

Universal Baby Bonds Reduce Black- White Wealth Inequality, Progressively Raise Net Worth of all Young Adults

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Abstract

The distribution of wealth in the United States has grown increasingly unequal over the past half-century, according to the Congressional Budget Office, especially along racial lines. Law makers and researchers have proposed to address the issue by introducing universal “baby bonds,” paid to each new born in the United States and preserved until the individual reaches young adulthood. The proposed bond value is based on a sliding scale up to a \$50,000 maximum investment for babies born to families with the lowest net worth. By tying bond values to net worth rather than income the proposed scheme intends to better address the more extremely unequal and persistent racial disparities in net wealth.

This study uses longitudinal data from the Panel Study of Income Dynamics on the assets of young adults currently and at birth to simulate contemporary racial inequalities under a counterfactual policy environment in which the U.S. had instituted a baby bond program when the current cohort of young adults were newborns. Young adults in the study are between 18 and 25 years of age in 2015. The initial value of the bond is defined categorically by quintiles of net household wealth observed in 1989 and 1994, then smoothed across the distribution as a function of the inverse hyperbolic sine of parents’ net worth at birth. Initial bond values are assigned in constant 2015 US dollars, and assumed to grow at a 2% rate for the number of years since the young adult’s birth.

I find that without the baby bond program, median wealth among young Caucasians is approximately sixteen times that of the young African Americans (\$46,000 vs. \$2,900). The baby bond program raises median wealth for both groups and reduces the disparity to a factor of 1.4, where Caucasian young adults hold \$79,159 and African Americans \$57,845 at the median. Moreover, the share of all wealth held by the top decile of young adults would decrease from 72% to 65%, marginally approaching the distribution of more egalitarian societies. A baby bond program would considerably narrow wealth inequalities by race while simultaneously improving the net asset- position of young adults and alleviating the increasing concentration of wealth at the top.

Introduction

If we take 100 people to represent the United States and \$100 to represent its wealth, \$40 would go to just one guy. Another \$40 would go to the next 9. That leaves about \$20 to distribute across the remaining ninety Americans, a dime here and a penny there. While wealth has grown increasingly concentrated over the past several decades¹, it has become a particularly acute problem in recent years. For example, since the year 2001, the share of household wealth held by the top tenth increased from 70% to 76% of all wealth. As a comparison, consider a perfectly equal society, which has never existed and isn't necessarily desirable in practice. In the perfectly equal society, one tenth of households would hold 10% of wealth. For essentially all of recorded human history, the top tenth has generally held anywhere from 60% to 90% of all wealth.² Within that context, the U.S. has significantly regressed down the continuum of recorded egalitarianism just since 2001. Over the same time period, the average wealth held by the bottom fourth of the population declined from \$0 in 2001 to -\$13,000 in 2013.³

While this problem is economy-wide, inequitable access to wealth disproportionately burdens African Americans. Racial disparities in wealth have persisted despite substantial gains in income disparities over the second half of the twentieth century. In 1963 the median Caucasian family held over \$45,000 more in wealth than the median non-white family. Today, that divide has grown to exceed \$150,000, with Caucasians holding \$171,000 at the median to African Americans' \$17,000.⁴

These phenomena are linked. Wealth is accumulated and transferred through generations.^{5,6} As the upper and lower ends of the wealth distribution move apart in opposite directions, it exacerbates pre-existing generational wealth disparities. Thus racial wealth disparities not only persist over time but grow with the overall stretching of the wealth distribution.

Observing the relationship between these phenomena, scholars have proposed a universal public program aimed at reducing generational wealth disparities⁷ that would also mitigate the concentration of

wealth. The proposal would provide a trust fund, or “baby bond” to every new born in the United States, which the child could access after reaching early adulthood. The value paid to each individual would range between \$2,000 and \$50,000, varying inversely with the net worth of the household at the child’s birth. By targeting bond values in this way, scholars intend to direct the greatest share of public resources to households with the greatest need, and thus mitigate inter-generationally inherited disadvantages of wealth. The proposed total public expenditure is \$80 billion a year, spread across 4 million babies born in the US per annum.

This study will empirically investigate the reach and feasibility of the proposed baby bond program. Could universal baby bonds meaningfully reduce racial disparities, compress the wealth distribution, and improve the asset positions of US households? Could all of this be achieved for \$80 billion, which is less than 10% of the annual cost of social security? I evaluate these claims using nationally representative data on the net worth of young adults today and of their households at birth, from the Panel Study of Income Dynamics.

