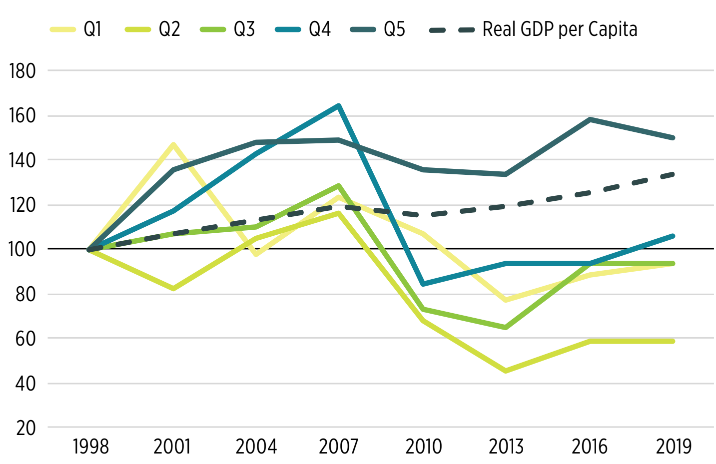
Family Wealth as an Engine for Macroeconomic Growth

BY KAREN DYNAN AND ABIGAIL WOZNIAK

In recent decades, expansions in the U.S. economy have benefited only some American families. Real GDP per capita rose more than 25% over the two decades that ended in 2019, and yet, as shown in the figure below, many families saw a backsliding in their financial positions. For working-age families, net worth in the lowest quintile of the income distribution was just $6,600 in 2019, 7% below where it was in the late 1990s (in inflation-adjusted terms). Families in the second quintile lost even more ground, with their net worth falling more than 40% to $27,000 in 2019. In contrast, the typical family in the highest quintile had more than $750,000 in 2019, up more than 50% relative to 20 years earlier. These patterns echo the rise in income inequality that began decades ago and continued into the 21st century.

Median Real Net Worth for Working Age Families*
by Income Quintile

Index, 1998 = 100



*Families with heads 25-64 years old.

Source: Authors' calculations using Survey of Consumer Finances.

Traditional thinking is that higher income inequality might be associated with greater rewards to hard work and innovation and thus higher macroeconomic growth. However, U.S. macroeconomic growth has slowed significantly since the rise in income inequality began in the 1970s. Growth in real GDP per capita averaged 1.3% per year in the first two decades of the 21st century, down from an average of 2.1% per year over the previous three decades and an average of 2.8% annually in the 1950s and 1960s. Many factors have likely contributed to this downtrend, but the absence of inclusive growth potentially plays an important role. Research findings suggest that helping households build wealth can serve as an engine for growth, through a number of channels.

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The first channel from wealth to growth works through easing family budget constraints, allowing for greater investments in children that lead to future growth. Early investments in children are strongly linked to a range of better outcomes, although the ways in which wealth might contribute to these outcomes are potentially numerous. Income transfers have been shown to raise educational attainment in childhood, and wealth may do the same. Early results from a randomized demonstration project on this question are promising. Importantly, wealth can also expand access to postsecondary education. Research across a range of settings finds that postsecondary outcomes improve when economic or policy conditions mimic wealth transfers (including greater college aid through broad merit scholarships, expanded Pell grants, state aid or housing wealth and business cycle expansions).

Liquid wealth and income transfers enter family balance sheets in similar ways, but low levels of net wealth are only partially related to low income. This insight suggests that policies to boost resources for families with children should consider measures specifically aimed at increasing assets in addition to those designed to boost incomes. While student loans can provide important access to postsecondary education for those who cannot self-finance, they should be viewed as a complement, not a substitute, for wealth building as loan repayment burden may limit opportunities for some young adults (e.g., student loans are associated with being more likely to live with parents post-college and delayed homeownership).

Better child outcomes—through learning gains at young ages and increased postsecondary attainment—represent a rise in what economists call human capital. Economic theory and empirical work suggest that boosting the level of human capital in an economy ultimately leads to macroeconomic stronger growth.

