



INCOME SUPPLEMENTS VERSUS BUILDING ASSETS AND THE RACIAL WEALTH GAP: TAX POLICIES

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Executive Summary

The goal of this report is to provide a background of tax policies designed to address the racial wealth gap in the US. and to give an overview of alternative approaches and current tax policy applications at the state level, and potential scenarios that assume the application of these state-level policies applied at the Federal level.

The wealth gap is a product of government policy that generally gets implemented through tax and transfer policies. The same but more pronounced story is behind the racial wealth gap. The racial wealth gap is structural, not behavioral. Historically, discriminatory redistributive and subsidy policies have favored already wealthiest white individuals and have put the balance against black families' income and wealth creation.

The report provides a rich context and background of tax policies addressing racial

and general wealth inequalities at the federal and state/local level. Second, the report examines alternative tax policies focused on asset-building approaches inspired by current ongoing tax policies implemented in cities, states, and other countries. Third, it explores a series of scenarios considering alternative policies, their fiscal implications, and their potential impact on reducing the racial wealth gap.

Tax policy provides several avenues for the federal government to narrow the racial wealth gap. Many current policies impact the racial wealth gap, either widening it or narrowing it through many programs. Much of this effect comes from disparate impacts on Black and white households: the Earned Income Tax Credit and Individual Development Accounts both have different impacts on Black and white families who are otherwise similar.

Policies and Summary of Key Findings

- **Current tax and benefit policies at the federal level** have an income-supplement narrative that has a **shortsighted view** of the **structural issues** behind the racial

wealth gap. Some even do not incorporate in their design solving racial inequality. Even if incorporated, most focus on short-term income-based trends. For instance, in 2021, when Congress

temporarily increased the size of the CTC and made it fully refundable, poverty fell more for Black children than white children in absolute terms. Still, the expanded CTC did not close racial gaps in child poverty. Child poverty remained roughly three times higher for Black children than white children after accounting for the expanded CTC (Wimer et al. 2022).

- Intergenerational transfers drive wealth inequality. The **estate tax** in the U.S. is limited and does little to break the cycle of inheritances preserving the racial wealth gap. In the U.S., the effective estate tax rate **was only 16.5 percent in 2018**, far below the 40 percent top statutory rate and even below the minimum statutory rate of 18 percent (Center on Budget and Policy Priorities 2018).
- Some current policies, such as the **Mortgage Interest Deduction (MID)** rewards wealth and **feed into the cycle of wealth preservation** and concentration by offering preferential tax treatment to individuals with significant assets.
- **Tax breaks for capital gains exacerbate the inequality** that capital gains drives –

particularly the step up in basis and the preferential capital gains tax rate. White families hold 89 percent of unrealized capital gains over \$2 million – and just 1 percent are held by Black families (Hughes and Sifre 2021).

- The **current structure of welfare eligibility rules traps impoverished – and disproportionately Black -families in a cycle of poverty**. States with strictest asset limits tend to have higher Black populations, and the types of assets often excluded (home and retirement funds)) are usually held by white households at higher average values.
- **States have a wide range of tax policies** - from personal income taxes, sales tax, corporate and business taxes, tax on expenditures, excise taxes, wealth taxes, and other taxes like carbon emission and cannabis taxes. **However**, these policies' combination and impact are difficult to estimate. Most of these policies **are limited to reaching their final goal and reducing the racial wealth gap because they target financing existing services and programs** that provide income or resource assistance to low- and middle-income families.

Alternative Policies

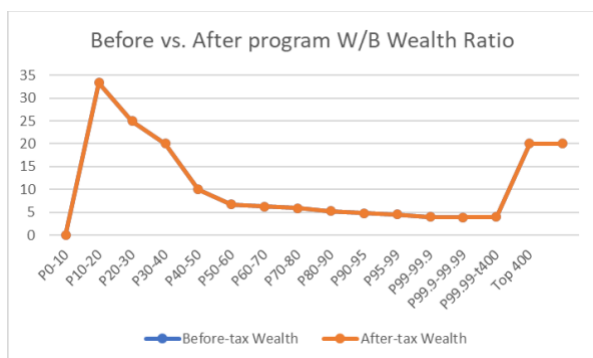
- A **wealth tax** could serve as a potentially less polarizing but also less redistributive policy than reparations. Because so much wealth inequality in the U.S. is driven by racial economic inequality, redistributing wealth would disproportionately benefit Black taxpayers. Using wealth tax proceeds to promote wealth accumulation for low- and moderate-income families – such as through baby bonds (discussed below) or other policies – would maximize the tax's impact in reducing the racial wealth gap.
- **Baby bonds** would provide each child born in the U.S. with a trust account. The proposal that most directly connects baby bonds with the racial wealth gap is that of Hamilton and Darity (2010), who propose using net family worth rather than income to determine the number of baby bond funds. Because black households have lower median net worth than white households, this would distribute larger amounts to black children than white children. SEED Oklahoma (SEED OK) is a large-scale experiment that provides participants with a one-time payment of \$1,000 in a state-owned 529 account. After the program, the proportion of children with privately-owned 529 plans rose more modestly, from around 20 percent to one-third.
- Early evidence from state **auto-IRA plans** suggests that workers of color would be particularly affected by further program expansion, although evidence on results by race is sparse. The implementation of a federal auto-IRA program holds great potential to improve retirement outlooks for workers, a significant source of the racial wealth gap.
- Some researchers, like one of the authors of this report, consider direct policies like **Reparations** as the only way to eliminate the racial wealth gap. The **federal government** would need to enact a massive reparations program to make significant progress on closing the racial wealth gap through reparations. Although it is gaining traction at the **state and local levels**, the small range of these policies and collected funds **fall short**

Illustrations

We evaluate the following scenarios: wealth tax and reparations (direct cash transfers and asset-conditional transfers).

Wealth Tax -- Taxes targeting top wealth groups will be targeting the lower end of the wealth gap (the white/black wealth gap ratio in the top quintile is lower than at other quintiles) and not addressing the largest source of the racial wealth gap that comes from lack of wealth (even negative wealth) or low wealth holdings among Blacks in the low and middle wealth quintiles.

Wealth Tax: White/Black Wealth Ratio



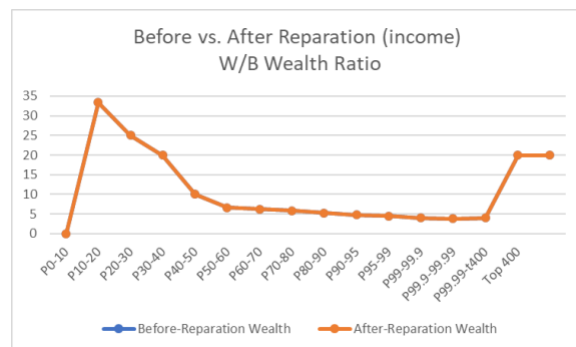
Source: Authors' calculations.

Suppose the wealth tax policy is paired with an income-supplement redistributive policy. In that case, our previous report shows that the racial wealth gap will be reduced. Still, the reduction is less effective than if the resources directly target Black individuals

and asset-accumulation incentives and policies.

Reparations (cash transfers) -- We assume that the transfers are given to those at income levels below the top 400. Because cash transfers become income, they are taxable. The individuals receiving the transfers move up in the income distribution, and by construction, they also face higher income taxes. There is an increase in fiscal revenues via income taxes of about 2 billion dollars. This means that only about 75% of the transfer will enter the economy as disposable income.

Reparations (cash transfers): White/Black Wealth Ratio



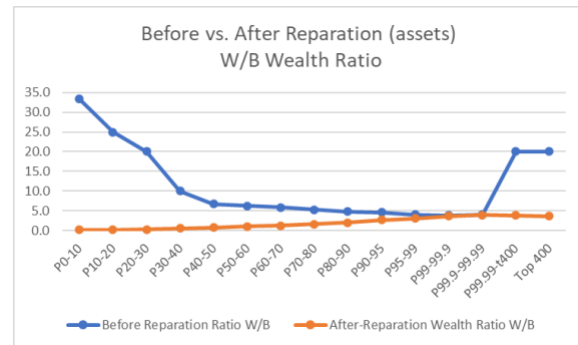
Source: Authors' calculations.

The average racial income gap is reduced by 50%. Meanwhile, the wealth distribution shows a smaller response because not all income becomes part of total wealth (some part is automatically reduced because of

individual income taxes). Despite the smaller gap reductions per percentiles, with a larger proportion of Black individuals holding higher wealth levels because of the one-time cash transfer, the estimated average white/black wealth ratio decreases by about 5%.

Reparations (assets) -- In this case, we don't observe a sharp reduction in the racial income gap like in scenario 2. However, there is a more even decrease at each income percentile level. Overall, the average racial income gap reduction is about 10 percent. Meanwhile, the racial wealth gap has significant reductions at each income percentile; the smaller drop happens at the higher income percentile because of the smaller relative size of reparations with respect to the average percentile-group wealth holdings. We estimate that the average racial wealth gap gets reduced by about 90%. Our estimates do not consider the dynamic pattern that higher wealth holdings would create among eligible individuals.