Background

Wealth provides the stability needed for individuals and families to solve unexpected crises in the short term, plan for investment and growth in the long term, and to exert social and political will in their communities across the life course. Similarly to an insurance policy, wealth creates a cushion from future uncertainty that minimizes the consumption effects of potential income shocks. In other words, the loss of income from losing a job or needing time off does less damage to one’s life style if assets are available to support consumption during these potentially difficult times either directly or by serving as collateral for a loan. In the same way that risk averse consumers are willing to pay more for insurance than they expect to receive in medical payouts⁸, so too do consumers derive utility from the simple fact of asset ownership and the peace of mind that provides.

Moreover, asset ownership has been shown to enable social mobility and educational attainment by providing a foundation from which to assume the risks of investment and growth. Even independent of the effect of income, evidence suggests that young people from wealthier families are more likely to complete two or four years of higher education and to move up in the socio-economic distribution.⁹ Finally, wealth can confer social and political power that is distinct from income.¹ Large accumulations of financial or business assets can confer special privileges in the political arena or in a local social context. The ongoing concentration of this power in the hands of a few Americans can thus undermine the democratic process.

The existing policies that do recognize and address the need to broaden the base of asset ownership work through regressively designed tax benefits that disproportionately benefit households with higher incomes or those who have some wealth to begin with. For example, the mortgage interest deduction reduces the taxable income of home-owning households by the amount of their interest payment. Lower income households with lower income-tax rates and households with smaller home values will necessarily benefit the least, while those who do not own a home do not benefit at all. In the end, most of this significant federal tax expenditure¹⁰ is allocated to households with higher incomes and to those with assets, while the lowest income and least wealthy get nothing.

Similarly to tax-benefitted home ownership, states offer tax-protected savings plans that support families to save for college. Money in these accounts, termed “529s,” are exempt from taxation on gains and are not considered income for tax purposes upon withdrawal.¹¹ The tax-based incentive system benefits the highest income, and can only benefit those who contribute deposits, which the income-constrained are unlikely to afford.

Furthermore, independently from the income available for such savings plans, individuals will be less likely to invest if they have weaker ties to the financial system, especially those who are

generationally disadvantaged or who grew up without assets. In fact, a substantial share of the intergenerational elasticity of wealth (not counting inheritance) is explained by a shared propensity to hold financial assets relative to other forms of assets.⁶ As a result, those from households with a greater propensity to hold financial assets are more likely to themselves contribute to these voluntary asset-subsidy schemes.

A universal baby bond program could run through a similar tax-benefitted structure as 529s but the initial seed would be planted with public expenditures. Rather than perpetuating pre-existing disparities in the propensity and ability to invest in financial assets, the program would ensure full participation in addition to transferring progressively administered bonds. Such a design could in theory reduce historically accumulated racial wealth disparities and greatly broaden access to assets.

The remainder of this paper will empirically evaluate whether the proposed baby bond program would eliminate racial wealth disparities, raise wealth at the bottom and middle, and reduce the concentration of wealth at the top. I examine the program's effects on the cohort of young adults between 18 and 25 years. I focus on young adults because it is the earliest point at which the bonds have an impact. In the proposal, withdrawal from the accounts would be barred or heavily penalized until adulthood. Predicting the program's effect on wealth at later ages after the bonds may have been consumed or invested would require additional foresight into, or assumptions about, the success of these various hypothetical ventures. Instead, I evaluate the economic impact of the program once the cohort reaches early adulthood.

Methods

Sample and Data

This study examines data on household wealth and demographics from the Panel Study of Income Dynamics (PSID). The PSID has continuously followed a nationally representative sample of families since 1968, when it began collecting data on household economic wellbeing to monitor progress

in President Lyndon Johnson's "War on Poverty."¹² The survey design follows family members, including children who start their own families, in order to demonstrate social and economic mobility across generations.⁶ In 1984, the PSID began to collect detailed information on households' assets and liability holdings. These wealth data compare well with other national surveys, including the Survey of Consumer Finances conducted by the Federal Reserve Bank. In previous assessments, the PSID is shown to miss the top 2% of wealth ownership but to otherwise perform well^{13,14} especially at the level of population deciles.³

For this study, I select young adults between the ages of 18 and 25 years in the 2015 wave of the PSID. Young adults from 2015 are then matched to earlier PSID waves to obtain information on their household's net worth at the time of their birth. Sample members were born between 1989 and 1996. Individuals are matched to the PSID wave from 1989 if they were born between 1989 and 1991, and matched to the wave from 1994 if they were born between 1991 and 1996. All values of household wealth at birth are inflated to 2015 USD using the Consumer Price Index less food and energy. I drop twelve observations reporting negative net worth in 1989 but greater than \$250,000 in 1994, and end with a sample size of 1,281 young adults with complete wealth data in 2015 and at birth.