Business formation represents a second channel through which helping families build wealth may benefit both individual households and the overall macroeconomy. Reducing barriers to new business formation appears to foster economic mobility. It also supports macroeconomic growth. Research has shown that start-ups and young businesses make important contributions to job creation and productivity growth.

A long literature suggests that financing constraints are an important obstacle to starting and expanding a new business. Given these constraints, many families, including those with ideas for growth-spurring innovation, will only have access to business ownership if they have an alternative source of initial capital. The rate of new business formation has declined in recent decades as part of a broader downtrend in dynamism that is believed to have dampened macroeconomic growth. Helping families build wealth could lead to a reversal of some of this decline, yielding benefits for both the would-be entrepreneurs and, via more innovation, the macroeconomy.

A final channel is that having some wealth puts families in a better position to weather disruptions to their income without having to cut back on spending or borrow (possibly in very high-cost ways for households of limited means). More research needs to be done to explore the connection between financial buffers at the family level and macroeconomic growth, but several plausible links come to mind. For example, having the resources to continue to make rent or mortgage payments in the face of income loss would allow families to avoid eviction, which could, in turn, contribute to a more stable and reliable workforce by sparing adult family members of the stress of displacement. Likewise, child family members would not be exposed to negative consequences of displacement—such as stress and weaker performance in school—that could reduce their skills and earning ability as adults. In addition, the ability to pay for needed health care for adult and child family members is likely to keep the current and future labor force healthier.

Low-wealth families who need to significantly reduce consumption in the face of an income shock will not only face their own hardship but also create spillovers to the firms they buy goods and services from. When income shocks are correlated across households, these multiplier effects tend to deepen recessions and hinder recovery. Beyond the direct and immediate consequences for macroeconomic growth, the greater business cycle volatility might reduce U.S. productive capacity over the longer run by damping the appetite to invest in our nation's capital stock.

While these three channels all contribute to macroeconomic growth, they may do so in ways that are more or less broad-based. Improving outcomes for children in low-wealth households, and facilitating their access to higher education in particular, should foster higher growth as well as growth that is more equal in origin. While growth-spurring innovation sometimes yields concentrated benefits in terms of market income, policy steps can be taken to redistribute some of the gains. Moreover, if innovation originates broadly—as a result of loosened credit constraints for lower-wealth households and broad education expansions—then it seems possible that the benefits from innovation will be more widely shared even in the absence of additional redistribution.

Building family wealth is not only important for economic mobility at the individual level but also an investment in the future of the American economy.

We conclude with two broad recommendations. First, policymakers seeking to boost macroeconomic growth, and, in particular, to create inclusive macroeconomic growth, should view steps to increase wealth broadly as important levers. Building family wealth is not only important for economic mobility at the individual level but also an investment in the future of the American economy. Second, the standards by which we gauge whether macroeconomic growth is inclusive should focus not only on whether income gains are broadly shared but also on whether there is a strengthening of family finances across the population. Given the channels through which wealth can foster growth, doing so will help to cultivate *sustained* inclusive growth.

Karen Dynan is a professor of the practice in the Department of Economics at Harvard University. She served as assistant secretary for economic policy and chief economist at the U.S. Department of the Treasury from 2014 to 2017, leading analysis of economic conditions and development of policies to address the nation's economic challenges.

Abigail Wozniak is a labor economist at the Federal Reserve Bank of Minneapolis, where she serves as director of the Opportunity and Inclusive Growth Institute. Dr. Wozniak has also served as a faculty research fellow of the National Bureau of Economic Research and a senior economist at the White House Council of Economic Advisers.

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SECTION VIII

GROWING WEALTH, GROWING THE ECONOMY

Reducing Racial Wealth Gaps—And Why That Matters for Families and the Economy

BY BRENDEN MCKINNEY, NICK NOEL,
DUWAIN PINDER AND SHELLEY STEWART

Racial economic inequality, a function of both wealth and income inequality, is stark and enduring. In 2019, the median white household in the United States had $188,200 in wealth (assets minus debt); for Black households, the figure was $24,100. White households, which account for about 60% of the US population, hold 84% of the wealth; Black households (13.4%) hold just 4%.[1]

These gaps are not just bad for Black Americans. They are bad for the United States as a whole. Inequality chokes off pathways for economic growth, leading to wasted talent, fewer new businesses and poor service delivery for public goods.

