Experts from across the country engage in a live discussion on minority business development. The event will include the perspectives of lawyers, economists, bankers, business school deans, venture capitalists, private equity investors, tax policy experts, and entrepreneurs.

Event Co-Chairs:

Samuel C. Thompson Jr.
Professor and Arthur Weiss Distinguished Faculty Scholar at Penn State Law

Sabrina Conyers
Partner at Nelson Mullins Riley & Scarborough

pennstatelaw.psu.edu/events/mbd-perspectives
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Perspectives on Minority Business Development

Tuesday, April 20, 4:00-8:45 p.m. EDT

Session 1: Perspectives of the Lawyers
4:05 - 4:45 p.m. EDT

Discussion Leader: Dr. Hari M. Osofsky, Dean, Penn State Law and School of International Affairs, Distinguished Professor of Law, Professor of International Affairs and Geography

Presenters: Robert Mundheim, of counsel, Shearman & Sterling, and former Dean, University of Pennsylvania Carey Law School; and Leo Strine, of counsel, Wachtell Lipton, and former Chief Justice on Delaware Supreme Court

Event Co-Chairs:

Samuel C. Thompson Jr.
Professor and Arthur Weiss Distinguished Faculty Scholar at Penn State Law

Sabrina Conyers
Partner at Nelson Mullins Riley & Scarborough
PENN STATE LAW, MINORITY BUSINESS DEVELOPMENT COURSE
PERSPECTIVES ON MINORITY BUSINESS DEVELOPMENT, APRIL 20, 2021

MATERIALS FOR: SESSION 1: PERSPECTIVES OF THE LAWYERS:

DISCUSSION LEADER: HARI M. OSOFSKY, DEAN, PENN STATE LAW IN UNIVERSITY PARK
PRESENTERS: ROBERT MUNDHEIM, OF COUNSEL, SHEARMAN & STERLING, AND FORMER DEAN, UNIVERSITY OF PENNSYLVANIA CAREY LAW SCHOOL; AND LEO STRINE, OF COUNSEL, WACHTELL LIPTON, AND FORMER CHIEF JUSTICE ON DELAWARE SUPREME COURT

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Duty and Diversity

Chris Brummer
Leo E. Strine, Jr.

Working Paper No. 642

February 18, 2021

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An index to the working papers in the Columbia Law School Working Paper Series is located at https://law-economic-studies.law.columbia.edu/content/working-papers
Duty and Diversity

Chris Brummer
Georgetown University Law Center

Leo E. Strine, Jr.
University of Pennsylvania Carey Law School
Columbia University School of Law
Harvard Program on Corporate Governance

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DUTY AND DIVERSITY

Chris Brummer
Leo E. Strine, Jr.

Discussion Paper No. 2021-2

2/2021

Harvard Law School
Cambridge, MA 02138

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DUTY AND DIVERSITY

CHRIS BRUMMER* AND LEO E. STRINE, JR.**

75 VAND. L. REV. 1 (Forthcoming 2022)

Abstract

In the wake of the brutal deaths of George Floyd and Breonna Taylor, a slew of reforms from Wall Street to the West Coast have been introduced, all aimed at increasing Diversity, Equity, and Inclusion ("DEI") in corporations. Yet the reforms face difficulties ranging from possible constitutional challenges to critical limitations in their scale, scope and degree of legal obligation and practical effects.

In this Article, we provide an old answer to the new questions facing DEI policy, and offer the first close examination of how corporate law duties impel and facilitate corporate attention to diversity. Specifically, we show that corporate fiduciaries are bound by their duties of loyalty to take affirmative steps to make sure that corporations comply with important civil rights and anti-discrimination laws and norms designed to ensure fair access to economic opportunity. We also show how corporate law principles like the business judgment rule do not just authorize, but indeed encourage American corporations to take effective action to help reduce racial and gender inequality, and increase inclusion, tolerance and diversity given the rational basis that exists connecting good DEI practices corporate reputation and sustainable firm value. By both incorporating requirements to comply with key anti-discrimination laws mandatorily, and enabling corporate DEI policies that go well beyond the legal minimum, corporate law offers critical tools with which corporations may address DEI goals that other reforms do not—and that can embed a commitment to diversity, equity, and inclusion in all aspects of corporate interactions with employees, customers, communities, and society generally. The question therefore is not whether corporate leaders can take effective action to help reduce racial and gender inequality—but will they?

* Chris Brummer is the Agnes N. Williams Professor; Faculty Director, Institute of International Law; Professor of Law, Georgetown University Law Center.

** Leo E. Strine, Jr. is the former Chief Justice and Chancellor of the State of Delaware; Ira M. Millstein Distinguished Senior Fellow at the Ira M. Millstein Center for Global Markets and Corporate Governance at Columbia Law School; Michael L. Wachter Distinguished Fellow in Law and Policy at the University of Pennsylvania Carey Law School; Senior Fellow, Harvard Program on Corporate Governance; Henry Crown Fellow, Aspen Institute; Of Counsel, Wachtell, Lipton, Rosen & Katz. The authors gratefully acknowledge Carolyn Exarhakis, Grace Kim, Aneil Kovvali, Barbara Kuhn, Peggy Pfeiffer, Shen Teng, and Jacob Werden and input received from Dan Awrey, Steve Bainbridge, Michael Barr, Stacey Friedman, Joseph Hall, Adrienne Harris, Todd Henderson, Robert Jackson, Donald Langevoort, Sebastain Niles, Elizabeth Pollman, Ed Rock, Kim Rucker, Bob Thompson, Urska Velikonja, Jamillah Williams, and Yesha Yadav.

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INTRODUCTION

Fifty years ago, Milton Friedman famously told corporate fiduciaries that they should narrowly focus on generating profits for stockholders. Less focused upon, but explicit, was his view that corporations should not have a “social conscience” and take action to “eliminat[e] discrimination,” which he trivialized as a “watchword[] of the contemporary crop of reformers.” Since then, Friedman and his adherents have espoused this cramped vision of fiduciary duty within the debate over corporate purpose, and even worse, sought to erode the external laws promoting equality and inclusion.

In 2021, the problem Milton Friedman trivialized remains urgent. The inequality gap between Black and white Americans has grown in the period in which Friedman’s views became influential with directors and policymakers and the pandemic’s unequal impact on minorities has underscored the persistence of inequality. So have horrific instances of violence against Black people and other evidence of ongoing exclusion. Likewise, inequality in wages and opportunity continue to adversely affect women.

Demands are growing for corporate leaders to address these serious issues by promoting effective practices to treat their employees, communities of operation, and service and customers with respect—and to take affirmative steps to ensure equal opportunity, create an inclusive and tolerant workplace, and embrace the diversity of humanity. This commitment to Diversity, Equity, and Inclusion (“Diversity” or “DEI” for short) is not just one corporations are being asked to make internally, but is also one requiring that companies evaluate how they treat their consumers and the communities in which they have an impact. Although the present moment has tended to mute those who


2 Because Diversity, Equity, and Inclusion in the corporate context is a comprehensive commitment to treating all stakeholders with respect regardless of their race, ethnicity, religion, or sexual orientation, to the extent we use Diversity (with a capital “D”) as shorthand, it at all times reflects this broader understanding and all the letters of DEI. We also will periodically employ “diversity” (with a small “d”) to denote specifically a focus on demographic heterogeneity as understood in its everyday context, and with an emphasis on historically underrepresented groups. This diversity is part and parcel of DEI, though only part.
view corporate action to address issues like Diversity as an improper and illegitimate diversion from the pursuit of shareholder profits, history shows that will not last for long. Those who share Friedman’s worldview will argue that corporate fiduciaries are on unstable ground if they commit their companies to Diversity, Equity, and Inclusion policies that go beyond the legal minimum of nondiscrimination, and will suggest they face possible legal risk for failing to focus solely on corporate profit. Indeed, even in a year when issues of racial equality have been central and leading members of the corporate community are recognizing their obligation to do better, some have openly taken Friedman’s position and have admonished their employees to stay focused on profits and do not concern themselves with Diversity, Equity, and Inclusion in the workplace. We fear that when the current moment passes, these voices will multiply and twist corporate law to argue that corporate leaders may not take action to assure that their companies are going beyond the bare legal minimum to promote these important values, because by doing so they would be improperly diverting their focus from profit maximization.

In this Article, we explain why arguments of that type have no grounding in a proper understanding of corporate law, and in particular the important principles of fiduciary duty that govern the equitable expectations of corporate directors and officers. We show that, even under the nation’s most stockholder-focused corporate law, that of Delaware, Friedman’s normative view is not one that American corporate law embraces, and that corporate law presents no barrier to voluntary corporate efforts to increase equality and diversity.

In fact, a proper understanding of corporate fiduciary duties supports the ability of corporations to put in place effective DEI policies. Indeed, fiduciary duty requires boards to attend to DEI by monitoring company policies and practices that assure the company’s compliance with important laws that focus on the equal treatment of diverse applicants, employees, customers, communities, and business partners. Not only that, the fiduciary duty of loyalty requires affirmative efforts to promote the sustainable success of the corporation, directors and managers must try to promote the best interests of the company. Substantial evidence exists that companies with good DEI practices will not only be less likely to face adverse legal, regulatory, worker, community and consumer backlash from their conduct, but that their boards and workforces will be more effective, their reputation with increasingly diverse customer bases and public will grow, as will trust from institutional investors increasingly focused on sustainable profitability and the avoidance of harmful externalities costly to their clients, who have diversified portfolios tracking the entire economy.

As a matter of fiduciary duty, therefore, corporate leaders not only have broad authority to promote an inclusive and diverse corporate culture, their affirmative obligation to act in the best interests of the corporation can be understood to require it, given the important legal requirements for corporations to avoid invidious discrimination and growing societal and investor expectations that business will contribute to reducing racial and gender inequality. Even more, foundational corporate law principles like the
business judgment rule protect and support directors and managers who believe that committing their companies to help improve Diversity, Equity, and Inclusion is the right way to do business. And that fiduciary duty does impose minimal guardrails and even floors of basic activity that must be undertaken to ensure that corporations honor societal laws protecting against discrimination.

This legal reality is important to ensuring that the accountability debate over whether corporate leaders, and the institutional investors who control public companies, are doing what they should to promote these values proceeds with clarity. All too often, the issue of Diversity is viewed as a cost center, or something external to the mission of the modern firm—driving criticisms of Diversity-oriented corporate reforms as “virtue signaling at the expense of someone else.” But this Article advances a different theory—that the pursuit of Diversity, Equity, and Inclusion is solidly authorized by the operation of traditional corporate law principles, and can even be easily squared with the views of those who embrace what has come to be known as “shareholder primacy.” As such, our contribution does not debate what corporate law “should be,” but instead explores what corporate law already “is”—and offers an old answer to the novel question of what tools and obligations managers and directors must contemplate when grappling with the challenge and opportunity of Diversity.

This Article proceeds as follows. In Part One, we document the demographic dilemma facing corporate boards and C-suites across the United States—namely, the striking gap between the demographics of the leadership of corporate America and the nation as a whole. We then explore the implications of the data in a post-George Floyd, post-pandemic environment, in which demands for better corporate behavior and greater racial economic opportunity have both swelled and intensified.

Part Two addresses the nexus between Diversity, Equity, and Inclusion, and firm value. It starts with a survey of the empirical research associating diversity with financial performance, and finds a mixed picture, but one that nonetheless has practical and legal importance for corporate decisionmakers weighing whether and how to address DEI issues. We find that as in many complex areas relevant to running a business, information is incomplete, at times defective and a work in progress; nevertheless the evidence from academic studies, and the logical arguments advanced by leading business consultants and thinkers, provide a rational basis for corporate fiduciaries to conclude that effective DEI policies are in the best interests of the corporation. Continuing this theme, we then turn our analysis to the long-running literature in organizational psychology that identifies cognitive diversity (and Diversity more generally) as prophylactics for groupthink and other social pathologies that can impair good decisionmaking and thus, in this context, endanger firm value. We then close this section with what is perhaps

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the most compelling business case for Diversity—that of corporate reputation and its relationship to firm credibility and success. The section investigates how DEI relates in a broader way to corporate success, highlights why attention to DEI is necessary for businesses to avoid the severe reputational harm, legal risk, and other downside consequences of being perceived as not being a business committed to treating all Americans with respect. We then connect that risk to the demographic realities facing firms seeking to preserve and maximize their returns. Because the available workforce, customer base, and strategic partners are diversifying both domestically and internationally, DEI considerations bear importantly on firms’ reputation with these key stakeholders, and thus on their cost of capital, talent and customer acquisition and retention. For all these reasons, we conclude that the requisite foundation for corporate policies advancing Diversity, Equity, and Inclusion exists, making the adoption of these policies, as we later address in more detail, eligible for the protection of the business judgment rule.

Part Three examines current legislative and market initiatives to improve DEI within the corporate sector. To provide context, we start with an analysis of key federal laws that advance racial and gender equality in the business sector. We then catalogue a growing number of initiatives: investment fund activities where employee, environmental, social and governance factors (EESG) have been integrated into investment processes, California and New York state corporate law reforms aiming for greater board diversity, proposed new listing rules for Nasdaq requiring disclosure of corporate board metrics, and a pledge made by Goldman Sachs to only assist companies meeting minimum diversity metrics when going public. These initiatives, we find, hold the prospect of potentially important upgrades to corporate Diversity. We conclude, however, that many face substantial constitutional challenges. As important, virtually all are board-level initiatives, and do not cover private companies, which comprise an increasingly large share of economic activity in our economy. Nor do they address Equity and Inclusion, and by extension issues such as how corporations use contracted workers and interact with customer communities. They are thus, by definition, limited in their reach and robustness. For these reasons, if serious improvement in corporate practices is desirable, supplemental actions by corporations will be essential.

In Part Four, we provide a foundational theory of how the corporate law of fiduciary duty applies to corporate Diversity, Equity, and Inclusion policies. First, we explain the general principles underlying the duties of

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4 Notably, these arrangements are described in the literature, and by the participants themselves, in different ways, though traditionally as “ESG” programs in light of the importance of environmental social, and governance factors in investment decisions. We use the term “EESG” in this Article to highlight the additional emphasis many corporations and funds are placing on how corporations treat the constituency arguably most responsible for its success — the employees — with respect. See David Katz and Laura A. McIntosh, Corporate Governance Update: EESG and the COVID-19 Crisis, HARVARD L. SCHOOL FORUM ON CORP. GOVERNANCE (May 31, 2020), https://corpgov.law.harvard.edu/2020/05/31/corporate-governance-update-eesg-and-the-covid-19-crisis (noting increasing stakeholder- and employee centric disclosures in response to the human capital impact of the COVID-19 crisis).
loyalty and care, and how the corporation’s obligation to comply with the law is fundamental to the operation of corporate law. We show that the fiduciary duty of loyalty requires not only a negative responsibility to avoid harm to the corporation, but that it also requires the duty to take affirmative steps to advance the best interests of the corporation. This includes, as reflected in Delaware’s famous Caremark decision, an obligation for fiduciaries to undertake active efforts to promote compliance with laws and regulations critical to the operations of the company. Importantly, we show that the most central role of Caremark is in the normative obligation it imposes on directors and to try to avoid the regulatory penalties, managerial turnover, stakeholder backlash, and overall reputational and financial harm that occurs when companies violate laws essential to society. As we show, the very fact that a Caremark case is brought is usually a sign that the company has already lost, even if the directors do not ultimately face liability under Caremark itself. We also highlight the considerable discretion that the affirmative component of fiduciary duty law gives business leaders to pursue policies they rationally believe to be in the best interests of the corporation, in terms of its sustained profitability and reputational integrity with its stakeholders, society, and regulators.

