SECTION V

Stronger Family Balance Sheets: Assets

We round out our three-part focus on shoring-up balance sheets by offering 15 essays on new ways to build assets or "capital," as well as new ways to think about those assets—savings, education and skills, homeownership, small businesses, and retirement. A few authors bring a strong racial equity perspective to their ideas, offering specific ideas around "baby bonds," reparations, student loan relief, homeownership, and legal reforms to promote land ownership. Another essay argues for more (but not unstructured) risk taking, while two others show the wealth-building benefits of marriage, as well as how we can think about shifting resources towards our "younger selves" and away from our "older selves" to promote family formation and building assets. A few authors argue for automatic savings at birth through state-sponsored 529 college savings plans, noting that this platform holds the potential to be inclusive, life-long and for assets beyond post-secondary education. And one essay essentially argues for "following the money": using the tax system, which heavily subsidizes wealth accumulation for better-off families, as a vehicle for more policies to build wealth inclusively.

Collectively, these essays underscore the centrality of building assets—in more traditional and novel ways—to building wealth and healthy balance sheets.

Transforming 529 College Savings Plans: Grow Assets for Everyone, Grow the Country

BY MICHAEL SHERRADEN AND MARGARET M. CLANCY

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.

As a nation, we should build assets in every household in America.

Why assets? Because income is not enough. Income helps us to get by, but assets help us get ahead. Seeded with an initial contribution, Child Development Accounts (CDAs) are investments that begin building assets for children when they are born.

Assets enable families to weather difficulties, invest in children and the future, engage in society and prosper over generations. We must expand our vision of economic stability and security beyond the weekly or monthly flow of income. Asset building is central to that elevated vision.

This is not a new idea. Indeed, it is a fundamental American philosophy exemplified by Thomas Jefferson's view that small property ownership is the foundation of democracy. Today, however, we know that land is not the only meaningful asset and asset holding must include everyone, not just white men.

Current Asset-Building Policy Benefits the Wealthy and White People

Federal asset-building policy is quite generous, though these benefits operate primarily as tax expenditures, which are skewed to those who already own assets. Most of these tax benefits build assets further. In 2020, 15 of the 20 largest tax expenditure categories built assets, at $873 billion per year.[1] Among

[1] U.S. Department of the Treasury, 2021. These tax expenditures include line items such as the home mortgage interest tax deduction and tax deferment on retirement pension contributions.

all tax expenditures to individuals, 59% goes to individuals in the top 20% of the population by income. This is a huge and somewhat hidden delivery of public benefits to those who are already wealthy.[2]

Continuing to build the assets of people who already have assets is the very definition of structural racism—it goes on and on with people never questioning it.

On top of this, a long history of racist policy in the United States has produced a wide gap between the asset holdings of whites and people of color. Given this history, continuing to build the assets of people who already have assets is the very definition of structural racism—it goes on and on with people never questioning it.

Transform Asset-Building Policy

It is time for a change. The dysfunction of current asset-building policy requires a structural solution. The goal should be to use public resources for purposeful and fully inclusive asset building for everyone.

By realigning policy to build assets for all Americans, particularly the least advantaged, the nation can reduce persistent wealth gaps, offset historical injustices, strengthen the economy and improve the workforce.

The dysfunction of current asset-building policy requires a structural solution. The goal should be to use public resources for purposeful and fully inclusive asset building for everyone.

Historical racial injustices in America can never be fully redressed, but the history can be clearly spoken and the wealth gap can be reduced. This does not require new public expenditures, only the redirection of massive tax expenditures that currently flow mostly to the wealthy.

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2 Most of these tax expenditures are in fact social policy. See Michael Sherraden, 1991. *Assets and the Poor: A New American Welfare Policy*. London: Routledge; Christopher Howard, 1993. *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States*. Princeton, NJ: Princeton University Press; and Melvin L. Oliver and Thomas M. Shapiro, 1995. *Black Wealth/White Wealth: A New Perspective On Racial Inequality*. London: Routledge. This understanding has gradually become more common, with terms such as "upside down policy" describing these large social expenditures to the already wealthy.

Begin with Child Development Accounts

An inclusive federal CDA policy would be a strong first step in the right direction. The policy is designed to provide assets for every child at birth and to reduce asset inequality by contributing more resources to the more disadvantaged.

In addition, CDAs encourage community participation and saving by families. Balances grow with subsequent deposits and market appreciation, enabling future investments in higher education and career development. Accumulated funds are transferred directly to the beneficiary's chosen college or vocational school.

In recent years, 529s are being transformed. Although 529 college savings plans currently cover very few children and youth in America, they can include all babies. Seven states—some red and some blue—have adopted statewide CDA policies built upon their 529 plans, most specifying that all newborns will have 529 assets. But public deposits are limited due to restricted state budgets.[3] A nationwide CDA policy could transform 529s by channeling substantial federal funding to state-run CDAs. The resulting CDA policy would use 529 plans to serve all children in America—100%. The additional federal support is necessary to make CDAs a substantial and successful national policy.

Evidence on positive effects of CDAs comes from the long-running, randomized, rigorous experiment, SEED for Oklahoma Kids. In this research, we have learned that children with CDAs have better social-emotional development. Parents of these children have a more positive outlook, more financial knowledge and better parenting practices. Many of these effects are substantially greater for disadvantaged families. Other research shows that children with college savings are more likely to enroll in college and graduate. Even before the money is spent, the children develop a college-bound identity.[4] Finally, we have demonstrated that a CDA

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[3] California, Illinois, Maine, Nebraska, Nevada, Pennsylvania and Rhode Island use their state 529 plan for universal CDA policies. A new birth record triggers notification to the CDA administrator, which is typically the state treasurer's office.

[4] For evidence from SEED for Oklahoma Kids, see Sondra G. Beverly, Margaret M. Clancy and Michael Sherraden, 2016. "Universal Accounts at Birth: Results from SEED for Oklahoma Kids." CSD research summary no. 16-07. Washington University, Center for Social Development, https://doi.org/10.7936/K7QC030S; Jin Huang et al., 2019.

policy is an efficient and fiscally sustainable way to build assets for children over time, even through economic downturns.

Policy Leadership and Public Engagement

A federal CDA effort would begin with a policy framework to deliver funding and guidelines that states would use to design and manage their own CDA policies. In this way, federal policy leadership would promote cost efficiency and asset building and focus resources to include financially vulnerable families.

Federal funding would finance a substantial initial deposit made when a child is born as well as subsequent contributions on certain birthdays or on completion of schooling milestones until the beneficiary reaches age 18. The federal effort would encourage partnerships in communities and with families to cultivate additional asset flows from state and local governments, nonprofit organizations, businesses, philanthropy, families and interested citizens.[5] Through these partnerships, CDAs could become an energetic and rewarding national project—perhaps cordially competitive across states or communities. As a nation, we could take pride in this policy and joyfully build assets for the future of the country.

As suggested above, CDA policy could also become the trusted and sustainable platform for payments for historical injustices and for other targeted purposes. For example, the statewide CDA model is the most promising delivery platform for baby bonds and other similar proposals. The fully inclusive,

"Exploring a Model for Integrating Child Development Accounts with Social Services for Vulnerable Families." *Journal of Consumer Affairs*, 53, 770-795, https://doi.org/10.1111/joca.12239; and Jin Huang et al., 2019. "Financially Vulnerable Families Reap Multiple Benefits from Child Development Accounts." CSD research brief no. 19-40. Washington University, Center for Social Development, https://doi.org/10.7936/akd8-d690. On children's accounts in general, see CFED, 2014. "Scholarly Research on Children's Savings Accounts," https://prosperitynow.org/files/resources/CSA_research_fact_file_08-2016.pdf; U.S. Government Accountability Office, 2020. "Higher Education: Children's Savings Account Programs Can Help Families Build Savings and Envision College." Report no. GAO-21-10, https://www.gao.gov/assets/gao-21-10.pdf; and William Elliott, Hyun-a Song and Ilsung Nam, 2013. "Small-Dollar Children's Savings Accounts and Children's College Outcomes by Income Level." *Children and Youth Services Review*, 35, 560-571, https://doi.org/10.1016/j.childyouth.2012.12.003.

[5] Among many possible examples, state CDA policies enable civic organizations and businesses to contribute to the CDAs of children in the community and grandparents to CDAs of their grandchildren.

efficient and sustainable statewide CDA policy platform is already building assets for children.[6] These are highly desirable policy features that baby bond proposals have not yet considered.

First Build Assets for Education, Then Other Goals

A federally guided CDA policy, vigorously implemented, would serve as a structure for addressing inequalities in wealth, child development and economic opportunity. The nation would grow stronger.

Over time, CDA policy would continue to evolve, expanding to address other life goals, including cultural experiences, career advancement, homeownership, business investments and eventually retirement security. This policy would be like a lifetime 401(k) for everyone, to be used for multiple purposes. For efficiency and investment returns, the assets would be managed in private financial markets—one of America's great strengths. Thus, we envision CDAs as a fundamental first step toward lifelong asset building for everyone.

A federally guided CDA policy, vigorously implemented, would serve as a structure for addressing inequalities in wealth, child development and economic opportunity. The nation would grow stronger.

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[6] Indeed, it seems likely that a baby bond policy discussion will lead to this conclusion. Treasurers in both red and blue states with CDAs will defend and promote a fully inclusive asset-building structure that is already in place, efficient, working well and popular.

Meeting the Task of Closing the Racial Wealth Gap: Reparations for Black American Descendants of U.S. Slavery

BY WILLIAM A. DARITY JR. AND A. KIRSTEN MULLEN

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.

We go against conventional wisdom and open with a bold statement.

The Black-white wealth gap is the critical economic indicator of the cumulative, intergenerational effects of white supremacy in the U.S.

Frequently, the magnitude of the difference in wealth between Blacks and whites is underestimated, drastically, in academic research. Underestimation in the public sphere also is commonplace, and there also is a strong tendency to associate wealth exclusively with homeownership. In fact, for the average household, primary residences amount to only 24% of their net worth; business interests, financial assets and retirement accounts amount to 62%.

How big is the Black-white wealth gap? Recently released Fed data show that Black households have about 13 cents in wealth for every $1 held by white households. Moreover, when we examine wealth across business enterprises, we see stark differences in how Blacks and whites stack up. Take for example, Black banks.

Recently, Reed Hastings, the owner of Netflix, provided a $100 million grant to Black banks. This grant, which represents 2% of the company's cash holdings, is clearly a generous gift. However, even with the Hastings gift, when comparing the assets of top Black-owned banks to those of the top white-owned banks, the differential remains cavernous.

There are now 21 Black-owned banks in America that have assets approaching a total of $5 billion. JPMorgan Chase alone has more than $3 trillion in

assets. The 100th white-owned bank on America's listing of top banks has four times the assets of all Black-owned banks combined. The 250th white owned bank on the list, the Bryn Mawr Bank, has $5.4 billion in assets, which is more than all 21 Black-owned banks combined. Mehrsa Baradaran, a professor at U.C. Irvine's law school, said, caustically, that the combined assets of Black-owned U.S. banks amount to "a bad weekend for JPMorgan Chase revenue-wise."

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Netflix's gift is significant. One hundred million dollars is the equivalent of 5% of the total assets of the nation's top five Black-owned banks. Clearly, this may be meaningful in terms of maintaining their stability and profitability. However, it will do little to alter their relative asset position.

Chase itself has made a commitment of $50 million to Black-owned financial institutions out of an overall $30 billion "racial equity" fund. This also is significant from the standpoint of the Black-owned banks, but in combination with the Netflix grant it would still leave them, collectively, below the asset level of the 250th ranked white-onwed bank.

Differentials in terms of business ownership, inclusive of bank ownership, are only a fragment of the array of disparities in Black asset holdings that explain the magnitude of the overall wealth gap. Black family household net worth—on average—is $840,900 less than the white household net worth. This is the estimate at the mean. Some complain that what happens at the mean is less relevant than the median because of the effects of outliers—the uber rich and the extremely poor.

The median gap is about $164,000. Eliminating that differential is more manageable. However, eliminating the wealth gap requires a focus on the mean.

Black Americans who are descendants of persons enslaved in the U.S. make up about 12% of the nation's population. However, they possess less than 2% of the nation's wealth.

Why the mean? First, 97% of white wealth is held by white households above the white median. This is not just because there are a handful of extraordinarily wealthy white billionaires, although that is indeed the case. Many are not aware

that 25% of white households have a net worth in excess of $1 million, while only 4% of Black households possess that amount. Black Americans who are descendants of persons enslaved in the U.S. make up about 12% of the nation's population. However, they possess less than 2% of the nation's wealth.

In our book on Black reparations, *From Here to Equality*, we argue that a primary objective of a "true reparations" plan must be raising the Black share of wealth to at least match the Black share of the population. This would require an expenditure of at least $11.2 trillion.[1]

A primary objective of a "true reparations" plan must be raising the Black share of wealth to at least match the Black share of the population.

This expenditure must be borne by the federal government for two major reasons. First, the federal government is the culpable party. It must be held accountable for the host of atrocities that have been inflicted on Black people from the formation of the American Republic in 1776. Second, combined state and local governments' budgets are $3.1 trillion, at least $8 trillion short of the amount needed to meet the task of closing the wealth gap. If their entire budgets were devoted to the reparations plan, they would have no resources to provide their services. Furthermore, our case for reparations is not predicated exclusively on slavery but instead on three phases of American history, including the present phase.

Of course, the crucible that set these atrocities in motion is slavery. On the eve of the Civil War, the family of Mississippian Sarah Katherine Stone enslaved 150 Black people on their 1,260-acre cotton plantation, Brokenburn. Stone would later recall the human chattel who they forced "to labor six days out of seven, week after week, month after month, year after year, as long as life lasted; to be absolutely under the control of someone until the last breath was drawn to win but the bare necessities of life, no hope of more, no matter how hard the work, how long the toil and to know nothing could change your

[1] We have frequently said that $11.2 trillion will be required to close the racial wealth gap. There are approximately 15 million Black households that consist of Black persons who are descendants of persons enslaved in the United States. If the average Black household has $142,500 in wealth, then total Black wealth comes to about $2.1 trillion. If total wealth in the United States now is about $130 trillion and Black American descendants of U.S. slavery are 12% of the population, and if they held a share of the nation's wealth consistent with their share of the population, they would possess a total net worth of $15.6. The $2.1 trillion actually held leads to a shortfall of $13.5 trillion. The $11.2 trillion shortfall is produced using a smaller estimate of total American wealth of $110 trillion.

lot. Obedience, revolt, submission, prayers all were in vain."