Bond Value Simulation

The aim of this study is to demonstrate the economic effects of a baby bond program that is both universal in its reach and targeted in its effect. In order to design a bond-allocation scheme that targets the greatest share of bond dollars to the households with the least assets, I first divide the young adults into five quintiles of household net worth at birth. Then I assign categorical bond values according to each wealth quintile, between \$200 for the top 20% and \$40,000 to bottom 20% (Table 1). I regress these discrete values on the continuous measure of net worth to smooth out the bond values across the wealth distribution. Rather than regressing on raw wealth values, I transform reported wealth using the inverse hyperbolic sine function (IHS). The IHS closely mirrors the logarithmic function for values greater than 10

or less than negative 10, and is symmetrical about 0 in between. This transformation is used in wealth models to reflect the skewed tails of the distribution of wealth holdings that trail in both the upper and lower directions.¹⁵ Figure 1 shows the IHS of wealth and its characteristic tails in either direction. Fitting bond values to the IHS of wealth allows the bond allocation to inversely mirror the distribution of household wealth, such that the highest bond values are directed at the least well-off households. Figure 2 plots the distribution of fitted bonds by wealth.

The third figure depicts an alternative allocation design, which regresses the discrete value of bonds on the raw measure of household wealth at birth without transforming wealth with the inverse hyperbolic sine function. Similarly to the IHS design, this alternative design also allocates somewhat greater bond amounts to the lower-asset households. Bond values here decrease as household wealth increases (Figure 3). However, it does not target the bond dollars as stringently toward the least well-off households. Figure 3 shows a less drastic decrease in bond dollars as wealth increases. I do not use this alternative specification.

I slightly adjust the fitted bond values depicted in Figure 2 by imposing a \$2,000 lower and \$50,000 upper bound on the bond values, which is binding for 155 observations. While these initial bond values are assigned according to household wealth at birth, in the results I present impacts on contemporary young adult wealth. I calculate the current value of the bonds that were distributed at birth by assuming a 2% annual rate of interest accrued to the bond holder and add to the individual's reported net worth in 2015.

In order to validate the total cost estimate at \$80 billion, I apply the bond simulation described above to the 1992 Survey of Consumer Finances (SCF), which are the best available data on the nation's total household wealth. I first separate households with newborns into weighted quintiles of net worth and regress the categorical bond values on IHS-transformed net worth, as described above. Because the

SCF reports age as a yearly variable, rather than in terms of months, one cannot identify exactly 12-months' worth of newborns to correspond to the number of newborns receiving the bond in one year. The SCF reports 1.7 million babies below the age of 1 year but 6.3 million babies age 0 or 1 (Table 2). To approximate the size of the newborn population in 1992 (4.07 million¹⁶), I take the average of the two groups and arrive at 4.18 million. I then find the weighted sum of the bond values across the population in both age groups and average between the two for a comparable population size. The total bond value comes to an estimated \$82 billion, fairly close to the proposed \$80 billion (Table 2).

In the results that follow, I evaluate the black-white gap in net worth at the median, with and without universal baby bonds. Then I investigate the program's effect on the distribution of wealth across the population using three indicators. I evaluate net worth at quintiles of the wealth distribution, with and without bonds; examine whether the bonds would reverse the earlier identified trend in which wealthier households' net worth has grown since 2001 while poorer households' net worth has declined; and finally evaluate whether the baby bonds would reduce the share of total wealth held by the top decile of the young adult population.

Results

At the start of adulthood, young adults begin with disparate access to assets according to their race. The overall median net worth among young adult households is \$29,000 in 2015. Among African Americans, the median is one-tenth the overall median (\$2,900). Among Caucasians by contrast, the median is nearly 1.5 times the overall median and over 15 times the African American median, at \$46,000 (Figure 4).

With universal baby bonds, each racial group would be better off at the median. The overall median comes to nearly \$77,000 (from \$29,000). The racial disparity would persist, but the relative differential would be substantially diminished. The median Caucasian young adult would hold

approximately \$79,000 versus the median African American's \$58,890. Thus the program would reduce the black-white wealth disparity from a factor of 15.9 to 1.4 at the median (see Table 3 for numbers corresponding to Figures 4 and 5).