Part Five takes the crucial step of showing how these general principles apply specifically to DEI. As to managers and directors skeptical about DEI, or those who fear Diversity, Equity, and Inclusion might be beyond their remit of responsibility as fiduciaries, we explain why fiduciary duty requires them to focus to some meaningful extent on anti-discrimination practices, and why failing to do so is riskier than making sure the company has effective DEI practices. We show how the legal expectation of lawful conduct, reflected in Delaware’s Caremark decision, charges fiduciaries with preventative monitoring for compliance with anti-discrimination laws and legislation as a core feature of their duty of loyalty. Should they fail to do so, not only do companies risk corporate liability accompanying such violations; they also face—along with their directors and top managers—the possibility of large reputational costs, stakeholder backlash, internal turnover at the top of management and on the board itself, and fines and injunctions from regulators, even if the follow-on derivative lawsuits are ultimately dismissed. From this standpoint, corporate law’s fiduciary duty of compliance is not only important as a matter of “hard” law enforced by the threat of corporate and personal liability. It also defines as normative “soft” law what fiduciaries are expected by corporate law to do, legal expectations that go beyond what fiduciaries can be held liable for in damages and that require them to protect the corporation from the financial, management, and reputational consequences that come when a corporation fails to comply with critical legal duties, consequences that in the context of DEI-related issues have been supercharged in the wake of George Floyd and Breonna Taylor, and the inequality-revealing and exacerbating Pandemic.5

5 By soft law, scholars refer to norms or guidelines, that though perhaps not legally binding at all or, as in the case of Caremark, not easily enforceable by way of monetary damages for their violation, but which nonetheless carry high costs where they are violated. For more, see Chris Brummer, SOFT LAW AND THE GLOBAL FINANCIAL SYSTEM, 141 (2012)
We then close by identifying why corporate managers and directors who wish to fulfill their normative duty of loyalty by taking affirmative steps to improve sustainable corporate profitability can safely embrace a commitment to Diversity, Equity, and Inclusion — i.e., more ambitious DEI policies that go beyond their duty under Caremark to monitor core anti-discrimination compliance obligations. In doing so, we emphasize that corporate fiduciaries do not need definitive evidence of DEI’s impact on value to act. Because there is a rational basis for concluding that the promotion of Diversity, Equity, and Inclusion will improve the ability of corporations to function profitably in an increasingly diverse domestic and international economy, fiduciary duty law, and in particular the business judgment rule, provides authorization for corporate DEI policies and therefore leaves business leaders no corporate law reason not to adopt them, and some strong reasons to do so.

In forwarding this framework, this Article offers a doctrinally sound, yet novel approach that will not be without its ideological detractors. For all of the attention now directed at DEI in Corporate America, Diversity is not usually talked about as a matter of long-standing corporate law principles. Indeed, from Friedman’s derision of reformist “watchwords” to a sensitivity even among some Black Lives Matter activists to belittling the significance of Diversity by reducing a moral call to action to one of business prerogatives, Diversity is most commonly understood as an external matter to the firm. We believe, however, that the case for Diversity has both a strong moral and business rationale, making it relevant even as a matter of traditional corporate law principles. Moreover, the internal/external dichotomy of the Friedman view is highly misleading: the very DNA of corporate law’s most foundational duty, that of loyalty, is as much outwardly facing as it is inwardly to the extent to which it creates obligations to comply with all laws—including core civil rights legislation—that are of critical importance to the company, its stakeholders, and society. These clarifications enable important interventions for refining current reforms and enabling new ones within even our legacy corporate law framework. This important reality poses a substantial question to American business leaders, and the institutional investors who wield power over them: If corporate law not only enables directors and the board to address important DEI issues, but also requires corporate attention to them, will they meet their duties head on, and even exceed them, or will they incur the high financial, reputational and legal risks of ignoring them?

I. THE DEMOGRAPHIC DILEMMA: THE INEQUALITY AND REPRESENTATIONAL GAP IN CORPORATE AMERICA

Discussions about corporate law—whether in the context of mergers & acquisitions, proxy statements or (much more rarely) Diversity—invariably focus on boards and management. This is in part because of the very peculiar governance challenges corporate leaders face vis-a-vis the corporation’s (noting how a poor reputation can hinder a regulator’s ability to conduct economic diplomacy).
shareholders; plus it reflects the concentrated power they wield collectively in making decisions that impact shareholders, employees and broader society. Yet American corporate leadership is markedly unrepresentative of our nation’s diversity—a reality that stands in stark contrast to broad calls for fairer economic opportunity and participation. To this end, we provide an overview of the most recent data concerning the Diversity of U.S. corporate boards and management. We then situate the problem against the backdrop of severe racial wealth and income gaps underscored by the Pandemic and calls across society in the wake of George Floyd’s brutal death to reform corporations in ways that not only diversify corporate upper ranks, but that also embed a commit to Diversity, Equity, and Inclusion in all corporate action affecting important corporate stakeholders.

A. Corporate Boards: Their 21st Century Importance and the Representational Gap

Corporate boards are intended to help address three sorts of agency problems associated with corporate organizations: those between managers and dispersed shareholders, between controlling and non-controlling shareholders, and between shareholders and creditors.⁶ And despite an earlier New Deal perception of corporate boards as part of a concentration of economic power catalyzed the rise of the large corporation, boards are today recognized as serving a key gatekeeping function given incentive problems that can arise in the separation of shareholder “ownership” and “control” by managers, especially apparent in public companies.⁷

On a less theoretical basis, corporate boards have also increased in importance because of real-world developments. Since concerns emerged about managerial improprieties in the 1970s, leading to the mandate for audit committees of outside directors, and the takeover boom of the 1980s, in which independent directors came to the fore as an answer to the problems such bids presented for management,⁸ corporate boards as an institution have become increasingly important in corporate governance.⁹ The board is now taken

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⁷ Id. See also Adolf A. Berle and Gardiner C. Means, The Modern Corporation and Private Property (1932) (identifying the separation of ownership and control as a master problem in corporate law and sociology). Though notably, for Berle and Means, the idea of “managers” consisted of both the “board of directors and the senior officers of the corporation.” Id. at 146.
⁸ Marty Lipton’s iconic article, Takeover Bids in the Target’s Boardroom, 35 BUS. LAW. 1 (1979), by way of example, articulated the manner in which a board of directors should operate in the context of a takeover bid, with a strong role for the non-management directors to deliberate among themselves and to oversee management’s conduct. That article would then influence the Delaware Supreme Court in key cases like Unocal v. Mesa Petroleum, 493 A.2d 946, 954-55 (1985), in encouraging a strong hand for independent directors and creating standards of review that shifted power away from management and toward them.
⁹ Melvin A. Eisenberg, The Board of Directors and Internal Control, 19 CARDOZO L. REV. 237, 238 (1997) (“The board is not itself unflawed, but as an organ that is compact and
seriously as a governing instrument in itself, distinct in important ways from day-to-day top managers, and corporate case law, Exchange Rules, and statutory reforms at the state and federal level have only acted to emphasize the salience of the role of the board.

Because of the increasing centrality of corporate boards, they have been the focus of a greater number of electoral and other challenges in recent decades, with institutional investors pressing for greater numbers of independent directors who would be more responsive to their demands, and who have characteristics institutional investors favor. But that focus on the composition of boards has not translated into boards representative of our nation; rather, corporate, boards have fallen short of even minimal thresholds of racial or gender Diversity. African Americans comprise 13.4% of the U.S. population, for example, but only 8.6% of the boards of the Fortune 500 companies. See Figure 1.A. Meanwhile, the share of white people on boards far outstrips that of Black people. On the boards of Fortune 500 companies,

cohesive, individualized to the corporation, and capable of being made relatively independent of management control, it is well situated to monitor management on an ongoing and close basis on the shareholders’ behalf.”.

10 The NYSE requires listed companies to “have a nominating/corporate governance committee composed entirely of independent directors.” NYSE Listed Company Manual Section 303A.04(a). NASDAQ requires director nominees of listed companies “must either be selected, or recommended for the Board’s selection, either by: (A) Independent Directors consulting a majority of the Board’s Independent Directors in a vote in which only Independent Directors participate, or (B) a nominations committee comprised solely of Independent Directors.” NASDAQ Equity Rule 5605(e).


12 During the last two decades, the incidence of proxy fights, withhold campaigns, and other contested votes has markedly increased, as has the rate of success of those efforts in procuring, by agreement or ballot box victory, what the insurgents wanted. See, e.g., John C. Coffee and Darius Palia, The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance, 41 J. CORP. L. 545 (2016) (identifying only 52 hedge fund activist campaigns over 20 consecutive months in 2005-2006 in contrast to 1,115 such campaigns between 2010 and early 2014, with 347 campaigns alone in 2014). In the United States, there were 261 “high impact campaigns,” defined as campaigns involving any of these market-moving objectives: board control/representation; maximize shareholder value; public short position/bear raid; remove director/officer(s); and no dissident nominee to fill vacancy, and 77 proxy fights in 2012, whereas even during the year of the pandemic, 2020 saw 331 high impact campaigns and 98 proxy fights. FACTSET.COM.

13 Jeff Green, Focus on Black Directors Has Latinos Asking: What About Us?, BLOOMBERG (Sept. 18, 2020), https://www.bloomberg.com/news/articles/2020-09-18/latinos-call-for-board-seats-left-out-of-efforts-to-promote-black-directors. For Latinos, the numbers are even more skewed. Despite comprising roughly 18.3% of the U.S. population, Latinos only comprise 3.8% of Fortune 500 boards — less than a quarter of their representation among the wider population. See HACR Corporate Governance Survey. Moreover, their participation does not appear to reflect the demographic changes facing the country. Since 1990, the Latinx share of the U.S. population has more than doubled from 9% in 1990 to 20% today. But even with this exponential increase of nearly 10% in the last two decades, the percentage of Fortune 500 board seats held by Latinos increased in this time by less than 3%. Green, supra note 12.
for example, whites reportedly comprise 83.9% of all members, over 28% higher than that of their percentage of the U.S. population. See again Figure 1.B.

Women’s representation on Fortune 500 Boards, at 26.1%, compares favorably to that of African Americans and Latinx, who make up roughly only 12.5%. They are, however, as a group, still disproportionately underrepresented compared to their 50.2% share of the overall population.\(^{14}\) Within this demographic, white women have seen their share of board seats increase the most, from around 15.7% in 2004 to 22.5% in 2018, accounting for nearly 70% of board seats transferred from white men.\(^ {15}\) See Figure 1.C. Minority women, meanwhile, saw virtually no increase in their board representation, with a gain of only 1%, from 3.2% to 4.6%. Minority men also experienced only minimal progress from 9.9% to 11.5%:\(^ {16}\) Figure 1.C.

**Figure 1.A**

![African American Under-representation on Fortune 500 Boards](source: Bloomberg)

**Figure 1.B**


\(^{15}\) On the other hand, minority men and women saw their share of board seats grow only 3.3%, from 12.8% to 16.1%. *We Know Diversity is Good for Business, So Why Do Corporate Leaders Remain Predominantly White and Male?*, DIVERSITY JOBS (Nov. 10, 2020), https://www.diversityjobs.com/2020/11/corporate-gender-ethnic-veteran-disability-lgbtqia-diversity/#:~:text=Only%203%25%20of%20Fortune%20500,si...since%20it's%20not%20a%20requirement.&text=Women%20account%20for%20just%206.2,first%20or%20mid%2Dlevel%20management.

\(^{16}\) *Id.*
An extensive literature has grown detailing the sources of the demographic shortcomings of corporate boards. The prospects for Black and female corporate board membership improved gradually in the aftermath of the Civil Rights movement of the 1960s. But progress has often been sporadic and slow.\footnote{Lisa M. Fairfax, \textit{Clogs in the Pipeline: The Mixed Data on Women Directors and Continued Barriers to Their Advancement}, 65 MD. L. REV. 579, 580 (2006) ( “while women have made substantial progress onto boards since 1934 as well as significant contributions to those boards, they confront considerable barriers to board membership that must be addressed proactively”).}

This literature identifies a number of common obstacles to board diversity, most relating to how board members are chosen. First, boards often lean towards candidates who have run business units or held operations posts—in short, chief executives from other companies who have served on an outside board—which translates into a pool of fewer female and minority candidates. Absent efforts to look for leaders with management experience in sectors of
the economy—government, military, education, and legal — where minority and women have made more inroads, corporate boards will tend to reflect the composition of corporate management ranks. Additionally, board seats for the country’s largest companies are rarely available due to low turnover—and the number of candidates interviewed is often small and often comprised of candidates with prior board experience. As a result, opportunities for Diversification are few, and even where slots are open, minority candidates and women may not be interviewed at all.

But arguably the most important reason is that women and minorities are unlikely to have the social networks and relationships necessary for candidates seeking positions on boards. CEOs prefer individuals they can trust, know are competent, are professionally accomplished, and can collaborate with—and influence. Often, this leads to the consideration of individuals who are already known within the social circles of C-Suite executives or other board members. These dynamics disadvantage women and minorities who do not necessarily hail from or participate in the same cultural or socioeconomic networks as the white men who dominate corporate boards. Though for those underrepresented persons who do make it, they fit to form: A 2016 survey of over 1,000 board directors indicated that over half of Black directors were known to a


21 We do not ignore the reality that corporate directors and managers are not representative of typical white men either. On balance, they come from far more privileged and elite backgrounds than typical white Americans. [to cite] Indeed, in our view of Diversity, Equity, and Inclusion, efforts to include all Americans are important, and that includes white people who do not come from privileged backgrounds, and who often face some of the same difficulties in opportunity and access as people of color with limited means. See Adia Harvey Wingfield, How Organizations Are Failing Black Workers — and How to Do Better (Jan. 16, 2019), https://hbr.org/2019/01/how-organizations-are-failing-black-workers-and-how-to-do-better (finding that many organizations fill available director positions through social networks, just as elite professional service firms strongly prefer, similar to elite professional service firms that only hire from a few select, elite universities in the East Coast).
fellow board member before being appointed (as compared to 35% of white directors).  

Similarly, white directors were more likely to be a current or former executive of the company. Nearly one third were already known by the CEO by the time they were introduced to the board.

B. CEOs and C-Suite Officers: The Representational Chasm Deepens at the Top Management Level

General corporate statutes vest management, and in particular the chief executive officer, with making major corporate decisions, and overseeing the operations and resources of a company. CEOs are the most important single officers of corporations, and in their management capacities are tasked with ensuring that the goals of the corporate board are pursued at lower levels of the firm. In practice, this means that CEOs hire other executives and staff, implement corporate policy and board instructions, and serve as the primary interface between the broader public and the corporation. CEOs are also primarily responsible for identifying how resources of the company are directed, and for what purpose. They may also be responsible for implementing recruiting, retention and promotion strategies at the firm and ensuring a workplace culture commensurate with the objectives of the company.

Even though what is required to be an effective CEO can vary considerably by industry, CEOs, like the board which is responsible for managing them, are a highly homogenous group. When it comes to CEOs of S&P 500 companies, only 11% are ethnic minorities. Specifically, 3% are Latino, 3% are Indian, 2% are Asian, 1% are Middle Eastern, 1% are multiracial, and 1% are Black.

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23 Cheng, supra note 19.
24 Cheng, supra note 19.
25 Will Kenton, Chief Executive Officer, INVESTOPEDIA (July 1, 2020), https://www.investopedia.com/terms/c/ceo.asp.
26 Te-Ping Chen, Why Are There Still So Few Black CEOs?, WALL ST. J. (Sept. 28, 2020, 10:16 AM), https://www.wsj.com/articles/why-are-there-still-so-few-black-ceos-11601302601 (stating that African Americans represent only 3% of executive or senior-level roles among U.S. companies with 100 or more employees).
27 Id.
Things get hardly better when assessing the diversity of Fortune 500 C-Suites, the most senior leaders of large companies that include not only the chief financial officer (CFO), but also the chief operating officer (COO), and the chief information officer (CIO). In this rarified group of officers, just 3.2% are African Americans. Only 4.3% of Fortune 500 executives are Latinx. Meanwhile, an overwhelming majority—over 85%—are white.

28 *Being Black in Corporate America: An Intersectional Exploration*, COQUAL (Sept. 2020), https://coqual.org/wp-content/uploads/2020/09/CoqualBeingBlackinCorporateAmerica090720-1.pdf (finding that despite the disparate numbers, African American professionals are more likely than white professionals to be ambitious; overall, 65% of African Americans were considered “very ambitious” in their careers, compared to 53% of their white counterparts).