The second phase began almost immediately after the war ended and hamstrung Black people with nearly a century of legal segregation in the United States, what Americans call, in a blithe understatement, the "Jim Crow" period.

The "mystic years" of Reconstruction, those all-too-brief seven years when both Black and white men were entitled to vote and the two groups governed jointly, were followed by American apartheid. The period of legal segregation was marked by upwards of 100 white terror campaigns, resulting in municipal coups in Colfax, Louisiana (1873); Coushatta, Louisiana (1874); and Wilmington, North Carolina (1898). Other sites of white terrorist uprisings included Atlanta, Georgia (1906); Elaine, Arkansas and Chicago, Illinois (1919); Ocoee, Florida (1920); and Tulsa, Oklahoma (1921). These violent white riots led not only to injuries of Black people but also to the loss of Black lives and destruction and seizure of Black property. There still are many living direct victims of the Jim Crow years.

These violent white riots led not only to injuries of Black people but also to the loss of Black lives and destruction and seizure of Black property.

The final phase began after passage of the Civil Rights Acts and continues to the present day.

The nation confronts mass incarceration of its Black citizens. The nation confronts police executions of unarmed Blacks. The nation confronts sustained discrimination in credit, housing and employment.

To heal the wounds caused by these injustices, we need a plan for reparative justice. We need a national policy that will close the racial wealth gap successfully—a national policy of reparations for Black American descendants of U.S. slavery.

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Three Bold Proposals to Overcome Our Nation's Enduring Racial Wealth Gap

BY DARRICK HAMILTON AND NAOMI ZEWDE

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.

America has a race problem manifesting as a Black economic problem. In a nutshell, our racial dilemma is grounded in a political, economic and identity-based devaluing of Black lives that has persisted ever since the first enslaved African arrived in Jamestown in 1619. The ensuing history of the United States is built on both racial and economic injustice: two related but distinct problems.

These injustices, while entrenched, can be addressed. Below are three complementary policies that can make meaningful progress toward undoing centuries of systemic inequities while prospectively ensuring capital access in perpetuity: (1) reparations through which the nation acknowledges and redresses its exploitation and extraction of Black resources and personhood, (2) baby bonds (publicly funded trust accounts) to establish a birthright to capital, and (3) a wealth tax to break up the vast concentration of wealth and diffuse the political power that goes along with such concentration.

Wealth Disparity and the Racial Wealth Gap in America Are Dramatic

The mean (or average) wealth of a white family is $933,700, nearly seven times that of Black family wealth at $138,200. Clearly, the "typical" white family are not millionaires and have nowhere near $933,700 in wealth. The everyday white family does have more than their Black counterpart ($171,000 versus $17,600 at the median, or midpoint), but nevertheless, their wealth is not well reflected by the mean.

Instead, mean wealth is driven by a skewed distribution where the wealthy own just about everything. According to one study, the top one-tenth of 1% of households, those with over $20.6 million in wealth, own about as much of the nation's wealth as the entire bottom 90%. We haven't seen this immense and disturbing concentration of wealth since the Great Depression, and it is driven largely by vast amounts of wealth held by a small number of overwhelmingly white billionaires.

Wealth concentration is wreaking havoc on our democracy and consistently thwarting our attempts at progress. For instance, a large majority of Americans want action on climate change. Yet, a special interest of energy tycoons stands to lose some of its short-term profits and funds aggressive lobbying that impedes democratic action.

A substantive redistributive wealth and/or estate tax could effectively break up the concentration of wealth and power...But alas, this would still leave unaddressed our unjust and unacceptable racial wealth gap, which requires more direct action.

Economic justice cannot take root or flourish when wealth, power, resources, news media, book publishers, educational curricula, technological surveillance, prisons, business capital and all of our existing institutions are owned or controlled by relatively few plutocrats, those able to translate vast economic power into anti-democratic political power. The bottom half of households (disproportionately Black) will own a lot more than just 1% of our nation's wealth in an economically just democracy.

A substantive redistributive wealth and/or estate tax could effectively break up the concentration of wealth and power, trending us away from the special interests of a plutocracy and toward the just and egalitarian public policies of a healthy democracy. But alas, this would still leave unaddressed our unjust and unacceptable racial wealth gap, which requires more direct action.

Truth and Reconciliation

Progress in racial justice requires an honest and sobering confession of our historical sins, directed or sanctioned by the state. We must build a shared understanding of the nation's original sin: chattel slavery and forcing Black people to serve as capital assets for a white-landowning plantation class. We must also understand what followed: sharecropping, lynching, Jim Crow and racialized exclusion from New Deal and postwar policies that built an asset-based white middle class.

Inequality and poverty have been intensely racialized in the United States. Poor people of all races are stigmatized under an umbrella of anti-Blackness. State interventions to promote their social mobility are seen as incentivizing bad behavior. Truth and reconciliation would diminish the saliency of

"blaming the victim" narratives, like the late and former New York Sen. Daniel Patrick Moynihan's "tangle of pathology," which laid a foundation for caricatures of Black, Brown and poor people as "welfare queens," "deadbeat dads" and "undeserving." This effort would reframe inequality from overtures of anti-Blackness to realities of resource deprivation.

The South African Truth and Reconciliation Commission was one recent example among many. That country's post-apartheid constitution charged its commission with shepherding a populace scarred by decades of racialized violence, dehumanization and exploitation into a new era of conciliatory nationhood—quite a tall order. The commission held hearings across the deeply divided nation, archiving volumes of personal histories of violence.

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Ultimately, however, South Africa continues to fail the economic fortunes of its Black citizens, 64% of whom live in poverty. By comparison, only 1% of white South Africans live in poverty. While truth and reconciliation ushered in a peaceful political transition, it left the country's resources in the control of an elite white minority, now with a few elite Black individuals involved in its leadership.

Acknowledgment Without Redress Is Incomplete

We should learn from the South African experience that economic justice cannot be left on the back burner. It is only with both these factors, apology and material redress that America can ever have racial justice. What's more, a sufficient reparations program could compensate the victims of our racist history through both unconditional cash payment and through ownership of land and/or means of production. For example, the government can purchase and transfer corporate stock to Black Americans. Without ownership, the cash stimulus of reparations could in effect further enhance racial inequality, multiplying economic gains for white people who disproportionately own American land and production.

Reparations provide a retrospective approach to racial justice. But whether implemented as a one-time payment or in installments, such transfers are not expected to occur in perpetuity. In that vein, we can establish other ongoing

channels that build and maintain access to economic security for all people regardless of race, gender or family inheritance.

An Anti-Racist Birthright to Capital

Baby bonds (or more accurately "baby trusts") would establish an economic birthright to capital for everyone in perpetuity. These accounts would be held in public trust, similar to Social Security, and could be used as a capital foundation for an economically secure life. Otherwise, even after implementing reparations, the iterative and consolidative tendency of wealth would likely trend toward inequality and wealth disparity.

The baby trusts program would allocate a trust fund to every child in the United States. The average account could be seeded around $20,000 and rise upward to $50,000 for babies born into families with the lowest net worth and downward for the wealthiest. The account would mature and transfer to those children upon entering adulthood. At that scale, a publicly seeded universal trust fund could, for example, substantially reduce the median wealth gap for young adults—where young white adult households currently have approximately 16 times the wealth of young Black adult households—to one where the disparity is just 1.4 times as large. Beyond race, baby bonds would disproportionately benefit low wealth households in general; and to the extent that intra family transfers drive the gender asset gap, the program would provide some redress for American patriarchy as well. In essence, "baby trusts" would deliver a more egalitarian economic security, independent of the financial position into which individuals are born, and redressive of structural racial inequalities.

Breaking Through the Plutocracy

Achieving justice requires an equitably and fairly structured society.

Imagine this: We eliminate student debt and instead fully fund tuition-free public colleges and universities, historically Black colleges and universities, and tribal colleges and universities. We have Medicare for All, an economic right to high-quality housing and child care, a job and enough income support so that no one has to endure poverty. And on top of that, every young adult has access to capital, independent of race, education, gender or generational legacies of exploitation.

That is a vision of a just and free society, one in which young people, even Black young people, can afford to build a future and have some chance of thriving across the course of their lives. It's a society that is within our collective reach.

The obstacle to fulfilling this vision is political will, largely constrained by forces emanating from the concentrated economic and political power of our nation's plutocracy.

Our vision of a just and free society, one within our collective reach, is one in which young people, even Black young people, can afford to build a future and have some chance of thriving across the course of their lives.

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A Risk-Free Way to Build Wealth? Forget It

BY ALLISON SCHRAGER

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.

It is impossible to grow a large amount of wealth without taking some risk. Riskier assets, like stocks, come with the potential for higher returns compared to low risk assets, like bonds. However, those higher returns come with a cost—possible loss. The good news is we have the tools to insure against extreme loss and make risk taking more accessible to all.

There is a perception that the wealthy game the market, and some do. But most of the time their higher returns are due to the fact they take more investment risk.

The fact that richer people tend to own riskier assets is one reason why their wealth grows faster. There is a perception that the wealthy game the market, and some do. But most of the time their higher returns are due to the fact they take more investment risk. For example, according to data from the 2019 Federal Reserve Survey of Consumer Finances, higher earning households—Americans whose income exceeds $150,000[1] a year—invest more of their retirement assets in stock. The median equity allocation in their retirement accounts is 54%, compared with just 37% among Americans who earn less than $50,000.

This is not surprising. Traditionally, policy did not encourage lower-earning Americans to invest in stock. Government-sponsored saving policies tend to steer them to low yielding returns that are guaranteed to not lose money. Take the myRA program, a short-lived federal saving scheme created during the Obama administration. The program aimed to increase saving among Americans who did not have a job that offered a retirement saving account. It offered only one investment option, a portfolio of Treasury bonds and bills. The program was discontinued. But today, several states, such as California and Oregon, offer similar saving programs that aim to increase retirement saving among low earners. And they also encourage low-risk investing. Their default investment is to put the first $1,000 in a money market account and

[1] Americans who have some retirement account assets and are between the age of 45 and 65.

any remaining savings in a target date fund. There is some equity in the target date fund, but the strategy overall is a very conservative one because the balances tend to be fairly small and don't exceed the $1,000 cutoff.

There is sensible economic logic behind the idea that low earners should not invest in the stock market. If you have very little savings and income, you can't afford to lose much wealth. Many low earners have little or no cushion against adverse events. And they tend to be more vulnerable to economic shocks since they are more likely to have a car break down or, during recessions, are more likely to lose their job and take longer to find another one. They tend to be hit harder by recessions because many low earners are in procyclical jobs such as retail. Investing in stocks exposes them to more risk than someone with a stable government job because their income is more closely correlated with the stock market.

But there is also a case to be made that lower earners need *more risk* exposure, especially for longer-term, less liquid assets like retirement accounts. First of all, they have less savings, and higher risk assets do grow faster. There is also an argument from a risk perspective. Low earners already have a large, risk-free retirement asset in the form of Social Security, which makes up most of their retirement wealth. Because of the progressive benefit formula, it also provides a fairly high replacement rate of their working income. Investing any additional retirement saving in a sensible equity strategy offers some diversification from government assets and upside potential from growth. Responsible, well-diversified investing offers low-income Americans a chance to share in the prosperity that higher income Americans experience.

But there is also a case to be made that lower earners need more risk exposure, especially for longer-term, less liquid assets like retirement accounts.

This leaves policymakers who wish to achieve more inclusive wealth generation with two problems: They must increase stock market participation and help protect low-earning participants from large losses. The first part is fairly easy. It starts with expanding access to long-term saving vehicles where savers can easily access the stock market. One possibility is increasing participation in retirement accounts among low earners who don't have the option at work. This can either involve expanding state saving accounts or reviving the federal myRA program. So far, these programs are not very popular, but that

is in part because of a lack of awareness. We can also incentivize participation by matching individual saving or seeding the accounts for people whose income falls below a certain threshold.

Another option is increasing access to 529 plans; already seven states establish these at birth automatically for every newborn. A similar idea gaining traction is "baby bonds." In Sen. Cory Booker's proposal, the government would put $1,000 in a savings account for each child born and add $1,000 to the accounts each year for lower-income households; this bond could be automatically placed in a 529 plan that is invested in stocks. The government could also use the newly created child care allowance to encourage investing. Parents could be offered the option to have some of their cash payment directly deposited into a 529 plan.

Then, to increase stock ownership, these government-sponsored accounts can entail a default investment that's a well-diversified stock index fund. Steering people to index funds offers them a chance at higher returns for relatively little risk because the funds include so many different stocks they eliminate idiosyncratic stock risk, or the risk that an individual stock will rise or fall.

Systematic risk can be reduced with insurance: government-sponsored saving accounts could include a "put" option on the S&P 500, or any index fund that is the default investment.

However, systematic risk, the risk the whole market will fall, remains a concern. Even if retirement and education assets are intended for long-term saving, there is a chance the stock market could fall and remain depressed for years. Lower-income Americans often use their accounts to finance setbacks, tapping into them early with a loan or withdrawing the assets and paying penalties. They are more likely to do this when the market is down.

But systematic risk can be reduced with insurance. The government-sponsored saving accounts could include a "put" option on the S&P 500, or any index fund that is the default investment. A put contract offers the investor the option to sell their shares at a preset price. It effectively puts a floor on the losses, an insurance against a large sustained market crash. Of course, insurance comes at a price, and long-term options contracts tend to be expensive. The myRA program offered an above-market return on its low-risk asset. Instead of subsidizing low-risk investing, the government could instead

subsidize a long-term insurance contract on the stock market. This will offer the possibility of growth along with some protection from the market falling and staying low.

Another concern with encouraging more people to take investment risk is it takes a level of financial acumen and understanding of markets many Americans (of all income levels) don't have access to. They might buy individual stocks that promise potential for extra-high returns but most of the time mean low returns and high risk. However, we do have evidence that nudges and default investment options can be an effective way to steer people to better risk decisions. An insured equity index fund could be the default investment in a government-sponsored saving account aimed at lower earners. And to ensure low-income savers don't take any undue, or inefficient, risk, the other investment options would be different index funds and some target date funds.

We appear to be moving into an economy where the returns to capital will continue to increase and outpace labor. Building a more inclusive economy—building wealth among low earners—requires sharing the gains that come from investing in riskier assets. There are reasons to be concerned that investing their savings in the stock market would expose them to too much risk. However, there is scope for subsidized insurance on well-diversified funds that can offer more upside with some protection.