While baby bonds would reduce race-based wealth inequalities, could a program of this size affect net worth across the wealth distribution? Without baby bonds in 2015, one in four young adult households own nothing or less (Figure 5, Table 3). At the other end of the distribution, the 90th percentile holds well over half a million dollars (\$567,000). Adding baby bonds substantially changes the wealth of young adults in the lowest quintile, who currently command \$0 in financial stock, to instead have over \$30,000 worth of financial assets. Net worth at the upper decile of the distribution increases by far less. Wealth at the 90th percentile does not depart much from the prior half-million-dollar benchmark, going to \$587,000 (up from \$567,000).

Next I examine whether baby bonds would affect the trend identified in the existing literature in which net worth has increased since 2001 at the top of the wealth distribution but declined at the lower end.^{3,17,18} I find that baby bonds cause no change to the differential time trend: the wealthiest quintiles increase in net worth over time while the least wealthy end up in approximately the same net asset position or somewhat lower (Figure 6). First, Figure 6 shows that consistent with the prior literature, the wealth of the upper quintile increased substantially while wealth of those just above the median, between the 60th and 80th percentiles, increased moderately and wealth at the lower end of the distribution shows a decline over the period.

The trends remain consistent whether one follows the dashed lines, which plots household wealth over time as reported in the successive waves of the PSID. Likewise, the trend remains when following the solid lines, which plot the slightly higher, new values of total wealth with the present value

of the bond added in.¹⁹ While the top quintile's marker on the far right rises well above its marker on the far left, those of the bottom three quintiles fall in line with or below the markers of their wealth in 2001.

While Figure 6 suggests that the baby bond program would not entirely overpower the economic forces driving the distribution of wealth production, I examine one final indicator for evidence of any movement towards a more egalitarian and less concentrated wealth distribution. I find that without baby bonds in 2015, the top decile of young adult households holds 72.1% of all wealth held in that population (Table 4). By comparison, the bottom three deciles hold -2.8% of all wealth, which is essentially debts owed to wealthier households. The middle six deciles share the remaining 30% of wealth. With the bonds, the bottom three deciles now collectively hold a greater than 0% share of wealth (0.6%), rather than a negative share; the middle six hold greater than a third (34.5%); and the top holds 65.0% of wealth (Table 4). The share of all wealth controlled by the top decile would thus decrease from 72% to 65% of all wealth held by this population.

Discussion and Conclusion

How can we contextualize the impact this program would have economically? In the short term, we can anticipate that the program would reduce generational wealth disadvantages and improve the net asset position of young African American households according to a number of wealth-based indicators of wellbeing. According to the Federal Reserve, most African Americans could not borrow \$3,000 from a family member in an emergency (59%, vs 29% of Caucasians).²⁰ The proposed baby bond program would raise the median net worth of young African American adults to nearly \$60,000, which would meaningfully improve the Fed's \$3,000 indicator. Furthermore, baby bonds would alleviate the effects of differential access to inheritance and gifts. Whereas Caucasians report receiving an inheritance at three times the rate of African Americans (26% versus 8%, Federal Reserve), baby bonds could introduce greater economic stability for young African American adults to use in navigating early life challenges and potential barriers to economic success and family creation.

Would this program meaningfully reduce the economic power of the top wealth holders? The evidence presented in this paper suggests that the share of total wealth held by the top decile of young adults would decline from its current share of 72% to a new share of 65%. When we consider 60% as the general lower limit, representing the most egalitarian societies “in all known societies, at all times²”, that 7 percentage point reduction takes on a more meaningful movement. Reaching 65% begins to approach the lower end of the historical range, suggesting the wealth distribution among young adult households would approach a relatively egalitarian distribution, at least relative to human history.

The baby bond program would not entirely upend the distribution of wealth in the United States. The top decile would still own far more wealth than the remaining 90%, and the poorest would still own little to nothing- or less. Still, by raising the bottom and median net-worth by more than it raises net worth at the top, the program would act to marginally compress the wealth distribution towards the middle, rather than concentrating wealth ownership at the far right tail.