29 J.D. Swerzenski, Donald Tomaskovic-Devey & Eric Hoyt, *This is where there are the most Hispanic Executives (and it’s not where you think)*, FAST COMPANY (Jan. 28, 2020), https://www.fastcompany.com/90456329/this-is-where-there-are-the-most-hispanic-executives-and-its-not-where-you-think.
As in the case of corporate boards, there are more women occupying top executive roles than underrepresented minorities—167 at the country’s top 3,000 companies. And the data indicate that there has been progress made by women among C-Suite executives, growing from roughly 7% of top management to nearly 12% today. By comparison, of the 279 top executives listed at the 50 biggest companies in the S&P 100, only five are Black. Still, women remain overwhelmingly underrepresented when compared to their 50.5% share of the overall size in the U.S. population. Moreover, women hold only seven percent of CEO positions among Fortune 500 companies, with

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31 Fuhrmans, supra note 30.
33 Fuhrmans, supra note 30.
ethnically diverse individuals faring similarly as nine percent of the Fortune 500 CEO population.34

Source: The Wall Street Journal

As with corporate boards, researchers have identified exclusion from professional networks as a key driver of the imbalance in C-suites. Networking—and socializing—can make or break careers, and women and minorities can find it difficult to integrate into dominant corporate cultures and participate on equal footing with their white male colleagues. As a result, they are often unable to fully develop the relationships necessary for advancement.35 The consequences can be important. Promotions in many companies are informally decided before jobs are ever posted, leaving members from underrepresented groups without the chance to compete, and without sponsors in the corporate leadership to put their name forward.36

Inadequate opportunities for advancement at earlier stages of careers play a role as well. CEOs, recruiters and scholars routinely report that women and Black professionals face greater obstacles early in their career, including work-life balance and family responsibilities, and are viewed more critically than their colleagues.37 And even if minorities and women make it close to the C-suite, they are rarely given the profit-and-loss positions that serve as stepping stones to the top jobs like CEO and CFO, and are instead more typically placed into roles such as marketing or human resources.38 A similar challenge faces women. A Wall Street Journal study of executives at the biggest publicly traded firms by market value, shows that men occupying the most senior jobs in companies overwhelmingly get the management jobs in which a company’s profits and losses hang in the balance.39 Women by contrast often fill roles such as head of human resources, administration or legal, the jobs that don’t have profit-generating responsibility, and that are not usually routes to running a company.40

For non-white women, climbing the corporate ladder is even more difficult.41 In a 2019 survey of 329 major companies and more than 68,000 of their employees, women of color were less likely to say their bosses gave them opportunities to manage people and projects or helped them navigate corporate

34 Id. at 2 (women comprise only 25% of all Fortune 100 C-Suite positions, with racially diverse individuals comprising only 16% of the Fortune 100 executive positions).
35 Te-Ping Chen, supra note 26.
36 Id.
37 Id.
38 Id.
39 Fuhrmans, supra note 30.
40 Id.
politics. They made up just 4% of C-suite roles, according to the research by McKinsey & Co. and LeanIn.Org, a nonprofit that promotes the advancement of women at work.

In the end, an increasingly steep decoupling of white men from virtually all other groups arises as one moves up the corporate ladder. What is an initially modest gap in representation at the entry level of hiring arising between white men on the one hand, and women and minorities on the other, jumps at every step across the corporate hierarchy. This demographic decoupling culminates in C-Suite figures that do not come close to representing the demographics of the United States. Instead, minorities and women lose ground as white men, predominately from relatively affluent backgrounds, gain an ever greater share of corporate leadership positions.

C. Corporate Law’s Post-George Floyd, Pandemic Moment

Corporate America’s demographic dilemma has attracted attention for decades, though scrutiny of the problem has intensified since the brutal death of George Floyd at the hands of Minneapolis police. The tragedy not only

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43 Id.


45 Richard L. Zweigenhaft, “Diversity Among CEOs and Corporate Directors: Has the Heyday Come and Gone?”, *Who Rules America?*, December 2013, https://whorulesamerica.ucsc.edu/power/diversity_among_ceos.html (closely examining corporate directors at elite companies and finding that they were overwhelmingly from upper class or upper middle class backgrounds, including directors who were female or from non-Black minority groups).
supercharged the then nascent Black Lives Matter movement, but it also highlighted an array of societal inequities, from police brutality to the racial wealth and income gaps. As activists have delved into questions of legal meaning and entitlement, and democracy, a natural point of emphasis has been the racially disparate allocation of resources and opportunity in society. The pandemic’s unequal impact on people of color has only doubled down on the focus, leading to an epistemic shift—or “Great Awakening”—in American consciousness.

Thus, the cruel events of 2020 made ignoring racial inequality impossible for most Americans, and especially for high-profile business leaders. The facts on the ground led to new questions being asked of corporations about their role in contributing to the undeniable problem of persistent inequality and what actions they may and should take to address it. And for the first time, a mainstream conversation has arisen as to what the relative lack of Diversity has meant for not only Blacks, but also for society—

46 See Veronica Root Martinez and Gina-Gail S. Fletcher, Equity Metrics, Yale L.J. Forum (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3772895 (observing that under the Black Lives movement “conversations that initially focused on the appropriate role of police within American society turned into debates about, quite simply, everything”). The picture that emerges according to an extensive review of George Floyd’s life based on hundreds of documents and interviews is one that underscores how systemic racism has calcified within many of America’s institutions, creating sharply disparate outcomes in housing, education, the economy, law enforcement, and health care. Toluse Olorunnipa & Griff Witte, Born with two strikes, How systemic racism shaped Floyd’s life and hobbled his ambition, WASH. POST (Oct. 8, 2020), https://www.washingtonpost.com/graphics/2020/national/george-floyd-america/systemic-racism/.

47 For an important summary of the economic and health effects of the pandemic on Black workers, see Elise Gould & Valerie Wilson, Black Workers Face Two of the Most Lethal Preexisting Conditions for Coronavirus—Racism and Inequality, ECON. POL’Y INST. (June 1, 2020), https://www.epi.org/publication/black-workers-covid/. Women, especially Black, non-Hispanic women and Latinas, were also hit hard by the pandemic, as they are overrepresented in sectors, such as the hospitality and retail sectors, that experienced the brunt of pandemic-related job losses. Jasmine Tucker and Claire Ewing-Nelson, COVID-19 Is Making Women’s Economic Situation Even Worse, National Women’s Law Center (September 2020) (https://nwlc.org/wp-content/uploads/2020/09/PulsedataFS-1.pdf).


49 See Natalie Sherman, George Floyd: Why are companies speaking up this time?, BBC (June 6, 2020), https://www.bbc.com/news/business-52896265 (“[F]or years, black deaths in the hands of police have gone unremarked in corporate America. But this time, as protesters pour into streets across the country set off by the killing of George Floyd, businesses are speaking out.”).
and whether corporate governance might have a role in promoting more constructive corporate behavior.

This is not to say that there have not been scholars with an eye on what social externalities an absence of corporate Diversity creates. Research has found, for example, that corporations with less Diversity and fewer women are less likely to engage in philanthropic giving. Similarly, recent events have highlighted how corporations with fewer powerful African Americans and Latinos on their boards and in their workforces are less likely to support causes relevant to Diverse communities—or to take social justice stands that reflect the values of diverse minority communities. Even attention to issues like equitable environmental policy may be less likely where corporate boards and management lack Diversity and the attendant perspective to recognize problems and optimize solutions.

Still, what are perhaps the most direct and concerning implications of the data are the larger macroeconomic repercussions for the country’s racial wealth and income gaps. In the decades since the height of the civil rights movement, corporate America has failed to consistently hire and promote women and historically underrepresented minorities, stalling many from rising

50 See Robert J. Williams, Women on Corporate Boards of Directors and Their Influence on Corporate Philanthropy, 42 J. OF BUS. ETHICS 1 (2003) (supporting the notion that firms having a higher proportion of women serving on their boards do engage in charitable giving to a greater extent than firms having a lower proportion of women serving on their boards).

51 The most obvious, and studied, recent case in point concerns the disparate NBA and NFL responses to Colin Kaepernick’s protest of the Flag, where the NBA—where economic power is wielded by Black players—embraced social protests, and where the NFL—where economic power is wielded by white owners—largely eschewed them and ostracized Kaepernick for his demonstration. See, e.g., Michael Conklin & Christine Noel, Unsportsmanlike Conduct? The NFL’s Response to the Kneeling Controversy, 12 J. ETHICAL AND LEGAL ISSUES (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3626675 (noting the higher percentage of Black players in the N.B.A. and the larger number of Black viewers). See also John Branch, Why the NFL and the NBA Are So Far Apart on Social Justice Stances, N.Y. TIMES (June 22, 2018), https://www.nytimes.com/2018/06/22/sports/nfl-nba-social-justice-protests.html (noting that the NFL’s lack of guaranteed contracts to the NBA’s smaller and more unified workforce, where Black players are marketed, resulted in vastly different corporate responses).

52 The same issue is under intense scrutiny in the nonprofit sector, where there are parallels. See Ambika Chawla, A Look at Why Environmentalism is So Homogeneous (July 28, 2020), https://ensia.com/features/environmental-workforce-diversity-systemic-racism/ (noting that “people of color can offer unique perspectives on both why diversity is lacking in the green sector and what organizations can do to diversify the environmental workforce”). See also Victoria Borfteld, This ‘Green’ Space Shouldn’t Be So White, https://blogs.ei.columbia.edu/2020/08/21/environmental-sciences-anti-racism/ (noting that “the institutional settings and professional workplaces that house and advance environmental work in some ways mirror the environmental injustices that unfold in our society”). See also Ihab Mikati, Adam F. Benson, Thomas J. Luben, Jason D Sacks, and Jennifer Richmond-Bryant, Disparities in Distribution of Particulate Matter Emission Sources by Race and Poverty Status, 108 AM. J. OF PUBLIC HEALTH 480 (2018) (finding that people of color are not only much more likely to live near polluters and breathe polluted air, but also that race has a stronger effect on exposure to pollutants than poverty, which indicates that something beyond the concentration of poverty among Black and Brown communities is at play).
above middle management. The absence of diversity at the top of corporations is widely accepted in the organizational psychology literature as one key factor likely impeding diversity lower down the corporate hierarchy, where the bulk of employees work and the most interactions between the corporation, customers, and community occur. The reasons are varied, but generally start with hiring. Individuals, regardless of race, tend to like individuals who are similar to themselves and evaluate them more positively than those who are different. Because of this “affinity bias,” managers may repeatedly favor individuals who are similar to themselves, viewing them as more trustworthy, intelligent or qualified. Meanwhile, women, and especially Black and Brown candidates, may be subject to “outsider bias,” the idea that those not part of a known circle of friends and associates must have values and interests foreign to your own.

In business, this and other affinity-based biases can have an especially large impact during the recruitment processes, where it presents itself as a lack of “culture fit,” an ambiguous evaluation employed to disqualify job candidates. Perhaps not surprisingly, data from the National Academy of Sciences indicate that the rate of callbacks for Black candidates is generally lower than that of white candidates, and this rate has changed little since the 1970s.


See William Samuelson & Richard Zeckhauser, Status Quo Bias in Decision Making, 1 J. OF RISK & UNCERTAINTY 7 (1988) (showing that individuals disproportionately stick with the status quo through a series of decision-making experiments); see also Amy Kristof-Brown, Murray R. Barrick, & Melinda Franke, Applicant Impression Management: Dispositional Influences and Consequences For Recruiter Perceptions of Fit and Similarity, 28 J. MGMT. 27, 33–40 (2002) (offering evidence that when making hiring decisions, interviewers will unconsciously favor candidates whom they see as similar to themselves).

Bagalini, supra note 55.

Similar dynamics complicate the promotion of those Black and Brown people who are hired. “Confirmation bias,” the human tendency to selectively seek out, favor, and use information that confirms what you already believe, can in non-Diverse contexts stymie the progress of Black and Brown employees.59 To the extent white leaders60 of a firm expect Black employees to be less qualified, they will likely be more inclined to ignore new information proving otherwise, even where performance is high.61 Employees who come from underrepresented groups are consequently more likely to be negatively evaluated. Additionally, mentors and promoters at firms who may be positioned to elevate junior and mid-level executives to positions of leadership may be disinclined to do so.62 For underrepresented groups, this means they may face competitive disadvantages vis-à-vis their white counterparts for promotion.

Another large factor impeded progress toward racial and gender equality. With an increased emphasis on short-term stockholder returns from institutional investors starting in the 1980s and accelerating since, the share of corporate profits that went into wage increases plummeted compared to previous generations.63 This decline in fair gainsharing hit Black Americans particularly hard, because they had only gained labor rights in the 1960s, and were more likely to be working and lower middle class.64 Growing inequality hasn't declined in 25-years (finding little evidence that conscious and unconscious forms of bias will diminish on their own).

59 Bagalini, supra note 55. See, e.g., Amos Tversky & Daniel Kahneman, Judgment Under Uncertainty: Heuristics and Biases, 185 SCIENCE 1124, 1128 (1974) (discussing “anchoring” as one of several key judgmental heuristics and the bias it produces).
60 Or even minority leaders, given the evidence that implicit bias affects everyone, including Black people’s perceptions of other Black people. Theodore R. Johnson, Black-on-Black Racism: The Hazards of Implicit Bias, Dec. 26, 2014, https://www.theatlantic.com/politics/archive/2014/12/black-on-black-racism-the-hazards-of-implicit-bias/384028/ (“When blacks are asked about their predilections, they express a solid preference for their group over whites, but, in general, performance on the Implicit Association Test [an implicit bias test used by Project Implicit] suggests they subconsciously hold a slight preference for whites over blacks.”).
61 Bagalini, supra note 55.
62 Id.
64 See David Leonhardt, The Black-White Wage Gap Is As Big As It Was in the 1950s, N.Y. TIMES (June 25, 2020), https://www.nytimes.com/2020/06/25/opinion/sunday/race-wage-gap.html (documenting that both the racial wealth and income gaps shrank after World War II because of rising wages due to strong unions, the inclusion of formerly
resulted for all Americans, and the gains made by Black Americans during the period when the New Deal/Great Society consensus was in place began to reverse.65 Public policy movements in the Friedman/Reagan direction also freed corporations from pressure to address DEI issues more assertively, a reality evidenced by the lack of progress in diversifying the boardroom and C-Suite.

Collectively, these obstacles are all widely understood to contribute to sprawling differences in economic outcomes and opportunities, a key concern of civil rights activists. Statistics compiled by the U.S. Equal Employment Opportunity Commission in 2018 indicate that among white people, the ratio of lower-paid service workers and laborers compared with higher-paid senior-level management is roughly 7 to 1. But for Black people, the ratio balloons to 105 to 1.66

These facts have a direct impact on racial wealth and income inequality. The net worth in 2016 of the typical white family ($171,000) was nearly 10 times greater than that of a Black family ($17,150). Meanwhile, the gulf in median household incomes between white and Black Americans has grown after the Reagan era, with improvements during the 1960s and 1970s being reversed, so that the gap of $23,800 in 1970 has now grown to roughly $33,000 in 2018 (as measured in 2018 dollars).67 Part of the gulf can be attributed to what has been described as the “Black Ceiling” that cuts career progression early. According to recent industry analysis, Black males reach

excluded jobs that many Black workers held at the minimum wage by the Great Society legislation in 1966, and other policies that benefited all blue-collar workers, but that these gains then reversed from the 1980s forward); William Domhoff, Wealth, Income, and Power, WHO RULES AMERICA?, https://whorulesamerica.ucsc.edu/power/wealth.html (showing that Black people are far behind white people in income and that the income gap is growing); Kristin McIntosh, et al., Examining the Black-White Wealth Gap, BROOKINGS INST. (Feb. 27, 2020), https://www.brookings.edu/up-front/2020/02/27/examining-the-black-white-wealth-gap/ (showing that the huge wealth and income gap disfavoring Black Americans is growing). See generally Facts: Racial Economic Inequality, INEQUALITY.ORG, https://inequality.org/facts/racial-inequality/ (documenting that the median Black family had net wealth of only $3,500 compared to white median family wealth of $147,000, and that this gap has grown considerably since the early 1980s); Philip Mattena, Grand Theft Paycheck: The Large Corporations Shortcoming Their Workers’ Wages, GOOD JOBS FIRST AND JOBS WITH JUSTICE EDUCATION FUND, June 2018 (documenting that wage theft affects Black and Latino workers disproportionately as they are overrepresented in the sectors that are the most penalized by courts for wage theft).65

Equality in the United States, including for Black Americans, was rising up until the Reagan Administration reversed the New Deal/Great Society consensus. See generally The Productivity–Pay Gap, ECON. POL’Y INST. (July 2019).

65 Guynn & Schrottenboer, supra note 32.

their peak incomes much sooner than white males, at lower levels ($43,859 at ages 45-19 for Blacks and $66,250 for white males). For all these reasons, there are increasing calls by advocates and by corporate stakeholders themselves for corporations to address inequality by undertaking more assertive and more comprehensive DEI policies that address all the important ways in which corporations affect their workers, consumers, business partners, communities of operation, and society as a whole. These demands are not just for symbolic actions, but for a top down, and bottom up approach that embeds a commitment to equality in all aspects of corporate conduct.

68 Closing the Racial Inequality Gaps, CITI GPS: GLOBAL PERSPECTIVES & SOLUTIONS (Sept. 2020), https://ir.citi.com/PRxPvgNWu319AU1ajGF%2BsKbjJjBJSaTOSdw2DF4xynPwFB8a2jV1FaA3ldy7vY59bOtN2ixVQM%3D.

