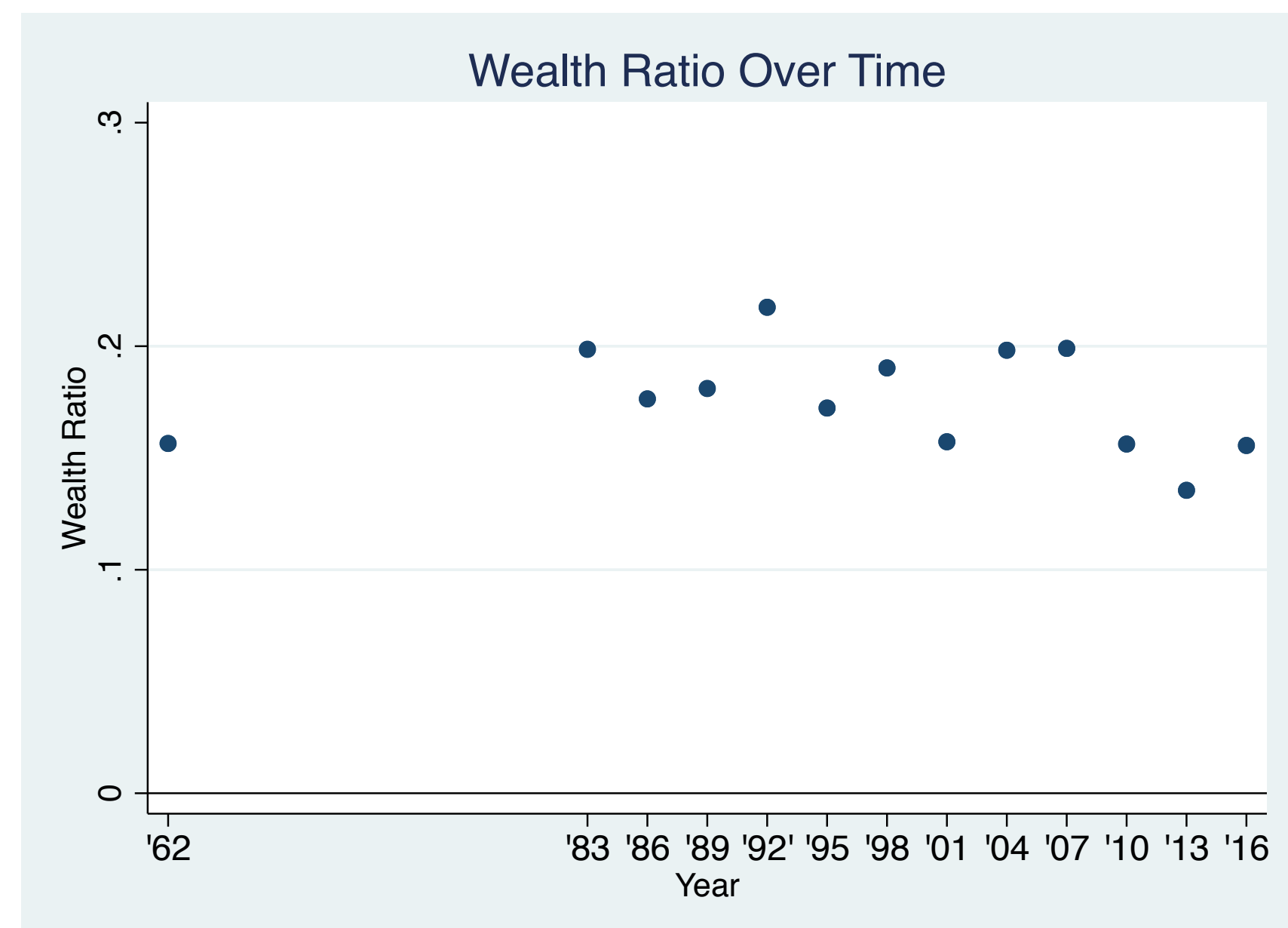


# Closing the Gap: Stratification Economics and Racial Wealth Inequality in America

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## Motivation

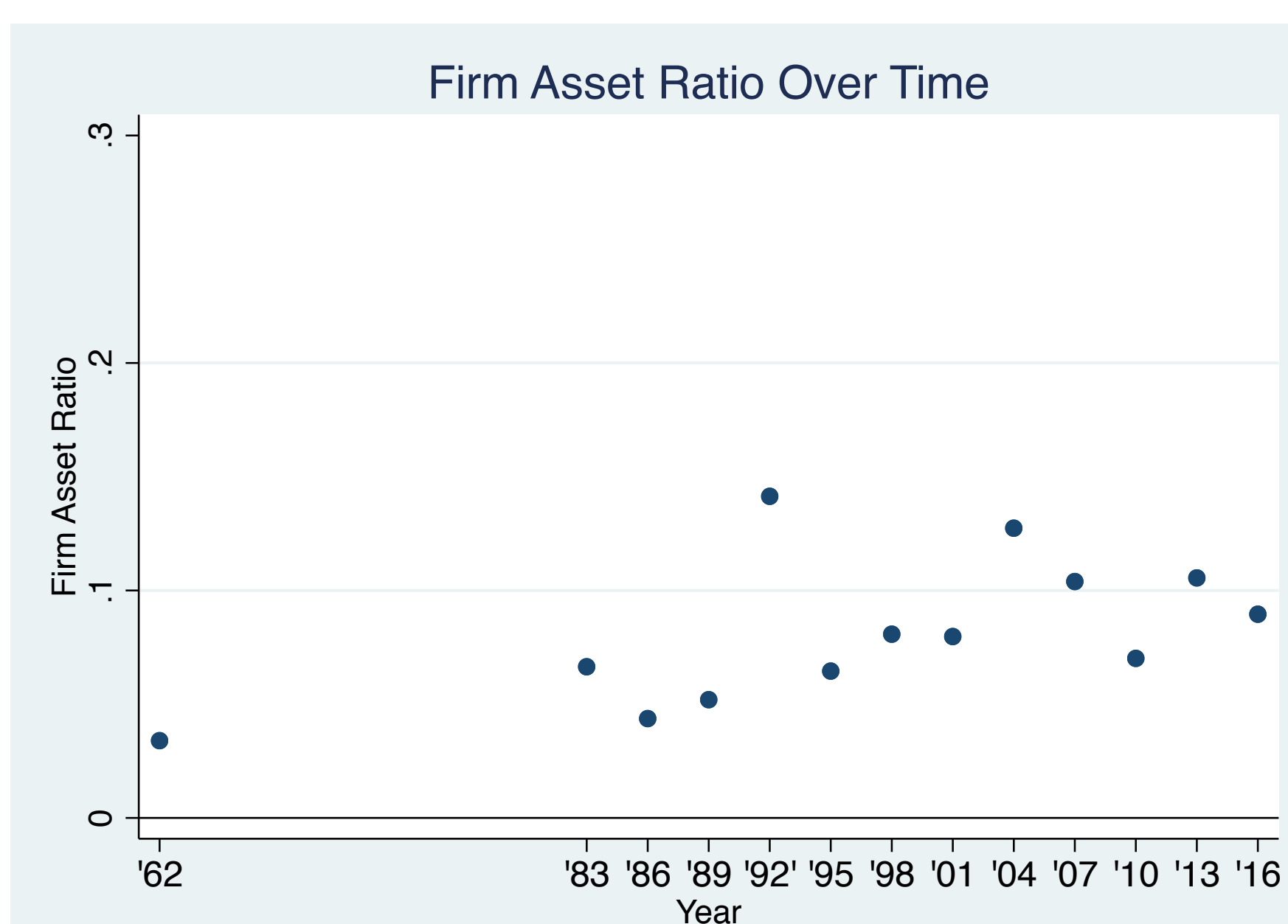
- From 1962 to 2016 the ratio of average household black wealth to average household white wealth has hardly improved - Survey of Consumer Finances (SCF).



- Darity (2005) argues that the wealth gap is a simple matter of the historical record. Previous generations of black Americans were systematically denied the opportunity to accumulate wealth throughout the history of slavery and Jim Crow. This "initial" gap in wealth then persisted after the legal end of Jim Crow in 1964 (Civil Rights Act) and 1965 (Voting rights Act) because black households did not have enough built-up wealth to make intergenerational wealth transfers at comparable levels to white households.