As returns to capital outpace those to labor, building a more inclusive economy and wealth among low earners requires sharing the gains that come from investing in riskier assets.

Allison Schrager is a senior fellow at the Manhattan Institute and author of *An Economist Walks Into a Brothel: And Other Unexpected Places to Understand Risk*.

Our Older Versus Our Younger Selves: Time Travel, Wealth and Family Formation

BY SCOTT WINSHIP

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.

A frequently expressed concern on both the political left and right is that the balance sheets of younger adults have deteriorated, which has made it difficult for them to marry and start families. These concerns are behind recent calls for a permanent child allowance, student loan debt forgiveness and free college. How we should think about policy to support family formation depends on the extent to which the net worth of millennials has actually declined relative to Gen Xers and baby boomers. But even if the data do not fully bear out the narrative of generational collapse, there are still ways that policy can help younger adults start families. In particular, by shifting debt repayment to our older selves and income from wealth to our younger selves, a variety of policies could make it more affordable to start a family in early adulthood.

By shifting debt repayment to our older selves and income from wealth to our younger selves, a variety of policies could make it more affordable to start a family in early adulthood.

Understanding changes in wealth is complicated by conceptual and measurement challenges. Conceptually, if wealth falls but the starting point occurs during an asset bubble, should we take the decline at face value? In terms of definitions, if "wealth" includes student loans on the debt side but omits the human capital financed by that debt on the asset side, how do we think about that? Americans would save a lot more if Social Security, Medicare and Medicaid disappeared tomorrow, yet we don't count senior entitlements as assets.

Further, assessing wealth trends requires considering preferences over spending income versus saving it. Wealth levels can decline because of rising hardship, but they can also decline if saving becomes less appealing relative to consuming.

To assess the change in wealth in recent years, my research assistant, Santiago Deambrosi, and I are analyzing data from the Survey of Consumer Finances, which is conducted every three years. For this essay, we compared median wealth in 1992 and 2013. These were years with similar unemployment rates and similar ratios comparing home prices to rents.[1] Accounting for the latter ensures that the wealth trend is not driven by housing bubbles, which involve wealth creation (and destruction) unrelated to the secular trend over time. We also exclude student loan debt from our wealth calculation since it provides a misleading picture without considering the stock of human capital it finances as an asset.

We find that the median net worth (less student loan debt) of households headed by someone under age 35 actually rose slightly from $16,872 in 1992 to $17,520 in 2013 (all in 2020 dollars[2])—an increase of 4%. Adults between the ages of 18 and 34 in 1992 were born between 1958 and 1974, while those in the same age range in 2013 were born between 1979 and 1995, so this comparison also is convenient for assessing how millennials have fared relative to Gen X and baby boomers.[3]

Notably, when student loan debt is included in wealth (without any corresponding asset), median net worth among adults under 35 falls by 25%, so the treatment of educational debt makes a big difference. If we assume, conservatively, that only half of educational debt is offset by more valuable

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[1] The unemployment rate was 7.5% in 1992 and 7.4% in 2013. See the Bureau of Labor Statistics Labor Force Statistics database. We computed ratios of home prices to rents by dividing Robert Shiller's monthly nominal home price index by the Rent of Primary Residence subindex of the Consumer Price Index for All Urban Consumers, after indexing both to January 2000. The 12-month average of the ratio was 0.94 in 1992 and 1.05 in 2013 (compared with 1.29 in 2004, 1.39 in 2007, 1.10 in 2016, and 1.15 in 2019). The Shiller index values come from his webpage. Rental price index values are from the Bureau of Labor Statistics, taken from the Federal Reserve Bank of St. Louis Federal Reserve Economic Data website (series CUUR0000SEHA).

[2] We use the Personal Consumption Expenditures deflator to adjust for inflation.

[3] The Pew Research Center, for instance, defines baby boomers as being born between 1946 and 1964, Gen Xers as born between 1965 and 1980 and millennials as born between 1981 and 1996.

human capital, then median net worth among young adults fell by 14% from 1992 to 2013, or $2,200.

Regardless of the trend, policy can focus better on ways to help more young adults who want to marry and become parents. The fundamental problem with family affordability is that people generally want to start families when they are relatively young, but this is the life stage at which their balance sheets are least able to support putting down roots. One approach to making family formation more affordable, then, would be to shift the timing of when lifetime income is received or when lifetime expenses are paid so that our older selves effectively subsidize our younger selves.

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For instance, a 30-year mortgage allows younger adults to finance the cost of buying a home over three decades, including years when they will be older and have higher incomes. However, tax breaks like mortgage interest and state and local income tax deductions actually end up subsidizing our older selves at the expense of our younger selves. These deductions inflate the value of homes, which benefits incumbent homeowners, who tend to be older. Younger adults looking to buy a home are faced with higher down payments than would be required absent this asset inflation. As Alan Cole, a staffer in Congress' Joint Economic Committee, notes, eliminating these deductions would make our older homeowning selves less wealthy but would make our younger selves looking to start a family more wealthy.

Another way to shift expenses to our older selves would be to encourage ways of financing higher education expenses that subsidize our younger, poorer selves. Expanding income-based repayment within the federal student loan system would be one option, but such a system depends heavily on federal subsidization of student loan interest and federal origination of loans, leaving the system vulnerable to inefficiencies and calls for bailouts. A better alternative would be to develop a system based on "income share agreements," or ISAs.

ISAs are contracts that stipulate that some amount of a student's higher education expenses will be paid by one or more investors, who are entitled to

receive a designated percentage of the student's future income over a specific duration. New graduates—or students who drop out of college—will have relatively low earnings relative to their future selves, but they will be on the hook for a fixed percentage of those low earnings. When they are older and further along in their careers, their incomes will be higher, and they will pay the same percentage of that higher income to investors. As a market-based system, investors and beneficiaries are likely to develop variations on this basic setup that could further push expenses toward our older selves.

As an example of shifting income from future wealth forward, consider the recent parental leave proposal from Senators Joni Ernst (R-Iowa) and Mike Lee (R-Utah). Their plan would let parents receive a benefit modeled on social security disability payments for up to three months to care for a newborn. The benefit would be financed through delayed social security retirement benefits on the part of the parent who takes leave.

My colleagues at the American Enterprise Institute, Katharine Stevens and Matt Weidinger, have offered a different proposal that would shift income forward and thereby promote family formation. The child tax credit is a per-child benefit available to most families with income tax liability and provides a reduced benefit to a smaller number of families with earnings who owe no income tax. (It has been temporarily expanded this year to families with and without earnings.) Instead of families receiving up to $34,000 in tax credits over the first 17 years of their child's life, Stevens and Weidinger would allow them to take up to $30,000 in benefits over their child's first two to five years.

Through these and other proposals, federal tax, safety net, housing, retirement and education policy could be reformed to address the basic mismatch between when we want to start families and when we have the wealth to afford them—and in a way that is friendly to family and federal budgets alike.

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Two Is Wealthier Than One: Marital Status and Wealth Outcomes Among Preretirement Adults

BY W. BRADFORD WILCOX

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 United States is an increasingly unequal society along many dimensions—including household wealth. For instance, a 10% minority of the country holds a majority of the household wealth (69%).[1] As with so much of the social and economic inequality in the nation, there is an important family dimension to this inequality story. The significant minority of adult men and women who get and stay married are much more likely to hold greater wealth—when measured in terms of the assets they own (including homes, retirement savings and bank accounts) minus their debts. To an important extent, the wealth divide in America coincides with a marital divide across the nation.

To an important extent, the wealth divide in America coincides with a marital divide across the nation.

In this essay, I use data from the National Longitudinal Survey of Youth 1979 (NLSY79) cohort to explore the character of this marriage divide in wealth—as measured by real estate holdings, retirement savings, cash and other investments, minus debts—for men and women who are in their 50s and on the verge of retirement.[2] I also cast an eye on how this divide plays out

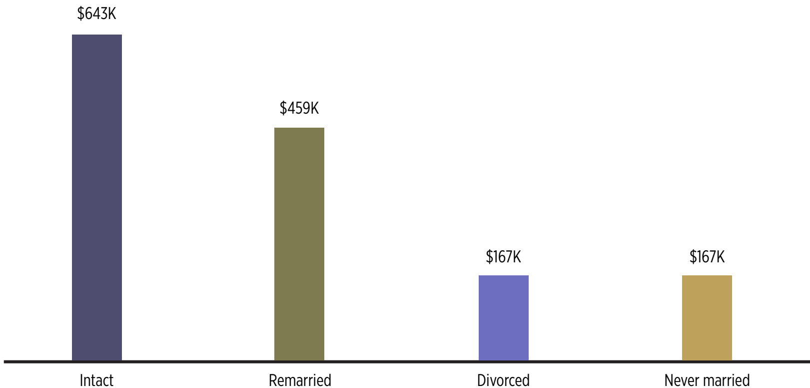
[1] Board of Governors of the Federal Reserve System (U.S.), "Share of Total Net Worth Held by the Top 1% (99th to 100th Wealth Percentiles) [WFRBST01134]," retrieved from FRED, Federal Reserve Bank of St. Louis; Board of Governors of the Federal Reserve System (U.S.), "Share of Total Net Worth Held by the 90th to 99th Wealth Percentiles [WFRBSN09161]," retrieved from FRED, Federal Reserve Bank of St. Louis.

[2] The NLSY79 follows the lives of a nationally representative sample of 12,686 young men and women starting in 1979 when the respondents were ages 14 to 22. The latest wave, round 27, was surveyed in 2016 when the respondents were ages 51 to 60. The survey was sponsored by the Bureau of Labor Statistics (BLS).

by race and class before concluding that, in order to bridge the marriage and wealth divides in the U.S., policymakers should pursue policies like means-tested "baby bonds" or universal savings accounts that will help more young couples feel financially prepared to marry while also rooting out marriage penalties from means-tested programs.

FIGURE 1

Household Assets of 51-60 Year-Old Men and Women, by Marital Status

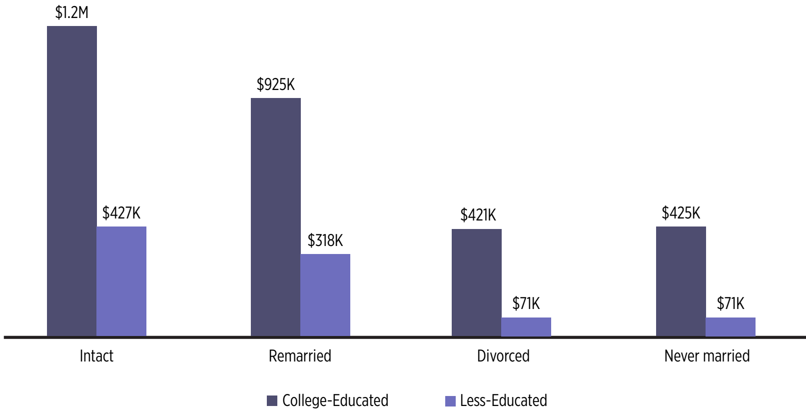


Note: Average wealth (real estate holdings, retirement savings, cash, and other investments, minus debts), after controlling for education, race, gender, age, and AFQT scores.
Source: National Longitudinal Survey of Youth 1979 (NLSY79), Round 27 (2016).

The marital divide in assets for 50-something adults is substantial. As Figure 1 indicates, married Americans have more than twice the average assets of divorced and never married Americans, even after controlling for gender, age, education, race, ethnicity and scores on the Armed Services Vocational Aptitude Battery, a standardized test that measures mathematical, scientific and word knowledge. On average, stably married men and women have more than $640,000 in assets, while the remarried have more than $450,000 in assets. By contrast, divorced and never married Americans have only about $167,000 in assets when they reach preretirement years.

FIGURE 2

Household Assets of 51-60 Year-Old Men and Women, by Marital Status and Education



Note: Average wealth (real estate holdings, retirement savings, cash, and other investments, minus debts), after controlling for education, race, gender, age, and AFQT scores.
Source: NLSY79, Round 27 (2016).

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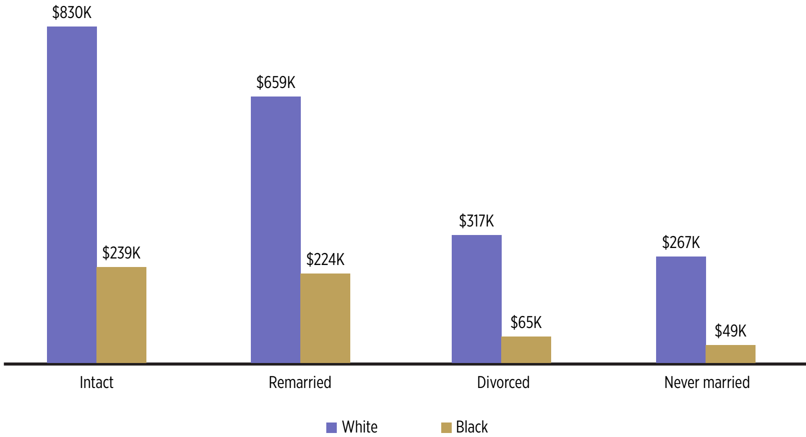
Large differences in wealth by family structure also apply within demographic groups in the United States. Among the college educated, those who are married have more than twice the wealth of those who are divorced or never married (about $1 million compared to $425,000) even after controlling for demographics (see Figure 2). Among the less educated, married Americans have about four times the wealth ($318,000-$427,000) of those who are not married (about $71,000). Thus, family structure is even more powerfully linked to wealth for less educated Americans than it is for highly educated Americans.

FIGURE 3

Household Assets of 51-60 Year-Old Men and Women, by Marital Status and Race



Note: Average wealth (real estate holdings, retirement savings, cash, and other investments, minus debts), after controlling for education, race, gender, age, and AFQT scores.
Source: NLSY79, Round 27 (2016).

Differences in wealth by family structure also apply across racial lines, with white and Black Americans who are married enjoying markedly more wealth than their unmarried peers of the same race. Figure 3 indicates that white Americans who are married have more than twice the wealth (about $750,000) of their unmarried peers (about $300,000). Among Black Americans, the association between marital status and wealth is even larger, with married Black Americans having more than three times the wealth of their unmarried peers, about $230,000 compared to $65,000. Note, however, that even married Black Americans have less wealth, on average, than do unmarried white Americans. These descriptive results suggest marriage is not a panacea when it comes to addressing the racial wealth gap in America and that other factors are in play.