The primary limitation of this analysis is its inability to discern the longer term effects of this baby bond program. The generationally disadvantaged may be more likely to consume the asset relatively quickly, diminishing the importance of the distributional effect over time. At the same time, models of asset ownership over the life course suggest that asset advantages and disadvantages earlier in life tend to accumulate over the life course.^{21,22} As a result, providing an unprecedented asset advantage to a broad swath of the population could have multiplying effects and reduce inequalities by much more over the longer term. Moreover, the program would introduce an unprecedented source of hope and opportunity for children and adolescents growing up in poor households, especially to black, brown, and generationally disadvantaged children, adolescents and their parents, many of whom would have no alternative access to assets of any kind. One must recognize the likelihood that such a sense of opportunity and hope are likely to outweigh, for many, an impulse to simply squander the asset and its potential benefits for their future.

The program's longer-term effects may be moderated by the program's interaction with other economic phenomena, especially the cost of higher education and housing. If tuition prices or other costs targeted at young people grow in tandem with their net worth, the ultimate proceeds could be siphoned off to cottage industries who would then bear the ultimate economic incidence of the transfer receipt. This outcome could be attenuated by accompanying policies to limit financialization of the asset, prohibiting risky loans or predatory annuitization. Future research should investigate the form and magnitude of potential economic interactions and the policies that could maintain the intended social benefits.

The allocation design presented in this paper emphasizes a bond distribution that stringently allocates the most bond dollars to households with the least wealth. The alternative allocation design, which distributed bond dollars linearly instead of logarithmically, would have provided a greater share of the bond dollars to households in the middle of the wealth distribution as opposed to concentrating on the bottom. The allocation design may play an important role in the ultimate impact of this program and the progressivity of its economic impacts.

Most importantly, this study demonstrates that it is mathematically and fiscally feasible to make substantial headway in reducing the generationally accumulated disparity in wealth that has burdened African American households throughout this country's history. Moreover, it would cost less than the tax expenditure on excluding pension contributions from taxable incomes or the tax expenditure on the preferential tax rates given to income from capital gains and dividends.¹⁰

A universal baby bond program would be race-neutral in its implementation, race-conscious in its design, and racially and economically progressive in its impact.

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Tables and Figures

Table 1: Quintiles of Household Wealth at Birth among Young Adult Households in the 2015 PSID

	Household net worth at birth		Bond Values		
	Mean	Median	Categorical	Fitted Mean	Fitted Median
Total Sample	\$416,928	\$116,481		\$19,748	\$14,783
<i>Wealth Quintiles</i>					
Q1 < \$500	-\$31,140	-\$7,092	\$50,000	\$45,132	\$50,000
Q2 500-17,000	\$21,420	\$19,459	\$45,000	\$18,691	\$18,271
Q3 17,000-62,000	\$109,008	\$103,567	\$7,500	\$15,056	\$15,012
Q4 62,000-185,000	\$325,023	\$303,178	\$5,000	\$12,878	\$12,918
Q5 > 185,000	\$1,602,002	\$898,973	\$200	\$10,358	\$10,800

Notes: This table presents the net worth of young adults' households at birth, and the progressively administered bond values assigned under a universal baby bond proposal.

Table 2: Total Cost Validation in the Survey of Consumer Finances

	Age Less than 1 year	Age 1 Year	Average of 1 and 2
Number of Births	1,734,917	6,301,550	4,018,234
Total Bond Value (Billions 2015 USD)	\$35.20	\$128.82	\$82.01

Notes: This table presents estimates of the total cost of the baby bond program, using representative data on household net worth from the 1992 Survey of Consumer Finances. Bonds are simulated for all households based on age of youngest child. Because data are not available on month of birth, the total cost of the program is assumed to be applied to newborns between 0 and 1 years old. The estimated cost of the program is \$80 billion, adjusted for inflation to 2015 dollars.

Table 3: Racial Disparities and the Distribution of Wealth among Young Adults Households

	Reported 2015		With Baby Bonds	
	Median Net Worth	SE	Median Net Worth	SE
All Young Adults	\$29,000	\$6,600	\$76,992	\$4,537
<i>By Race</i>				
White	\$46,000	\$7,750	\$79,159	\$4,773
Black	\$2,900	\$1,250	\$57,845	\$4,475
Ratio	15.9	--	1.4	--
<i>Percentiles of the Wealth Distribution</i>				
25th	\$0	\$251	\$31,157	\$1,365
50th	\$29,000	\$6,600	\$76,992	\$4,537
75th	\$206,200	\$26,250	\$230,810	\$24,965
90th	\$567,000	\$84,800	\$587,987	\$81,615

Note: This table reports median net worth by race and net worth at percentiles of the wealth distribution reported for young adults, between the ages of 18 and 25 years, in the 2015 Panel Study of Income Dynamics. The right column presents net worth with the present value of a progressively administered universal baby bond program. Numbers correspond to Figures 4 and 5.