## Methodology

- My thesis explores Darity's argument theoretically with an overlapping generations model that isolates the impact of the "initial" 1962 wealth gap and intergenerational wealth transfers on the long run dynamics of the wealth distribution, in an economy with no other forms of discrimination.
- The purpose of this analysis is to see if the initial wealth disparity and intergenerational transfers, by themselves, can lead to the rigid and persistent wealth gap found in the data.
- If so, Darity's argument is salient and even if all forms of racial discrimination had ended with the passage of Civil Rights legislation, the wealth gap would have persisted in the absence of a reparations policy directly addressing the fact that the initial wealth gap arose in the first place.
- The model considers two distinct type of households, type  $R$  (white) and type  $P$  (black). The households are identical except for their initial stock of physical capital and the initial fraction of the economy's firms that they own.
- At the end of each period, the old generation in each household passes on all the firm ownership to the new young generation, which causes the distribution of firm assets in the economy to remain constant over time. This assumption is largely supported by the SCF data.



## Model Basics

- Every member of each household lives for two periods. In each period,  $t$ , the young cohort in a household of type  $i$  ( $R$  or  $P$ ), chooses their consumption in period  $t$ , their consumption in period  $t+1$ , and the intergenerational transfer of capital they will leave to the young generation in period  $t+1$ , to maximize lifetime utility subject to an intertemporal budget constraint.

$$\max_{c_{1t}^i, c_{2(t+1)}^i, b_{t+1}^i} \ln(c_{1t}^i) + \beta \ln(c_{2(t+1)}^i) + \rho\beta \ln(b_{t+1}^i)$$

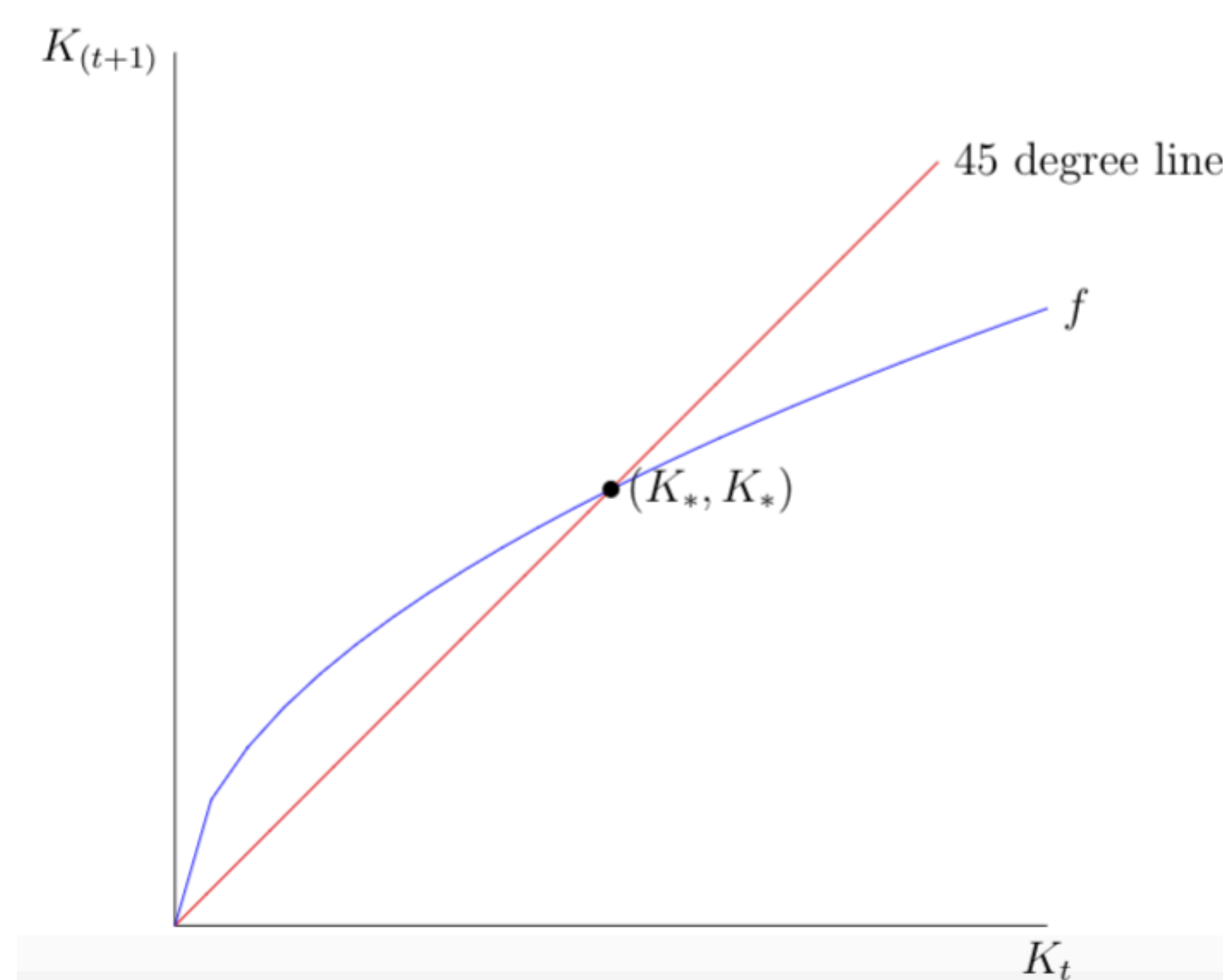
$$s.t. \quad c_{2(t+1)}^i + b_{t+1}^i \leq (1 + r_{t+1})(b_t^i + lW_t + \pi_i P_t - c_{1t}^i)$$