Undoubtedly, some of the substantial divide in U.S. household wealth associated with marital status is driven by selection. Americans with more income and assets are more likely to marry and to stay married. This is especially the case today with highly educated men and women being more likely to be

stably married than less educated Americans. As sociologists Pilar Gonalons-Pons and Christine R. Schwartz have noted, "the well-off are now 'doubly advantaged': they are both more likely to be married and thus have access to a second paycheck, and because of increased economic homogamy, they are also more likely to be married to another high-earning spouse," all of which increases their ability to accumulate wealth. Moreover, some of the marital divide in wealth can be attributed to the fact that men and women who have particular personality traits and values—such as a long-term orientation to life—are more likely to save *and* be stably married. So, to some extent, other factors besides family structure per se—like education or prudence—help to explain the marital divide in assets.

Nevertheless, marriage and marital transitions also appear to independently influence the accumulation of wealth in America. Married couples, for instance, benefit from economies of scale that allow them to share housing, food and utilities and devote more of their household income to building wealth. Stably married couples also avoid the substantial costs associated with family instability, especially among parents—legal costs, child support and moving to a different home, to name a few. Furthermore, marriage itself appears to engender a responsibility ethic, where spouses set aside money for an imagined future together. This translates to higher rates of per capita savings and lower rates of spending per capita among the married compared to their demographically similar but unmarried peers. Because marriage makes it easier to save, reduces costs associated with family instability and engenders a savings ethic, the significant association between marital status and wealth looks to be at least partly causal.

Marriage and marital transitions also appear to independently influence the accumulation of wealth in America.

Given the deeply unequal character of family structure and household wealth in the U.S. today, and the reciprocal relationship between wealth and marriage—where wealth appears to foster stable marriage *and* stable marriage seems to increase one's odds of building wealth—two policy conclusions follow. First, policymakers should pursue measures—like "baby bonds" or savings accounts at birth that are funded more generously for more disadvantaged children and may be used once a child turns 18 for paying for college or technical education, buying a home or starting a business—that will

reduce wealth inequality in America and help more young men and women feel financially prepared to enter into marriage. Second, policymakers should also seek to bridge the marriage divide in America by minimizing or eliminating marriage penalties in means-tested programs and policies that hit working-class families especially hard today. Medicaid and disability benefits, for instance, should be reformed so as not to penalize couples who marry.

Such policies will help engender a future where more financially struggling young men and women can marry at the age they want to and can tap into the many benefits of marriage—including increased ability to accumulate wealth. The alternative, a world where wealth and marital success is divided ever more unequally by class, is unacceptable.

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SECTION V

STRONGER FAMILY BALANCE SHEETS: ASSETS

Building Wealth by Investing in Four Forms of Capital

BY ROSS DEVOL AND DAVID SHIDELER

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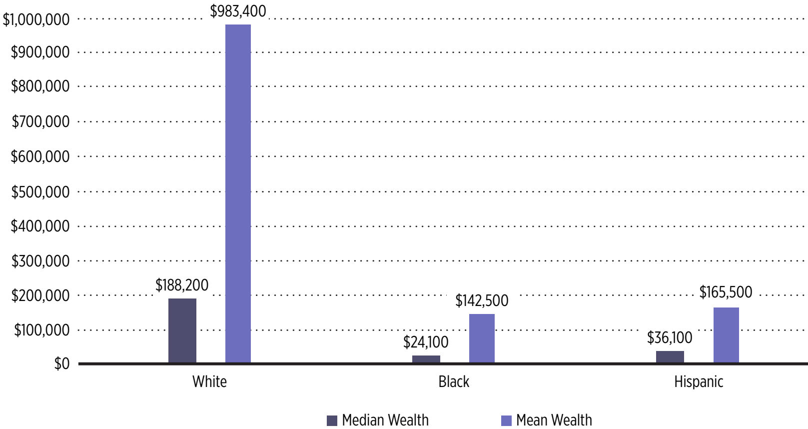
Wealth gaps have been rising in the U.S. for decades, but they have widened most acutely between whites and people of color. These wealth disparities are causing fissures in opportunities between children from families with accumulated financial assets relative to those children from families lacking these assets. As shown in Figure 1, wealth is more concentrated among whites. The ratio of mean to median family wealth among whites in 2019 was over five; this is the widest the ratio has been since the Federal Reserve began conducting its Survey of Consumer Finances. The figure also illustrates the disparity of wealth between whites and other races and ethnicities in 2019. The ratio of mean wealth of whites relative to Blacks was 6.9; however, in 1989, the same ratio was 4.3. The ratio of mean wealth for whites relative to Hispanics rose from 4.9 in 1989 to 5.9 in 2019.

FIGURE 1

Comparison of Median and Mean Wealth Across Races and Ethnicity



Source: Federal Reserve Bank Board of Governors, Survey of Consumer Finances, 2019.

To address these wealth disparities in a meaningful way, we must focus on policies that address the underlying causes, not the symptoms. We need to invest in building four types of capital: human, health, entrepreneurial and financial, and digital.

Human Capital

There is a clear relationship between educational attainment and income; as one accumulates human capital (from education), one becomes more productive in the labor force and garners a higher wage. For example, an individual with a high school diploma had median earnings of $38,792 in 2019, while one holding a bachelor's degree made $64,896—a premium of 67.3%. Even someone with an associate's degree earns a premium of 18.9% compared to a high school graduate. The premium can be larger for someone with an associate's degree in a technical field.

To address these wealth disparities in a meaningful way, we must focus on policies that address the underlying causes, not the symptoms.

While educational attainment and income are linked, the performance of institutions of higher education as catalysts of upward mobility is spotty. Some colleges have a high proportion of students from low-income families (high access), while others have a large percentage of those low-income students who are successful as adults (high income). The reality is that very few colleges combine a high access rate and a high success rate. Colleges that intersect in both categories provide the greatest impetus to upward mobility in a region. However, there doesn't appear to be an inherent trade-off between access and success among colleges.

A policy worth pursuing further is heavily subsidized or free tuition for students from low-income families who enter community colleges and are enrolled in programs for high-demand occupations, as is being discussed in the American Families Plan. More focus on establishing in-demand career pathways by local firms might improve prospects for earnings mobility. Universities and colleges would better serve students from low-income families if they tracked their progress from the moment they arrive on campus as well as provide coaching and social support services before an irreversible event occurs (dropping out, never to return).

Health Capital

Low human capital is also related to poor health. On the one hand, low-skill workers often lack access to employment that provides health insurance; on the other hand, poor health status reduces lifetime earnings and can create a downward financial spiral when unforeseen medical expenses (heart attack, cancer, etc.) occur. Affordable and more accessible health insurance can protect accumulated wealth or prevent deep indebtedness. Despite efforts like the Affordable Care Act, disparities across race also exist, with 6.3% of whites having the lowest uninsured rates compared to Blacks, who have a rate of 10.6%.

More health insurance options need to be offered that are not tied to employment. The Affordable Care Act could be expanded by offering higher subsidies for families. Without access to affordable health care, we limit upward mobility and the ability to build wealth. Some expansion of existing Medicaid programs must also be considered. Longer term, we need reforms to the health insurance system that moves us toward a value-based model that reimburses providers for keeping people healthy (whole health system). People of color would benefit most from this change, as COVID-19 demonstrated. Because of previous poor access to health care, people of color had multiple comorbidities, subjecting them to higher rates of infection, hospitalization and death.

Entrepreneurial and Financial Capital

Heartland Forward research has shown that entrepreneurship has a significant positive influence on a community's ability to create jobs and economic opportunities for its citizens. Like so many other parts of the public sector, entrepreneurial ecosystems lack coordination, so they have been unable to stem the 44% decline of U.S. entrepreneurship between 1978 and 2013. And entrepreneurship rates are extremely subdued in Black neighborhoods. For example, just 0.24% of Blacks in the U.S. started a new business in 2019—the lowest of any racial or ethnic group.

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There is evidence that business ownership plays an instrumental role in closing the racial wealth gap. Business ownership helps families build wealth: It diversifies their portfolios, business assets generate greater average returns over time than household assets and, most importantly, it is associated with higher wealth levels. Research demonstrates that Black entrepreneurs have greater wealth mobility than Black workers. Black entrepreneurs have similar wealth mobility compared with white entrepreneurs; however, white workers have greater wealth mobility than Black workers.

Two significant barriers to business ownership, particularly among persons of color, include access to early stage risk capital and technical assistance. While the federal government plays a role in funding innovation and entrepreneurship, through Small Business Administration (SBA) loan guarantee programs and grants for small business innovation (e.g., SBIR), the majority of Black- and Hispanic-owned businesses lack awareness and access to these programs. For example, the Payroll Protection Program (PPP) did not fund Black-, Hispanic- or female-owned businesses in proportion to their share of firms overall. However, Homeowner Assistance Funds, in the American Rescue Plan, will help to preserve existing homeowner wealth that is often a form of collateral on small business loans. The State Small Business Credit Initiative is another American Rescue Plan program that seeks to inject financial capital into state-sponsored technical and capital access assistance programs.

There are several approaches to addressing entrepreneurs' access to capital, such as

- Reconfiguring and expanding SBA loan programs to assist younger, smaller firms.
- Funding alternative financial institutions (such as community development financial institutions, or CDFIs) to provide startup capital, such as expanding minority-owned depository institutions' lending capacity by $20 billion.
- Funding state and local venture capital programs from the new Small Business Opportunity Fund.
- Encourage business angel investment to both increase funds available to startups and educate accredited investors on investment opportunities.

As with all programs, geographic and demographic diversity must be a priority in resource allocations.

To boost entrepreneurial capital, communities and governments should seek to establish entrepreneurial support organizations (ESOs) to help get startups off the ground. ESOs coordinate efforts across institutions to ensure the delivery of the right resources to the right businesses; by reducing competition for resources and guiding entrepreneurs to the right services, ESOs reduce barriers in the community to new firms.

Investing in diverse and ethnic people of color and women will be critical to spur inclusive growth, boost economic performance and create wealth.

Digital Capital

COVID-19 highlighted the bare necessity of digital capital for the creation of human, health, financial and entrepreneurial capital. Access to high-speed internet has been—and continues to be—a lifeline for education, commerce, health, workforce and equity. Individuals (and even whole communities) without access have genuinely suffered. We must digitally connect all of America to address building other forms of capital. And there exists consensus on this, as funding for high-speed internet access, adoption and utilization is a common theme throughout the federal recovery strategies—as an allowed use of American Rescue Plan funds for recovery and capital projects and as specifically targeted funds in the American Jobs Plan.

Investing in diverse and ethnic people of color and women will be critical to spur inclusive growth, boost economic performance and create wealth. McKinsey and Company estimated that if we could close the wealth gap between Blacks and whites alone, it would add $1 trillion to real GDP. We must be intentional about addressing the underlying causes of wealth disparities.

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David Shideler is chief research officer at Heartland Forward. He joined Heartland Forward after more than a decade at Oklahoma State University, most recently serving as a professor and community and economic development specialist in the Department of Agricultural Economics.

Show Me the Money: To Build Wealth Inclusively, Look to Where People Accumulate and Government Subsidizes It

BY C. EUGENE STEUERLE AND SAFIA SAYED

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.

Any policy effort with hope of having a significant effect on building wealth for everyone must look at (1) where families accumulate wealth and government distributes subsidies and (2) how significant wealth building almost always requires (a) *long-term* ownership of (b) *real* assets with (c) decent *rates of return* (d) *accumulating* and compounding over time.

Failing those tests, policies to encourage wealth building may serve as vehicles for learning or emergencies, but they are unlikely to move the needle much on increasing the net worth of those many households together holding only a small share of total household wealth.

Over the past four decades, domestic spending has more than doubled in real dollar terms and also increased as a share of GDP, while the share of total household wealth has declined for many groups, including Black households, those with below-median wealth and the young. The failure of government redistributive and investment policy to have greater influence on real and financial wealth of most households, we believe, derives from its failure to address the two primary sets of considerations just outlined.

Among the most logical ways to change course would be to attend to where households naturally succeed in accruing wealth. Not surprisingly, for most households, this correlates highly with homeownership and retirement saving, both of which contain processes that encourage accumulation, compounding and investment in assets with higher real rates of return. Changing course also requires looking to the size and distribution of current government wealth building subsidies, largely tax subsidies for holding these same assets.

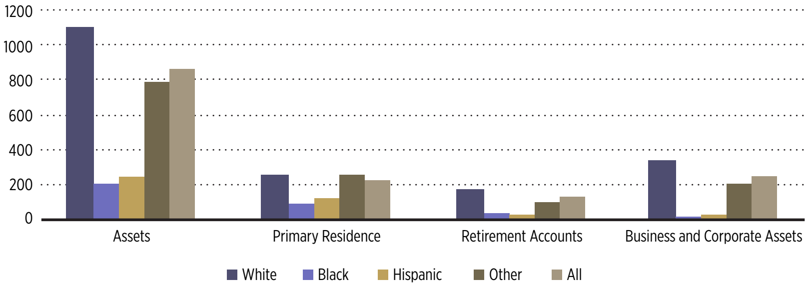
At the end of the third quarter of 2020, the combined assets of all households and nonprofit institutions in the U.S. equaled $140 trillion and their liabilities, $17 trillion. When we look to where households in all racial and ethnic groups tend to accumulate wealth, we see that homeownership and retirement assets stand out in general and dominate in the middle (here defined as the

average in the third quintile) of the wealth distribution of each group (Figures 1 and 2). Direct ownership of business assets and corporate stock stands out in the highest wealth classes.

FIGURE 1

Mean Asset Values, 2019

Thousands of 2019 dollars



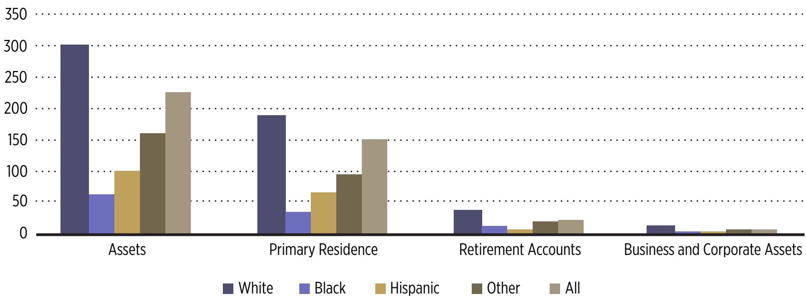
Source: Survey of Consumer Finances.
Note: Retirement Accounts exclude less liquid pension entitlements. Business Assets include the value of active business interests and directly held stocks and mutual funds.