Closing the Black-white and the Hispanic and Latino-white racial wealth gaps, according to McKinsey research, could boost consumption and investment by an additional $2 trillion to $3 trillion, or 8% to 12% of GDP. In individual terms, it could mean an additional $6,000 to $8,500 a year in per capita income. Fostering economic and social inclusion, then, could promote growth and prosperity for businesses, families and communities across the country.

McKinsey's Institute for Black Economic Mobility explored these issues in "America 2021: The Opportunity to Advance Racial Equity," from which much of the following analysis is drawn. (This research was directed largely at Black Americans; many of the insights and recommendations, however, would also be broadly applicable to Hispanic and Latino Americans and other minority communities who experience similar but not identical issues.) In this article, we argue that racial economic inequities are found across four dimensions: family wealth, family income, family savings and the "community context"—where families begin the wealth-building process through access to public health, education, safety and community economic development.

There are ways to remove the barriers blocking economic progress across all four dimensions—and thus foster greater opportunity for all.

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1 https://www.brookings.edu/blog/up-front/2020/12/08/the-black-white-wealth-gap-left-black-households-more-vulnerable/

Improving Family Wealth Creation, Especially for Business Owners and Entrepreneurs

The average starting capital for Black-owned businesses is $35,000, compared to $107,000 for white-owned businesses.[2] From the beginning, then, Black-owned businesses have a smaller margin for error. Healthy businesses depend on networks—or "ecosystems"—of talent, capital and expertise. Better-functioning ecosystems can reduce the structural obstacles to Black business development—and add an estimated $290 billion in business equity by achieving revenue parity between Black- and white-owned businesses (our analysis shows that if Black-owned companies were to attain the same average revenue in their industries as white-owned companies, their revenue gains would be about $200 billion. This estimate does not account for the higher revenue's multiplier effects, which would represent the impact of the change on the overall economy or from the growth of the number of Black-owned businesses).[3]

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There are four key areas to consider to promote Black-owned businesses: (1) practices that produce equitable outcomes (such as more inclusive governmental small- and medium-sized programs and procurement practices), (2) equitable access to capital (from banks, investors, foundations and government programs), (3) new business capabilities and knowledge sharing (enabling technological diffusion with assistance from the private and social sectors), and (4) greater opportunities for mentorship and sponsorship within companies. New funding (such as impact investing vehicles) and increased support for technical assistance could also help.

[2] Robert Fairlie, Alicia Robb, and David T. Robinson, 2017. "Black and White: Access to Capital Among Minority-Owned Startups." Working paper. Stanford Institute for Economic Policy Research.

[3] U.S. Census Bureau's Survey of Business Owners, from 2007 and 2012.

Boosting Family Income

Black workers are poorly positioned in the U.S. economy due to gaps in human capital development. Without concerted efforts to address this problem, long-term shifts in the economy, such as automation, could widen existing labor market and wealth disparities. By McKinsey's analysis, if labor and wage gaps were closed, Black workers could earn an additional $200 billion in aggregate compensation a year, a boost of 30%.

To take just one slice of the labor market: 20 occupations, accounting for fewer than 4% of all jobs, account for more than 60% of the aggregate wage gap, based on our analysis. These are, unsurprisingly, high-paid, high-skilled jobs. Among them are computer and information systems managers, physicians, engineers, frontline supervisors and accountants. Moreover, wages for Black workers are lower than wages for white workers—a gap of $44 billion a year just for those 20 occupations.