Table 4: Share of Total Wealth Owned by Deciles

Deciles of Wealth Distribution	Net Worth Reported 2015		Net Worth with Baby Bonds	
	1	-2.5%	-2.8%	-1.2%
2	-0.4%	1-3 rd deciles	0.7%	1-3 rd deciles
3	0.0%		1.1%	
4	0.2%		1.5%	
5	0.6%		2.2%	
6	1.8%	30.7%	3.0%	34.4%
7	3.8%	4-9 th deciles	4.5%	4-9 th deciles
8	8.1%		8.1%	
9	16.2%		15.2%	
10	72.1%	72.1% 10 th decile	65.0%	65.0% 10 th decile

Notes: This table presents the share of wealth held by each decile of the young adult population in the 2015 PSID. The final column presents the distribution of wealth among young adult households, with the present value of bonds from a proposed, progressively administered universal baby bond program.

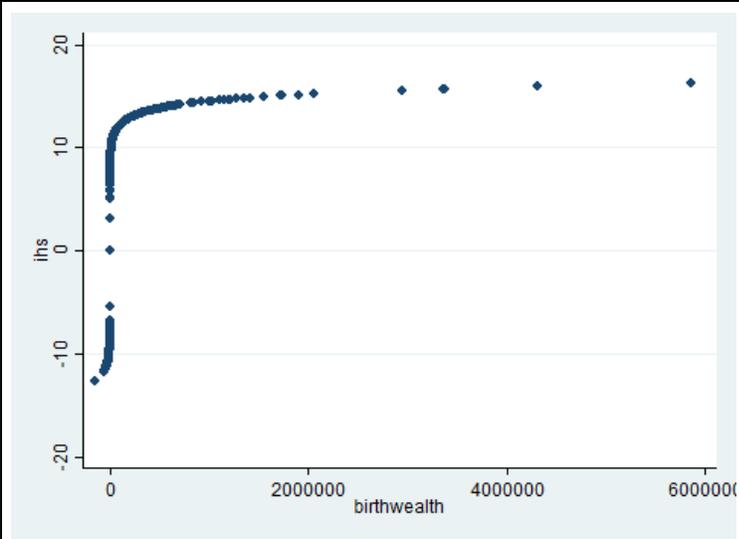


Figure 1: Scatter plot of the inverse hyperbolic sine of wealth plotted against wealth.

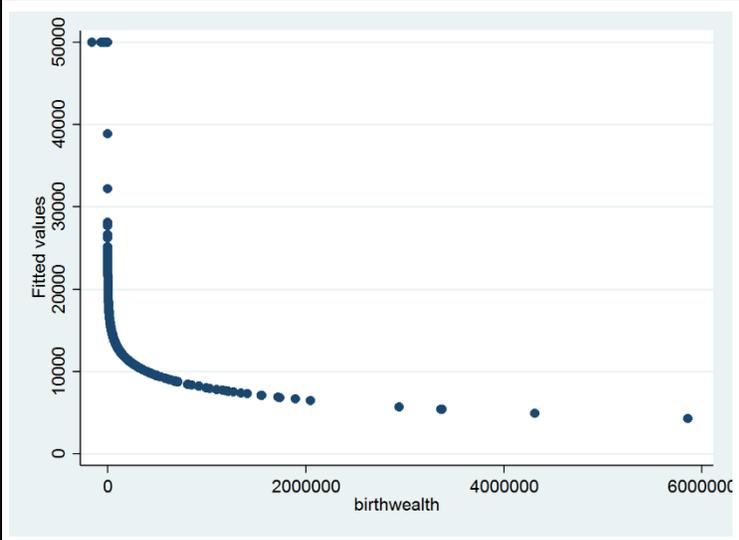


Figure 2: Fitted bond values plotted against household wealth.