II. **DIVERSITY AND ITS CONNECTION TO SUSTAINABLE FIRM PROFITABILITY AND SHAREHOLDER VALUE**

For all of the attention now directed at DEI in Corporate America—and, as we shall later see, an increasing legislative and regulatory preoccupation with the diversity of corporate boards—Diversity is not usually talked about in terms of its relationship to longstanding corporate law principles. For those adopting the view of Milton Friedman, the pursuit of Diversity, Equity, and Inclusion is most commonly understood as an external matter to the firm, unassociated with shareholder profits, and that should be addressed by external regulatory law, not internal corporate action. Notably, this understanding of Diversity is not entirely incongruous with that of many Diversity supporters to the extent to which they view corporate Diversity as part and parcel of social justice and fairness—and not (necessarily) a matter relevant to firm-level performance.\(^{70}\) Indeed, for some activists, associating Diversity with business concepts like profits inherently cheapens the moral imperative for reform.

Although we are sensitive to this latter argument, and agree entirely with the strong moral imperatives behind Diversity and public law reforms, the case for Diversity has also had a strong business rationale for many years. That rationale has only grown stronger as societal concerns about equity and inclusion have entered the social and political mainstream at a breathtaking pace after last year’s conscience-raising. Generational moral moments like the one in which we find ourselves have economic and legal repercussions for corporations which, as we highlight later in the Article, also offer a corresponding scope for moral action protected by the business judgment rule, especially when that action also makes good business sense.

But first, in this Section, we canvass the most cited building blocks of the business case for Diversity and its connection to firm success and long-term value. We start with a survey of the empirical research associating Diversity with financial performance, and find a mixed picture, albeit one that is still important for corporate decisionmakers considering whether and to what extent to focus on DEI. We then turn our analysis to comparatively stronger qualitative and analytical arguments from the long-running literature in organizational psychology identifying cognitive diversity (and Diversity more generally) as a key ingredient for cognitively “smart” businesses. We then end with what is, in our view, the easiest way to understand the business argument for Diversity—its impact on the corporation’s reputation with regulators and all its key stakeholders, and thus and by extension, on its cost of capital, access to talent and business partners, and its attractiveness to customers. Taken in total, this Section thus details what is most critical for the connection between

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corporate law and DEI: the rational basis for business leaders to conclude that attention to good DEI practices makes good business sense in terms of improving the likelihood that a corporation will be sustainably profitable.

A. The Empirical Debate

We start first with the numbers. Although Diversity has not been a focus of critical inquiry within corporate law, it has attracted substantial interest from scholars interested in its impact on the financial performance of businesses. This literature is extensive, and can be summarized, albeit somewhat crudely, into two categories: i) recent studies from a growing number of researchers whose work suggests that diversity has a positive impact on financial performance; and ii) studies, typically less recent, that find the evidence to be more ambiguous, or even conflicted. We begin with examples from the first category.

Some of the most highly cited work finding a positive relationship between Diversity and investment has come from top-tier financial services firms and consultants. The Carlyle Group, for example, has observed that its portfolio companies that had two or more diverse directors—where diverse directors were defined as female, Black, Hispanic or Asian—had on average earnings growth of 12.3% over the previous three years, compared to 0.5% among portfolio companies with no diverse directors.71 McKinsey, too, has found that corporations with the most ethnically diverse executive teams are 33% more likely to outperform corporations with the least ethnically diverse teams in terms of profitability. Similarly, a Citi report finds that companies in the top quartile for both gender and ethnic diversity are 12% more likely to be more profitable than companies in the lower quartiles and that the gap increased by 36% compared to companies in the fourth quartile.72 In addition to Diversity, Deloitte’s research highlights the importance of Inclusion, what it describes as the feeling of being treated “equitably and with respect” and “feeling valued and belonging,”73 in increasing performance.74 The research finds that organizations with inclusive cultures are twice as likely to meet or exceed financial goals, three times as likely to be high performing, six times more likely to be innovative and eight times more likely to achieve better business outcomes.75

72 Citi GPS, supra note 68.
73 Id.
74 Juliet Bourke and Bernadette Dillon, The diversity and inclusion revolution, D ELOITTE REVIEW, January 2018.
75 Id.
Perhaps the largest body of research has focused on gender. Credit Suisse’s Research Institute has, for example, found over a series of studies that companies with at least one woman on the board had on average a sector-adjusted return on equity of 12.2%, compared to 10.1% for companies with no female directors. It also found in 2013 price-to-book values of 2.4x for companies with female representation on their boards versus only 1.8x for those without, and a nine-year average for boards with women directors of 2.3x versus only 1.8x for companies with all-male boards. Similarly, MSCI observed in an analysis of director seats held by women over a five-year period in four global indexes that once U.S. companies achieved a “tipping point” of at least three women on their board, they experienced median gains in return on equity of 10% and earnings per share of 37%. Meanwhile, companies that had no female directors showed reductions in return on equity of -1%, and reductions of -8% in EPS over the same five-year period. Catalyst, a nonprofit advocacy group, likewise found in a series of reports comparing of groups of firms that differed in the gender diversity of their corporate boards, that companies with three or more women on their boards outperformed companies with none by 46% in terms of their return on equity. Other industry studies make similar claims.

This is in part, we suspect, because of the seemingly boundless data available to be culled: women are, after all, everywhere, and in greater numbers than, say, African Americans, who may be concentrated in a few select countries.


Id.

Meggin Thwing Eastman et al., MSCI, The tipping point: Women on boards and financial performance 3 (December 2016), https://www.msci.com/documents/10199/fd1f8228-cc07-4989-acce-3f9ed97ee8bb (analyzing of U.S. companies that were constituents of the MSCI World Index for the entire period from July 1, 2011 to June 30, 2016).

Id.


McKinsey (2020) found “a positive, statistically significant correlation between company financial outperformance and [board] diversity, on the dimensions of both gender and ethnicity,” with companies in the top quartile for board gender diversity “28 percent more likely than their peers to outperform financially,” and a statistically significant correlation between board gender diversity and outperformance on earnings before interest and taxation margin. See McKinsey & Company, Diversity wins: How inclusion matters 13 (May 2020), https://www.mckinsey.com/~/media/McKinsey/Featured%20Insights/Diversity%20and%20Inclusion/Diversity%20wins%20How%20Inclusion%20matters/Diversity-wins-How-inclusion-mattersF.pdf (analyzing 1,039 companies across 15 countries for the period from December 2018 to November 2019). Moody’s (2019) found that greater board gender diversity is associated with higher credit ratings, with women accounting for an average of
Some Research from the academy has echoed these findings. A Harvard study found that venture capital firms that increased their proportion of female partner hires by 10% saw, on average, a 1.5% spike in overall fund returns each year and had 9.7% more profitable exits—a deceptively impressive figure given that only 28.8% of all VC investments have a profitable exit.83 Meanwhile, other studies from scholars at Oklahoma State University have found significant positive relationships between the fraction of women or minorities on the board and firm value after controlling for size, industry, and other corporate governance measures of Fortune 1000 firms.84 Yet another inquiry studying performance data and the percentage of women and minorities on boards of directors for 127 large U.S. companies in 1993 and 1998 found the percentage of Caucasian females plus ethnic minority directors on the board to be positively related to both return on equity and return on assets.85

But, as we highlighted, a second set of studies exist that has not found the same positive empirical results. For example, an international team of academic researchers in Germany found in a metaanalysis of literature from 20 studies covering 3,097 companies that female representation on corporate boards has a “small and non-significant” relationship with a company’s financial performance.86 Moreover, they found that firm financial performance is not directly related, but depends on moderators, such as board size or the time of data collection.87 Similarly, another team (including one of the Oklahoma researchers who had previously observed a positive relationship in terms of gender and firm value) found in its analysis of 541 S&P 500 companies from 1998-2002 that financial performance had no relationship to gender diversity or ethnic minority diversity, positive or negative, when Tobin’s Q was used as the measure of financial performance.88

28% of board seats at Aaa-rated companies but less than 5% of board seats at Ca-rated companies. See Moody’s Investors Service, Gender diversity is correlated with higher ratings, but mandates pose short-term risk 2 (Sept. 11, 2019), https://www.moodys.com/research/Moodys-Corporate-board-gender-diversity-associated-with-higher-credit-ratings-PBC_1193768 (analyzing 1,109 publicly traded North American companies rated by Moody’s).


86 Jan Luca Pletzer et al., Does Gender Matter? Female Representation on Corporate Boards and Firm Financial Performance – A Meta-Analysis 1, PLOS One (June 18, 2015).

87 Id., supra note 86.

Other studies offer more nuanced appraisals and are at times highly critical of the methodologies employed in the studies cited by Diversity advocates. Alice Eagly, in particular, has criticized studies like those produced by Catalyst and Credit Suisse for not revealing the strength of the relation between the participation of women and financial success and for lacking correlations relating the percentages of women on corporate boards to corporate outcomes or simple scatter plots of the relationships. She also criticizes early studies for not raising questions about reverse causation from financial success to the inclusion of women and possible confounding of the percentage of women on boards with omitted variables. Consequently, a number of unacknowledged correlations could be driving the data such as company resources derived from performance and an ability to invest in diversity. Along similar lines, Renee B. Adams and Daniel Ferreira criticize previous studies that are not robust to endogeneity, and find in their analysis of nearly 2,000 S&P mid- and small caps from 1996 to 2003 that that gender diversity can add to shareholder value, but generally only where governance is weak. Likewise, Corrine Post and Kris Byron find a “near zero” relationship with a company’s market performance, but a positive relationship with a company’s accounting returns. The U.S. Government Accountability Office, 89 Alice H. Eagly, When Passionate Advocates Meet Research on Diversity, Does the Honest Broker Stand a Chance?, 72 J. SOC. ISSUES 199, 200 (2016), https://www.psychologie.uzh.ch/dam/jcr:94328113-6e62-4545-80a5-9c2ac865c95d/Eagly-2016-Journal_of_Social_Issues.pdf (noting that few researchers of the connection between diversity and firm performance have addressed endogeneity in a manner that allows claims about causation).

90 Eagly, supra note 89 at 202.


meanwhile, has concluded that the mixed nature of various academic studies may be due to differences in methodologies, data samples and time periods.\footnote{United States Government Accountability Office, Report to the Ranking Member, Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services, House of Representatives, Corporate Boards: Strategies to Address Representation of Women Include Federal Disclosure Requirements 5 (Dec. 2015), https://www.gao.gov/assets/680/674008.pdf (noting that research on the impact of gender diversity on firms is “mixed,” due in part to “differences in how financial performance was defined and what methodologies were used”).}

Conflicting assessments like these can invite paralysis and uncertainty and thus it is easy, but we think wrong, to interpret the overall direction of the literature as collectively taking the conversation on Diversity “nowhere.” Working with incomplete and imperfect data is the job of most corporate leaders (and, apparently, academics).

CEOs and boards make decisions every day with very little information, and often without the benefits charts or regressions, whatever their statistical or scientific robustness. And in doing so, they take whatever data are available, discount them, and apply that information to the particulars of the firm they manage, and then act. That is why the business judgment rule in large part exists, to ensure that business leaders can proceed with confidence that their good faith decisions in a world of uncertainty are not second-guessed in litigation, with the counterproductive effect of deterring them from managing their businesses in an effective manner.\footnote{See Jens Frankenreiter, Cathy Hwang, Yaron Nili, & Eric Talley, Cleaning Corporate Governance, (forthcoming. U. Pa. L. Rev. 1 2021) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3796628 (noting that several of the most heavily relied-upon governance datasets suffer from inaccuracies so extensive as to call into question some of the landmark insights of the field). See also, Eric Talley, Cleaning Corporate Governance: A New Open-Access Dataset on Firm- and State-Level Corporate Governance, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE, March 17, 2021.}

From this standpoint, it is worthwhile noting that there are several studies suggesting that, at a minimum, diversity may have a positive impact on the financial operations of a company. And CEOs and boards are, in a world of incomplete information, entitled to also take into account the studies by firms—paid to assist them in making their companies more profitable—that take the clear position that that effective DEI policies are positively associated with protecting and improving firm value. This may not mean much to academics, who may consider the views of business consultants and investment banks to lack empirical rigor, and to not have controlled for all variables, especially when contrary evidence may also exist. But it is important for decisionmakers, and for that matter, the operation of corporate law, a point we will return to in our detailed discussion later of the business judgment rule. For now, suffice it to say when faced with the body of the empirical work done\footnote{E.g., Corwin v. KKR Financial Holdings LLC, 125 A.3d 304, 313-314 (Del. 2015) (“judges are poorly positioned to evaluate the wisdom of business decisions and there is little utility to having them second-guess the determination of impartial decision-makers with more information (in the case of directors) or an actual economic stake in the outcome (in the case of informed, disinterested stockholders”).}
thus far, a CEO and board could rationally conclude that, whatever the literature’s weaknesses, it shows that a business case for Diversity is present. And the ability for the CEO and the board to do so rationally has enormous stakes for the legal protections and discretion that they will have in terms of the actions taken on that assessment.

Of course, corporate policy cannot be made in a vacuum consisting of only statistically validated and replicated studies that dictate with certainty the direction to take. Corporate leaders cannot wait for an academic consensus about a complex issue in a fast-changing world in which action is required in the here and now. They are expected to make the best judgment they can based on the information available to them, however imprecise and imperfect. In that calculus, they may also consider factors rationally contributing to the business case for Diversity, factors like societal expectations and their corresponding consequences for corporate value and reputation, which they understand as a matter of lived experience, both as citizens and business professionals.

B. Governance and Risk Management

In a world of limited quantitative evidence, analytical arguments bolstered by organizational theory and case studies have emerged as important building blocks substantiating the business case for diversity. For decades, organizational psychologists have held that cognitive diversity, properly constructed, can lead to superior problem solving and execution in groups and businesses. Cognitive diversity can be understood as the variance among people in terms of their perspective and how they process information—whether it be in terms of decisionmaking, conflict resolution, problem analysis or problem solving. It is not necessarily predicted by factors such as gender, ethnicity, or age, though each of those factors can and often do shape the ways

97 Lynne Dallas, The New Managerialism and Diversity on Corporate Boards of Directors, 76 TUL. L. REV. [1363], 1391 (2002). The organizational literature has long suggested that heterogeneous groups tend to improve the quality of thinking where complex decisionmaking requires creativity and judgment. See generally Susan E. Jackson, Consequences of Group Composition for the Interpersonal Dynamics of Strategic Issue Processing, 8 ADVANCES IN STRATEGIC MGMT. 345, 354-56 (1992); Alan C. Filley, et. al, MANAGERIAL PROCESS AND ORGANIZATIONAL BEHAVIOR (1976). See also Taylor H. Cox, Sharon A. Lobel, & Poppy Lauretta McLeod, Effects of Ethnic and Group Cultural Differences on Cooperative and Competitive Behavior on a Group Task, 34(4) ACAD. MGMT. J. 827 (1991) (finding superior problem-solving skills by groups with more ethnic diversity); Janet Snizek & Rebecca A. Henry, Accuracy and confidence in group judgment, 43 STAN. ORG. BEHAV. & HUM. DECISION PROCESSES 1, 20 (1989) (finding that “the more disagreements that group members reported, the more accurate were their group judgments”); David Rock & Heidi Grant, Why Diverse Teams Are Smarter, HARV. BUS. REV. (Nov. 4, 2016), https://hbr.org/2016/11/why-diverse-teams-are-smarter.

members of that group process information as compared to others outside the group.99

One of the most popular use case applications for cognitive diversity in the business literature is in corporate governance. Corporate governance manages the conflicts that arise among shareholders, boards and managers. In doing so, it enables an efficient flow of information and rigor among decisionmakers,100 increases transparency and accountability so that performance is rewarded and poor performance addressed,101 and ensures that operations align with the company’s mission. Governance is perhaps most commonly associated with divisions of power between corporate managers and owners. But it is not, however, only a structural feature of corporate operations. It also includes the safeguards embedded in a firm’s approach to addressing all the complex issues that arise when human beings collaborate and when there is the potential for some to gain at the expense of the larger enterprise, a subject some would refer to as managing human capital.102 For example, corporate boards are largely required to have a minimum number of independent directors alongside inside directors. The idea is that independent directors are more likely to be impartial and vigilant in monitoring C-Suite actions than corporate insiders with dual roles as executives and directors.103 Not only are they able to bring their own expertise to bear, the logic goes that they will be less directly beholden to the CEO in terms of their careers and livelihoods

Similarly, cognitive diversity—and for that matter, Diversity, too—is often understood as a human-capital based governance mechanism premised on the usefulness of “outsider” perspectives and interests. Most commonly, it is associated with reducing the social pathology of groupthink.104 Groupthink is a phenomenon that arises when the urge to conform or the belief that dissent is itself harmful or unproductive leads a group of well-intentioned people to

100 Maria Aluchna & Tomasz Kuszewski, Does Corporate Governance Increase Company Value? Evidence from the Best Practice of the Board, J. OF RISK AND FIN. MGMT. (Oct. 2020) at 4 (showing a negative correlation between compliance with the code provisions on board practice and company value, suggesting that investors do not find the adoption of board practice a plausible solution for the principal–principal conflict in an environment of concentrated ownership).
101 Id. at 2.
102 Our own preference is to refer to human beings who labor for corporations as workers or employees, but we understand the business reason for the term.
103 G. Sanchez-Marin, J.S. Baixauli-Soler, and M.E. Lucas-Perez, When much is not better? Top management compensation, board structure and performance in Spanish firms, 21 INT. J. OF HUM. RESOURCE MGMT. 2778, 2792 (Dec. 4, 2010) (finding that, generally, when the percentage of outsider directors is higher, the earnings of top managers are lower, which indicate that it is positive to allow the board greater independence through the inclusion of outsiders to limit the discretionary power of the top management team and to moderate its earnings).
104 Irving Janis first defined “groupthink” in 1972 as “a psychological drive for consensus at any cost that suppresses dissent and appraisal of alternatives in cohesive decisionmaking groups which in turn may lead to “incredibly gross miscalculation about both the practical and moral consequences of their decisions.” Irving L. Janis, VICTIMS OF GROUPTHINK: A PSYCHOLOGICAL STUDY OF FOREIGN-POLICY DECISIONS AND FIASCOS (1972).
make irrational or non-optimal decisions. In such circumstances, premature consensus and decisionmaking can arise as individuals self-censor their true opinions or ideas, and therefore the group accumulates few or no dissenting views.