Private sector employers leave value on the table by not including and supporting Black talent to the fullest. McKinsey's "Diversity Wins" research has shown that organizations with top-quartile diversity in their leadership teams are 36% more likely to outperform their peers in EBIT (earnings before interest and taxes). Nevertheless, the same research has documented severe underrepresentation of Black talent as early in the career path as the vice president stage. A clear CEO mandate, strong metrics and targeted programs can help move Black professionals into higher leadership, where the true opportunity for family wealth creation is found. A focus on skill-based hiring, rather than credential-based hiring, can also create additional opportunities for diverse talent to enter the pipelines of leadership positions earlier in their careers.

Increasing Family Savings Through Better Access to Financial Products for Savers and Consumers

Nearly half of Black households in 2017 either did not have a bank account or were "underbanked," meaning they had limited access to or use of products beyond the basics. Without the ability to affordably save, invest and insure themselves against risks, many Black families struggle to translate their income into wealth.

For example, studies have shown that people who live in predominantly

Black communities pay higher auto insurance rates, regardless of their driving record.[4] Black Americans with bachelor's degrees also hold nearly $4,400 more debt than the average American college graduate.[5] Or consider homeownership, where Black Americans receive offers for higher-cost mortgages when compared with white homebuyers and are denied loans at much higher rates than white Americans (28% versus 11%, respectively).[6] Even before the COVID-19 pandemic, only 42% of Black households owned a home, compared to 73% of white households. If Black Americans had the same access as white Americans to financial products such as mortgages, high-yield savings accounts and life insurance, McKinsey estimates that financial institutions could realize approximately [$2 billion in incremental annual revenue a year](). With full wealth parity, that figure could reach $60 billion.

Banks and other financial institutions can start by rooting out the geographic, process, economic, market and institutional barriers, such as credit inequality and redlining, that make it more difficult for Black families to access financial products and services.

Banks and other financial institutions can start by rooting out the geographic, process, economic, market and institutional barriers, such as credit inequality and redlining, that make it more difficult for Black families to access financial products and services. Ensuring that current programs, such as the Department of Housing and Urban Development's mortgage insurance and first-time homebuyer programs, are accessible and used to their fullest extent could be one potential solution.

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[4] https://www.theatlantic.com/business/archive/2015/11/auto-insurance-race-discrimination/416988/

[5] Lorelle L. Espinosa et al., 2019. "Race and Ethnicity in Higher Education: A Status Report." American Council on Education, https://1xfsu31b52d33idlp13twtos-wpengine.netdna-ssl.com/wp-content/uploads/2019/02/Race-and-Ethnicity-in-Higher-Education.pdf

[6] Debbie Gruenstein Bocain et al., 2011. "Lost Ground, 2011: Disparities In Mortgage Lending And Foreclosures." Center for Responsible Lending, https://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf.

Improving the Community Context

Systemic quality gaps in areas such as health and education damage economic mobility. These inequalities have been laid bare during COVID-19, which has disproportionately hurt Black (3.8 times higher morbidity rate), Hispanic and Latino (2.5 times) Americans. Black, Hispanic and Latino workers have also been more likely to lose their jobs.[7] The share of minority-owned businesses and minority employment is highest in industries most directly impacted by COVID-19. And Black, Hispanic and Latino school children have been hurt by prolonged in-person school closures.

Tightening social safety nets and ensuring equal participation in community decision-making can go a long way in improving the community context for residents. One possible approach to consider is to support "place-based transformations," defined as initiatives that seek to boost economic development in a specific geography. The European Investment Fund is an example of a development bank that could be referenced in creating vehicles that help underinvested neighborhoods. Other critical areas place-based transformations could focus include enforcing local fair housing policies, increasing housing security, improving public health, broadening digital access and combating food insecurity.

The challenges will not be solved overnight. What the country can do is start.

The challenges will not be solved overnight. What the country can do is start. That means working together to create a national framework that can lock racial economic equity into the national agenda; reinforce long-term accountability for government, business and society; and find ways to increase coordination and maximum impact as individual stakeholders implement these and other ideas.

Brenden McKinney and Nick Noel are consultants in McKinsey's Washington, D.C., office. Shelley Stewart is a partner in the New Jersey office, where Duwain Pinder is an associate partner. They can be reached through Maria_Gutierrez@mckinsey.com.