Reparations (assets): White/Black Wealth Ratio



Source: Authors' calculations.

Many of the reforms discussed in this report are within easy reach for tax policymakers. In comparison, other policies may require political and legal debates. Other efforts to implement longer-term goals, such as a federal baby bond or reparations program, could maximize the tax code's impact on the racial wealth gap. A two-pronged approach combining immediate reforms and these ongoing pushes for larger changes presents an achievable and meaningful path to progress on reducing the racial wealth gap through the tax system. Given the high concentration of current discussions on income-supplement-based policies, we think it is imperative to evaluate the racial income and wealth gap to illustrate the potential reach of these policies in solving the deeper structural issues behind the racial wealth gap.

Introduction and Background

The wealth gap is a product of government policy that generally gets implemented through tax and transfer policies. The same but more pronounced story is behind the racial wealth gap. The racial wealth gap is structural, not behavioral. Historically, discriminatory redistributive and subsidy policies have favored already wealthiest white individuals and have put the balance against black families' income and wealth creation. State and local policies sometimes reinforce or exacerbate the widening of the wealth gap by deepening the roots underlying the racial wealth disparities with policies that target tax cuts paired with a reduction of subsidies and public good resources.

In the late 19th century, although American social policy was aimed explicitly at wealth-building, these policies were applied discriminatorily, excluding black individuals from rightly owned benefits. In the past sixty years, American social policy has focused exclusively on providing income support rather than building wealth. Today, no major asset-building program exists for the wealth of poor individuals. If anything, federal tax policy builds assets for those already holding wealth. Furthermore, state and local governments historically had little role in explicit redistributive policies that contrasted Federal tax policy guidelines. Redistributive justice through the tax and budget system has been a more recent discussion in Congress and the economy. However, most of the debate considers provisions such as the Earned Income Tax Credit (EITC) and the Credit Tax Credit that substantially increased the incomes and well-being of low- and middle-income households targeting the overall wealth gap, but not the structural racial wealth gap. Further, these provisions have been implemented in a system where broad tax

cuts have highly benefited high-income families and have made redistribution policies heavily rely on fiscal expenditures.

Asset-building policies require direct transformational investment in Black individuals' wealth creation and accumulation to diminish the racial wealth gap. However, this investment also needs changes in wealth and income distribution policies and a declaration of intentions through tax incentives. The analysis extends from traditional income and property taxes to estate taxation and new taxes on inheritance and wealth. The perspective is reducing the racial wealth gap by increasing taxes or reducing tax breaks at the top wealth percentile and redistributing tax revenues to correct disproportionately and systematic biases generated by policies.

Several tax policy exercises are considered and implemented at state and local levels to address income and wealth inequality. The variation considers broader tax system reforms, considering changes to tax brackets and exceptions, creating new taxes (i.e., cannabis taxes), or relaxations of tax limits that benefit wealth-holding families (i.e., property tax limits). Most of these policies are, however, limited to reaching their final goal and reducing the racial wealth gap because they target the financing of existing services and programs that are directed to provide income or resource assistance to low- and middle-income families. States have a wide range of tax policies at hand to work with - from personal income taxes, sales tax, corporate and business taxes, tax on expenditures, excise taxes, wealth taxes, and other taxes like carbon emission taxes-. However, these policies' combination and impact are difficult to estimate. Nevertheless, states and local governments are responsible for redistributing resources as they manage more than 90 percent of K12 educational funding and public infrastructure and half of the national public expenditures overall while collecting one-third of the taxes in the country (Lechman et al. 2018).

Tax policy provides several avenues for the federal government to narrow the racial wealth gap. Many current policies impact the racial wealth gap, either widening it or narrowing it through many programs. Much of this effect comes from disparate impacts on Black and white households: the Earned Income Tax Credit and Individual Development Accounts both have different impacts on Black and white families who are otherwise similar.

Potential programs could be run through the tax system to either directly or indirectly address the racial wealth gap. In this chapter, we outline both existing and potential tax policies at the federal level, showing where the tax system succeeds and where it fails to reduce racial wealth inequality. The next section discusses existing policies and rules, followed by examining several policy alternatives. Then, we simulate some alternative policies to illustrate their effect on racial wealth inequality. We end with some concluding remarks.

Current Policies

Income Tax Credits

Earned Income Tax Credit

The Earned Income Tax Credit (EITC) provides subsidies to low-income workers, especially single parents (IRS 2022; Jones and Michelmore 2018; Marr et al. 2015; Athreya et al. 2010). Low-income households, especially single mothers, use EITC payments to boost checking and savings account balances (Jones and Michelmore 2018), and reduce unsecured debt (Shaefer, Song, and Shanks 2013). EITC receipt has also documented racial income inequality, reducing the income gap between Black and white households by roughly 5 to 10 percent each year (Hardy, Hokayem, and Ziliak 2022).

The EITC's effect on wealth is mixed. Some research finds that EITC receipt raises wealth for eligible households (Jones and Michelmore 2018; Shaefer, Song, and Shanks 2013). But Froemel and Gottlieb (2021) find that EITC expansions reduce the incentive to save for low-income recipients while increasing wealth for higher-income recipients, increasing wealth inequality among recipients. Weber (2016) finds that the households that receive higher EITC payments hold lower savings in income-bearing accounts. Notably, these studies do not distinguish between the EITC's effects on Black and white households, not showing its ability to narrow the racial wealth gap.

One study found that while EITC receipt increases wealth for white households, it has no statistically significant effect on Black household wealth (Michelmore and Lopoo 2021). This is true even for otherwise similar homes, revealing a possible disparity in how the same policy affects families that differ only by race. However, the authors do not rule out the possibility that the EITC raises wealth for Black households, and no other study has examined the EITC's effects

on Black and white households separately. In order to discover whether the EITC narrows or widens the racial wealth gap, more research will need to focus directly on its effect on wealth for Black and white households.

Child Tax Credit

The Child Tax Credit (CTC) is another major antipoverty credit that provides funds to low-income parents until their children turn 17. Benefits phase in at low incomes, then gradually phase out for higher-income households. The CTC is not targeted at low-income households; the credit begins to phase out at an adjusted gross income of \$200,000 (\$400,000 for married taxpayers filing jointly). It does not seem to replace work for households receiving the credit, and there does not appear to be a large labor supply response due to the phase-in at low incomes (Enriquez et al., 2023; Ananat et al., 2021, 2022). The CTC is only partially refundable, leaving households with a low tax liability eligible for only a portion of the CTC.

The first evidence from this year of expanded CTC payments is extremely promising for its potential to improve children's lives (Parolin et al. 2021). In 2021, Congress temporarily increased the size of the CTC and made it fully refundable – both reforms meant to help families with children during a time of great financial instability. Child poverty fell by 43% in 2021 due to the expanded CTC's effects (Wimer et al. 2022). The picture is slightly more complicated for racial inequality: poverty fell more for Black children than white children in absolute terms, but the expanded CTC did not close racial gaps in child poverty. Child poverty remained roughly three times higher for Black children than white children after accounting for the expanded CTC (Wimer et al. 2022).

The payment structure of the CTC changed dramatically with its expansion. In 2021, families received advance monthly CTC payments, temporarily transforming the CTC from a yearly lump-sum payment to regular additional income. While no research has examined the

broad impacts of these periodic payments on wealth accumulation, early evidence shows that households used a large portion of those payments to pay down unsecured debt (Perez-Lopez and Mayol-Garcia 2021; JP Morgan Chase 2022). While these analyses do not break results down by race, Black households hold higher levels of median unsecured debt than white households (USAFacts 2022). Reducing credit card and other unsecured debt levels could contribute to increasing net worth among Black households, narrowing the racial wealth gap.

Years of research before the COVID-related CTC expansions show racial gaps in its receipt. Over half of Black non-Hispanic children receive partial or no credit because their household income is *too low*, compared to just a quarter of white non-Hispanic children (Goldin and Michelmore 2021; Collyer et al. 2019). This research emphasizes that the CTC is not a universal program; it leaves out many low-income Black households that already face the largest barriers to building wealth. CTC reforms in 2021 began to address these issues: under a fully refundable CTC, families of Black children were just as likely, or slightly more likely, to benefit from the CTC (Parolin et al. 2021).

Making the CTC permanent would allow families to invest more fully in their children (Shaefer et al. 2018). Investing in children has a double effect: making direct payments to families allows them to immediately use those payments to save or pay down debt, and improving children's financial stability gives them the resources they need to build their own wealth as adults (Gale 2019). A permanent CTC would reduce the racial wealth gap.