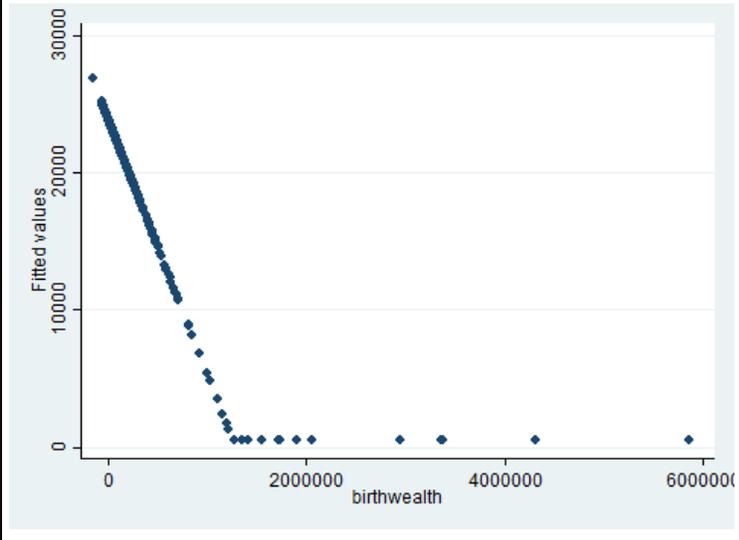


Figure 3: Alternative linear specification of fitted bond values, that does not decrease as steeply with rising incomes. Non-preferred specification.

Figure 4: Racial Asset Inequality Currently and with Proposed Universal Baby Bonds

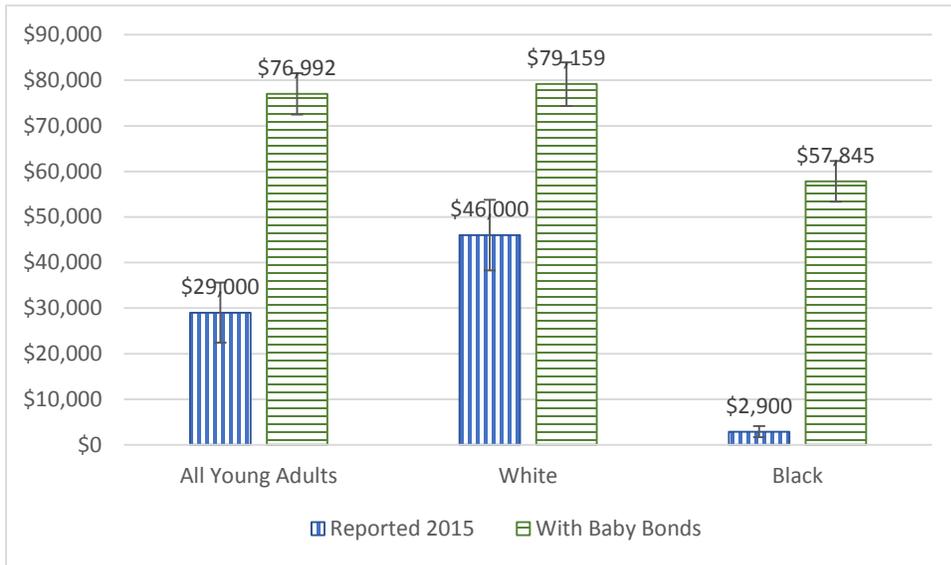


Figure 5: Wealth Inequality of Young Adults, with and without Universal Baby Bonds