FIGURE 2

Mean Asset Values, 2019

Middle net worth quintile in each race/ethnicity

Thousands of 2019 dollars



Source: Survey of Consumer Finances.
Note: Retirement Accounts exclude less liquid pension entitlements. Business Assets include the value of active business interests and directly held stocks and mutual funds.

At the same time, Frank Sammartino and Eric Toder show that total tax subsidies for homeownership and retirement plans, as estimated by the Treasury for fiscal years 2019 through 2022, equaled $1.7 trillion, or approximately $850 billion each.

While one might argue that these policies are targeted to the assets most critical to household accounts and to wealth accumulation, they are fairly exclusive and ill-targeted for households with limited wealth and income and those just beginning to invest. Because these subsidies come almost entirely in the form of deferred taxation or deductions and exclusions that increase in value with both one's wealth and higher tax rates, they tend to be highly skewed toward higher-income households. For instance, the top income quintile (or richest 20%) of taxpayers garner 63% of the tax benefits for retirement saving incentives and 79% of tax benefits for home mortgage interest deductions (Table 1). Yet these are the households already most likely to have adequate assets to meet their financial needs.

TABLE 1

Tax Benefit of Housing and Retirement Saving Tax Incentives

Distribution of tax benefits, by income percentile, calendar year 2018

EXPANDED CASH INCOME PERCENTILE	ITEMIZED DEDUCTION FOR HOME MORTGAGE INTEREST		RETIREMENT SAVING INCENTIVES	
	SHARE OF TOTAL BENEFIT (%)	AVERAGE BENEFIT ($)	SHARE OF TOTAL BENEFIT (%)	AVERAGE BENEFIT ($)
Lowest quintile	0.1%	$0	0.4%	$20
Second quintile	0.7%	$10	3.7%	$180
Middle quintile	4.3%	$40	10.9%	$600
Fourth quintile	15.6%	$160	22.5%	$1,470
Top quintile	79.3%	$960	62.5%	$4,840
All	100.0%	$170	100.0%	$1,100

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0718-1) via Sammartino and Toder (2019).

To be clear, the government does provide health insurance, food assistance and other support to low- and middle-income households, and it does

promote investment, though largely to those who already have significant wealth. The point here is that investment in wealth building for most low- and middle-income households falls through the cracks.

Consider by analogy promoting wealth in the form of human capital or education, where similar failures occur. Policies that support ever more years of retirement support for everyone, perhaps the dominant domestic social policy of government over the last 80 years, or emphasize educating mainly those who are already well off, often let educational opportunities for those less well off and the noncollege bound fall through the cracks.

When one saves for the near term or emergencies it makes sense to concentrate on accounts with limited short-term risk. Over the long term, however, the risk associated with investments in higher-return real assets such as housing and stock declines.

If we look at those who have successfully accumulated financial and real capital, they invest mainly in *real assets*: homes, shares of corporations (either owned directly or through pension and retirement accounts) and businesses. They don't just lend to others by holding interest-bearing assets. Stock ownership over time typically has provided a real *rate of return*, averaging 5% or more higher than that available from saving accounts and bonds. Similar calculations apply to returns from homeownership.

When one saves for the near term, or to be ready to meet some emergency, it often makes sense to concentrate on checking accounts or interest-bearing assets with limited short-term risk. Over the long term, however, the risk associated with investments in higher-return real assets such as housing and stock declines.

As a simple example, within one year, the $1 invested in a savings account yielding 1% would be worth exactly $1.01 before inflation. A diversified stock investment providing an average return of 6% would accrue to an expected value of $1.06, but potential losses could reduce it to 70 cents or less. Invested and accumulated for 30 years, however, the savings account would have risen to $1.36 before inflation, the expected stock value to $5.74. Even taking into account significant fluctuations in valuation of the stock, it turns out that the long-term real investment tends to be the less risky one, especially when inflation is taken into account.

Saving for retirement years typically engages a natural cumulation of deposits and potential compounding of returns from working years to retirement. Homeownership does also, though in a different way. Say a home provides a return in the form of rental savings of 5% of home value, but an initial loan of most of the home value requires a payment of 4% to the bank. The net gain in wealth from that first year of ownership would be fairly modest. The continual payout of the mortgage, however, compounds over time, leading to full ownership of the house when the mortgage is paid off. In the meantime, the homeowner generates ever higher net rental saving as home equity grows. Primarily because of these mortgage-saving dynamics and the need to rent or own housing from the time one establishes an independent household, homeownership often plays a dominant saving role for many middle and even low wealth households throughout much of their lives.

Reform of homeownership and retirement tax subsidies may soon be on the table: Many individual provisions of the Tax Cut and Jobs Act of 2017, including those that led to significant reductions in deductible home mortgage interest payments, expire in 2025, and President Biden made campaign promises that, while needing much refinement, would provide a first-time homebuyer tax credit and partly equalize retirement plan subsidies. Opportunities for promoting wealth building for everyone may be higher than at any time in recent decades, especially if there is a willingness to look at where and how people accumulate real asset wealth.

Opportunities for promoting wealth building for everyone may be higher than at any time in recent decades, especially if there is a willingness to look at where and how people accumulate real asset wealth.

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Land and Opportunity: Reforming Heirs Property Rights

BY KARAMA NEAL, PHD

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 2020 list of the top 100 U.S. landowners has many familiar names—billionaire tech giants, titans of finance and heirs to oil and other fortunes. Few would be surprised that the very wealthy have invested in land given its significant and lasting value for food, feed, fuel, fiber, fun and family sentiment. Land's value may even increase with the effects of climate change, causing decreasing availability. But the ultrawealthy are not the only ones who invest in land. Many low and moderate wealth families are also generational landowners.

In the late 1800s, my great-great-grandfather, about 20 years out of slavery, purchased a homestead in southwest Arkansas. He wanted a place his family could always call home and was told that if he died without a will, his property could never be sold. That was not sound legal advice. When he died, his property was informally passed down, undivided, to his five children. The same thing has happened for several generations so that now, I, along with dozens of my cousins, are heirs to this bucolic family land. It is heirs property, real property transferred in an undivided state from one generation to another.

Because every family death changes the ownership structure, heirs property is a legally unstable form of ownership and is particularly susceptible to hostile acquisition.

Because every family death changes the ownership structure, heirs property is a legally unstable form of ownership and is particularly susceptible to hostile acquisition. For example, in addition to furthering land loss, the

Dawes Act of 1887[1] facilitated substantial Native American land fractionation when individual owners passed their property to heirs in an undivided state. Also, between 1920 and 1980, more than 90% of African American farms were lost, in large part due to the vulnerability of multiple owners.[2] Such land loss is facilitated by both public policy[3] and common practice.[4] In addition, because these "tangled titles" cloud ownership, family landowners can have difficulty receiving home repair, FEMA or other home maintenance support,[5] making it challenging for heirs property owners (or "cotenants") to both retain and maintain their property and the collective wealth it represents. And while heirs property is found among Asian Americans, European Americans and Hispanic Americans groups,[6] Native Americans and African Americans are often disproportionately affected.

Despite these issues, heirs property presents an economic opportunity, especially when family landowners can address the legal issues and make use of the property in ways that meet their family goals. When that happens, families can build lasting wealth for themselves and for future generations

Heirs property presents an opportunity for families to build lasting wealth for themselves and future generations.

1 The Dawes Act or General Allotment Act authorized allotments of reservation land to individuals who often passed the land down to their heirs in an undivided state. Unallotted land was typically sold. This land loss is in addition to the loss of Native American lands caused by European colonization. See, for example, the Indian Land Tenure Foundation, "Fractionation" from the US Department of the Interior, and "Removing Native Americans from their Land" from the Library of Congress.

2 U.S. Commission on Civil Rights, 1983. "The Decline of Black Farming in America 2," https://files.eric.ed.gov/fulltext/ED222604.pdf.

3 Thomas W. Mitchell, 2019. "Historic Partition Law Reform: A Game Changer for Heirs' Property Owners." In *Heirs' Property and Land Fractionation: Fostering Stable Ownership to Prevent Land Loss and Abandonment*, edited by Cassandra Johnson Gaither, Ann Carpenter, Tracy Lloyd McCurty and Sara Toering, pp. 65-82. Asheville, NC: U.S. Department of Agriculture Forest Service.

4 For an example, see p. 181 of Olly Neal, Jr. and Jan Wrede, 2020. *Outspoken: The Olly Neal Story*. Little Rock, AR: University of Arkansas Press.

5 For a discussion, see Richard Kluckow, 2014. "The Impact of Heir Property on Post-Katrina Housing Recovery in New Orleans," https://mountainscholar.org/handle/10217/88564.

6 Karama Neal, 2019. "Heir Property: Issues and Opportunities." *Arkansas Journal of Social Change and Public Service*, 8, https://ualr.edu/socialchange/welcome/publications/volume-8/.

through harvesting timber, renting a family home, leasing farmland or the like. In addition, as family landowners develop their rural, urban and suburban properties, communities can benefit through a higher taxbase. More work in policy, service provision and research is needed to ensure that families can unlock the billions of dollars of value present in hundreds of thousands of heirs property parcels.

Because of the complex and protean ownership structure of heirs property and the variety of state laws governing property and inheritance, state and federal policy can have a significant impact on families' ability to access the full value of their property. To address this issue, in 2010 Texas A&M legal scholar Thomas W. Mitchell drafted the Uniform Partition of Heirs Property Act (UPHPA). This model legislation gives families a fighting chance to keep their land when faced with external attempts to acquire it. For example, the UPHPA gives families the right of first refusal so they can buy the interest of a co-tenant who wants to sell the property. It also requires an appraisal so that families know and ideally receive the full economic value of their property in the event of a sale.

The UPHPA is an important step in replacing policies that facilitate land loss among low wealth families. As of this writing, the UPHPA has been passed in 17 states and the U.S. Virgin Islands. Interest is increasing, in part, because of the 2018 federal Farm Bill that provides financing and other opportunities for family landowners in states that have passed the UPHPA. Importantly, the law allows families to take proactive steps toward unlocking the value of their property, steps that would put their property at risk without UPHPA protections. For these reasons, the Business Roundtable and other organizations have endorsed the UPHPA. Joining or creating a state initiative to pass the UPHPA is a critical tool for releasing the value of heirs property.

The scarcity of accessible legal, financial and other services contributes to the creation of heirs property and to families' reticence and inability to take legal action to improve their property. Often, heirs property occurs in locations that are legal or financial deserts, and even if families find those services, the providers may prioritize wealthier developers or land speculators over lower wealth families. For example, I once talked with an attorney who routinely scoured the obituaries to find likely heirs to property he fancied. Upon locating them, he would offer a small sum for their interest in the property

and then move to acquire the entire property, often at less than market value. These and related situations could be avoided with sound legal advice for families. In addition to having more attorneys focused on real property, it would be helpful to have clarity on how family property ownership is or is not counted toward assets when calculating legal aid eligibility.

Once families have a clear title, they need capital to do home repairs, hire a forester or irrigate or otherwise improve their property. Community development financial institutions, for example, focus on "supporting economically disadvantaged communities" and so may be particularly well positioned to provide access to capital to family landowners. Families also need business development services to address questions about the best ways to use and benefit from their property.

Finally, there is significant need for research on the full nature of the opportunity heirs property presents to families and communities. Research from the Federal Reserve Bank of Atlanta, for instance, shows projected numbers of heirs property parcels in the Southeast, but similar research is needed in other states. Additional research is needed on topics like understanding where owners live (since many heirs live away from their property), the tax and other impacts of improved heirs property management (to help justify local investment), and the possible role of gender in heirs property ownership (since women outlive men statistically). These analyses can provide the support needed to implement state and federal policies and to increase the availability of legal, financial and other resources families need.

Many conversations about household finance only consider liquid or local assets, but distant fixed assets may also contribute meaningfully to the family balance sheet.

Many conversations about household finance only consider liquid or local assets, but distant fixed assets may also be relevant, particularly when they have the potential to contribute meaningfully to the family balance sheet. While families like mine are not likely to ever be among the top 100 U.S. landowners in the county (nor is that our goal), we do want the real opportunity to recognize the full value of the property our grandmothers and great-great-grandfathers purchased, often with our generation in mind. We want to unlock the opportunity they provided us without the interference of predatory wealth extraction

efforts. And we want to create more meaningful assets for our children and their children. Heirs property, land purchased a generation or more ago, is an often neglected but critical part of today's efforts to promote family economic mobility. The collective wealth and opportunity heirs property offers will pay benefits not just for family landowners but for us all.

Karama Neal, PhD, is the founder of the Heirs Property Information Project and led a grassroots organization that successfully promoted passage of the Uniform Partition of Heirs Property Act in Arkansas. Until April 2021, she served as the president of Southern Bancorp Community Partners, a nonprofit community development loan fund. @karamaneal

Black Homeownership Matters

BY VANESSA G. PERRY AND JANNEKE RATCLIFFE

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.

Homeownership is the primary cornerstone for asset building in the U.S. As a lasting legacy of racism, households of color have much lower homeownership rates than white households and consequently hold, at the median, just one-eighth the wealth of white households. As America's population ages and diversifies, homeownership is expected to drop, with each new age cohort less likely to own a home than prior generations at the same age.[1] *We can do better. This article lays out clear steps to increase access to the benefits of homeownership, safely and equitably.*

Homeownership works. Of the opportunities covered in this volume, owning a home remains the clearest path to long-term and intergenerational asset building.

It works because we make it work. The government subsidizes housing for the wealthy via the tax code, has engineered a system of mortgage finance to facilitate homeownership, and intervenes in economic crises to help owners keep their homes. However, the system has not worked for all. Some 75% of white households own their own homes, yet less than half of Black and Hispanic households do.[2] The Black/white homeownership gap is greater today than it was in 1968,[3] when the Fair Housing Act supposedly ended racial discrimination in housing.

As America's population ages and diversifies, homeownership is expected to drop, with each new age cohort less likely to own a home than prior generations at the same age. We can do better.