Groupthink is often explored in the context of corporate boards, where members may feel pressure to agree with one another or the CEO. In its classic iteration, members may not offer perspectives necessary for the board to achieve the corporation’s strategic interests, or maximize shareholder value. Instead, they typically submit themselves under the influence of an autocratic CEO/Chairman, or find themselves influenced by peer-pressure inside the group. As a result, board members either succumb to apathy, and simply go through the motions, or hubris can come to define their collective decisionmaking such that members believe every decision they make as a group will indubitably foster positive results.”

Against this backdrop, researchers have identified cognitive diversity, under the proper circumstances, as a prophylactic for groupthink pathologies. In culturally homogenous spaces, Diversity can help introduce competing interests, ideas, values, and perspectives into a more creative and higher quality decisionmaking process. When faced with complex strategic issues necessitating out-of-the-box thinking, cognitively diverse groups will be able to leverage a broader range of information and possible solutions for


106 Daniel P. Forbes & Frances J. Milliken, Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups, 24 THE ACAD. OF MGMT. REV. 489, 496 (1999) (developing a model that links board demography with firm performance); see also Letter from public fund fiduciaries to Elizabeth M. Murphy, Sec’y, SEC (Mar. 31, 2015), Petition for Amendment of Proxy Rule, https://www.sec.gov/rules/petitions/2015/petn4-682.pdf (letter from several state investment and pension plans to the Securities and Exchange Commission stating that diverse boards are beneficial because they “raise different ideas and encourage a full airing of dissenting views”).

107 But, as discussed below, psychologists examine groupthink in much more varied situations, and the issue is widely understood even in a corporate context to be one that can undermine decisionmaking from high-level executives to front line workers. See, e.g., Marleen A. O’Connor, The Enron Board: The Perils of Groupthink, 71 U. CIN. L. REV. 1233 (2003) (analyzing directors’ role in the Enron scandal to illustrate how intelligent individuals can succumb to cognitive biases prevailing in corporate cultures); Melanie B. Leslie, Helping Nonprofits Police Themselves: What Trust Law Can Teach Us About Conflicts of Interest, 85 CHI.-KENT L. REV. 551, 564 (2010) (discussing the unique dangers of groupthink in nonprofits); Melissa L. Breger, Making Waves or Keeping the Calm?: Analyzing the Institutional Culture of Family Courts Through the Lens of Social Psychology Groupthink Theory, 34 L. & PSYCHOLOGY REV. 55 (2010) (analyzing the institutional culture of family courts through the lens of groupthink).


109 Id.

110 PSYCHOLOGY TODAY, supra note 104.
consideration than homogeneous groups.\textsuperscript{111} And where a board captured by groupthink may cut off early dialogue and questioning, a Diverse board, comprised of different personal, professional and social backgrounds, might instead test hypotheses and policies brought up by managers and subject all ideas generated in the group to more rigorous review.\textsuperscript{112} This in turn can lead to vastly different interpretations of data points, along with more nuanced debate and consideration of alternative strategies and courses of action.\textsuperscript{113} Researchers consequently find that Diversity can lead to more communication on boards,\textsuperscript{114} and even more accountability of management.\textsuperscript{115} Similarly, within the organization, diverse opinions and perspectives can power reflection and critical thinking on the front lines of executing corporate policy.

\textsuperscript{111} Jackson, \textit{supra} note 96 at 361.
\textsuperscript{112} This observation has been made in the greater finance literature as well, where stock picking is viewed as at times highly complex art involving complex considerations. In one highly cited series of experiments conducted in Texas and Singapore, scientists put financially literate people in simulated markets and asked them to price stocks. The participants were placed in either ethnically diverse or homogenous teams. The researchers found that individuals who were part of the diverse teams were 58\% more likely to price stocks correctly. Sheen S. Levine et al., \textit{Ethnic diversity deflates price bubbles}, PNAS (2014), https://www.pnas.org/content/111/52/18524.abstract.
\textsuperscript{113} “Heterogeneous groups often invest more time resolving issues that require creativity and consensus building, because of their members’ diverse vocabularies, paradigms and possible objectives.” Lynne Dallas, \textit{The New Managerialism and Diversity on Corporate Boards of Directors}, 76 TUL. L. REV. 1363, 1391 (2002). \textit{See also} Donald C. Hambrick, Theresa Seung Cho, and Ming-Jer Chen, \textit{The Influence of Top Management Team Heterogeneity on Firms’ Competitive Moves}, 41 ADMIN. SCI. Q. 659, 660–82 (1996). Variations of this theme have been echoed in the psychology literature suggesting that such productive cognitive rigor can arise in settings well beyond the boardroom. For example, in a study published in the \textit{Journal of Personality and Social Psychology}, scientists assigned 200 people to six-person mock jury panels whose members were either all white or included four white and two black participants. The people were shown a video of a trial of a black defendant and white victims. They then had to decide whether the defendant was guilty. […]Diverse panels raised more facts related to the case than homogenous panels and made fewer factual errors while discussing available evidence. If errors did occur, they were more likely to be corrected during deliberation. One possible reason for this difference was that white jurors on diverse panels recalled evidence more accurately. Samuel R. Sommers, \textit{On Racial Diversity and Group Decision Making: Identifying Multiple Effects of Racial Composition on Jury Deliberations}, APA (2006), https://www.apa.org/pubs/journals/releases/psp-904597.pdf.
\textsuperscript{114} Dallas, \textit{supra} note 112 (suggesting that “heterogeneous groups share conflicting opinions, knowledge, and perspectives that result in a more thorough consideration of policy”).
\textsuperscript{115} Studies have, for example, found that the presence of gender diversity can lead to a more intense focus on whether management is improving the company’s profitability and stock price. \textit{See, e.g.}, M. E. Lucas-Perez, \textit{Women on the Board and Managers’ Pay: Evidence from Spain}, 129 J. BUS. ETHICS 285 (2014) (noting that gender diversity on boards is associated with connecting executive pay to company performance); \textit{see also} Renee B. Adams & Daniel Ferreira, \textit{Women in the boardroom and their impact on governance and performance}, 94 J. FIN. ECON. 291, 292 (2009) (finding that “more diverse boards are more likely to hold CEOs accountable for poor stock price performance”).
Empirical evidence has also emerged that Diversity can serve as a useful risk mitigation tool. Studies have argued that Diverse firms, especially those displaying gender Diversity on their boards, adopt less risky financial policies than their homogeneous counterparts. Researchers have also compiled data suggesting that Diversity is correlated with a lower likelihood of illegal and fraudulent behavior, and fewer irregularities and less opacity and vagueness in public filings and disclosure. Here again, diversity may play a role though alternative explanations range from the possibility that firms that have the resources to invest in gender Diversity may also have the resources (and inclination) to invest in compliance to intuitions that as members of underrepresented groups women are more likely to have arm’s-length relationships with CEOs and management, prompting more rigorous scrutiny of financial reports and policy.

Perhaps a more direct role for cognitive diversity is in the areas of employment, where a commitment to good DEI practices can also help reduce the likelihood of risks that can arise in the context of employment discrimination. In 2019 alone, the EEOC reported 23,976 lawsuits on the basis of race, and 23,532 claims of gender-based discrimination. The average

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116 Gennaro Bernile, Vineet Bhagwat, & Scott Yonker, Board Diversity, Firm Risk, and Corporate Policies, 127 J. OF FIN. ECON. 588 (2018) (stating that homogeneity of preferences and views among board members could lead to idiosyncratic decisions, free of scrutiny within the board. Results of the study indicate that both operating performance and asset valuation increase with board diversity, and the benefits of diverse perspectives among directors outweigh the potential costs).

117 Id.


119 Wahid, supra note 117 at 24.

120 The management literature has found, for example, that gender-Diverse boards engage in better discussions because women are more willing to discuss issues that seem unpalatable to an all-male board. Yu Chen, John D. Eshleman, and Jared S. Soileau, Board Gender Diversity and Internal Control Weaknesses, 33 ADVANCES IN ACCT. 11 (2016), Clarke, 2005; Huse & Solberg, 2006; Stephenson, 2004. Diverse boards may as a result exhibit fewer information asymmetries, and as such provide fewer routes for company insiders to engage in opportunistic behavior prior to public disclosure of material information. See Self-Regulatory Organizations: The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity, 85 Fed. Reg. 80,472 at 271 (Dec. 11, 2020).

employment lawsuit costs a company $200,000: of which $80,000 goes to the employer’s attorneys’ fees, $80,000 for the employee’s attorneys’ fees, and $40,000 in settlement to the employee. Moreover, employment discrimination can attract the kind of publicity and community activism that may negatively affect firm value wealth through negative reputational feedback loops, a lesson learned by commercial giants like Texaco and Coca-Cola.

Employment discrimination may be less likely where there is a strong culture of inclusion and a highly diverse workforce. Scholars have noted that initial reactions to allegations of racial discrimination can be defensive, precluding meaningful discussion of the harmful conduct or racial equity matters more generally. Diverse corporate staff with experience in addressing such frustrations can minimize this risk. And to the extent to which DEI policies are written, reviewed and implemented by individuals with diverse personal backgrounds, and expertise in Diversity, they are more likely to be effective from the standpoints of both firm culture and liability-reducing mechanisms.

A similar logic is easily applied to many other situations involving racially insensitive and illegal behavior. By way of example, some major companies have faced both criticism and lawsuits for unlawful environmental practices because they have located operations that generate the most hazardous pollutants to human health in Black neighborhoods and other communities with poorer populations. Likewise, major financial institutions


124 See also Lerner & Tetlock, Accounting for the Effects of Accountability, 125 PSYCH. BULL. 255 (1999) (noting that accountability leads people to overrationalize the rightness of actions to which they are committed); Don Langevoort, Cultures of Compliance, 54 AM. CRIM. L. REV. 933, 969 (2017) (noting how assignments of blame lead often to intense denial and defensive bolstering, making them seem unfair by the individual receiving the criticism).

have been criticized for selective lending and banking practices that disadvantage Black consumers, practices that can also expose them to liability under federal and state statutes such as the Fair Housing Act (“FHA”) and the Equal Credit Opportunity Act (“ECOA”). Even industries that the public largely approves of—like grocery chains—have faced adverse publicity for failing to serve urban communities of color and rural communities in poverty, and thus depriving those communities of access to healthy, quality food choices. The retail industry has also drawn fire for racial discrimination and profiling practices against customers.

refinery in Detroit sued Marathon Oil Corporation and Marathon Petroleum Corporation, alleging air, noise, and odor pollution from the refinery. Virginia Gordan, Residents Sue Marathon Refinery Over Pollution, MICHIGAN RADIO (Feb. 23, 2016), https://www.michiganradio.org/post/residents-sue-marathon-refinery-over-pollution. The community residing in the area next to the refinery, which is one of the most polluted areas in the country, is a low-income, minority community. Id.

See infra notes [155-60] and accompanying text. Bank of America agreed to pay $335 million to settle allegations brought by the Department of Justice that Bank of America’s Countrywide subsidiary charged higher fees and interest rates to more than 200,000 Black and Hispanic borrowers than white borrowers. Justice Department Reaches $335 Million Settlement to Resolve Allegations of Lending Discrimination by Countrywide Financial Corporation, Department of Justice, (Dec. 21, 2011), https://www.justice.gov/opa/pr/justice-department-reaches-335-million-settlement-resolve-allegations-lending-discrimination. Recently, Wells Fargo agreed to pay Philadelphia $10 million to settle a lawsuit from 2017 that the city brought against the bank, alleging that the bank violated the FHA by offering more expensive and riskier mortgages to Black and Latino borrowers than to white borrowers, which led to foreclosures and reduced city property taxes. Caitlin McCabe, Wells Fargo to pay Philly $10 million to resolve lawsuit alleging lending discrimination against minorities (Dec. 16, 2019), https://www.inquirer.com/real-estate/housing/philadelphia-settles-lawsuit-wells-fargo-allegations-discriminatory-mortgage-lending-minorities-20191216.html.

A study of the 50 largest metropolitan areas in the United States found that 17.7% of predominantly Black neighborhoods had limited access to supermarkets, while only 7.6% of predominantly white neighborhoods had limited access. Critics have described this disparity as a result of “supermarket redlining” by grocery chains. Nathaniel Meyersohn, How the rise of supermarkets left out black America, CNN Business (June 16, 2020), https://www.cnn.com/2020/06/16/business/grocery-stores-access-race-inequality/index.html. Kroger faced a boycott upon closing its stores in certain predominantly Black communities, following which these communities were at risk of becoming food deserts. Alexander Coolidge and Sharon Coolidge, Jesse Jackson calls to expand Kroger boycott over its shuttering of stores in minority neighborhoods, USA TODAY (Apr. 10, 2018), https://www.usatoday.com/story/money/nation-now/2018/04/10/jesse-jackson-kroger-protest/502688002/.

Aimee Green, ‘Shopping While Black’ lawsuits accuse Portland area retailers of discrimination (Jan. 30, 2019), https://www.oregonlive.com/portland/2018/06/shopping_while_black_lawsuits.html (a Black man filed a racial discrimination lawsuit against Walmart, alleging that the store clerk accused him of stealing); Neil Vigdor and Elisha Brown, Walmart Says It Will No Longer Lock Up African-American Beauty Products, N. Y. TIMES (June 10, 2020), https://www.nytimes.com/2020/06/10/business/walmart-black-hair-beauty-products.html (Walmart was also hit with a federal discrimination lawsuit for locking up beauty care products for Black women in black cases, following which the company stated that it will end this practice); Nadra Nittle, Moschino has been accused of using the code word
In each of these cases, it is rational to assume that the presence of racially or ethnically diverse corporate staff, coupled with equitable policies and an inclusive culture, might in many instances result in different outcomes. Personal experiences affect what facts individuals see and problems they recognize. Individuals coming from racially and geographically diverse communities can share perspectives that might not be apparent for others. If they lived in, or had friends or family who lived in urban or rural food deserts, they could communicate the human costs, as well as potential economic upside of serving affected communities. Individuals with personal experiences with environmental racism, or racism more generally, might be more quick to raise objections to locating factories and pollutants in Black and Brown communities, or recognize the likely reputational fallout and risks to shareholder value where their institutions employed lending or front-office practices that unfairly disadvantaged or mistreated minority communities.

But gender and racial diversity are not always sufficient to achieve superior outcomes in all situations. If minorities and women share the same age, socioeconomic, educational, and geographic backgrounds as other colleagues in their group, the group may not necessarily be cognitively diverse enough to achieve superior solutions for certain problems. It is for that reason we embrace Diversity in its fullest sense of drawing on the full range of talents in society, including white people from working and middle-class backgrounds, and Americans from urban, suburban, and rural communities. Put simply, many kinds of diversity might be important, from socioeconomic status to professional training and education. Moreover, diversity can only be operationalized as an organizational feature if it is accompanied by an equitable and inclusive culture. Only where people feel like their views are respected and welcome will they be willing to speak. In the absence of leadership and corporate structures to support the free exchange of ideas, members of underrepresented groups can be easily marginalized, especially when their presence in a large group is modest. In such circumstances, their very presence can be reduced to tokenism, and stereotyping could result in barriers to exert influence on decisions in the group as well as self-doubt. In the absence of an inclusive culture, a corporation may have Diverse cognitive capital at its disposal, but it will not be able to deploy it in ways that maximize the corporation’s success.