Social Security

Social Security combines elements of income-based and wealth-based policy interventions. It is one of the most successful antipoverty initiatives in the history of the U.S. Starting in 1935 during the Great Depression, policymakers aimed to create a program that would give security to workers and their families throughout their lives. Social Security is now

largely credited with the dramatic fall in poverty among elderly populations over the last century (Engelhardt and Gruber 2004; Liebman 2002); it provided just over half of all income to households 65 years or over in 2017 (Thompson and King 2022). Among low-income elderly households, Social Security is even more important: for households in the second- and third-lowest income deciles, Social Security made up over three-quarters of their income in the same year.¹ Notably, Social Security is not asset-tested, meaning that recipients do not have to spend down their wealth to qualify for benefits. This allows recipients to build wealth while paying into and receiving Social Security, supporting wealth accumulation for all households.

Viewing the present value of Social Security benefits (minus future contributions) as an asset can yield insights on the impact of Social Security on the racial wealth gap. Traditionally, benefits are seen as income – however, the expected value of that income is also an asset to households. Including Social Security wealth as part of a household's overall wealth reduces the racial wealth gap, because Social Security wealth is distributed more equally than private wealth alone (Catherine et al. 2022, Veghte et al. 2016). Wealth gaps in other assets make Social Security an especially vital resource for elderly people of color; they are more likely to rely on Social Security benefits in retirement than white retirees (Rockey Moore-Cummings and Lui 2011): white retirees are nearly twice as likely to have income from other assets than are Black retirees (Social Security Administration 2014). For example, relative to the median Black household, the median white household has over ten times the pension and IRA wealth, but only just over two times the Social Security wealth (Veghte et al. 2016).

¹ Many elderly people in the lowest income decile do not have the necessary work history to receive substantial Social Security payments; Supplemental Security Income often fills this gap for those retirees (Thompson and King 2022).

Social Security's impacts are not isolated to the elderly. Providing steady income to retired workers relieves the pressure of supporting older relatives for young workers (Rockey Moore-Cummings 2010). Young Black Americans are more likely than young white Americans to need to support their parents, grandparents, or other relatives (Brown 2021). As a result, Social Security's income to older people is especially valuable to Black workers, allowing them to keep more of their income. They can use this income to increase their savings, purchase financial assets, or invest in a home – all activities boosting their wealth.

Survivor and disability benefits are an often overlooked but vital financial security for Black Americans. In 2021, 35 percent of Black Americans receiving Social Security benefits received survivor or disability benefits, compared to just 21 percent of white Americans (Social Security Administration 2022). Supporting children after a parent's death and spouses after their partner's death provides a lifeline for families suffering a loss of income and stability, helping households keep more of their wealth rather than spending down their savings. Of all Black Americans receiving Social Security survivor benefits, over half are children – just 28 percent of white Americans receiving survivor benefits are children (Social Security Administration 2022). Financial security early in life is a vital part of amassing the resources to build wealth later in life; Social Security reduces shocks to this financial security for Black children, in particular after the death of a parent.

Social Security, however, works to increase the wealth gap in one particular way. Black Americans have lower life expectancies than white Americans due to the history and consequences of racial oppression in the U.S. (Hummer and Chinn 2011; Hendley and Bilimoria 1999). This differential mortality means that Black retirees take advantage of Social Security benefits for less time on average than white retirees do after paying the same taxes on their

earnings (Baldwin 2021; Bishnu, Guo, and Kumru 2018; Rockeymoore-Cummings and Lui 2011; Hendley and Bilimoria 1999). This is partially offset by Black households being more likely than white households to receive survivor and disability benefits (Social Security Administration 2022; Rockeymoore-Cummings and Lui 2011; Hendley and Bilimoria 1999).

The implications for the racial wealth gap include the notion that Social Security reform should not raise the minimum retirement age, should be financed as progressively as possible, and should protect survivor and disability benefits.

Wealth Taxes or Subsidies

Estate or Inheritance Tax

One of the most significant and enduring sources of racial wealth inequality in the U.S. is the ability of families to pass on their wealth to their relatives, preserving wealth within families and creating a cycle of wealth that individuals without rich relatives are locked out of. Recipients tend to start their adult lives with a financial cushion in case of instability, and eventually, a large lump sum from their parents gives wealthy children – especially white Americans – an enormous advantage in growing their finances (Chiteji 2010; Chiteji and Hamilton 2002; Hamilton and Darity 2010). Black households are far less likely than white households to receive an inheritance, and their inheritances tend to be smaller (Thompson and Suarez 2015). In fact, intrafamily transfers often run in the opposite direction in Black families vis-à-vis white families: Black households can find themselves supporting their parents or grandparents, who are more likely to struggle financially during retirement than white retirees are (Brown 2021).

The estate tax mitigates a small portion of this effect by reducing the amount of money that wealthy decedents (who are overwhelmingly white) have to give to their relatives. However, in the U.S., the effective estate tax rate – the amount of taxes that individuals actually pay on

their estate, after exemptions and credits – was only 16.5 percent in 2018, far below the 40 percent top statutory rate and even below the minimum statutory rate of 18 percent (Center on Budget and Policy Priorities 2018). Only around 4,100 estate tax returns for people who died in 2020 were filed, and over half of those had their entire estate tax liability wiped out by exemptions and credits (Tax Policy Center 2020). In short, the estate tax in the U.S. is limited and does little to break the cycle of inheritances preserving the racial wealth gap.

Examples from other countries point to alternatives. The United Kingdom has, like the U.S., a history of racial inequity rooted in colonialism and oppression – and this racial inequity has spurred a substantial racial wealth gap. Black African and Bangladeshi households in the UK have just one-tenth the wealth of white British households, and Black Caribbean households are not much better off (Khan 2020). The U.K., however, has a much more expansive estate tax² than the U.S., with just the first £325,000 (around \$390,000) of each estate exempted from the tax – far less lenient than the \$12.06 million exemption in the U.S. All estate value above the exemption threshold is taxed at a rate of 40 percent, and in 2021, the estate tax collected revenue of roughly 0.25 percent of GDP – compared to estate tax revenues of 0.1 percent of GDP in the U.S. (His Majesty's Revenue and Customs 2023; CBO 2021). Lowering the estate tax exemption threshold and limiting avenues of avoidance would reduce the concentration of wealth transfers in the U.S.

Converting the estate tax to an inheritance tax could make inheritances more equitable by taxing those who inherit large amounts. Batchelder (2020) proposes setting a lifetime inheritance exemption threshold of \$2.5 million – lower than the current \$12.06 million but still a substantial sum – and counting inheritances above that threshold as ordinary income for tax purposes.

² While the UK calls their estate tax an “inheritance tax,” it is structured as an estate tax: people pay taxes on the estate of the decedent, rather than on the inheritances passed to their heirs.

Additional exemptions for smaller gifts and bequests – Batchelder (2020) proposes \$15,000 per year – and income-smoothing techniques would reduce the burden on heirs. The inheritance tax structure would encourage wealthy individuals to spread their estates among many heirs rather than concentrating their wealth among a few relatives. An effective inheritance tax could help disrupt the cycle of wealth that inheritances create, moderating the unearned income that relatives of wealthy – often white – decedents receive. This form of tax could significantly impact the racial wealth gap by reducing racial disparities in inheritances, gifts, and bequests.

Treatment of Capital Gains

Capital gains represent another asset treated favorably in the tax code – further preserving wealth and concentrating wealth among white households. Capital income is taxed at a lower rate than labor income, rewarding individuals with enough wealth to receive income from it. Capital gains benefit from several tax provisions. They are not taxed until realized – until the asset is sold. At that time, they are taxed at preferential rates. Unrealized capital gains are frequently never taxed due to the step up in basis at death: when an individual dies and leaves an asset to others, the value of the asset used as a basis for tax purposes is stepped up to the value at the time of the owner's death. In other words, any unrealized gain in the asset's value during the owner's life is left entirely untaxed under the income tax (although it might be taxed under the estate tax, if the estate is large enough). Because the wealthy are more likely to own assets with substantial capital gains, and more likely to be able to give those assets to inheritors rather than selling them to pay for retirement, they are far more likely to receive benefits from the lower capital gains tax rate and the step up in basis. This taxation system creates a "lock-in" effect, rewarding investors for holding onto their wealth for as long as possible (Enda and Gale 2020).

Nearly 70 percent of realized long-term capital gains went to the top one percent of households ranked by income in 2018; treating these gains preferentially in the tax system

preserves this inequality (Enda and Gale 2020). Researchers have long shown that the lower capital gains tax undermines the progressivity of the federal income tax because of the uneven distribution of capital income (see, e.g. Piketty and Saez 2007). The same argument applies to wealth: wealth is rewarded through favorable tax treatment, protecting high-wealth portfolios at the expense of low-wealth households (Moran 2010). Tax breaks for capitals gains are extremely unevenly distributed, with the vast majority of the tax benefit going to the richest 1% of households (Wamhoff 2019).