1 Laurie Goodman and Jun Zhu, 2021. "The Future of Headship and Homeownership." Urban Institute.

2 American Community Survey of 2019 and the 2020 Census Housing Vacancy Survey

3 Decennial censuses 1960-2010 and the 2019 American Community Survey. The Black/white homeownership gap was 24.3% in 1960, 26.8% in 1970 and 30.1% in 2019.

These outcomes are no accident.

Before 1968, overt and institutionalized racism denied many families of color access to homeownership, while thousands of white families got federal help to accumulate wealth. The legacy of these policies endures in systemic forms for whole communities once explicitly denied a foothold on the middle class.

Homeownership works.

Interventions at the margin have not taken root. Small gains made from 1994 to 2006 were largely lost in the Great Recession,[4] when Black and Hispanic borrowers, who were disproportionately set up for foreclosure with predatory loans, lost their homes at around 1.8 times the rate of white borrowers. And now, a year into the COVID-19-related mortgage foreclosure moratoriums, Black and Hispanic borrowers are more likely to be in forbearance or delinquent on their mortgages, once again facing greater risk of home loss when these expire.

The Black/white homeownership gap is greater today than it was in 1968, when the Fair Housing Act supposedly ended racial discrimination in housing.

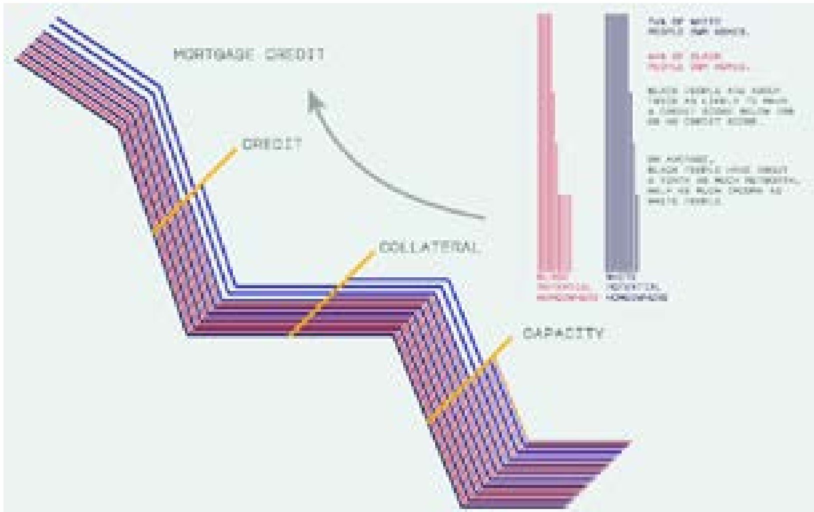
We can do better. Our vast mortgage finance system can intentionally address its past failures by extending well-regulated, affordable safe mortgages with low down payments to more people, through three steps.

First, we should update how models assess the three Cs of lending: capacity to repay, credit reputation and collateral (as illustrated below). Historical disadvantage has resulted in fewer financial resources for Black and Hispanic applicants who are in turn are more likely to be denied mortgages[5] yet manage regular, and increasingly high, rent payments. Such inequities will persist until mortgage lending models are more inclusive and fair.

[4] Census Bureau Housing Vacancy surveys 1994-2019

[5] Alanna McCargo and Jung Hyun Choi, 2020. "Closing the Gaps: Building Black Wealth Through Homeownership." Urban Institute, https://www.urban.org/sites/default/files/publication/103267/closing-the-gaps-building-black-wealth-through-homeownership_1.pdf.

Race, Access to Credit and the Homeownership Gap[6]



Models that count more types of income such as earnings in the gig economy and contributions of other household members are likely to be more inclusive. Adding new factors to credit scoring models—rental payments, utilities, remittances and digital transactions—would also likely benefit unbanked and "thin-file" consumers, who are disproportionately Black, Hispanic and recent immigrants.

Second, a targeted down payment assistance (DPA) program is critical. Renters report the lack of a down payment as the primary barrier to buying a home. For the median Black family, who holds less than 15% of the wealth of the median white family, this barrier is especially steep. Across the U.S., a patchwork of DPA programs is deployed across a network of over 1,300 state, local and national agencies.[7] These funds are often oversubscribed. With new federal funds for DPA, targeted to borrowers of color, many otherwise "mortgage-ready" families could buy a home with a standard mortgage they

[6] Vanessa Perry et.al., 2020. "2020 State of Housing in Black America: Challenges Facing Black Homeowners and Homebuyers During the COVID-19 Pandemic and an Agenda for Public Policy." National Association of Real Estate Brokers, https://www.nareb.com/shiba-report/.

[7] Laurie Goodman et al., 2018. "Barriers to Accessing Homeownership: Downpayment, Credit, and Affordability." Urban Institute, https://www.urban.org/sites/default/files/publication/99028/barriers_to_accessing_homeownership_2018_4.pdf.

could afford.[8]

And third, mortgage products and processes can, by design, enhance the safety and benefits of homeownership. The standard 30-year fixed rate, fixed payment mortgage, for example, protects borrowers from unexpected payment increases. Likewise, the rules for how lenders manage loans can speed a delinquent borrower to foreclosure or give them a way to catch up. Features that would reduce risk, improve benefits and provide safer on-ramps to homeownership for more families might include loans with built-in reserves, loans that are easy to refinance when rates fall, small-balance loans, lease-to-own and shared-equity financing, and loans that facilitate home improvement and rehab.[9]

Such advances can become mainstream but only if the federal housing agencies take the lead in piloting and standardizing. The government-sponsored entities that provide liquidity to lenders to make mortgages (Fannie Mae and Freddie Mac) should be refocused on their original mission, which, since the 2008 crisis, has fallen far short of proportionate service to Black and Hispanic communities. Furthermore, with additional investments in technology and capability, Federal Housing Administration (FHA) and Veterans Administration (VA) programs that disproportionately serve Black and Hispanic homebuyers can operate more efficiently and serve more borrowers.

At the same time, our system of public support for housing should also be refocused on bolstering the supply of homes for first-time buyers. If current trends continue, we expect 6.9 million net new homeowners by 2040, all of which will come from non-white households.[10] Skyrocketing demand and

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[8] A consumer is mortgage ready if he or she does not currently have a mortgage, is 40 or younger, has a FICO score of 620 or above, has a debt-to-income ratio not exceeding 25%, has no foreclosures or bankruptcies in the past 84 months, and has no severe delinquencies in the past 12 months (based on September 2016 data). For more information, see Vanessa Perry et al., 2020. "2020 State of Housing in Black America: Challenges Facing Black Homeowners and Homebuyers During the COVID-19 Pandemic and an Agenda for Public Policy." National Association of Real Estate Brokers, https://www.nareb.com/shiba-report/.

[9] Testimony of Alanna McCargo in 2017 before the Subcommittee on Housing and Insurance, Committee of Financial Services, U.S. House of Representatives. "Sustainable Housing Finance: Private-Sector Perspectives on Housing Finance Reform, Part III, p. 10-13," https://www.urban.org/sites/default/files/publication/94501/alanna-mccargo-testimony-part-iii.pdf.

[10] Laurie Goodman and Jun Zhu, 2021. "The Future of Headship and Homeownership." Urban Institute.

house prices during the pandemic have further tightened the housing supply, but incentives could tip the scale to producing more affordable inventory for owner-occupancy. Viable proposals call for tax incentives and subsidies for the construction of new homes or rehabilitation of existing homes. Others focus on preserving and stabilizing affordable neighborhoods by helping current owners maintain distressed properties, or else, seeing that properties get into the hands of new owner-occupants instead of absentee investors.[11] Even more could be accomplished through concurrent changes in zoning and land-use regulation, permitting and a broader adoption of new building technologies.

We know how to get homeownership right and to dismantle barriers to Black and Hispanic homeownership. But policies that fail to acknowledge that race reflects systematic and institutional discrimination will continue to fall short.

As an asset-building strategy, we know how to get homeownership right. We have the tools to dismantle barriers to Black and Hispanic homeownership. But well-intentioned public policies that fail to acknowledge that race is a complex reflection of systematic and institutional discrimination will continue to fall short. We need public policies and business practices that explicitly target historically disadvantaged homebuyers and communities. In this way, we can correct structural inequities using the very system that created them.

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Janneke Ratcliffe is the associate vice president for the Housing Finance Policy Center at the Urban Institute. Prior to joining Urban, she served as assistant director for the Consumer Financial Protection Bureau's Office of Financial Education.

[11] Center for Community Change, 2021. "New Deal For Housing Justice: A Housing Playbook for the New Administration," https://communitychange.org/wp-content/uploads/2021/01/New-Deal-for-Housing-Justice.Policy-Paper.Community-Change.1.2020.pdf.

Building Wealth Inclusively Through Business Ownership

BY JOYCE KLEIN

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.

Although business ownership may not be the primary way that most individuals and families build wealth in the United States, in any capitalist economy it's a route that cannot be ignored. Especially when the rules of that economy have been set such that in the past two decades, much of the growth in income inequality has been driven by a combination of returns to capital and, at the highest levels, pass-through business income.[1]

Although business ownership is clearly driving income generation and wealth accumulation among the top 10% and 1%, it can and should have a role in raising wealth levels for those in the bottom quintile of the wealth distribution. While it may be harder to draw the connection between the ownership of mom-and-pop enterprises or self-employment and wealth accumulation, there is evidence that households in which the head of household is self-employed have substantially higher wealth levels than those in which the head works for someone else.[2] Research has found this outcome is particularly strong for minority and women business owners and that the median net worth for Black business owners is 12 times higher

There is evidence that households in which the head of household is self-employed have substantially higher wealth levels. This outcome is particularly strong for minority and women business owners.

1 Thomas Piketty, Emmanuel Saez and Gabriel Zucman, 2018. "Distributional National Accounts: Methods and Estimates for the United States." *Quarterly Journal of Economics*, 133, 553-609, https://gabriel-zucman.eu/files/PSZ2018QJE.pdf; Matthew Smith et al., 2019. "Capitalists in the Twenty-First Century." *Quarterly Journal of Economics*, 134, 1675-1745, https://academic.oup.com/qje/article/134/4/1675/5542244?login=true.

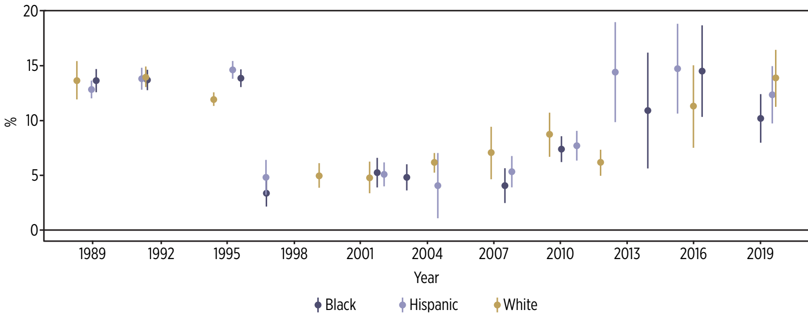
2 Brian K. Bucks, Arthur B. Kennickell and Kevin B. Moore, with assistance from Gerhard Fries and A. Michael Neal, 2016. "Recent Change in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances." Federal Reserve Bulletin, A1-A38, https://www.federalreserve.gov/pubs/bulletin/2006/financesurvey.pdf.

than Black nonbusiness owners.[3]

But while Black and Hispanic families are about as likely as white families to own wealth in the form of equity in a closely held business, the level of wealth they hold is lower. The images below show time-series data from the Survey of Consumer Finances on the share of families with wealth from a closely held firm and the median value of business equity (from analysis by the Institute for Economic Equity at the Federal Reserve Bank of St. Louis).[4] Data on both measures are quite volatile over time, but the general trend is that Black families have about half the level of business equity as white families, with Hispanic families having wealth levels somewhere in between the two.

Black families have about half the level of business equity as white families, with Hispanic families having wealth levels somewhere in between the two.

Share of Families That Own Equity in Closely Held Businesses

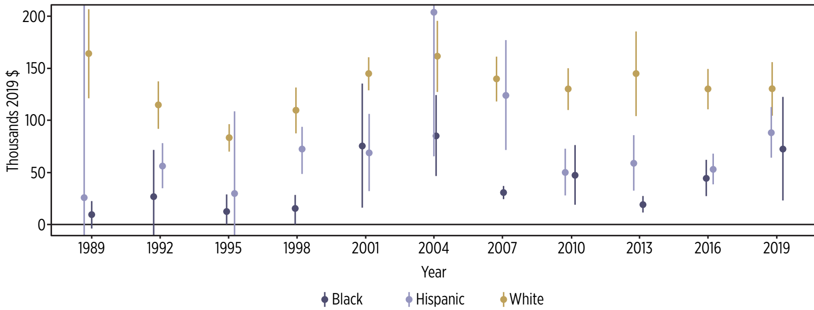


Source: Federal Reserve Board's Survey of Consumer Finances, calculations by Institute for Economic Equity.
Note: Replicate weight adjusted 90% CIs.

[3] Analysis of 2008 SIPP microdata conducted by Robert Fairlie for the Association for Enterprise Opportunity, as cited in The Tapestry of Black Business Ownership in America, 2017, Washington, DC: Association for Enterprise Opportunity, p. 8, http://www.aeoworks.org/wp-content/uploads/2019/03/AEO_Black_Owned_Business_Report_02_16_17_FOR_WEB.pdf.

[4] The Survey of Consumer Finances aggregates all other racial and ethnic identities into an "other" category. As a result, it is not possible to include analysis of these data points for Asian, Native/Indigenous or any other racial and ethnic identities.

Median Value of Business Equity (Conditional on Ownership)



Source: Federal Reserve Board's Survey of Consumer Finances, calculations by Institute for Economic Equity.
Note: Replicate weight adjusted 90% CIs.

Unfortunately, many of the same forces that have contributed to income and wealth inequality—and perhaps as or more important, the very low wealth levels among most Black and Hispanic households—have hampered the growth of their firms. Most firms are started largely with the owner's own money—it is the source they use to provide equity or patient financing. Next, most owners leverage their assets (homes or retirement savings) or their credit histories to borrow—from their IRAs via a home equity line of credit or a personal credit card. Absent any of these assets, it is hard to borrow funds from traditional sources. Business owners with weaker credit histories have been able to borrow from nonbank alternative lenders, but in many cases the products they offer lack transparency and carry high costs, which in the end often strip wealth or limit the owner's ability to build the business.