C. Corporate Reputation

The empirical literature highlighting Diversity and shareholder value is at times useful, but the evidence is mixed, and how cognitive diversity relates to Diversity, Equity, and Inclusion can be context dependent. Against this backdrop, it is plausible that a third business case for Diversity—that of

“Serena” to refer to black shoppers, VOX (Jan. 16, 2019), https://www.vox.com/the-goods/2019/1/16/18185696/moschino-code-word-serena-black-shoppers-racism (a former employee filed a racial discrimination lawsuit against Moschino, alleging that the staff used code words for Black customers).

129 Adams & Ferreira, supra note 14 at 292.
131 See John G. Oetzel, Self-Construals, Communication Processes, and Group Outcomes in Homogeneous and Heterogeneous Groups, 32(1) SMALL GROUP RES. 19, 42, 44 (2001).
reputational enhancement in light of an increasingly diverse world—is the most uncontroverted and compelling for corporate directors and managers. According to this view, many investors, customers and employees value Diversity greatly, so much so that it informs their behaviors. Corporations should thus attempt to secure strong reputations in Diversity in order to help lower their cost of capital, secure top talent, and grow revenue.132

Considerations of shareholder value often begin with a corporation’s reputation, and for good reason. An important body of research indicates that “reputation was, is, and always will be of immense importance to organizations, whether commercial, governmental, or not for profit.”133 Reputations are the means by which stakeholders interpret corporate brands—and the concomitant attractiveness of a company’s goods and services to its customers and clients.134 They inform how individuals investigate investment opportunities.135 And they affect how many prospective employees judge employers,136 where customers want to spend dollars, and the willingness of other business to form important alliances. In short, strong reputations can enable corporations to premium prices, attract better job applicants, enhance

132 Damion Waymer & Sarah VanSlette, Corporate Reputation Management and Issues of Diversity in THE HANDBOOK OF COMM. & CORP. REPUTATION 471, 473 (Craig E. Carroll ed., 2013) (noting that the benefits of a favorable reputation include the ability for corporations “to charge premium prices, attract better applicants, enhance their access to capital markets, and attract investors”).

133 Tom Watson, Reputation models, drivers and measurement in SAGE HANDBOOK OF PUB. REL. 339, 339 (Robert L. Heath ed., 2010) (holding that reputation paves the organizational path to acceptance and approval by stakeholders).

134 Reputation is, critically, multidimensional and can be rooted in a variety of different performance criteria (Rao 1994). Mary-Hunter McDonnell and Brayden G King, Order in the Court: How Firm Status and Reputation Shape the Outcomes of Employment Discrimination Suits, American Sociological Review, 83(1), 61-87 (citing Rao, Hayagreeva, 1994, The Social Construction of Reputation: Certification Contests, Legitimation, and the Survival of Organizations in the American Automobile Industry: 1895–1912. STRATEGIC MANAGEMENT JOURNAL 15(S1):29–44). The same organization can have a positive reputation in one domain, such as product quality, and yet have a weak or negative reputation in another domain, such as treatment of employees. Id. 2. See also Michael L. Barnett, John Jermier, & Barbara A. Lafferty, Corporate Reputation: The Definitional Landscape, 9 CORP. REPUTATION REV. 1, 13 (2006) (synthesizing prior definitive statements of corporate reputation to define corporate reputation explicitly and narrowly, distinguished from corporate identity, corporate image, and corporate reputation capital).


136 See, e.g., D.B. Turban & D.W. Greening, Corporate social performance and organizational attractiveness to prospective employees, ACADEMY OF MANAGEMENT JOURNAL 40, 658–72 (noting that the image of an organization affects potential applicants’ initial job decisions).
their access to capital markets, and attract investors. Reputations thus have important implications for the profitability of corporations.\textsuperscript{137}

Diversity, or the lack thereof, comprises one element of a company’s reputation.\textsuperscript{138} The reasons why companies may seek a reputation as being Diverse, Equitable, and Inclusive are varied, but many researchers often focus on the signaling function it may provide, especially to prospective employees. Having a diverse board or management may convey otherwise unobservable information to the public, like how receptive the company is to a diverse workforce, or how open and inclusive the company’s culture may be.\textsuperscript{139}

These kinds of signals are important for securing top talent. Industry surveys consistently show that workplace Diversity ranks high on job seekers’ list of priorities when looking for a job, with nearly half of all Americans indicating that diverse workplaces are important to them. The pull of diversity is, however, strongest among Millennials and Generation Xers, who together account for over two-thirds of today’s labor force.\textsuperscript{140} In one recent survey by ZipRecruiter, 86\% of respondents identified workplace diversity as a top consideration, placing it among the top three job search criteria, along with salary and schedule flexibility.\textsuperscript{141} Millennials are even likely to stay nearly twice as long as their average 2.8-year tenure at a company that fosters Diversity, Equity and Inclusion.\textsuperscript{142} To some extent, this reflects the greater Diversity of younger-aged people in the United States, though not entirely.

\begin{itemize}
\item Waymer & VanSlette, \textit{supra} note at 473 (finding that the damage to reputation sustained by companies embroiled in diversity scandals is significant by conducting case studies of Deloitte, Lowe’s, and Abercrombie & Fitch). This is a point not lost in the literature. \textit{See} John C. Coffee Jr., \textit{Racing Towards the Top?: The Impact of Cross-Listing and Stock Market Competition on International Corporate Governance}, 102 COLUM. L. REV. 1757 (2002), https://scholarship.law.columbia.edu/faculty_scholarship/31 (discussing how companies can signal sounder corporate governance by listing in the United States to achieve higher valuations).
\item For a general overview of signaling theory, see Brian L. Connelly et al., \textit{Signaling Theory: A Review and Assessment}, J. OF MANAGEMENT (2011), https://www.researchgate.net/publication/254121372_Signaling_Theory_A_Review_and_Assessment. \textit{But see} Lisa Broome & Kimberly D. Krawiec, \textit{Signaling Through Board Diversity: Is Anyone Listening?}, 77 UNIV. OF CIN. L. REV. 431, 448 (2008) (concluding that the signaling rationale for board diversity is at its strongest under particular conditions that may not exist in all corporations at all times).
\item \textit{Over 86\% of Job Seekers Say Workplace Diversity Is an Important Factor When Looking for Job}, CISION PR NEWSWIRE (Nov. 25, 2019), https://www.prnewswire.com/news-releases/over-86-of-job-seekers-say-workplace-diversity-is-an-important-factor-when-looking-for-a-job-300964115.html; \textit{see also} Michal Barzuza, Quinn Curtis & David H. Webber, \textit{Shareholder Value(s): Index Fund ESG Activism and the New Millennial}, 93 S. CAL. L. REV. 101, 139, 151–52 (forthcoming 2020) (arguing that Millennials also want to work for companies whose values they share and are acting as employees to call for their companies to improve their commitment to social responsibility).
\end{itemize}
Although women tend to favor workplace Diversity more than men, and Black, Latino and Asian employees more than whites, clear majorities of men and whites have been found in studies to consider Diversity, Equity, and Inclusion to be important workplace considerations.\textsuperscript{143}

Reputations for strong Diversity can also be helpful in securing and keeping customers and clients. At least part of many consumers’ purchasing decision comes from one’s perception as to whether the product or services provider aligns with their values.\textsuperscript{144} This has become more important in today’s world of social activism, and with the younger consumers who are more likely to be “values-driven, not value-driven.”\textsuperscript{145} In a recent survey by Deloitte, for example, both Millennials and Gen Z, nearly one third of millennial customers stated they have deepened or initiated relationships with retailers who balance doing “good” and making a profit.\textsuperscript{146}

Conversely, bad reputations can be damaging to the firm and shareholder value. Often this is reflected in lawsuits, a point long emphasized in the anti-discrimination literature. Litigation arising from contravening the values of Diversity can lead to the disrepute of the corporation that undermines its ability to increase its sustainable profitability. Verdicts of culpability and liability shape public perceptions of a firm’s commitment to equality. The publicity that flows from the very process of regulatory investigations and litigation produces information on the behavior of the corporation—and parties to the dispute.\textsuperscript{147} This information reaches third parties and affects the way that outsiders view the corporation and relevant actors regardless and beyond the effects of direct legal outcomes. In other words, this information helps shape the market reaction to alleged misbehavior, even if the outcome is eventually favorable to the company.\textsuperscript{148} Savvy jobseekers research the company before applying, and workplaces facing several discrimination lawsuits often observe a chilling effect on recruiting as top candidates to look

\textsuperscript{143} In one Glassdoor survey, for example, 72 percent of women consider workforce diversity important versus 62 percent of men. It also found that 89 percent of Black respondents, 80 percent of Asians and 70 percent of Latinos said it was important to them. What’s more, a large majority of white respondents say workforce diversity is important. Glassdoor Team, \textit{What Job Seekers Really Think About Your Diversity and Inclusion Stats}, GLASSDOOR (Nov. 17, 2014), https://www.glassdoor.com/employers/blog/diversity.

\textsuperscript{144} Olivia Valentine, \textit{The Growing Importance of Brand Responses to Equality and Diversity}, \textit{WE ARE SOCIAL} (July 30, 2020), https://wearesocial.com/blog/2020/07/the-growing-importance-of-brand-responses-to-equality-and-diversity (showing that at least part of consumers’ purchasing decision comes from consideration of whether a brand aligns with their values).

\textsuperscript{145} Barzuza, \textit{supra} note 140 (arguing that a three-dimensional millennial effect—as investors, customers and employees—is an important development with the potential to provide a counterweight to the wealth-maximization paradigm of corporate governance, and specifically arguing that institutional investors recognize that attention to issues like Diversity is attractive to the new generations whose capital they seek to attract).

\textsuperscript{146} The Deloitte Global Millennial Survey 2020, 21, https://www2.deloitte.com/global/en/pages/about-deloitte/articles/millennialsurvey.html (exploring the views of more than 27,500 Millennials and Gen Zers to understand their perspectives on business, government, climate, and the pandemic, among other issues).

\textsuperscript{147} Roy Shapira, \textit{A Reputational Theory of Corporate Law}, p. 1.

\textsuperscript{148} \textit{Id.}
to less controversial or accommodating employers. Investors may decide not to purchase shares of the company out of principle. Prospective customers may decide to take their business elsewhere. Other corporations may steer clear of joint ventures.

Bad reputations do not, of course, only result from regulatory actions and litigation. Deloitte’s surveys also made clear that young consumers will not “hesitate to penalize companies whose stated and practiced values conflict with their own.” And this is far from an empty threat in today’s age of social media, where anyone can congregate and organize against firms, sometimes to devastating effect. Perhaps one of the most obvious instances of the harm that can possibly arise was observed in 2018 when Papa John’s founder used a racial epithet on a conference call and criticized Colin Kaepernick and other athletes for protesting police brutality; the pizza chain’s sales began to decline. Competitor chains, such as DiGiorno and Pizza Hut, engaged in “Twitter wars” attacking Papa John’s, and a white supremacist website crowned Papa John’s as the “official pizza of the alt-right,” bringing even more negative attention to the worsening reputation of Papa John’s. Sales dropped 7.1% for the year, and first quarter income dropped from $22.8 million, to $4.6 million. It was not the first time even that year that reputational consequences would come to cost a major company: Just three months prior, Starbucks had to delay a marketing push after two African Americans were arrested in Philadelphia after wishing to use the restroom, an event watched over eight million times on Twitter. The ensuing criticism prompted the company to close its stores and conduct sensitivity training across many of its locations, hurting same-store sales and driving profits down over nine percent.

Domestic demographic changes have worked with globalization and the free flow of information to increase reputational and business stakes. The U.S. population, the country’s domestic consumer pool and workforce, is expected to become ever more racially and ethnically diverse, without a single racial majority or ethnic majority by 2055—with Millennials and Gen Zers

150 Id. at 3.
151 Barzuza, supra note 140 at 152–53.
152 Id.
153 Id.
154 Tonya Garcia, Starbucks says racial bias incident delayed its marketing push, hurt same-store sales (June 21, 2018), https://www.marketwatch.com/story/starbucks-says-racial-bias-incident-delayed-its-marketing-push-hurt-same-store-sales-2018-0620; see also Jason Del Rey, Amazon employees are outraged by their company’s opposition to a plan to add more diversity to its board (May 8, 2018), https://www.vox.com/2018/5/8/17328466/amazon-jeff-bezos-board-diversity-proposal-shareholder-vote (reporting that Amazon was the subject of recent criticism when its board recommended a vote against a proposal to implement a “Rooney Rule,” which requires the initial list for new director nominees to include qualified women and minority candidates, citing complex considerations in the process for nominating director).
155 D’Vera Cohn and Andrea Caumont, 10 demographic trends shaping the U.S. and the world in 2016, PEW RESEARCH CENTER (Mar. 31, 2016), Electronic copy available at: https://ssrn.com/abstract=3788159
comprising the most diverse generational cohort in U.S. history. Furthermore, the North American workforce is expected to fall from 5% to 4% of the global workforce in the next two decades while the population in sub-Saharan Africa and Latin America are set to explode. Experts consequently connect the pursuit of Diversity with not only cultivating new domestic consumers, workers, and investors, but also with engaging new foreign stakeholders with varied cultural values, experiences and interests.

There is also a growing recognition that collective action by the business sector to include more Americans in our economy’s benefits can fuel overall growth for the economy, and drive demand in a way that will increase corporate profits. Citi’s report finds that if racial gaps had been closed 20 years ago, the U.S. economy could have benefited from as much as $16 trillion of additional GDP. Based on this calculation, the report estimates that the closing of the gaps could add roughly $5 trillion to U.S. GDP through 2025. From a global perspective, Accenture similarly estimates that if the perception gap of gender equality between employers and employees were narrowed by 50%, global profits would increase by 33%, including an increase of $1.05 trillion by the U.S. The businesses in the vanguard of driving this positive change are the ones most likely to improve their reputations and secure a larger share of the resulting gains. The acknowledgement of Diversity as a reputational asset is abundant. Magazines, from DiversityInc to Working Mother, release surveys sent to leading corporations from which they derive annual rankings on issues including recruitment and retention, specific ethnic groups, and LGBTQ+ communities, work-life balance, and more. And major companies submit materials needed to be evaluated by these independent raters, and boast on their websites and in promotional materials when they score well.

The importance of independent raters, and high Diversity reputations, has grown as institutional investors increasingly focus on social issues like DEI. As society has become more socially conscious, new investment funds have emerged, epitomized by the EESG movement, which attempt to identify corporations that, while profitable, embrace positive social values like Diversity, Equity, and Inclusion—and adjacent areas such as fair worker treatment, environmental responsibility and sound governance. Spurred by high-net-worth clients and pension funds, fund managers have created offerings designed to allocate assets to investment funds that make a difference, usually with Diversity as one of the metrics for assigning scores of


156 The consumer is changing, but perhaps not how you think, Deloitte Insights, 2019.
158 Citi GPS, supra note 68.
159 Id.
162 Id. at 474.
portfolio companies. And in the future, the weighting of Diversity is likely to only increase.

Part of the impetus behind the EESG sector’s growth has been financial: the returns thus far have been positive, with EESG funds largely outperforming the market. But this growth also reflects an awareness that because investor preferences are themselves diverse, moral-driven choices can drive market activity and shareholder returns. Things once considered immaterial, like new information being introduced into the market concerning a company’s Diversity performance, can push a company’s stock price higher.

163 George Sarafeim, *Investors as Stewards of the Commons?*, 30 J. OF APPLIED CORP. FIN. 1, 11 (2017) (noting that when investors’ pressures are not satisfied through private mechanisms, the investors will often engage publicly by filing shareholders’ proposals: in 2015, 34% of all shareholder proposals were EESG related, led by socially responsible investment funds and public pension funds, followed by activist hedge funds and index funds); Jenna Weinberg & Simon Greer, *Diverse Asset Managers Initiative, Fiduciary Guide to Investing with Diverse Asset Managers and Firms*, SEC (Apr. 2017), https://www.sec.gov/files/amac-background-dami-fiduciary-guide.pdf; but see Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 386 (2020) (arguing that a trustee can engage in ESG investing only if “(1) the trustee reasonably concludes that the ESG investment program will benefit the beneficiary directly by improving risk-adjusted return; and (2) the trustee’s exclusive motive for adopting the ESG investment program is to obtain this direct benefit”).