Racial inequality in capital gains tax breaks reflects the notable racial imbalance in capital income. Racial inequality in capital gains, like racial wealth inequality in general, has widened since the 1980s, which contributes to the racial wealth gap (Derenoncourt et al. 2022; Gale et al. 2022). Tax breaks for capital gains exacerbate the inequality that capital gains drives – particularly the step up in basis and the preferential capital gains tax rate. 89 percent of unrealized capital gains over \$2 million are held by white families – and just 1 percent are held by Black families (Hughes and Sifre 2021). Preferential treatment of capital income feeds into several aspects of the racial wealth gap that we have already discussed: inheritances, the income gap, and policies that create wealth cycles by rewarding households that already hold significant assets. Numerous policy alternatives – including eliminating the step up in basis at death, taxing accrued but unrealized capital gains at death, raising the tax rate on realized gains, and/or finding a way to tax unrealized gains more aggressively than under the current system – would help break these cycles, narrowing the racial wealth gap.

Mortgage Interest Deduction

Many of the policies we have examined thus far, like the estate tax, seek (however ineffectively under current law) to disrupt the cycle of wealth preservation and concentration.

The mortgage interest deduction (MID) does the opposite: it rewards wealth and feeds into that cycle by offering preferential tax treatment to those with a significant asset.

The MID allows homeowners to deduct interest on up to \$750,000 of their principal from their taxable income, reducing their tax liability. This benefit is obviously limited to homeowners – while 74.9 percent of white Americans own a home, just 44.9 percent of Black Americans do, precluding them from receiving the MID at the same rate as white Americans (U.S. Census Bureau 2023). Less apparently, the MID can only be collected by taxpayers who itemize their deductions –most low- and middle-income taxpayers do not have enough deductions to itemize and therefore receive no benefit from the MID (Gale 2019). Low-income households who do claim the MID receive only small amounts from the deduction (Gale et al. 2007). Households who itemize their deductions tend to have high income and wealth; accordingly, 76.3% of households claiming the MID in 2018 had an income above \$100,000, and 90.7% of the total tax expenditure was received by those same households (Knightley 2020). Researchers cannot directly observe racial differences in MID claiming, but zip codes with high claiming rates have far more white households, and fewer Black households, than zip codes with low claiming rates (Brown 2021; Harris and Parker 2014). This indicates that the households claiming the MID are disproportionately and overwhelmingly white, and the MID protects and increases these households' wealth.

Abolishing or limiting the MID would allow the federal tax system to stop rewarding existing wealth, making it possible for taxes to narrow the racial wealth gap. The MID could be replaced with a first-time home buyer's tax credit (FHC). Gale et al. (2007) propose a fully refundable FHC available to households where no one has owned a home in at least three years. Full refundability is a vital aspect of the credit, allowing households with low federal tax

obligations – mostly low-income households – to receive the full credit. The three-year window removes the burden of proving that no one in a household has *ever* owned a home, but because most people who sell a home buy a new one within three years, most recipients of the credit would be first-time homeowners. A credit amount of \$3,000 (\$6,000 for married filing jointly) would phase out, beginning at an income of \$75,000 (\$150,000 for married filing jointly), providing significant help with the expenses associated with buying a home.

Repealing the MID and replacing it with a revenue neutral FHC would be very progressive. Because the FHC would be a fixed amount and would not increase with the price of the taxpayer's home, the benefit would be a larger proportion of housing wealth for households with less expensive homes – mostly low-income households. It would also be fully available to all first-time homeowners, unlike the MID, which is available only to a fraction of homeowners. Reducing housing costs for first-time homeowners would benefit those who have historically been locked out of homeownership – disproportionately Black households (Choi and Ratcliffe 2021).

Saver's Credit

The Saver's Credit is a tax credit given to low-income individuals when they contribute to their retirement accounts. Savers can receive up to \$1,000 depending on their income and filing status, encouraging low-income individuals to save for retirement.

Several design features, however, limit the effectiveness of the Saver's Credit. The Saver's Credit is nonrefundable, effectively removing the added incentive to save for anyone whose federal income tax obligation is very low – primarily low-income taxpayers.

Secure 2.0, passed at the end of 2022, will convert the Saver's Credit to a Saver's Match starting in tax year 2027. Under the Saver's Match, contributions made by taxpayers will be

matched at a similar rate to current law and deposited directly into a retirement account. This solves the problem of refundability.

It can be difficult for households to predict whether they will be eligible for the credit. This discourages households from saving earlier in the year, since they do not have a reliable tax incentive to save (Duflo et al. 2007). While the new payment structure will better encourage taxpayers to save the match will be deposited directly into their retirement accounts, it will remain difficult for them to predict their eligibility and the size of their benefits.

Current research on the Saver's Credit has not examined its effects by race; however, the racial wealth gap in retirement is significant, making it a vital goal for racial equity (Veghte et al. 2016; Rockey Moore-Cummings and Lui 2011). By targeting low-income taxpayers – who are disproportionately Black – the Saver's Credit can increase retirement savings for the people who need it most. Expanding and simplifying the Saver's Credit could make it a more powerful retirement-saving reward among low-income taxpayers, boosting retirement assets and narrowing the racial wealth gap in retirement.

Asset Tests

Most welfare programs, including TANF, SNAP, SSI, and Medicaid, include asset tests: households with levels of liquid or illiquid savings above a certain threshold are ineligible for assistance. In theory, this ensures that low-income, high-wealth households cannot collect welfare benefits in addition to their large financial safety net. In practice, however, the negative impacts of these asset tests are well-known: they discourage saving as low-income households face the possibility of losing necessary benefits if they accumulate even \$3,000 in liquid savings. They prevent low-income households from accumulating wealth by threatening their other resources.

Research shows that asset tests lower the net worth of potentially welfare-eligible low-income households (Chen and Lerman 2005). While asset tests have become less strict over the past 20 years, with assets like IDAs and 529 accounts now frequently excluded from welfare asset limits, they remain strict in many states (Hamilton et al. 2019). Asset limits differ widely across states: in 2015, eight states had asset limits for TANF of \$2,000 or less, while another eight states had no limits (Hamilton, Fawson, and Dollar 2019).

The states with the strictest asset limits tend to have higher Black populations, suggesting a connection between race and asset limits that depress low-income households' wealth (Hamilton, Fawson, and Dollar 2019). Furthermore, the types of assets most often excluded from asset tests – homes and retirement accounts – are more often held by white households and with higher average values (Francis and Weller 2021; Rothstein 2017). These studies suggest that the current structure of welfare eligibility rules traps impoverished – and disproportionately Black – families in a cycle of poverty. As a result, asset limits likely exacerbate the wealth gap. Eliminating or substantially loosening the tests would help reduce the racial wealth gap.

Policy Strategies: Alternative Wealth-Based Policies

Wealth Tax

The close connection between general wealth inequality and the racial wealth gap in the U.S. opens possibilities for addressing both at once. By taxing wealth from the highest-net-worth households, who are disproportionately white, and focusing on a distributive policy that promotes asset building among lower income individuals, wealth tax could lessen overall wealth inequality and the racial wealth gap while still generating growth. Using wealth tax proceeds in to promote wealth accumulation for low- and moderate-income families – such as through baby bonds (discussed below) or other policies – would maximize the tax's impact in reducing the racial wealth gap.

A general wealth tax would not target the racial wealth gap but would lower wealth inequality in the U.S. overall (Saez and Zucman 2019; Leiserson 2020). Because so much wealth inequality in the U.S. is driven by racial economic inequality, redistributing wealth would disproportionately benefit Black taxpayers (Brown 2021; Moran 2010). A wealth tax could serve as a potentially less polarizing but also less redistributive policy than reparations (Moran 2010).

Recent political campaigns show a growing interest in progressive wealth taxes. Senator Elizabeth Warren suggested during her 2020 presidential campaign a progressive wealth tax of 2 percent per year for households with over \$50 million in net worth and 3 percent per year for households with over \$1 billion (in 2019 dollars) (Saez and Zucman 2019). In his bid for the presidency, Senator Bernie Sanders put forward a proposal for a similarly progressive wealth tax, starting at 1 percent at \$32 million in net worth and rising to 8 percent for households with \$10 billion (Saez and Zucman 2019).

Saez and Zucman (2019) estimate that a wealth tax of 2 or 3 percent per year on wealth above \$50 million would yield a tax base of roughly \$10 trillion, thus generating between \$200 and \$300 billion per year in revenues. While this revenue projection is far below the \$14.3 trillion needed to close the pre-tax mean racial wealth gap (Darity et al. 2022), it would be a start to raising the necessary funds.