$$c_{1t}^i = \frac{b_t^i + lW_t + \pi_i P_t}{\beta + \rho\beta + 1}$$

$$c_{2(t+1)}^i = \frac{\beta(1 + r_{t+1})(b_t^i + lW_t + \pi_i P_t)}{\beta + \rho\beta + 1}$$

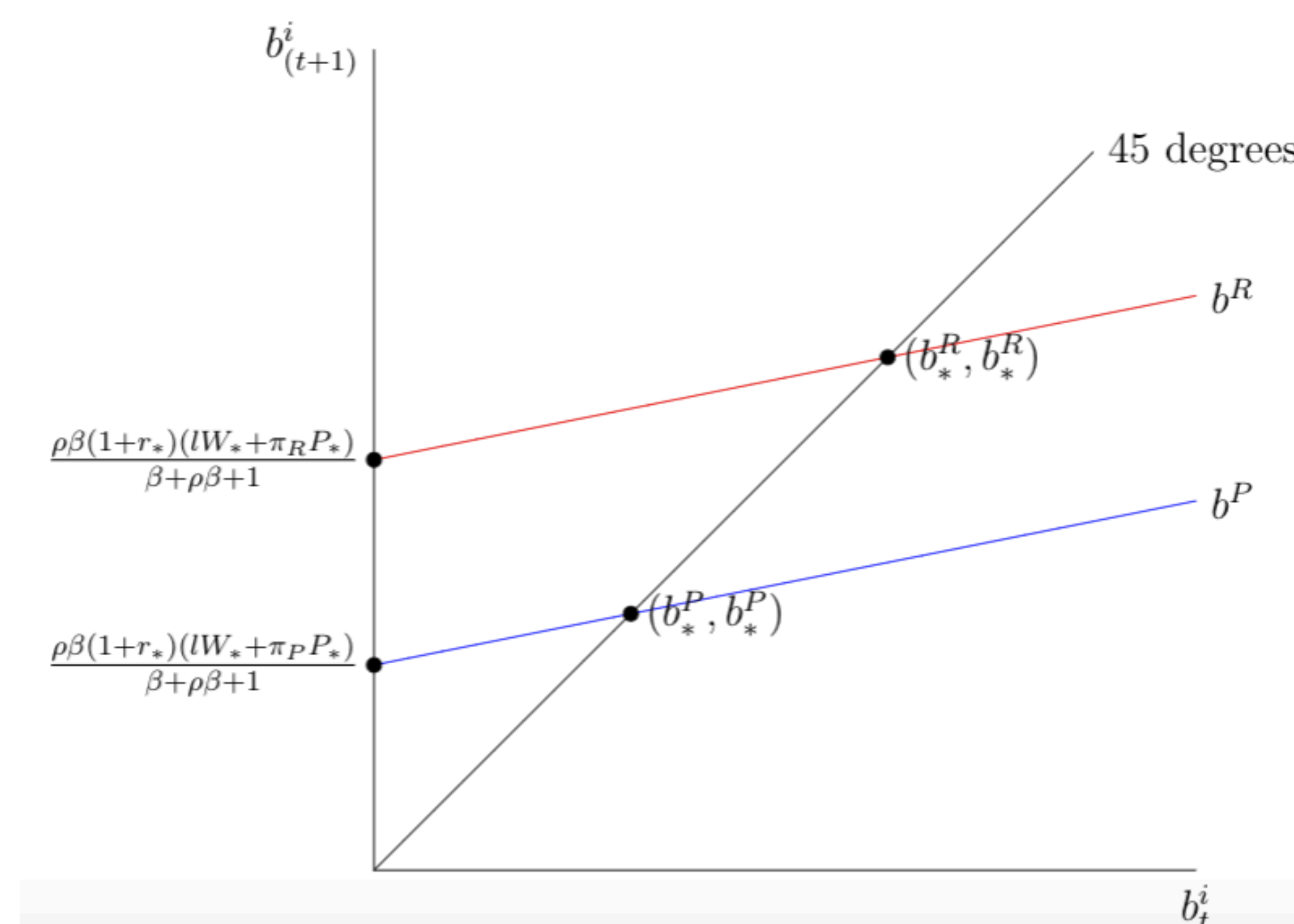
$$b_{t+1}^i = \frac{\rho\beta(1 + r_{t+1})(b_t^i + lW_t + \pi_i P_t)}{\beta + \rho\beta + 1}$$