164 See Lizzy Gurdus, *Diversity, inequality metrics will see ‘a lot of scrutiny’ next year as ESG investing grows, MSCI says*, https://www.cnbc.com/2020/12/18/diversity-under-scrutiny-as-esg-investing-grows.html (noting how companies are going to get more creative about how they can actually better beef up their social credentials with investors).

165 Emiliano Rabinovich, *ESG Equity Index Performance in the US: Outperformance vs. the Benchmark During Market Volatility*, https://www.etftrends.com/esg-channel/esg-equity-index-performance-in-the-us (noting that although the magnitude of the outperformance varies among the different ESG index providers, it’s important to note that each has beaten the benchmark over time and has done so consistently, regardless of ESG methodology or ESG data provider).

With demand for socially conscious offerings growing, EESG ratings have proliferated, and corporations face growing pressure to achieve and then maintain strong rankings or “scores.”\textsuperscript{167} If a company’s stock is designated an “unsustainable asset” due to its failure to adopt measures consonant with EESG credentials or priorities like Diversity, corporate officers and directors face the prospect of their company’s stock being excluded from investment portfolios.\textsuperscript{168} And for many companies, the consequences could be material. If a sufficient number of investors are then excluded from accessing the fund, or if a sufficient number of funds act in concert based on a score, or series of scores, the price of a company’s stock can fall as demand falls—or other investors could even short the company’s stock, putting downward pressure on its share price.\textsuperscript{169}

* * *

For all the reasons we have addressed, we therefore believe that a plausible, indeed sound, business rationale exists that businesses that cultivate collaboration by diverse minds, that value merits-based factors instead of social origins, and that welcome working with customers, communities, and partners from all segments of society and the globe will be better positioned to thrive in what is itself an increasingly diverse world economy.

III. AN OVERVIEW OF CURRENT REFORMS TO ENCOURAGE CORPORATE DIVERSITY, EQUITY, AND INCLUSION

The private sector’s growing awareness of the business advantages of Diversity, the ethical values of business leaders, and the anticipation of the demographic changes coming in the U.S., had already led some corporations to adopt voluntary DEI policies. But it has been above all the national reckoning with the death of George Floyd and the disparate effects of the COVID-19 pandemic that have led to concrete policy initiatives being announced across the country aimed at increasing Diversity, Equity, and Inclusion within corporate organizations. Widespread moral outrage and a cultural awakening has catalyzed both new government activism and corporate action, on the other, with energy being directed in improving the Diversity, Equity, and Inclusion of corporate America.


\textsuperscript{168} Robert Eccles and Svetlana Klimenko, The Investor Revolution, HARV. B. REV. https://hbr.org/2019/05/the-investor-revolution (observing that as it becomes clear that the people who decide whether to buy or sell a company’s stock have internalized ESG into their calculations, business leaders will be forced to do the same within their companies).

\textsuperscript{169} See Chris Sloley, \textit{How ethical is it to short the bad boys of ESG?}, https://citywireselector.com/news/how-ethical-is-it-to-short-the-bad-boys-of-esg/a1283784 (examining whether investors should actively short such stocks to further punish socially problematic players).
In this Section, we survey the most high-profile efforts. We start, however, with an analysis of the limitations of legacy anti-discrimination laws geared towards advancing racial and economic equality. We then catalogue a growing number of corporate Diversity initiatives: California state reforms aiming for diversity, Nasdaq’s board diversity initiative and capital markets initiatives spearheaded by pension and investment funds. As will be seen below, most reforms are aimed at either reforming perceived inadequacies in corporate law to reflect the potential value of Diversity or leveraging securities law to enable greater transparency of board-level Diversity. We explain, however, that although these initiatives represent fresh and much needed thinking about the demographic dilemma facing corporations, they offer in practice limited and incomplete answers to the profound challenge of corporate inequality, and fail to address the full range of DEI issues involved in corporate conduct toward all their stakeholders.

A. Federal Anti-Discrimination Laws

Calls for reform of corporate entities are not arising in a vacuum, and it is important to understand the preexisting legal backdrop against which they operate. Critically, a range of federal laws require corporations to, as a matter of basic compliance, implement policies and practices that attend to DEI, which are supplemented by comparable state laws. For example, the Equal Pay Act of 1963 (“EPA”), which amended the Fair Labor Standards Act of 1938, prohibits employers from sex-based wage discrimination between men and women who are in substantially equal positions. One year later, Congress passed the Civil Rights Act of 1964 that further broadened the scope of federal anti-discrimination laws, and bans practices that have a disparate impact on protected groups, unless these practices can be justified by a legitimate business reason. Title VII of the Act of 1964 (“Title VII”) in particular prohibits discrimination not only based on sex but also based on race, color, religion or national origin, and applies to any employer who has 15 or more employees. In addition, Title II of the Civil Rights Act of 1964 prohibits discrimination based on race, color, religion or national origin that denies a person “the full and equal enjoyment of the goods, services, facilities, privileges, advantages, and accommodations of any place of public accommodation.” Public accommodation is defined broadly to include facilities such as hotels, restaurants and theaters.

170 Most states, and some cities, have their own anti-discrimination laws, which extend prohibitions against discriminatory conduct to additional categories of protected persons. The New York State Human Rights Law, for example, prohibits discrimination on the basis of sexual orientation, military status, familial status, marital status, domestic violence victim status, and arrest and conviction status. N.Y. Exec. Law § 296.
171 29 U.S.C. § 206(d). Substantially equal positions are positions that require “equal skill, effort, and responsibility, and which are performed under similar working conditions.” Id.
The Civil Rights Act of 1991 then strengthened anti-discrimination laws in the wake of several controversial decisions,\(^{175}\) giving plaintiffs the right to trial by jury and compensatory and punitive damages for intentional discrimination under Title VII. In addition to federal laws, employers must adhere to the anti-discrimination laws that have been adopted by most states.\(^{176}\)

In response to systemic racial segregation and in the wake of Martin Luther King, Jr.’s assassination, the Congress passed the FHA in 1968 to prohibit discrimination in housing transactions based on race, color, religion and national origin, and, as amended, sex, disability and family status.\(^{177}\) The U.S. Department of Justice and the U.S. Department of Housing and Urban Development (“HUD”) enforce the FHA, and individuals may file lawsuits under the FHA as well.\(^{178}\) In addition to the FHA, Congress passed the ECOA in 1974, which, as amended, prohibits creditors from discriminating against applicants based on race, color, religion, national origin, sex, family status and age.\(^{179}\) Despite the FHA and ECOA, housing discrimination against Black Americans continued as financial institutions used the deposits they accepted from inner cities to lend and invest in other neighborhoods.\(^{180}\) The practice of denying credit to an eligible applicant based on the neighborhood the applicant resided, referred to as “redlining,” led to the enactment of the Community Reinvestment Act (“CRA”) in 1977 to encourage financial institutions to meet the credit needs of the communities in which they are located.\(^{181}\)

Notably, the damages from violating these rules can be substantial. Most employment discrimination cases under Title VII, for example, can be brought under traditional class actions under Rule 23 of the Federal Procedure Act, along with violations of ECOA.\(^{182}\) Meanwhile, violations of the Equal


\(^{181}\) Id.

Pay Act ("EPA") are brought as collective actions, which though requiring that all plaintiffs consent, can be larger monetarily, as can administrative actions taken by agencies like the EEOC to punish actors for systemic discrimination.\textsuperscript{183}

For the purposes of corporate diversity, however, the reach of federal civil rights laws is subject to considerable constraints, especially as it pertains to corporate boards. Although the Civil Rights Act of 1964 makes it illegal to discriminate in employment practices, it does not apply to corporate board membership because board members, with the exception of the corporate insiders who serve,\textsuperscript{184} are usually not employees.\textsuperscript{185} In fact, courts routinely hold that the statute does not apply to corporate directors. As the Seventh Circuit has put it: "Directors are traditionally employer rather than employee positions."\textsuperscript{186}

The upshot is that nondiscrimination laws apply to firms, and to hiring and promotion, but as one moves toward top-level corporate governance, where in some instances board Diversity may be most important, it ceases to have as much applicability. It does, however, apply to the C-Suite, though as discussed above, other issues including social networking and internal advancement obstacles have been found to stymie women and ethnic minorities as a group in terms of both getting hired by, and climbing, corporate hierarchies.

In response to these gaps, Congress has weighed in on the importance of improving board transparency. In 2017, Representative Carolyn Maloney introduced the "Gender Diversity in Corporate Leadership Act of 2017," which would require public companies to provide proxy disclosure regarding the gender Diversity of the board of directors and nominees.\textsuperscript{187} In November 2019, the U.S. House of Representatives, with bipartisan support, passed the "Corporate Governance Through Diversity Act of 2019," which requires certain registrants annually to disclose the racial, ethnic, and gender composition of their boards and executive officers, as well as the veteran status.


\textsuperscript{185} As Fanto has noted, the Supreme Court has set forth guidelines for determining when a board member should be considered an employee. See Clackamas Gastroenterology Assocs. v. Wells, 538 U.S. 440, 449–51 (2003). A typical board member will not be considered an employee. See Stephanie Greene & Christine Neylon O’Brien, Who Counts?: The United States Supreme Court Cites “Control” as the Key to Distinguishing Employers from Employees Under Federal Employment Antidiscrimination Laws, 2003 COLUM. BUS. L. REV. 761, 787 (“The language in the EEOC guidance indicates that principals must overcome a presumption that they are employers.”).

\textsuperscript{186} Chavero v. Local 241, Div. of the Amalgamated Transit Union, 787 F.2d 1154, 1157 (7th Cir. 1986).

of any of those directors and officers, in their proxy statements.\textsuperscript{188} The bill also requires the disclosure of any policy, plan or strategy to promote racial, ethnic, and gender Diversity among these groups. Legislators have proposed a companion bill in the U.S. Senate.\textsuperscript{189}

\textbf{B. SEC Board Diversity Disclosure Rules}

In 2009, the SEC adopted a rule designed to assess individual companies’ commitment to establishing and maintaining Diversity on their board.\textsuperscript{190} Under the rule, public companies are required to disclose whether diversity is a factor in considering candidates for nomination to the board of directors, and how the company assesses how effective the policy has been.\textsuperscript{191} But, as Laurence Trautman has explained, companies and the SEC diverged in terms of their interpretations of the rule, with the majority of companies differentiating “consideration” of Diversity and Diversity “policy.”\textsuperscript{192}

A decade later, the Commission revisited the rules by establishing new Compliance and Disclosure Interpretations (“C&DI”).\textsuperscript{193} The revisions did not, however, provide a definition of Diversity, leaving issuers free to refrain from disclosing the race, ethnicity or gender of their directors or nominees.\textsuperscript{194} Instead of identifying what criteria constitute Diversity, a non-exhaustive list of examples of Diverse characteristics was provided, including “race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background.”\textsuperscript{195} Meanwhile, the issuer’s description of a company’s Diversity policy would be relied on as an explanatory tool providing “a discussion of how the company considers the self-identified diversity attributes of nominees as well as any other qualifications its diversity policy takes into account, such as Diverse work experiences, military service, or socioeconomic or demographic characteristics.”\textsuperscript{196}

\textsuperscript{193} For an overview of the C&DI, from which this discussion is partially based, see Nasdaq, Notice of Filing of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity, https://www.sec.gov/rules/sro/nasdaq/2020/34-90574.pdf.
\textsuperscript{194} \textit{Id.}
\textsuperscript{196} \textit{Id.}
Currently Item 401(e)(1) of Regulation S-K requires a company to “briefly discuss the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director.” The C&DI clarifies that if a board considered a director’s self-identified Diversity characteristics (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background) during the nomination process, and the individual consents to disclose those Diverse characteristics, the Commission “would expect that the company’s discussion required by Item 401 would include, but not necessarily be limited to, identifying those characteristics and how they were considered.”

Along with requiring companies to indicate whether Diversity is considered when identifying director nominees (and if so, how) Item 407(c)(2)(vi) of Regulation S-K requires companies to indicate if the board or nominations committee has adopted a Diversity policy and describe how the policy is implemented and its effectiveness is assessed. The Commission’s logic was one that sought maximum flexibility for firms given the fact that “companies may define diversity in various ways, reflecting different perspectives. For instance, some companies may conceptualize diversity expansively to include differences of viewpoint, professional experience, education, skill and other individual qualities and attributes that contribute to board heterogeneity, while others may focus on diversity concepts such as race, gender and national origin.” In the view of the Commission, and in light of such Diversity in Diversity, companies should be allowed to define Diversity in ways that they consider appropriate.

Critics have, however, asserted that the flexibility provided under the rule has rendered it, if not meaningless, then gravely ineffective. For one, the self-executing nature of the disclosures, combined with the substantive voluntariness of embracing Diversity policies, has meant that the data reported have been unreliable and of minimal utility to investors. Not only have public companies failed to disclose much information about their boards, but also there has been little uniformity in either what is reported or the definitions of Diversity characteristics across companies. Some policymakers have, as a consequence, urged reforms of Reg S-K to require data and reporting regarding gender and racial diversity on corporate boards.
C. State Law Initiatives

In addition to federal rules, states have turned their attention to laws that go beyond anti-discrimination. The legislature in each of Michigan, Pennsylvania, Hawaii, and Massachusetts are working on bills that, if passed, would nudge (and in some instances require) employers to increase Diversity in leadership positions, especially boards of public corporations. Only two states, California and New York, have passed legislation imposing such duties. Below, we examine their key features.

1. California’s Board Diversity Laws

California has passed two separate board diversity statutes, one aimed at gender diversity, the other at racial and ethnic diversity, as well as sexual orientation. First, on September 30, 2018, former California Governor Jerry Brown approved Senate Bill 826 (“SB 826”), which mandated “female representation on California-based companies’ corporate board.”\(^\text{203}\) Two years later, California Governor Gavin Newsom approved Assembly Bill 979 (“AB 979”), mandating a similar requirement whereby public companies headquartered in California must “diversify their boards of directors with directors from ‘underrepresented communities’.”\(^\text{204}\) Both SB 826 and AB 979 apply to publicly held companies which are headquartered in the state of California, and both impose mandatory Diversity requirements beyond merely disclosing board composition.

By the end of 2021, SB 826 requires every “publicly held domestic or foreign corporation whose principal executive offices . . . are located in California” to “adhere to a schedule whereby boards of six or more have three or more female directors; boards of five have two or more female directors, and boards of four or fewer have one or more female directors.”\(^\text{205}\) The legislation grants the California Secretary of State authority to enforce company violations of the law by either (1) publishing a list of companies who are compliant or non-compliant or (2) imposing fines on boards who failed to disclose board composition. In the case of monetary fines, the quantum to be assessed for an initial violation is $100,000; $300,000 is to be assessed for every subsequent violation.

AB 979 is a parallel law with similar provisions, though with a broader scope. Specifically, AB 979 defines “director from underrepresented community” as “an individual who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian,

\(^{202}\) S.B. 115, 100th Leg. (Mich. 2019) ("[A] publicly held domestic corporation or foreign corporation whose principal executive offices, according to the corporation’s SEC 10-K form, are located in this state must have a minimum of 1 female director on its board.").
\(^{204}\) Jackson Lewis, AB 979 Requires California-Based Publicly Held Corporations To Diversify Their Boards Of Directors, JD SUPRA (Oct. 1, 2020).
\(^{205}\) Riley, supra note 202.
or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender."

Its mandatory quotas state that “[publicly held corporations with HQ in California] must have at least one director from an underrepresented community on their boards by December 31, 2021. By December 31, 2022, covered corporations with boards of nine or more directors must have a minimum of three directors from underrepresented communities on their boards, and covered corporations with boards of more than four but less than nine directors must have a minimum of two directors from underrepresented communities. AB 979’s two enforcement mechanisms are identical to those of SB 826.

2. New York’s Board Diversity Study and Disclosure Mandate

In December 2019, New York Governor Andrew Cuomo signed Senate Bill 4278 (“SB 4278”), which enacts the “Women on Corporate Boards Study.” Similar to the California bills, SB 4278 mandates that “domestic and foreign corporations ‘authorized to do business’ [in New York]” abide by board composition reporting mandates. Under the law, both private and public corporations — regardless of whether they are headquartered in the state — must disclose the number of directors they appoint to their board and how many of those directors are female. The information will be collected as part of the corporation’s filing statement required by the Business Corporation Law. New York’s Department of State and Taxation and Finance Departments are then charged with studying the number of women directors who serve on each board of directors of domestic corporations and foreign corporations licensed to do business in New York state.

The initial results of the study will be published on February 1, 2022, likely leading to more concrete action. In its current state, the bill does not impose any quotas and does not mandate a specific number of women to be on the boards of corporations that do business in New York.