Every wealth tax faces a variety of problems: enforcement issues, impacts on capital stock and other unintended consequences, and constitutional questions about Congress's power to tax wealth (Saez and Zucman 2019; Leiserson 2020; Glogower 2020). Some European wealth taxes have faced issues relating to low exemption thresholds, incentivizing taxpayers to underreport wealth or strategically reduce their assets to avoid the wealth tax (Saez and Zucman 2019). A failure to modernize wealth taxes through independent third-party information reporting has also plagued European wealth taxes, creating an avenue for evasion that could be eliminated with careful implementation (Saez and Zucman 2019). Evidence like the Panama Papers point to opportunities for wealthy people to hide their assets in offshore accounts, a far larger risk in the U.S. than expatriation – another issue seen in the E.U. Estimates of avoidance and evasion for a wealth tax run a wide range, but generally lie between 15% and 55% erosion of the possible wealth tax base (Saez and Zucman 2019; Scheuer and Slemrod 2021). Evasion is very hard to estimate because proposals for a U.S. wealth tax differ significantly from existing wealth taxes in the E.U. (Scheuer and Slemrod 2021). Through thoughtful implementation, a wealth tax in the U.S. could minimize these issues, making the tax more effective than it has been in the E.U.

Of course, the impact of a wealth tax on the racial wealth gap depends heavily on how the funds raised by the tax are distributed. Progressive spending on policies that narrow the racial

wealth gap, like boosting retirement savings, baby bonds, or reparations, would increase Black wealth while taxing wealth at the upper – and mostly white – end of the spectrum. The opposite extreme would regressively distribute the funds from a progressive wealth tax through tax expenditures like a robust MID and preferential treatment of capital gains income. As with any tax policy, a progressive wealth tax would not exist in a vacuum, and its effects on the racial distribution of wealth would depend heavily on the spending funded by the tax.

Baby Bonds

Child development accounts focus directly on saving for young children. "Baby bonds" would provide each child born in the U.S. with a trust account. The proposal that most directly connects baby bonds with the racial wealth gap is that of Hamilton and Darity (2010), who propose using *family net worth rather than income* to determine the amount of baby bond funds. Because black households have lower median net worth than white households, this would distribute larger amounts to black children than white children.

A similar program has already been implemented in Israel, with promising results. The Israeli Saving for Every Child Program (SECP) deposits roughly \$13.50 per child per month into a savings account for all resident children aged 18 or younger, regardless of family economic status. This universal program allows for both passive and active enrollment to accommodate parents' preferences.

Under "passive" enrollment, where the parents do not need to make any decisions about depositing SECP funds, the government deposits the amount into low-yield savings accounts. Through "active" enrollment, parents can also opt to move the funds into higher-yield investment accounts and transfer a portion of their regular child allowance into the accounts, increasing their child's savings. Almost 65% of Israeli households with children actively enrolled in the SECP in

its first six months of existence, with most of those adding additional funds from their child allowance and actively choosing where to deposit those funds (Grinstein-Weiss et al. 2019).³

Engagement with the SECP is less among low-wage households, households with low educational attainment, and Arab Israeli families (Grinstein-Weiss et al. 2019). Similar challenges could arise for implementation in the U.S., necessitating intentional outreach to racially marginalized communities, low-income households, and other families that are likely to have weaker engagement with the financial system.

Other similar programs have been experimentally implemented in the U.S. at the state level. SEED Oklahoma (SEED OK) is a large-scale experiment that provides participants with a one-time payment of \$1,000 in a state-owned 529 account, as well as savings matches, tax incentives to contribute to their 529s, and incentives to open their own private account (Nam et al. 2013). The program began in 2007, and evidence from participating children is optimistic. A universal CDA provided a large number of children of color with higher assets: the proportion of children with state-owned 529 plans who are children of color skyrocketed from 20 percent to over 50 percent –making the population of children with state-owned 529s representative of the total Oklahoma population (Clancy et al. 2021). The proportion of children with privately-owned 529 plans rose more modestly from around 20 percent to one-third. SEED OK also significantly increased asset accumulation among participating children compared to the control group, although no researchers have yet separated these results by race (Clancy et al. 2021; Nam et al. 2013; Sherraden et al. 2015).

³ Targeted outreach improved program implementation in Ultra-Orthodox Jewish communities and proved successful at increasing active enrollment rates and engagement with the SECP (Grinstein-Weiss et al. 2019). The success of the SECP and the Israeli government’s effective outreach to the Ultra-Orthodox community points to potential success in the U.S. if the implementation is paired with intentional outreach to Black parents and other communities.

Auto-IRA

Automatic (auto) IRAs have significant potential for improving retirement outcomes among American workers and reducing the racial wealth gap. Under auto-IRA programs, workers who are not already enrolled in a pension or 401(k)-type saving plan are automatically enrolled in a workplace IRA, with contributions automatically made with every paycheck. Workers can opt out of the plan and choose investment options if they remain in the plan. Employers do not contribute, and they receive a small tax credit based on how many of their employees participate in workplace retirement plans (Iwry and John 2007).

By encouraging workers to save for retirement and removing steps in enrolling in and contributing to workplace retirement plans, automatic IRAs increase retirement savings. Expanding access to workplace retirement plans is especially important for savings among Black and Hispanic workers. While 62 percent of white workers have access to a workplace retirement plan, only 54 percent of Black workers and 38 percent of Latino workers have that access (Rhee 2013). While these numbers have likely risen somewhat in the last decade – in 2022, 62 percent of all civilian workers had access to employer-sponsored defined-contribution plans, compared to 55 percent in 2012 (Bureau of Labor Statistics 2023) – the gaps in access have yet to be addressed. White households near retirement have six times the retirement savings as Black households at the same age (Rhee 2013). The gap in pension and IRA wealth is even larger: in 2013, median white pension and IRA wealth was over ten times median Black pension and IRA wealth (Veghte et al. 2016). Expanding access to workplace retirement accounts could lessen this divide, building more assets for Black workers and narrowing the racial wealth gap.

Early evidence from state auto-IRA plans suggests that workers of color would be particularly affected by further program expansion, although evidence on results by race is sparse (Harris et al. 2018). Oregon was the first state to implement a statewide auto-IRA with its state-

sponsored OregonSaves program, which required all employers that did not already offer a retirement plan to enroll their employees in the program. OregonSaves reduced costs for workers to find a retirement plan, increasing saving and significantly increasing the number of workers with a retirement plan (Chalmers et al. 2021). More than half of eligible employees took advantage of the program, likely using their accounts as retirement savings and precautionary savings (Quinby et al. 2020).

Similar programs have been implemented more recently in California, Colorado, Connecticut, Illinois, Maryland, and Virginia. Delaware, Hawaii, New Jersey, New Mexico, and New York have all enacted programs that will soon be implemented. Two cities – New York City and Seattle – have enacted their own auto-IRA plans, although New York City's plan will eventually be combined with New York's statewide plan.

Secure 2.0 created a federal auto-IRA plan: employers creating new retirement plans will, starting in 2025, be required to allow their employees to opt out of their retirement plan rather than opting in. The rate of contributions will need to be at least three percent of eligible wages, increasing by one percentage point annually until it reaches between 10 and 15 percent. The implementation of a federal auto-IRA program holds great potential to improve retirement outlooks for workers, a significant source of the racial wealth gap.

Reparations

Due to the enduring legacy of white supremacy and the other economic, social, and political constraints of modern America, some scholars of the racial wealth gap believe that direct action against the wealth gap, rather than indirect action like the other proposals listed here, is the only way to eliminate it (Darity and Mullen 2020, 2021; Weller et al. 2021; Deroncourt et al. 2022, among others). The racial wealth gap was caused by the history of racial discrimination in the U.S.: a race-neutral solution simply has less power to target that gap

than reparations paid to Black Americans (Althoff and Reichardt 2023). Significantly, researchers emphasize that reparations must not account only for the direct effects of enslavement, but also the longer-lasting impacts of Jim Crow and continuing discrimination (Althoff and Reichardt 2023; Darity and Mullen 2020, 2021; Derenoncourt et al. 2022).

Reparations programs are gaining popularity across the country. In 2021, Evanston, Illinois became the first city in the U.S. to implement reparations, giving Black residents⁴ \$25,000 to apply to the purchase or improvement of a home in Evanston. The city identified housing wealth as the most promising avenue to narrowing the racial wealth gap in Evanston, focusing on redlining and zoning practices that limited Black wealth in the city (Robinson and Thompson 2020). However, the program's budget of \$400,000 is far too small to serve the city, which had over 12,000 Black residents in the 2020 census (U.S. Census Bureau 2020). With the current budget, Evanston could pay reparations to just 16 families, a number that falls short of the city's ambitious goals.

Providence, Rhode Island recently implemented its own reparations program, providing eligible residents with access to a variety of housing improvement and purchasing funds, internship programs, support for Black businesses *and* organizations, and other programs (Providence Municipal Reparations Commission 2022). Like in Evanston, many funds paid directly to residents are related to housing wealth. The reparations program in Providence is not directly targeted at the racial wealth gap, however. Black and Native American residents are automatically eligible for the program; residents in certain neighborhoods and residents earning less than 50% of the area median income are also eligible. Overall, the reparations program will

⁴ The two main categories of eligibility are (a) Black residents who lived in Evanston between 1919 and 1969, and (b) descendants of people in group (a). Other Black residents who can prove that they are victims of a discriminatory housing policy or procedure can also apply, but will be considered only after other applications are reviewed.

include about half of the city's white residents (Felton 2022). Despite the broad inclusion of many white Providence residents, the program will provide more Black residents with benefits than white residents, acting against the racial wealth gap when viewed as a whole.