- The capital stock in period  $t+1$  is equal to aggregate savings in period  $t$ , which governs the dynamics of the capital stock and leads to a steady state level of capital in the long run.



## Steady State Inheritance Gap

- The steady state of the capital stock determines the steady state interest rate, wage rate, and profit level, which determines the long run dynamics of intergenerational wealth transfers in the economy.



## Baby Bonds

- Darity and Hamilton (2010) recommend a wealth targeted transfer program, Baby Bonds, as a form of reparations. The policy would have the federal government create a trust for all newborn children in the U.S. whose parents have wealth below the median that the children can access when they turn 18. The purpose of the program is to equalize inheritances between white and black households and thus reduce the wealth gap.

- I introduce an idealized version to the baseline model that levies an inheritance tax on the young cohorts of the white households in the economy and transfers the capital to the young cohorts of the black households. This policy changes the intertemporal budget constraints.

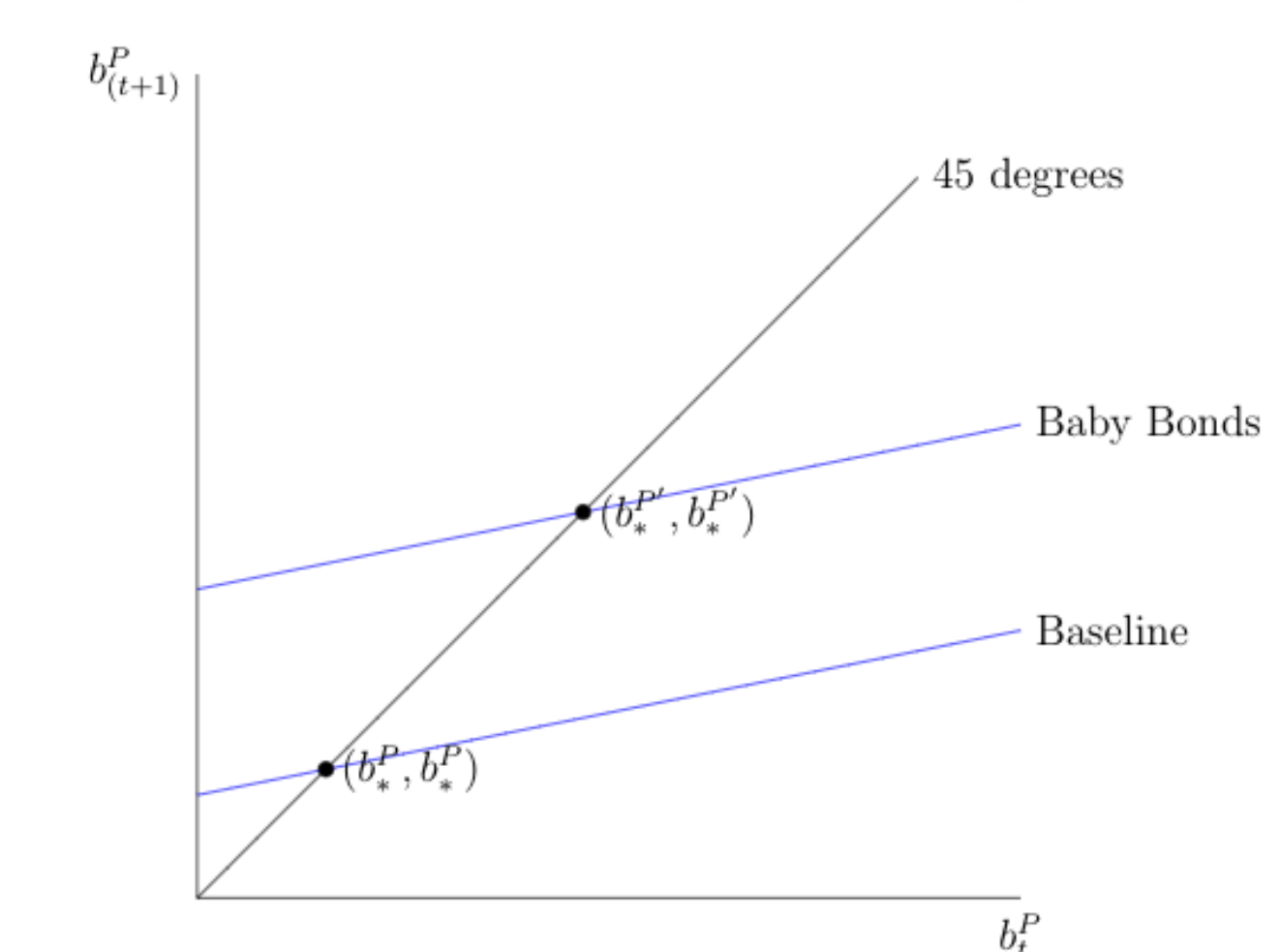
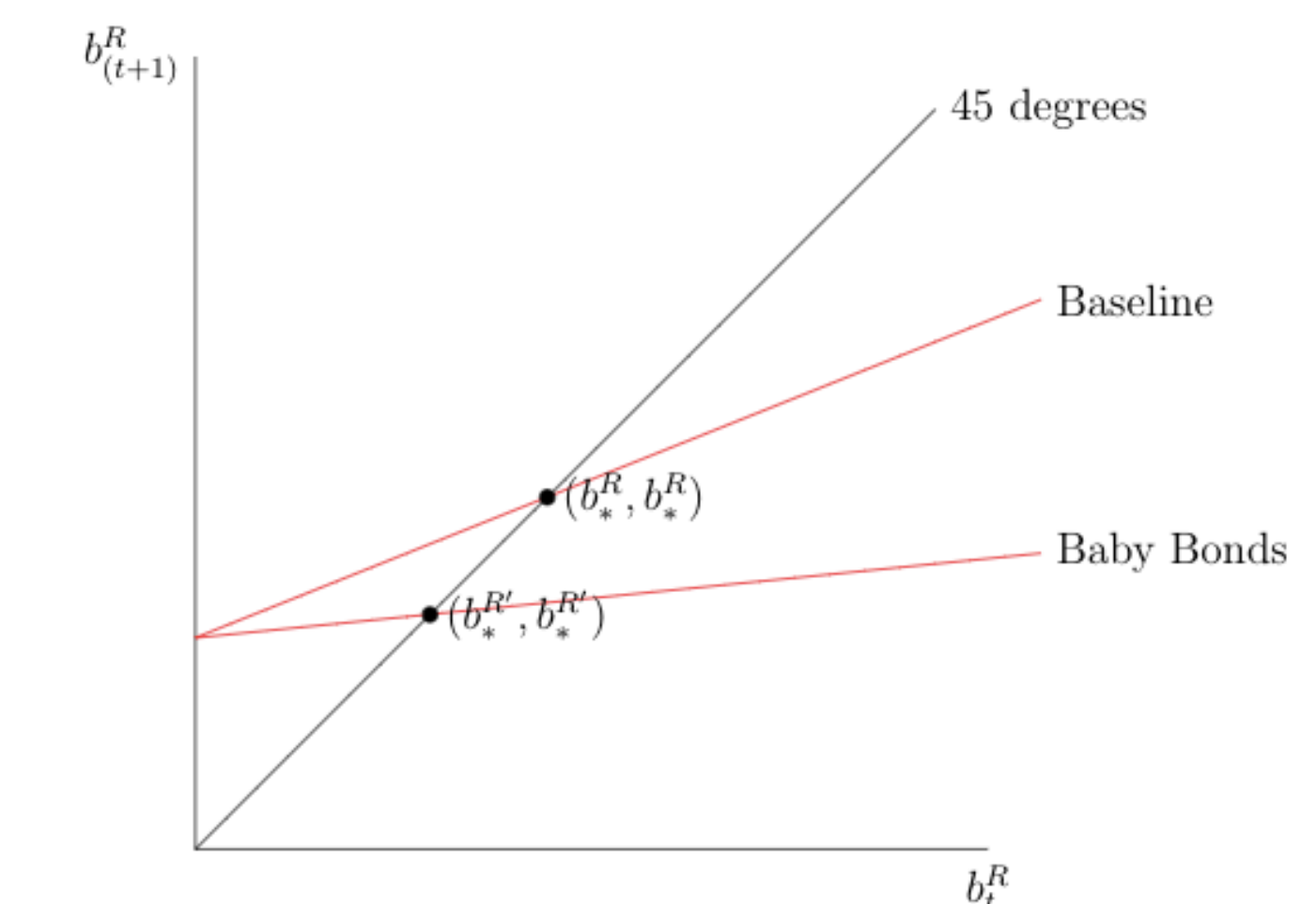
$$c_{2(t+1)}^R + b_{t+1}^R \leq (1 + r_{t+1})((1 - T)b_t^R + lW_t + \pi_R P_t - c_{1t}^R)$$