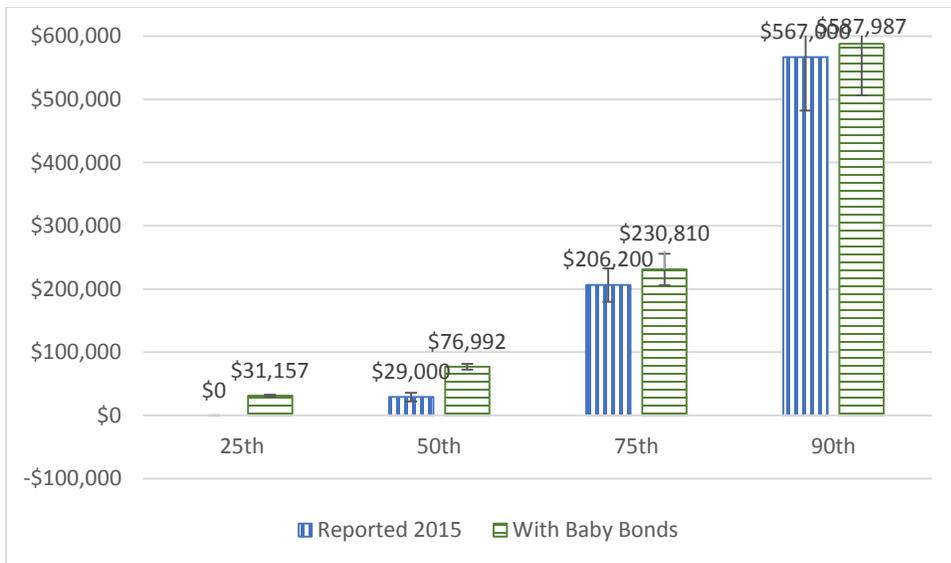
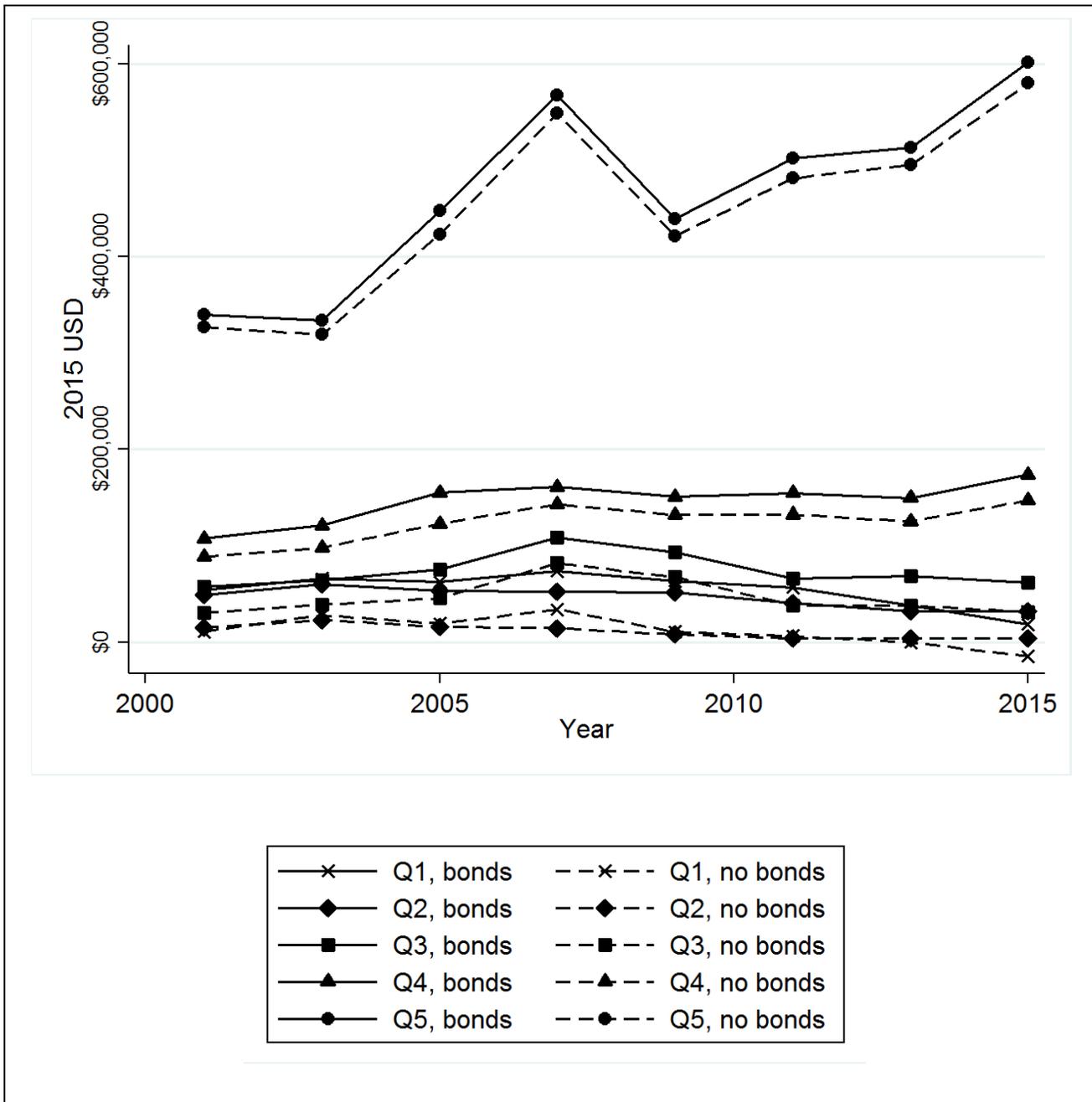


Figure 6: Net worth of Young Adults' Households, 2000-2015 with and without Universal Baby Bonds



Note: Figure 6 displays net worth over time from 2000 and 2015 as reported in the PSID. Solid lines illustrate net worth with the present value of a universal bond administered at birth. The solid and dashed lines are slightly further apart in 2015 than in 2001, reflecting an assumed rate of interest accruing at 2% per year.