A notable characteristic that the Evanston and Providence plans share is the form that these programs take. Neither program distributes funds directly to Black residents with no constraints on how families spend those funds. In Evanston, households must apply for funds to use for mortgages, down payments and closing costs, or home improvement. In Providence, reparations will fund housing support, financial literacy and employment training, and community centers in Black neighborhoods, among other programs. None of these policies put money in the hands of Black residents. The two programs are a notable start and will begin to narrow the wealth gap in Evanston and Providence, but a more comprehensive and direct approach to reparations is necessary on a broad scale (Perry and Ray 2021; Mullen and Darity 2021).

In order to make significant progress on closing the racial wealth gap through reparations, the federal government would need to enact a massive reparations program. Estimates on the necessary size of a national reparations program vary, but the sum total of the racial wealth gap – the amount needed to eliminate the racial wealth gap evaluated at the mean – is \$14.3 trillion (Darity et al. 2022). Darity and Mullen (2020) propose a direct wealth transfer that would eliminate the racial wealth gap evaluated at the mean, around \$240,000 per person, paid in cash to Black Americans.⁵ True reparations would take the form of direct payments rather than conditional grants and vouchers applied to specific circumstances. Even with direct cash

⁵ Darity and Mullen (2020) recommend that recipients be required to (a) establish that they had at least one ancestor who was enslaved in the U.S., and (b) prove that they self-identified as “Black,” “Negro,” “Afro-American,” or “African-American” at least 12 years before enactment of reparations program or establishment of a congressional/presidential commission to study/develop reparations for African Americans

transfers to Black households in an amount that would close the racial wealth gap, the gap could reappear without further intervention to address discrimination and disadvantage in housing, labor, and credit markets (Perry 2020; Derenoncourt et al. 2022; Boerma and Karabarbounis 2021). Programs like those in Evanston and Providence show that reparations programs are possible to implement; while substantial reforms and expansions to them are necessary to close the racial wealth gap through reparations, these two cities show that reparations are possible in the U.S.

Simulations: Illustration of Proposed Policies Scenarios

The policies extensively evaluated in the previous section offer a view of strategies to improve wealth across low-income families, but most significantly among black families. This section aims to offer a simplified set of scenarios that can provide a baseline comparison across potential policies: wealth tax versus reparations.

To illustrate some of the alternative policies we previously described, we evaluate the change in fiscal revenues, tax policy distribution, and inequality by designing a tax simulation model inspired by Saez and Zucman (2019) and assuming a distribution of income and wealth of two racial groups (whites and blacks).⁶ Also, our model assumes a static population distribution across income/wealth brackets and does not consider general price changes. The analysis is also static as it doesn't evaluate the long-term iterative effects of the proposals. However, it does incorporate individual behavioral effects arising from tax policy changes considered in the literature. We use estimates from different sources. For averages by race group, we use the Survey of Consumer Finance (2016), the American Community Survey (2019), and general economic parameters estimates from Saez and Zucman (2019). Data availability defines the most current period estimates we can use. Further, the estimates use the environment pre-Covid19 to avoid blurring our analysis with the outcomes of special programs and tax policies arising from the pandemic crisis. Like previous work, we take into consideration the behavioral response to tax increases by incorporating the response rate to these policy changes and the bargaining power change emerging from them. We also include an average estimate of tax evasion used by Saez

⁶ One limitation of this methodology is that the underlying population do not

and Zucman (2019). To the best of our simulation ability, we consider these barriers as static components.

We also consider that in our simulated world, the implementation cost of these policies is very low at the margin, so we can omit it from the analysis. The goal is to provide insights about the direction of these policies rather than estimate a detailed tax burden analysis. We provide the comparison of marginal tax rates, before and after racial policy income and wealth gap across deciles, and total potential fiscal revenues,

In our analysis, we illustrate the changes in outcomes by income deciles. The idea is to compare the racial wealth gap with a similar benchmark when policies affect income and wealth. Also, we use this illustration for comparison reasons. Previous studies show changes by income levels (i.e., average, deciles, quantiles) when evaluating other tax changes such as individual income tax, estate tax, and sales and services tax reforms.

Black households have less income than White families and significantly less wealth too. Our simulations use estimates from Darity, Addo, and Smith (2021) of Black/White income and wealth ratios by percentiles to adjust for the variation in this ratio by different income and wealth groups. The higher the income and wealth group, the larger the gap between Black and Whites income and wealth. For consistency in the comparison across scenarios, we will illustrate the comparisons across income percentiles.

We evaluate the following scenarios: wealth tax and reparations (direct cash transfers and asset-conditional transfers). **Table 1** shows the details.

Table 1 Scenarios details

Scenarios	Assumptions	Other assumptions
Wealth Tax	Gradual tax: 1% above #32m, 2% above \$50m, ... up to 8% above \$10 billion. Evasion rate of 15%, and corporate tax (25%).	Elasticity rate: 0.25 Bargaining rate: 0.5
Reparations (as full income)	Cash transfer to African enslaved descendants that fully complement their income. Average transfer per individual (\$250 thousand – Darity and Mullen, 2020)	Consistent proportion of direct line descents across income levels.
Reparations (only assets)	Cash transfer to African enslaved descendants that can only be used for housing or investments (50/50). Average transfer per individual (\$250 thousand – Darity and Mullen, 2020)	Consistent proportion of direct line descents across income levels. Only assets considered are real state and dividends. Tax rates on these assets are from Saez and Zucman (2019).

Source: Various.

Scenario 1: Wealth Tax

For our illustration, we model a wealth tax scenario that resembles the one proposed by Bernie Sanders. A gradual wealth tax like shown in **Table 1**. **Table 2** shows the estimated black/white ratio by quintiles used progressively in our estimates. Despite having policies that separate single versus married filing individuals, we generalized the assumptions by following Saez and Zucman's (2019) approach and combining the policies at a higher tax rate at higher wealth levels. The wealth tax is applied to everyone who satisfies the eligibility regardless of race.

Table 2: Estimated Marginal Tax Rates comparison

Income quintiles	White	Black	W/B Ratio	B/W Ratio
1	18,227	1,139	1.63	0.61
2	38,480	2,278	1.73	0.58
3	61,771	5,442	1.74	0.57
4	99,238	9,746	1.66	0.60
5	204,553	101,264	2.02	0.49

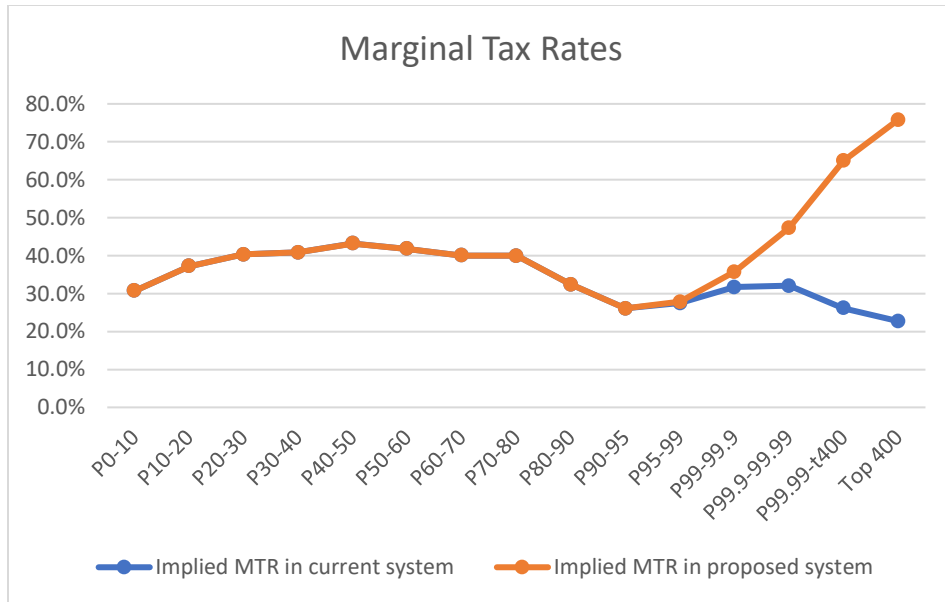
Wealth Quintiles	White	Black	W/B Ratio	B/W Ratio
1	420	-11,900	-0.035	-28.33
2	48,080	1,510	31.84	0.03
3	171,000	17,300	9.88	0.10
4	409,500	77,300	5.29	0.19
5	1,590,000	283,200	5.61	0.18

Source: Darity, Addo, and Smith (2021) using SCF (2016).