Occupational segregation and lack of access to capital have also meant that Black and Hispanic entrepreneurs are concentrated in industries with low barriers to entry but also have lower revenues and low margins. It's harder to build wealth from these types of firms—especially when debt, or in some cases only high-cost debt, is the only source of financing that a business owner can access. This is because it's hard to make great leaps when repayments begin soon after borrowing and loans are sized relative to existing cash flows.

So what do we do to realize the potential for business ownership to be a

route to wealth building, particularly for people of color?

It's worth starting by acknowledging that many of the other policies identified by other essay contributors to build wealth and protect against financial predation—by increasing savings, expanding homeownership, addressing student debt, eliminating unfair and unequal fines and fees, and so forth—will over time enable more individuals to invest equity in their own firms. Increasing access to capital share and employee ownership will allow workers as well as business owners to benefit from the wealth generated by larger firms. Strengthening policies that expand and improve the benefits of labor market participation will also help—by enabling those who are forced into self-employment out of necessity to achieve better economic outcomes and also removing some of the most marginal firms from the competition pool.

There are things we can do now to support business ownership that will disproportionately benefit people of color.

But as we also put those policies into place, there are things we can do now to support business ownership that will disproportionately benefit people of color:

- Expand access to debt that is appropriately sized and affordably priced. Three policies are important here:
  - Increase the level of grant support for community development financial institutions (CDFIs) so that they can build the organizational capacity and capital bases needed to scale the level of their lending (note: the CARES Act included $12 billion in funding for CDFIs and minority depository institutions, which is an important start in strengthening these institutions).
  - Provide subsidies and incentives to CDFIs that make microloans (less than $50,000) so that they can scale their ability to make smaller dollar loans at affordable rates. The American Rescue Plan reauthorized and provided $10 billion in funding for the State Small Business Credit Initiative, which will fund state, territory and tribal government small business credit support and investment programs. To ensure these reach business owners of color, it will be important that state programs support smaller-dollar small business lending.

– Pass legislation that requires small business lenders to clearly disclose the price and terms of small business credit (including through the disclosure of annual percentage rates).[5]

- Continue to expand efforts to help small firms connect to markets and revenue-generating opportunities (through public and private procurement and other means as well). Importantly, also recognize that appropriate financing and support in scaling up operations may also be important—getting awarded a contract without appropriate financing can doom or weaken a business in the long term.
- Support capital markets and product innovation that increases the availability of equity and more patient capital. Among more bank-like institutions and CDFIs, this might involve appropriately structured and priced revenue-based financing or residual-value leasing; it can also include creating crowdfunding and equity models that are suited to businesses that have strong growth potential but do not meet the criteria sought by venture financing.
- Examine and revise laws and regulations that unnecessarily push business owners toward informality. At the local level, these often include licensing rules. At the state level, they can include limits on the types of jobs held by individuals who have been incarcerated, while at the federal level they include immigration laws. In the long term, businesses that remain informal simply cannot grow to the levels of those that can access financing and markets more formally.

Supporting the ability of business owners of color to build their firms will not only be important in addressing racial wealth inequality—it will also be important for the strength of the U.S. economy, as other essay contributors have demonstrated. As the percentage of new entrepreneurs who are people of color increases,[6] we will lose the benefits that small and growing businesses

[5] These disclosures are embodied in the recently passed New York State Small Business Truth in Lending Act as well as the truth in lending disclosure provisions included in the Small Business Lending Disclosure Act (H.R. 7921) introduced in the 116th Congress and poised to be reintroduced in the 117th.

[6] In 2018, the share of new entrepreneurs who are from minority groups was 45.6%, close to twice that in 1996 (22.9%). Robert Fairlie et al., 2019. "2018 National Report on Early-Stage Entrepreneurship," Ewing Marion Kauffman Foundation, p. 4, https://indicators.kauffman.org/wp-content/uploads/sites/2/2019/09/National_Report_Sept_2019.pdf.

play in driving innovation, product diversity and experiences if we cannot figure out how to ensure that Black, Brown and other non-white-owned firms can thrive and grow. And the bigger and more profitable the firms owned by business owners of color, the more likely they will contribute to building the wealth of their owners.

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How College Degrees Can Become Assets, Not Liabilities, for Disadvantaged Students

BY KEVIN CAREY

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.

College degrees are assets. Or at least they are sufficiently asset-like that many people are willing to borrow large amounts of money to obtain them. Degrees unlock valuable parts of the labor market and yield returns in the form of additional compensation that can be used to make loan payments.

Degrees are, like homes, critical milestones on the standard path to prosperity. Because people tend to get their first degrees and homes earlier in adult life, when they have fewer financial assets and less established credit, it makes sense for the government to subsidize the loans used to acquire them.

But degrees are also *not* assets, in the traditional sense of the word. By too fully embracing the degree-as-an-asset idea, we have created a higher education policy architecture that doesn't work in important ways.

Traditional financial assets are fungible. You can sell one and use the money to buy another. When retail investors purchase stock in a company, they probably care very little for the corporate governance voting rights that come with their shares. Dividends matter, sometimes. Mostly, the price is the thing that matters.

That's why asset-minded policymakers often see higher education policy almost exclusively in terms of prices. To help students, make college cheaper or free. Lower the cost of borrowing by subsidizing interest to below-market rates. Forgive outstanding debt after a certain number of affordable payments—or maybe just all at once.

That's also why policymakers who are less inclined toward free tuition and mass loan forgiveness see college debt in classically moralistic financial terms. Students willingly chose to borrow money to purchase something

valuable, the thinking goes, just like an automobile or a home. So they should pay their loans back and be subject to the mercies of the debt collection industry if they don't.

But degrees aren't fungible—at all. They cannot be resold or foreclosed upon or bundled or securitized. They do not, by themselves, yield anything, other than memories, sometimes fond. People cannot sell degrees and use the proceeds to repay their loans. College debts are all but undischargable in bankruptcy precisely because banks feel vulnerable to the unrepossessability of diplomas.

The generic nature of easily converted financial assets has crept into the language we use to describe higher education. A thousand think pieces have pondered "is college worth it?" College, singular? Just one? Does anyone ask, "is a car worth it?"

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The unitary college of this formulation is, in the popular mind, a single system in which students are individually matched to the right institutional "fit" and tuition charges and financial aid packages simply reflect a straightforward combination of what education costs to provide and what families can afford to pay. While admissions criteria may vary, academic standards are enforced throughout.

In other words, college degrees are valuable financial assets provided by a fundamentally benevolent system. That would be nice, if it were true. In reality, college degrees are more like a combination of services and intellectual property provided by a private free market that is chronically prone to failure.

The evidence of that failure can be seen in the one million people who default on their student loans every year, compared to the approximately zero million people who enroll in college thinking that default is a likely outcome.

College degrees are valuable financial assets provided by a fundamentally benevolent system. That would be nice, if it were true.

Why do they default? Often, it's because their so-called asset isn't yielding the promised returns. According to the U.S. Department of Education's College Scorecard, there are over 780 colleges and universities where fewer than one-third of students have annual earnings above $25,000 six years after beginning school.

In fairness, there are a lot of branch campuses of shady for-profit beauty schools in that cohort. But raise the standard from one-third to one-half, and hundreds of public institutions, mostly community colleges and regional four-year universities, enter the mix. At Eastern New Mexico University, only 46 percent of students exceed the $25,000 earnings threshold. Seventy-three percent of debtors there are in default, delinquency, deferment, forbearance or otherwise not making progress paying down their loans two year after leaving school. Industry wide, debt and default numbers are especially dire for Black students.

Why do people enroll in colleges where impoverishment and financial calamity are the most likely outcomes? Because it's hard to see inside a college while standing on the outside, particularly if neither you nor anyone you know has been to one before. Undergraduate education is relational, interior and contingent, not something you can touch and feel. It also only happens once, unlike a neighborhood restaurant you won't return to if they serve you a bad meal.

If we want college degrees to consistently and robustly perform more like the assets everyone already thinks they are, the government needs to provide more of the hard-nosed skepticism that consumers will not.

Students, moreover, do not want a *caveat emptor* relationship with higher education. There are certain people in this life whom you want to trust: your doctor, your priest, your teacher. Students choosing colleges do not go searching for evidence they might be mistreated, which we know because all of the damning facts cited above about earnings and loan repayment are available on a high-profile website designed specifically to facilitate college choice, yet students keep enrolling into those colleges anyway.

All of which means that if we want college degrees to consistently and robustly perform more like the assets everyone already thinks they are, the government needs to provide more of the hard-nosed skepticism that consumers will not.

The Obama administration tried to do this by imposing a common sense rule that students can't use their federal grants and loans to attend for-profit programs that chronically fail to provide students with degrees that yield enough money to pay back their loans. The fact that this rule was fiercely

contested in Congress and the courts before being shredded by the for-profit college lobbyists that former Education Secretary Betsy DeVos hired to run federal higher education policy during the Trump administration belies the fact that the Obama standards were mild to the point of permissiveness and did not even apply to most college programs.

Colleges will complain that the best of what they do for students cannot be reduced to percentages and dollar amounts. That's true. But the worst of what colleges do to students absolutely can.

The rules did nothing to reign in the fast-growing and almost entirely unregulated market for professional master's degrees provided by public and nonprofit universities, a sector increasingly driven by fully online programs run by corporations that act as silent partners and marketing middlemen for brand-name institutions, in exchange for the lion's share of the profits.

Colleges will complain that the best of what they do for students cannot be reduced to percentages and dollar amounts. That's true. But the worst of what colleges do *to* students absolutely can.

For college degrees to really pay off for everyone—to actually translate into a financial asset, especially for lower-income and first-generation students who are most sensitive to education quality and most vulnerable to exploitation—the federal government needs to construct a strong floor of consumer protection that applies to all colleges, great and small.

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Building Human Capital and Assets for Those *Without* a College Degree

BY OREN CASS

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 median new home in America costs $334,000. Public education for two children raised in that home, from kindergarten through the 12th grade, costs $333,000.[1] Both costs have doubled in real terms since the 1970s, but while the home's asset value has risen, the high school education's has not.

Young adults emerging from high school into the labor market of the 1970s had credentials sufficient to find jobs that would support their families. About one-half of their peers would go on to college, and about one-third would attain their bachelor's degrees by age 25. But that was neither expected nor required. "An American father," the New York Times reported in 1974, "can support a family of two, three or four children without his wife's working." Median earnings for a man over age 25 with a high school degree in 1974 was $53,000—just over three years of income would buy the median new home. By 2019, median earnings for that man over age 25 with a high school degree was just $37,000; earning enough to afford the typical home would take nearly three times as long.

The popular solution to this predicament is to get everyone into college. To that end, we have converted our public high schools into veritable college prep academies, oriented education reform around rigorous academic standards and testing regimes and flooded the postsecondary system with more than $150 billion in annual subsidies. We send many more students to college—two-thirds now enroll after completing high school. But not many more come out the other end. In fact, for two generations, the share earning a bachelor's degree by age 25 has barely budged. Among those who do complete college, 40% land in jobs that don't require degrees anyway. All told, barely one-in-five young Americans moves smoothly from high school to college to career.

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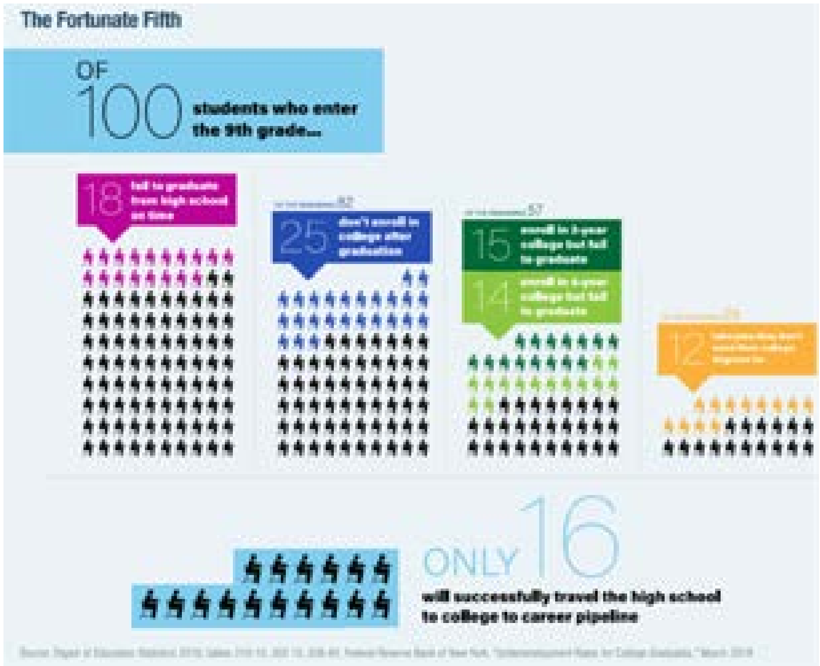
[1] The U.S. Department of Education's Digest of Education Statistics reports that expenditure per pupil in public elementary and secondary schools rose in constant 2018-19 dollars from $5,037 in 1970 to $6,813 in 1980 to $12,794 in 2017. Two students x 13 years of school x $12,794 = $332,644. See table 236.65 (2019).

The obvious financial catastrophe wrought by the college-for-all mindset is the student debt crisis, which is better understood as a college dropout crisis. The share of monthly income spent on debt repayment has remained constant in recent decades for the typical borrower, and the higher earnings associated with a college degree far exceeds the higher cost associated with the debt. The crisis exists for those who have borrowed without completing a degree or earned a degree that proves not to have value in the labor market, leaving a large liability on the personal balance sheet with no offsetting asset. Beyond tuition paid, a fair accounting should also consider the opportunity cost of not having gained the earnings or on-the-job experience of full-time work during the time spent in school.

The far larger and more intractable challenge, however, is our failure to help most Americans accumulate the human capital that they need to build successful careers and support stable families. The student debt problem can be erased easily (if expensively) enough, as many politicians have proposed:



Source: Manhattan Institute

The far larger and more intractable challenge is our failure to help most Americans accumulate the human capital that they need to build successful careers and support stable families.

Forgive the debt. Make college free. Such attitudes remain beholden to the empirically disproven propositions that most people can succeed in college and college is the right preparation for most jobs. What we need is not a reduction in the liability associated with pursuing the college pathway—which, for most people, is not a journey that leads to the accumulation of meaningful assets. Indeed, it is counterproductive to make that choice more attractive to precisely the people who benefit least from making it. We need other pathways that *do* strengthen the personal balance sheets young people possess as they set out into the world.