$$c_{2(t+1)}^P + b_{t+1}^P \leq (1 + r_{t+1})(b_t^P + lW_t + \pi_P P_t + \frac{q^R}{q^P} T b_t^R - c_{1t}^P)$$

- Baby Bonds does not affect aggregate savings in the economy so the dynamics of the capital stock remain the same; but, the policy does impact the dynamics of intergenerational wealth transfers for each type of household.

$$b_{t+1}^R = \frac{\rho\beta(1 + r_{t+1})((1 - T)b_t^R + lW_t + \pi_i P_t)}{\beta + \rho\beta + 1}$$

$$b_{t+1}^P = \frac{\rho\beta(1 + r_{t+1})(b_t^P + lW_t + \pi_i P_t + \frac{q^R}{q^P} T b_t^R)}{\beta + \rho\beta + 1}$$



## Conclusions

- The racial gap in firm ownership allows white households to receive a larger share of the economy's aggregate profits every period than black households, so white households can consistently leave higher levels of physical capital to the next generation.
- Crucially, these factors result in a persistent and rigid wealth gap independent of any other dimensions of racial inequality (overt discrimination, earnings, education, etc.). Thus the wealth gap will persist without a reparations policy to counter the initial firm ownership gap.
- Baby Bonds can help close the wealth gap by working to equalize inheritances; but, if the program were ever to phase out, the original dynamics of the economy governed by the firm ownership gap would kick back and the wealth gap would return.