Figure 1 compares the marginal tax rate by percentile before and after the change. The estimate, as expected, is significantly higher at very high deciles levels. According to our estimates, a wealth tax scenario increases total tax collection by 1.5% from the total taxes collected if a wealth tax was not in place. As we implement the wealth tax across the distribution, income and wealth are expected to be affected as tax payments finally come from individual income.

However, it is expected that after a wealth tax, the Black and White income and wealth ratio doesn't change within each percentile. Yet, the estimated average Black and White income and wealth ratio would change depending on the difference in the distribution of wealth and income between whites and blacks.

Figure 1: Estimated Marginal Tax Rates Comparison

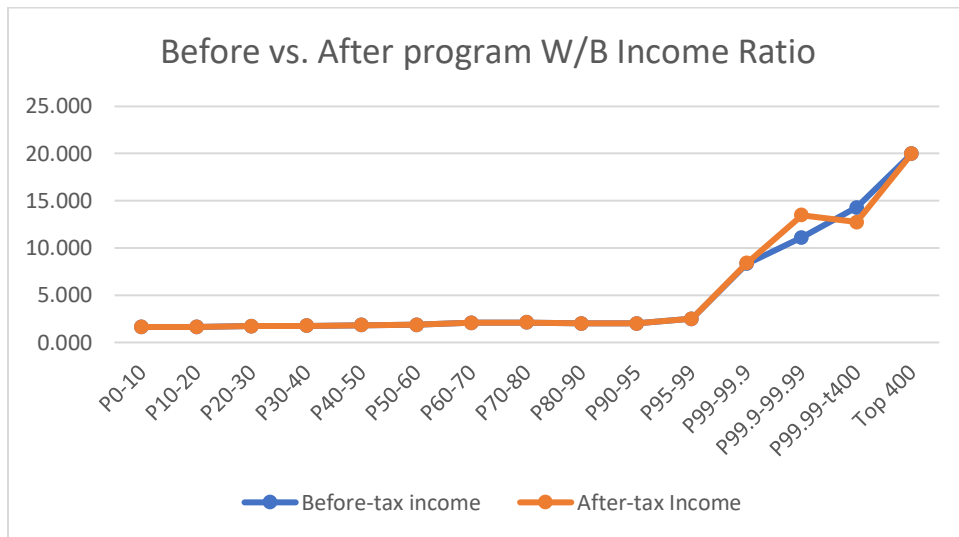


Source: Authors' calculation using tax simulator with modifications.

Figures 2 and 3 show the white/black income and wealth ratio by percentile before and after a wealth tax. Notice that by definition, the within-percentile racial gap does not change after the wealth tax because it is implemented for eligible people. However, at higher income levels, there is some variation among high-income/high-wealth groups because the payment of the wealth tax represents a higher proportion of high-income/high-wealth Blacks relative to high-income/high-wealth Whites. The average estimated white/black income and wealth ratios change despite the almost unaltered ratio across percentiles. On average, the income white/black gap is reduced by 20 percent after the Wealth Tax, and the white/black wealth gap is reduced by only 2 percent. As **Table 2** shows, although Whites across the entire

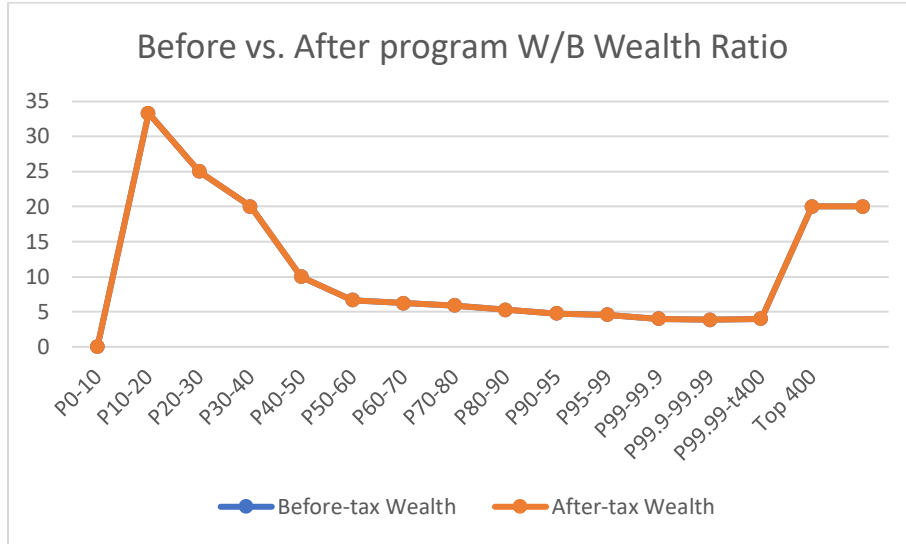
wealth distribution have higher wealth than Blacks, the racial wealth gap, measured at the median level within wealth quintiles, is significantly more prominent in the first quintiles. Taxes targeting top wealth groups will be targeting the lower end of the wealth gap (the white/black wealth gap ratio in the top quintile is lower than at other quintiles), and not addressing the largest source of the racial wealth gap that comes from the lack of wealth (even negative wealth) or low wealth holdings among Blacks in the low and middle wealth quintiles. Suppose the wealth tax policy is paired with a income-supplement redistributive policy. In that case, our previous report shows that the racial wealth gap will be reduced. Still, the reduction is less effective than if the resources directly target Black individuals and asset-accumulation incentives and policies.

Figure 2 White/ Black Income Ratio



Source: Authors' calculations.

Figure 3 White/Black Wealth Ratio



Source: Authors' calculations.

Scenario 2: Reparations (cash transfers as income)

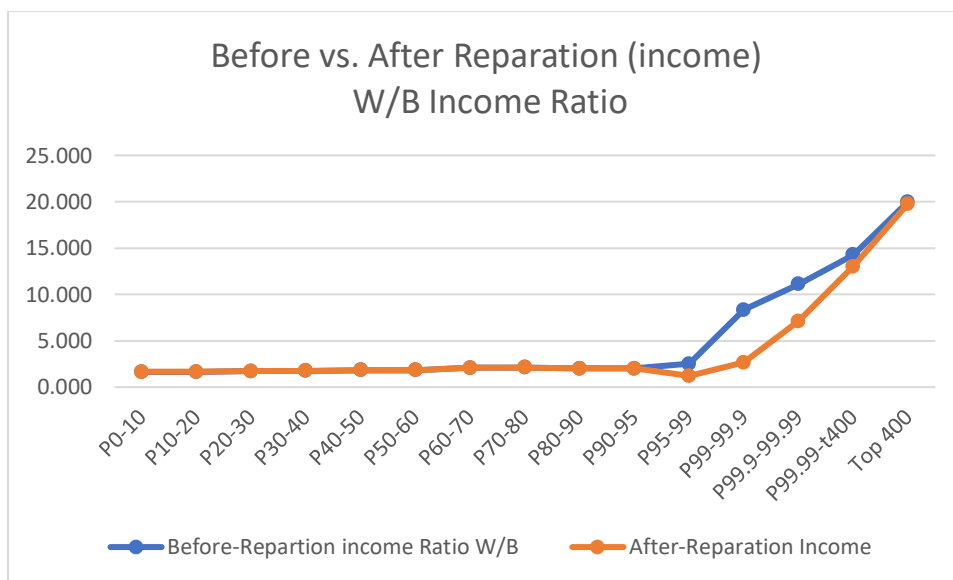
We model a reparations scenario where individuals receive a cash transfer as extra income. The amount of the transfers I, on average, \$250,000, and we also assume that only those individuals confirming being enslaved descendants would obtain the transfer (about 57%⁷). Using the previous estimates as parameters, we estimate that about 8 billion dollars are needed to provide the program's cash transfer. We also assume that the transfers are given to those at income levels below the top 400. Because cash transfers become income, they are taxable. The individuals receiving the transfers move up in the income distribution, and by construction, they also face higher income taxes. There is an increase in fiscal revenues via income taxes of about 2 billion dollars. This means that only about 75% of the transfer will enter the economy as

⁷ Most reparations programs require some level of demonstration of having been affected by the adverse action. We decided to use a self-reported estimation of the potential enslaved descendant population instead of the entire estimated black population. About 57% of the respondents to Pew Research Survey in 2021 responded having at least one of their ancestors having been enslaved.

disposable income. For the sake of simplicity and consistent comparisons, we don't make any assumptions about how this income is spent.