[7] https://www.pewresearch.org/social-trends/2020/09/24/economic-fallout-from-covid-19-continues-to-hit-lower-income-americans-the-hardest/

A Citizen's Wealth Fund: Broadening Asset Ownership, Reducing Inequality and Stabilizing the System

BY MARK BLYTH AND ERIC LONERGAN

The views expressed in this article are those of the individual author/authors and do not represent the views of or an endorsement by the Federal Reserve Bank of St. Louis, the Federal Reserve Board of Governors, the Federal Reserve System or the U.S. Department of Agriculture.

The GameStop debacle from earlier this year should remind us of two things.[1] First, ownership matters. Ordinary people want broader asset ownership, even if it's chasing a bubble. Second, those same people feel that who gets to own assets is a rigged game. In both cases, they are not wrong. When share ownership is highly concentrated, when a minority of workers have pensions tied to stocks and when the majority of workers earn less than $20 an hour, that feeling of a "rigged game" rings true.

Asset ownership, far from broadening, has been concentrating for the past 30 years. Stocks, bonds, real estate (commercial and residential), commodities and even cryptocurrencies are owned and controlled by fewer and fewer players. Concentrated asset ownership in turn turbocharges income gains among those who already have the most assets.[2] Today, amplified by COVID-19, these inequalities powered a K-shaped recovery, where the asset rich saw their values rebound, while the asset poor suffered real income and quite possibly real wealth destruction.[3]

Asset ownership matters because it gives citizens a stake in their economy at a time when the country is polarized economically as well as politically. Assets are not just valuable because they produce an income stream to the holder. When widely held, they are perhaps more important as a form of insurance. Stocks can be sold, houses can be remortgaged and bonds can be cashed in. Broadening asset ownership gives citizens their own recession buffers as well as broadening the number of people anti-recession policies can effectively support.[4]

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[1] For those who don't obsess over financial markets, GameStop was a stock heavily hyped on Reddit because it was the subject of a short squeeze by hedge funds. Thousands of micro-investors used the RobinHood share trading platform to boost the price, forcing the hedge funds to close out their positions.

[2] Thanks to Piketty's famous R > G process.

[3] See https://www.stlouisfed.org/household-financial-stability/the-real-state-of-family-wealth.

[4] It also fosters the intergenerational transmission of wealth, thereby lowering inequality over time.

Given that broadening asset ownership is one of those rare policy goals that has no obvious trade-off with another cherished goal, how best can it be advanced when private mechanisms seem to concentrate rather than broaden ownership?

We put forward a citizen's wealth fund that would broaden asset ownership, give citizens a much bigger stake in their economies and provide those same citizens a different kind of insurance against future risk.

In our recent book *Angrynomics*, we put forward our version of a citizen's wealth fund (CWF) that would broaden asset ownership, give citizens a much bigger stake in their economies and provide those same citizens a different kind of insurance against future risk. It's different from current sovereign wealth funds in that it is not funded by carbon rents (Abu Dhabi or Norway) or from a portfolio of state-owned enterprises (Singapore). Rather, we envision one funded from the upside of financial crises. Yes, we did say upside, and there is one.

The original book on how central banks should handle financial crises was written by Walter Bagehot in 1873. The basic rules were "bail (at a penalty rate), fail (anything truly insolvent), and jail (fraud)." Since 2008 we have operated with a different set of rules that has fed the perception that "the game is rigged." That is, when you are dealing with "too big to fail" institutions, you bail at zero, fail no one due to "systemic risk" and jail no one due to the system's opacity.

This different set of rules has given us a world where central banks routinely support crisis-hit asset prices and even create protected classes of securities that are guaranteed not to fall in value. As a result, the largely asset-less, taxpaying citizen ends up paying asset insurance for the already rich while receiving nothing in return. Indeed, they most likely pay for such generosity through rounds of austerity on the public budget. Little wonder, then, that trust in the system evaporates.