How would such pathways look? We needn't strain our imaginations—they are prevalent in most of the developed world, which finds our college obsession bizarre. Vocational training, apprenticeships, and so forth are established and respected on-ramps to well-paying careers. Across OECD countries, 40% to 70% of secondary school students are enrolled in vocational or technical programs. In Germany, for instance, apprenticeship remains roughly as popular as college, and former apprentices populate the ranks of senior management.

What we need is not a reduction in the liability associated with pursuing the college pathway—which, for most people, is not a journey that leads to the accumulation of meaningful assets.

The starting point is our high schools, which should aim to serve the majority of students who will not earn a college degree at least as effectively as it serves those who are campus bound. The idea of "tracking" students, even if the choice of track is left entirely to the family (as it should be), raises American hackles. But until we hire a personal tutor for every student, tracking is inevitable. The current system's problem is that it has only one track, the college track, which well serves only one constituency. Suggest to a self-righteous tracking opponent that, if we should only have one track, it should be a vocational track—let college-obsessed parents send their children to a special school three towns over—and the opposition to tracking fades quickly.

Noncollege pathways would vary somewhat by occupation and industry, but an illustrative example is instructive: A pathway might concentrate essential academic work in the 9th and 10th grade and, by the latter, begin exposing students to career opportunities and even occasional time in a workplace. Eleventh grade would include some academic work, some preparatory technical work in the classroom and an internship. Twelfth grade would be split between subsidized employment and time in a community college program designed by employers. Two more years of subsidized employment would follow, with time on the job supplemented by time in the classroom. A young American would arrive at age 20 with valuable skills and an industry credential, years of workplace experience and connection to an employer and earnings in the bank—and no debt whatsoever. Compare that balance sheet to the struggling college student's or the young person who never attended college to whom we provide little or no support today.

Such a program would be expensive, but, importantly, it would be much less expensive than attempting to move a student through four years of high school and four years of college. Thus, the resources to provide these pathways are already available. What is missing is the admission that college is not for everyone, or even for most of us, and the political will to redirect funds from the entrenched interests on our campuses toward nontraditional high school programs and employers. The transition will need to be gradual, but we could shift half of our $150 billion in higher-education subsidies over 10 years, allowing both public schools and employers time to develop capacity along the way. With a better strategy, the enormous investment that America makes in building the human capital of its youth could give all Americans valuable assets on which to build their lives.

What is missing is the admission that college is not for everyone, or even for most of us, and the political will to redirect funds from the entrenched interests on our campuses toward nontraditional high school programs and employers.

Oren Cass is the executive director at American Compass and author of *The Once and Future Worker: A Vision for the Renewal of Work in America* (Encounter Books, 2018).

How Child Savings Accounts Can Offer All Children the Future They Deserve

BY WILLIAM ELLIOTT III

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.

When talking about the New Deal, Roosevelt said, "Liberty requires opportunity to make a living decent according to the standard of the time, a living that gives man not only enough to live by, but something to live for." Without this opportunity, he continued, "life was no longer free; liberty no longer real; men could no longer follow the pursuit of happiness." Despite this proclamation, the American welfare system has become bifurcated, providing poor and upper-income children with different life chances. For the poor, policies focus on providing enough to live on (i.e., income/consumption), while policies for upper-income families focus on providing something to live for (i.e., wealth). This unequal system has resulted in gross wealth inequality.

While education has been touted as the elixir for America's bifurcated welfare system, education has been proven inadequate.

And while education has been touted as the elixir for America's bifurcated welfare system, education has been proven inadequate. Research shows that young adults from low-income families start careers earning about one-third less than their higher-income counterparts. People of color with a degree have less income than their white and Asian counterparts. Regarding wealth, Hamilton and colleagues find that Black families whose head of household graduated from college have about 33% less wealth than white families whose head of household dropped out of high school. These findings demonstrate that receiving a college degree has not brought about equality, even if it raises standards of living for the relatively few (about 36%) who attain a four-year degree. Indeed, research from the St. Louis Fed shows that college, rather than being the "great equalizer," is in fact an *engine* of the racial wealth gap.

What Do Different Life Chances Look Like?

I am a 50-year-old black male who grew up in poverty and dropped out of high school. My family had no money for me to attend college. Consequently, I relied heavily on student loans, graduating with $40,000 in debt. After paying off these loans in the military, I went to graduate school and left with $100,000 in debt. I was not able to buy a home until almost 40. My story represents the debt-dependent path to the American Dream. Let me tell you a different story. As my colleague Melinda Lewis grew up, what was a source of financial security for her parents became a foundation for economic mobility for her and her family. Melinda started building home equity before 25 and had access to retirement savings and no student debt. Melinda's story represents the asset-empowered path. It is a path that requires hard work but is eased because of wealth transfers at critical stages. Most people do not have access to the asset-empowered path.

What Is Needed to Change the American Narrative?

The answer is not surprising. Families need not only income to consume enough to survive but also wealth to have something to live for. Wealth allows people to plan for future consumption. In this way people can see their future selves going to college or retiring, for example. Knowing what you can consume in the future makes it feel close, something you should act on now.

Where deep wealth inequality exists, it reflects an economic system that produces different life chances, and a correction is required. If the correction is not made, belief in the American dream starts to fade, and civil unrest may become more common.

A Vessel for a 21st-Century Wealth Correction

I propose using Children's Savings Account (CSAs), sometimes called Child Development Accounts (CDAs), as the vessel for a 21st-century wealth "correction" (that is, a wealth transfer from wealthier households to counter stark wealth inequality). CSAs are provided through financial instruments (state 529s or savings accounts) and connect families to financial institutions while providing them with an opportunity to contribute and receive transfers, thus developing their capacity to build new wealth. Small-dollar CSAs

typically include most, if not all, of these components: (a) an opportunity to own a wealth-building account, (b) initial seed deposit ($5 to $1,000) and (c) incentives. As of 2019, there are approximately 922,000 children in 36 states who are participating in a CSA program.

Targeted Ongoing Deposits

By providing every child with an account, the scaffolding is put in place to augment saving efforts of low-income families through targeted ongoing deposits.

Nevertheless, today's growing economic inequality means that small-dollar CSAs are not enough. Low-income families have little discretionary money and will never be able to save enough to end wealth inequality. By providing every child with an account, the scaffolding is put in place to augment saving efforts of low-income families through targeted ongoing deposits.

Maybe the best example of a proposal for targeted or progressive ongoing deposits is Sen. Cory Booker's American Opportunity Accounts Act. This legislation would provide every newborn child with a baby bonds savings account and an initial $1,000 deposited. Poorer children would receive an additional $2,000 annually until age 18. Upon turning 18, the child could access the funds (up to $46,000 if low income) for wealth-building purposes.

Another proposal for ongoing deposits was made by the College Board. They recommend putting a portion of Pell Grant funds into savings accounts for children starting as early as age 11 or 12. Similarly, nonprofit scholarship providers are beginning to use some of their scholarship funds as early awards placed in accounts. For example, the Community Foundation of Wabash County (CFWC) was approached by a donor who wanted to provide funding for a traditional scholarship. However, after consulting with CFWC, the donor opted to award eligible students with a $1,000 scholarship to be placed in their CSA in grades four through eight, and the Wabash City Schools Opportunity Award Program was born. This change in thinking, placing early award scholarships into CSAs, may be a game changer.

Early Children Investments Reverberate into Adulthood

It is well established that early investments are important for determining children's outcomes. However, higher-income families can make these

investments more often. Importantly, research shows that predicted household income and net worth are higher for adults who received parental financial support for college than for those receiving no such support, which might help explain the higher return on a degree for these adults. CSAs mimic these early parental investments. Additionally, research on CSAs indicates that they have indirect effects such as cultivating young children's social and emotional health while helping parents develop and sustain college expectations.

Effort and Ability Is Still Needed

Forty-six thousand dollars, while significant, will not eliminate the need for families to create new wealth on their own. They will still need to develop human capital (i.e., postsecondary credentials and financial capability) to turn this wealth into new wealth. And while I have proposed in the past CSAs with targeted ongoing deposits as a replacement for free college, I can see more clearly now how a better way forward, one that reflects Melinda's story and most upper-income children's stories, is one where college is free and they start off with wealth transfers from their families that put them in the best position to leverage their degrees. This is what a level playing field looks like. Effort and ability would finally come to the forefront for determining who the winners are, overshadowing a legacy of wealth inequality that was born out of slavery and Jim Crow.

I propose combining free college and a wealth correction with financial capability training delivered through a national CSA program.

I propose, then, combining free college and a wealth correction with financial capability training delivered through a national CSA program. With this policy, wealth inequality might just become something for historians to remind us of while giving all children in America futures. This is what President Roosevelt must have had in mind when he said liberty requires "something to live for."

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Achieving a Holistic, Inclusive, People-Centric Retirement Savings System

BY KAREN BIDDLE ANDRES AND DAVID C. JOHN

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.

Savings play an essential role in modern life. Retirement savings, which are invested and grow over decades, are second only to homeownership as a source of household wealth in America. They serve as both the source of additional retirement income and a critical backstop for large, unexpected retirement expenses like long-term care.

But several other kinds of saving are also vital in the accumulation and growth of household wealth in the United States. Highly liquid emergency savings help people weather unexpected shocks and smooth out uneven cash flow, thus serving as an insurance policy that protects longer-term, less liquid savings. And goal-based savings, for purposes like financing higher education or making a down payment on a home, have the potential to increase the saver's income and household wealth.

Unfortunately, many Americans simply don't save enough. Across these three basic types of savings—emergency savings, goal-based savings and retirement savings—Americans are struggling to save. In 2019, 37% of Americans could not come up with $400 in emergency savings without borrowing or selling something. Only 10% of low-income families had 529 college savings plans in 2020, compared to 49% of high-income families. Fifty-seven percent (more than 100 million) of working-age individuals do not own any retirement account assets in an employer-sponsored 401(k)-type plan, individual account or pension.

The problems revealed by this holistic picture of savings often lead observers to conclude Americans do not fully understand the value of saving or that they would prefer to consume today rather than prepare for tomorrow. But the reality is different. While there are certainly people who might benefit from financial education or persuasion about the value of delayed gratification, we must acknowledge three facts.

First, the costs of life's big-ticket items—housing, healthcare, dependent care and higher education—have risen faster than both inflation and wages. Most people must save to afford them. Second, millions of Americans face structural barriers that prevent them from accessing the tools and accounts that wealthy households use to save. Third, we already know how to help people to save, even when their income levels make it hard. America's retirement savings system, including both private plans and emerging state-facilitated Auto IRA programs, prove that people with low and moderate incomes—with access to automatic savings features—can consistently save.

A major part of the problem is a fragmented, complex savings system that offers many types of products that use mystifying terms and complex requirements. A simple, multipurpose way to save is needed. By building and improving upon our existing retirement savings system, we can create an inclusive, people-centric savings system that can improve Americans' financial health and security throughout their lives.

By building and improving upon our existing retirement savings system, we can create an inclusive, people-centric savings system that can improve Americans' financial health and security throughout their lives.

Creating a people-oriented savings system requires understanding the realities of household finances. Financial emergencies occur regularly and can cause longer-term damage to household finances. An effective saving system recognizes that short-term savings are intended to be used and not just sit in an account. The value of a savings balance goes beyond the ability to cover an emergency expense. The ongoing process of building, using and then replenishing short-term savings helps to protect families from immediate problems while staying on track for their long-term goals. Saving is a habit, much like exercise, that must be regular to be effective.

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Similarly, even a relatively small amount of saving can make a significant difference. Researchers found that households that had

total savings of roughly $2,500 at any point between 2013 and 2016 were significantly less likely to experience financial hardship up to three years later. High-hardship households that achieved that savings goal at any point had nearly twice the likelihood of improving their financial well-being compared to households that did not achieve the savings goal. This improvement also allows households greater ability to build longer-term savings.

Flexibility is also important. Savings priorities change over time, and existing products rarely allow savers to easily move their money to a different savings vehicle. An effective savings system would allow households to repurpose both existing balances and new contributions. Luckily, behavioral finance has developed a number of mechanisms that help to make saving simpler and more automatic. With policy changes and innovation, a better savings system that better meets the needs of today's households is possible.

In the future, each user could have one master account with specific subaccounts for different priorities. It would use auto enrollment with a single deduction that is divided among goals. One key difference from today's retirement accounts is that the account would move with the saver, much like Social Security accounts do, from employer to employer. Everyone would have their own account that employers would connect to their payroll system. This would ensure that everyone has the ability to be automatically enrolled into savings, no matter where they work or how they get paid, while also reducing leakage of retirement assets.

The system would feature a people-centric, simple, accessible design interface that provides savers with easy ways to use savings when needed but with the right safeguards and resources to help them make the best long-term decisions too. The various subaccounts would actually be linked but would appear to the saver as distinct.

The master account would have two major buckets, one for short-term goals and the other for longer-term ones like college savings or retirement. Each bucket would have a different investment strategy: preservation for the shorter term and growth investing for longer. The retirement account in the longer-term section would look essentially like those that exist today.

Savers could create subaccounts for new priorities at will or close or combine them as their needs change. But while it would be simple to move funds within the two buckets, it would be more difficult to move money out of the

longer-term bucket in order to encourage the saver to preserve those balances.

Our goal is not to scrap and replace today's retirement system but to add features that make it better able to meet more of the needs of today's households. To start the process, a series of specific policy changes are needed.

Our goal is not to scrap and replace today's retirement system but to add features that make it better able to meet more of the needs of today's households.

First, in addition to making the savings platform available to all Americans, regardless of whether their employer offers a retirement plan, there must be one clear, simple, equitable tax advantage for all types of saving. Instead of the existing system of specific tax advantages that mainly serve the needs of upper-income households, all types of saving need to be a priority that is reflected in the tax system. Short-term savings could be used without a penalty. However, to preserve retirement balances, restrictions on its early use would remain.

Second, employers would be strongly encouraged to make a contribution for both long- and short-term savings and could take a tax deduction for doing so. For long-term savings, the employer contribution could be structured as either a match or a flat contribution that is equitably structured to deliver the same benefit for all income levels. Finally, there should be a series of legislative and regulatory changes that would allow different employers across a saver's career to connect to this lifelong savings platform.

Today's complex financial system makes it harder for people to save—and to grow those savings into wealth. Enabling people to save for a variety of purposes in one platform, directly from their paycheck, can help more Americans improve their financial security.

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