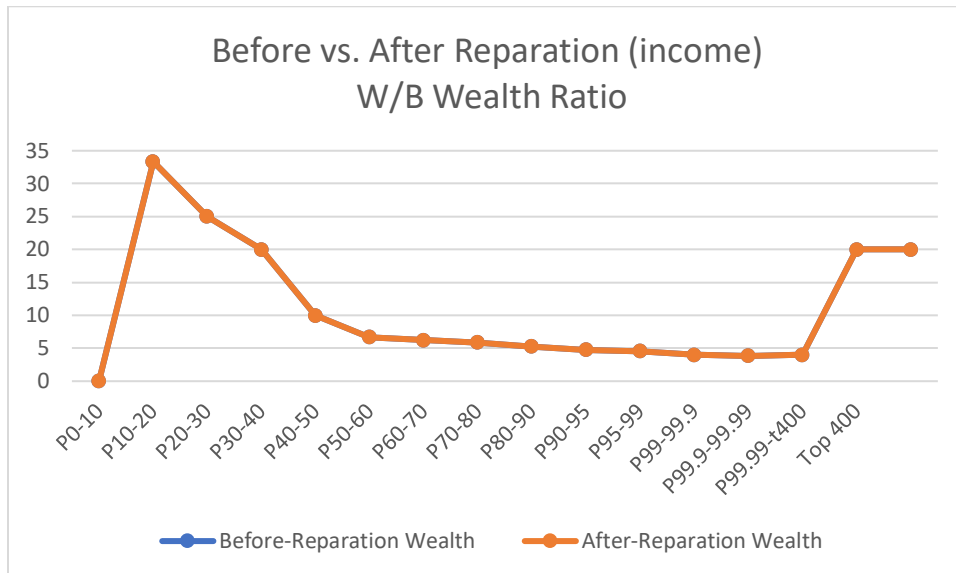
Figures 4 and 5 show the white/black income and wealth ratios before and after reparations. The white/black Income ratio shows a larger reduction on the higher income percentiles because the African American enslaved descendants automatically move up in the distribution. The average racial income gap is reduced by 50%. Meanwhile, the wealth distribution shows a smaller response because not all income becomes part of total wealth (some part is automatically reduced because of individual income taxes). However, there is still a small reduction (hard to observe in Figure 5) in the wealth ratio across the groups receiving the transfer. Despite the smaller gap reductions per percentiles, with a larger proportion of Black individuals holding higher wealth levels because of the one-time cash transfer, the estimated average white/black wealth ratio decreases by about 5%. This is a static vision of the impact. We don't make assumptions about future iterations of this scenario. For example, individuals could use this extra income to invest, consume, or transfer to other family members.

Figure 4 White/Black Income Ratio



Source: Authors' calculations.

Figure 5 White/Black Wealth Ratio



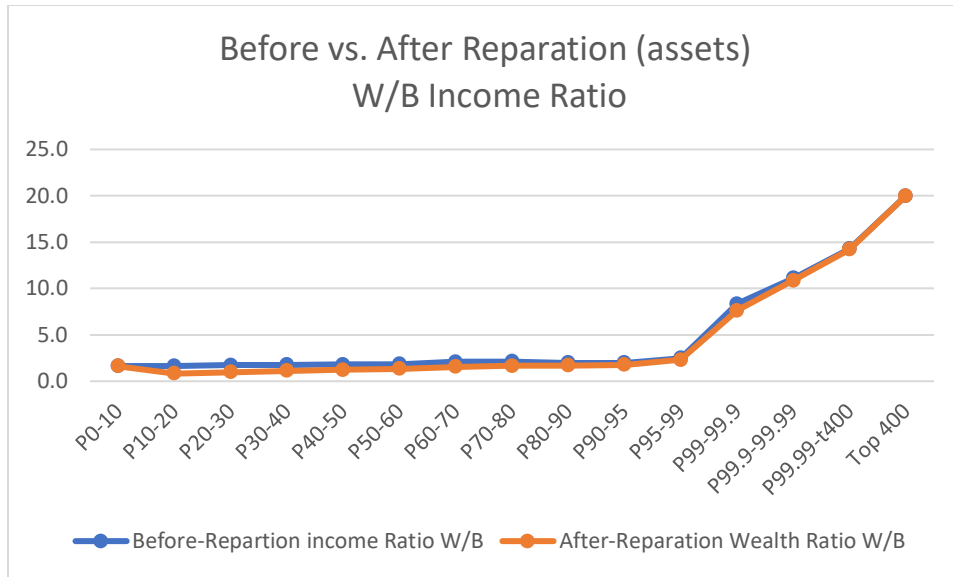
Source: Authors' calculations.

Scenario 3: Reparations (only assets)

Similar to our previous scenario, we assume the same benefit amount and proportion of the Black population receiving reparations. The difference here is that individuals only receive the dividends from the investments in the form of income, but most of the benefit is kept in non-liquid funds. However, in this scenario, the benefit can only be used in asset-building components such as investments in the asset market or real estate. We assume a 50-50 distribution of the resources, keeping in mind that investments will provide returns that will be reflected in income. We consider a rate of return of 5%. Because assets have a lower tax rate, there is only an increase of \$0.27 billion in fiscal tax revenues from property and income taxes. However, there are other potential economic gains in the long run that we don't consider here. For example, investments increase the activity in the asset market, promoting the economy overall. Further, potential gains are more likely to be consistent across the years rather than a

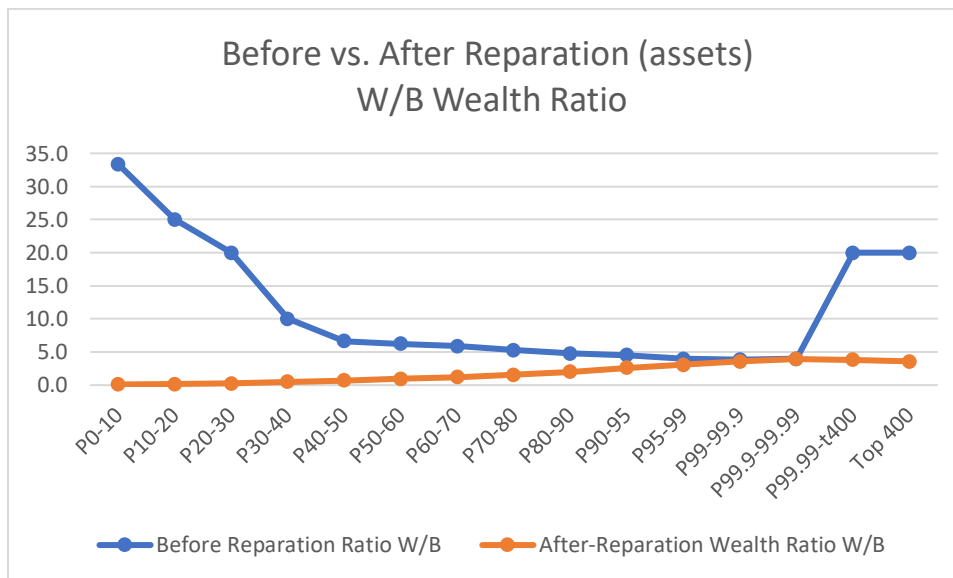
one-time fiscal gain. **Figures 6 and 7** show the change in white/black income and wealth ratio after a reparation program that must be used only in assets (housing or investments). In this case, we don't observe the sharp reduction in the racial income gap like in scenario 2. However, there is a more even decrease at each income percentile level.

Figure 6 White/Black Income Ratio



Source: Authors' calculations.

Figure 7 White/Black Wealth Ratio



Source: Authors' calculations.

Overall, the average racial income gap reduction is about 10 percent. Meanwhile, the racial wealth gap has significant reductions at each income percentile; the smaller drop happens at, the higher income percentile because of the smaller relative size of reparations concerning the average percentile-group wealth holdings.

We estimate that the average racial wealth gap gets reduced by about 90%. Our estimates do not consider the dynamic pattern that higher wealth holdings would create among eligible individuals. Individuals can still transform their wealth holdings into income or transfer them to other individuals.

A Future Vision

Under current law, the tax code fails to reach its full potential to narrow the racial wealth gap. Some policies, such as the Child Tax Credit and the Saver's Credit, could do more with effective reform. Several tax policies actively widen the racial wealth gap by allowing an intergenerational cycle of wealth preserved among a few people: the mortgage interest deduction, the tax treatment of capital gains, and the tax code's failure to tax inheritances effectively. Some policies with great potential to reduce racial wealth inequality have never been implemented at the national level in the U.S. – including reparations, the most direct approach to addressing the racial wealth gap. Reforms to introduce these policies at a federal level, strengthen policies that work against the racial wealth gap, and limit those that increase racial wealth inequality would make the tax code a more powerful tool for reducing the wealth gap between Black and white households.

While other policies may require political and legal debates, we have presented many immediate steps policymakers can take to narrow the racial wealth gap through the tax code. Many of these reforms are within easy reach for tax policymakers. Expanding the Child Tax Credit, for example, is a widely popular initiative that has been implemented temporarily during the COVID-19 pandemic. Other efforts to implement longer-term goals, such as a federal baby bond or reparations program, could maximize the tax code's impact on the racial wealth gap. A two-pronged approach combining immediate reforms and these ongoing pushes for larger changes presents a viable and meaningful path to progress on reducing the racial wealth gap through the tax system.

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