Our proposal breaks this pernicious cycle of policymaking and truly broadens asset ownership in American society. We want to exploit an empirical regularity—that the government's cost of capital varies inversely with that of the private sector in moments of crisis. Specifically, in any recent financial crisis, the value of private sector assets falls as liquidity dries up in a flight to safety.[5] The supplier of safe assets is the state, which is why as equity prices fall, bond prices rise and the yield on those bonds fall. Because of this regularity, and because of the centrality of government debt to financial markets in general, since 2008 pretty much any OECD government has been able to issue debt at a negative real rate.[6]

COVID-19 has served as proof of concept where even the promise of an additional $2 trillion in US spending on top of an existing $2 trillion in COVID-19 relief has barely moved inflation. Such a funding environment is correctly seen as a way for the government to rebuild infrastructure and finance decarbonization, and it is that. But it is also the perfect environment to build a multigenerational CWF. Despite the recovery in global stock markets, a diversified portfolio of stocks is still priced to deliver around 5% in real (or inflation-adjusted) terms per year. By contrast, even after the recent sell-off, 30-year Treasuries yield close to zero real.

We propose that the U.S. government create a wealth fund that is funded with bond issuance that invests in diversified portfolios of global risk assets. Importantly, the federal government's *net* debt—that is, liabilities less assets—is unchanged on day one. Over time, however, because the assets should compound at 5% real and the bonds could be structured as zero coupons, liabilities can be repaid as assets are accumulated. If, for example, the U.S. government issued bonds equivalent to 20% of GDP and its diversified portfolio returns 5% real compounded over 15 years, the fund would be able to repay all the borrowing and retain assets equal to 20% of GDP.

When you are dealing with "too big to fail" institutions, you bail at zero, fail no one due to "systemic risk" and jail no one due to the system's opacity.

To do this, Congress would authorize the Fed to open up a "fidelity for the people" fund. Modeled on the famed Boston firm that has built wealth

[5] Even the fraying of the Treasury market in March 2020, which required backstopping from the Fed to the tune of $1.45 trillion, did not disrupt long-term flows into Treasuries and the consequent lowering of yields.

[6] Sebastian Mallaby has referred to this situation as the "era of magic money," where a confluence of falling real rates and structurally low inflation has created an environment where governments are effectively being paid to issue debt.

for American families for over 80 years, the fund will be an independent institution, with a board drawn from the fund management industry that in turn is overseen by a board drawn from a multiplicity of citizen stakeholder groups. There will be no political representation by Congress on the board nor access by Congress to the funds. The funds will use this initial windfall to develop a highly diversified passively managed portfolio of assets (equities and bonds) with the target of producing a real rate of return on the fund of 5% a year.

Congress would authorize the Fed to open up a "fidelity for the people" fund.

Currently, 2% of U.S. GDP is $4 trillion. Compounded over a decade, that fund would grow to over $6.5 trillion. Just think about what could be accomplished with $2.5 trillion that is earned, not raised by taxes and belongs to everyone except Congress.

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We would give equity shares in the fund to the 80% of Americans with the fewest assets. Inequality could be massively reduced with simple endowment payments to citizens as they turn 21 (why should only the rich get inheritances?). Like an inheritance, the founding statute could restrict drawdowns of capital to the beneficiaries to education, home equity, starting a business, health care or retirement income. Recipients could pool funds to raise start-up capital. The statute could be targeted to the bottom 80% so that we can raise the bottom without punishing the top.[7]

The system as is cannot stand another crisis. Populism is the canary in the coal mine for capitalism, which cannot exist without broad benefits and trust in the system. While a CWF would not solve all of these problems, it would at least address some of them in a fundamental and significant way and in terms of rebuilding trust. It would be giving ordinary taxpaying citizens the upside, for once.

[7] After all, they already have plenty of assets.

Mark Blyth is a political economist at Brown University. As well as being the co-author of *Angrynomics*, he is the author of *Austerity: The History of a Dangerous Idea* (2015).

Eric Lonergan is a macro fund manager, economist, author of *Money* (2009) and co-author of *Angrynomics* (2020).