D. Market “EESG” Initiatives

Private market participants are also driving the debate on corporate Diversity. As shown, people have shown increasing interest in participating in markets—as either consumers or investors—in ways that conform with their values. This interest has in turn pushed varying market participants to adopt

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206 Lewis, supra note 203.
209 Michal Barzuza, Quinn Curtis, and David H. Webber, Shareholder Value(s): Index Fund ESG Activism and the New Millennial, 93 S. CAL. L. REV. 101, 106–07 (“When it comes to investment preferences, Millennials are markedly different than their predecessors. The literature and market research unanimously concludes that, compared
practices and stances that reflect these changing, and intensifying, preferences, especially given the data-driven nature of investment products such as Diversity-specific indices and broader EESG funds.\footnote{210}

1. Investment Company Initiatives

Pension funds and investment companies have shown increasing interest in the topic of Diversity during this century, especially as to gender.\footnote{211} As early as 2009, the SEC sought comment on whether to amend Item 407(c)(2)(vi) of Regulation S-K such as to require disclosure of whether a nominating committee considers Diversity when selecting a director for a position on the board.\footnote{212} Of the more than 130 comment letters on its proposal, most were submitted in favor of the proposal, and by groups with a specific interest in Diversity, or by institutional investors, including mutual funds, pension funds, and socially responsible investment funds.\footnote{213} Several years later in 2015, nine large public pension funds who collectively supervised $1.12 trillion in assets at the time petitioned the SEC to require registrants to disclose information related to, among other things, the gender, racial, and to prior generations, Millennials are less interested in investment returns and more interested in their investments reflecting their social values.”); 146-50 (citing studies supporting this conclusion).


\footnote{211} The reality is that it took the sad events of 2020 to move the major institutional investors to make a focus on racial Diversity a priority. \textit{See}, \textit{e.g.}, Larry Fink and Rob Kapito, \textit{Our Actions to Advance Racial Equity and Inclusion}, BlackRock (June 22, 2020), https://www.blackrock.com/corporate/about-us/social-impact/advancing-racial-equity; Richard Lacaille, \textit{Diversity Strategy, Goals & Disclosure: Our Expectations for Public Companies}, State Street Global Advisors (Aug. 27, 2020), https://www.ssga.com/us/en/institutional/etfs/insights/diversity-strategy-goals-disclosure-our-expectations-for-public-companies; \textit{Vanguard Investment Stewardship Insights}, Vanguard (Dec. 2020), https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/ISWORK_122020.pdf. The reasons for this lag bear exploration, but for present purposes, we just note the positive development that racial Diversity has now emerged as a stated institutional investor priority. We also note, however, that there is still more work that institutional investors should do to combat racial injustice, such as casting their proxies for proposals requiring corporations to disclose political spending, as such spending often supports candidates and political issues that are contrary to the interests of minorities. \textit{See} Eleanor Bloxham and Bruce F. Freed, \textit{It’s Time for Boards and Institutional Investors to Act on Racial Justice}, \textit{BARRON’S} (June 19, 2020), https://www.barrons.com/articles/its-time-for-boards-and-institutional-investors-to-act-on-racial-justice-51592527239?mod=hp_INTERESTS_economy-and-policy&refsec=hp_INTERESTS_economy-and-policy.

\footnote{212} \textit{See} 17 C.F.R. § 229.407(c)(2)(vi).

\footnote{213} \textit{See} Thomas Lee Hazen and Lissa Lamkin Broome, \textit{Board Diversity and Proxy Disclosure}, 37:1 \textit{UNIV. DAYTON L. REV.} 41, 51, n. 82 (citing the comment letters).
ethnic Diversity of the registrant’s board nominees.\textsuperscript{214} In 2017, Human Capital Management Coalition, which described itself as a group of institutional investors with $2.8 trillion in assets at the time, made a similar petition to the Commission.\textsuperscript{215}

Nearly a half decade later, pressured by not only its members facing investor pressure and enhanced interest in EESG funds, but by also ratings companies seeking to design systems for categorizing firms, the investment company industry is once again calling for more information on diversity from companies. In October 2020, the Illinois Treasurer spearheaded an initiative along with 20 other investor organizations, calling on all companies in the Russell 3000 Index to disclose the composition of their board, including each board member’s gender, race and ethnicity.\textsuperscript{216} That same month, BlackRock Inc., the world’s largest asset manager, announced plans in 2021 to push companies for greater ethnic and gender Diversity for their boards and workforces, and disclosed that it will vote against directors who fail to act to promote that goal. The money manager, which oversees more than $7.8 trillion of assets, is asking U.S. companies to disclose the racial, ethnic and gender makeup of their employees—data known as EEO-1—as well as measures they’re taking to advance diversity and inclusion.\textsuperscript{217} It will also make explicit pushes for Diversity in select jurisdictions.\textsuperscript{218} Meanwhile, Vanguard has said it plans to vote against company directors who fail to push for greater racial and gender diversity on their boards.\textsuperscript{219} State Street Global Advisors, which manages about $3 trillion for clients, has committed to ask companies about their metrics and goals to boost racial Diversity within their ranks.

Against this backdrop, the ICI, the trade association for American and international investment companies like mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts, has likewise announced plans to push for greater Diversity. Initial priorities include measuring industry

\textsuperscript{218} For example, BlackRock U.K. companies to adopt the Hampton-Alexander Review target for female directors in the U.K.’s top businesses—the minimum threshold for this target is 33% female board composition or greater.
demographics “at both the board and workforce levels” through mandatory surveys of members. This information will then be used to develop benchmarks to improve Diversity in the future. Once these benchmarks are eventually implemented, it is expected that there will be more explicit reporting guidelines, and perhaps requirements, for board diversity similar to those proposed by other securities industry participants.

2. NASDAQ Listing Requirements

NASDAQ’s proposed rule (the “Rule”) would mandate certain board diversity requirements for public companies listed under its exchange. The Rule was submitted on December 1, 2020 for SEC approval. Under the proposed Rule, each NASDAQ-listed company would face two sets of requirements. First, each listed company would have to annually disclose in a uniform format, either in the company’s annual proxy statement or on the company’s website, statistical information regarding its directors’ self-identified gender, race, and self-identification as LGBTQ+. Additionally, companies listed on the Nasdaq Global Select tier or Global Market tier would have to have (or explain why they do not have) at least one Diverse director within two years of SEC approval, and at least two Diverse directors within four years of SEC approval. Smaller-cap companies listed on the Nasdaq Capital Market tier would have to have (or explain why they do not have) at least one Diverse director within two years of SEC approval, and at least two Diverse directors within five years of SEC approval.

NASDAQ’s proposed rule would presumably have a broad impact, encouraging thousands of companies listed on its stock exchange to include women, racial minorities and LGBTQ+ individuals on their boards, in what would be one of the most forceful moves yet to bring greater diversity to U.S. corporations. Notably, more than three-quarters of its listed companies would, in the absence of changes to their board, fall short of the proposed requirements. Although 80% or 90% of companies had at least one female director, only approximately one-quarter had a second director who would meet the Diversity requirements. Overall, smaller companies tended to have less Diverse boards and would need to do more to respond to the proposed rule.

220 Hathorn, supra note 216.
223 Though even here, the data were reportedly difficult measure because of inconsistencies in the way companies report such data. NASDAQ defined underrepresented minorities as individuals self-identifying as Black, Hispanic, Asian, Native American or belonging to two or more races or ethnicities. Id.
224 Id.
3. The Goldman Sachs IPO Pledge

In February 2020, Goldman Sachs announced that it will only underwrite IPOs for U.S. and European private companies that have at least one Diverse board member.225 This rule became effective on July 1, 2020, and starting in 2021, Goldman Sachs will raise its target to “two diverse candidates for each of our IPO clients.” As stated, the commitment relates to any private company looking to hire Goldman Sachs to underwrite its initial public offering. The Diversity requirement is mandatory, but it is implied that there is discretion as to what qualifies as “Diverse.” The commitment statement cites Goldman Sachs’ own Board of Directors, where the Lead Director is a Nigerian man and four of the 11 board seats are held by women.

E. The Limitations of External Regulation and the Corresponding Need for Corporate Action

Collectively, current U.S. proposals designed to increase corporate Diversity do so in largely unprecedented ways, with particular emphasis falling most squarely on corporate boards. They do so along two basic dimensions: either a) state law reforms, or b) reforms that leverage capital markets infrastructures and services providers.

There are, however, a number of important limitations with the current trajectory of reforms. First are possible constitutional challenges.226 California’s SB 826 has already been challenged on equal-protection grounds in several lawsuits.227 In Meland v. Padilla, a conservative legal organization unsuccessfully claimed on behalf of a public company shareholder that, in requiring a female board member, the law prevented that shareholder from voting as he desired.228 In another case, Crest v. Padilla, the plaintiff sought to prevent the California Secretary of State, Alex Padilla, from spending taxpayer money to enforce the law on the ground that it violated the California constitution by imposing an unconstitutional gender-based quota. In June, a


228 Id.
state Superior Court judge overruled Padilla’s argument that the plaintiffs lacked standing. The matter is currently in ongoing litigation, and the Secretary of State’s office will be required to answer the complaint.

AB 979 will likely be challenged on similar grounds. Opponents of the laws may argue that male candidates, or non-Diverse candidates, are denied fundamental rights under the equal protection clause as a result of mandatory diversity quotas. Notably, these challenges will likely trigger strict scrutiny of these race- and gender-based laws and thus, though remedial in nature and designed to address a long-standing history of discrimination, the laws will, as we discuss below, face an uncertain future before the right-wing majority of the U.S. Supreme Court, and that reality will create dilemmas for corporate decisionmaking. To the extent to which the law imposes substantive board requirements on corporations that may be headquartered in California, but incorporated elsewhere, the law could additionally be challenged on the basis of the internal affairs doctrine, which provides that the state of incorporation should have the authority to regulate a corporation’s internal affairs (such as corporate governance and composition and election of boards).

The NASDAQ reforms create far less uncertainty insofar as they, although expressing clear objectives, do not introduce mandatory reforms to Boards. Instead, listed firms are required to comply or explain why they did not meet listing standards. Theoretically, however, challenges could nonetheless arise if a qualified candidate seeking a position on a public company’s board argued that he was deprived of a property interest by being denied a board position primarily for not meeting “Diverse” criteria under the Rule. Alternatively, the Rule might be challenged under the internal affairs doctrine. Under this logic, NASDAQ should not be able to impose federal guidelines about board composition when state corporate law should govern its makeup.

Still, the most obvious limitation of NASDAQ’s new listing rules—along with that of the ICI—is that they are ultimately not mandatory. Instead, a company can choose whatever course of action it wants, unless other legal constraints arise in some other corner.

Additionally, NASDAQ’s rules, along with the engagement of ICI and Goldman Sachs, apply exclusively to public companies. None apply to private companies. From a public policy perspective, and from the standpoint of racial equity, this limited scope is problematic. There are only about half as many public companies in the United States today as there were in the late 1990s. And promising start-ups are tending to stay private longer, with elite investors capturing even more of the biggest gains. By thus extending only to public companies, the capital markets-based reforms miss companies where the most value is created. They also fail to affect firms at a point in time when the introduction of Diverse boards might likely prove most transformative.

229 Id.
230 Id.
232 Id.
Diversity experts agree that the easiest means of ensuring that firms are diverse is by making sure that they take steps toward diverse hiring early on. It is, in short, much easier to ensure Diversity by hiring Black and Brown people early on, than scaling, and then taking on Diverse board members with the hope that they can retroactively change the demographics and culture of the firm.

Critically, NASDAQ’s reforms, like virtually all of the major reforms thus far introduced, focus almost exclusively on boards. None target the Diversity of senior and middle management—or the broader workforce as a whole. The most charitable reading of their scope would be that they speak to the holes in federal employment law discrimination. But, the bulk of opportunity that corporations provide for Americans to improve their lives, engage in fulfilling work, and interact with customers and communities, is at the other levels of the firm—where line workers, middle managers, and contracted workers collaborate to serve the company’s customers. For reforms at the board level alone to effectively change corporate demographics at all, they would at best involve slow, incremental, and not transformational change—and for even that to occur, consistent board oversight and involvement to drive the deeper and more comprehensive action required to ensure that corporate policies toward all stakeholders embrace respect for Diversity, Equity, and Inclusion.

Many of the reforms rely on quotas as drivers of reform. And while we applaud decisive action at establishing clear goals for organizations, and compelling corporate boards to open long-denied doors of opportunity, the threat of constitutional challenge is clear. And the outcome, given recent Supreme Court jurisprudence, is uncertain. Quotas are also gameable. In

233 See Brian Nordli, How to Make Diversity A Hiring Priority at the Startup Stage, BUILT IN (June 6, 2020), https://builtin.com/diversity-inclusion/small-business-diversity-and-inclusion-hiring-strategy (noting “It’s so hard to course correct once you go from 50 people to 150-300.”).

234 Id.

235 A learned colleague posed this hypothetical: Imagine a California-based corporation subject to the “at least three women requirement,” and that has only two women on the board. A vacancy arises. May or must the board limit its search to only women candidates? Even assuming it may do so without running afoul of anti-discrimination statutes because directors are likely not employees covered by those statutes, may the board do so consistent with the federal constitution if it is doing so by mandate of state law? As a matter of law compliance, the board would have to consider not just its obligations under state law, but under federal constitutional law, and make a difficult calculus about whether these statutes can be applied validly in a context like this where compliance would literally require only considering women candidates to the exclusion of all males. And, of course, similar situations could arise to the extent that statutes were to require a certain percentage of minority representation, or of a particular minority, such as Black people.

236 As a matter of recent constitutional jurisprudence, the U.S. Supreme Court has displayed little tolerance for federal and state law efforts to remediate past discrimination. Prominent examples include its decision in Shelby, striking down key provisions of the Voting Rights Act that had been extended by overwhelming bipartisan majorities, and its decision in Seattle School Dist. No. 1, striking down a school district’s plan to continue efforts to promote desegregation and racial balance in its schools after being relieved of federal court supervision. Shelby County, Ala. v. Holder, 570 U.S. 529, 556–57 (2013) (holding that the Voting Rights Act’s coverage formula and preclearance requirement, which required covered jurisdictions to demonstrate that proposed voting law changes were not
many instances, the numerical thresholds are minimal—sometimes just one diverse director—and the capaciousness and sheer number of factors that qualify as diverse present the opportunity for employers to selectively target people coming from groups that may be more socially or personally palatable to hirers instead of from those who are most historically or demographically underrepresented. Thus, to the extent they represent check-the-box exercises, quotas allow companies to meet minimal numerical thresholds, and upon doing so can unintentionally encourage them to relax or disengage from further board reform. As at least currently contemplated, they risk being “half measures.”

Finally, none of the reforms speak to closely allied, but importantly distinct, concepts of Equity and Inclusion, the “E” and “I” in DEI. As a result, the reforms do not provide the tools with which to address issues beyond board personnel, like ensuring an inclusive environment to support communication and innovative ideas from Diverse pockets of the workforce. Goldman Sachs has taken the laudable step of effectively constraining itself via a voluntarily adopted quota system in which it will only assist companies with IPOs that meet a basic board-level diversity threshold. But this new positive standard does not address less quantifiable issues of corporate culture toward DEI. For example, Goldman Sachs is helping the crypto exchange Coinbase in going public, despite moves by Coinbase’s CEO to limit Black Lives Matter protests and other communications about racial equity issues.

discriminatory, was unconstitutional); see also Parents Involved in Community Schools v. Seattle School Dist. No. 1, 551 U.S. 701, 729-32 (2007) (plurality opinion) (finding that the use of racial classification to create a racially diverse environment was racial balancing and thus, unconstitutional).

We stress, however, that how and under which context quotas are applied matters. Leaving the constitutional question aside, quotas can plausibly serve to forward a number of Diversity goals because it is often difficult to make progress on a long-standing inequity without a reasonable target to aim for and against which to measure the effectiveness of efforts. The application of strict numerical goals thus far leaves, however, open questions as to whether or not ostensibly muscular measures like quotas would over time make a measurable impact on the representation of the most historically underrepresented or persecuted groups.

As Nancy Leong recognizes in a similar context, striving for numerical diversity, without more, may result in awareness of diversity only in its thinnest form—as a bare marker of difference and a signal of presence. Nancy Leong, Racial Capitalism, HARV. L. REV. at 2155. Diversity could then be merely a useful word for nondiverse corporations to use to acquire social and economic benefits of listing or incorporation while avoiding more difficult questions of racial and gender equality. Id. See also Derrick Bell, Diversity’s Distractions, 103 COLUM. L. REV. 1622, 1622 (2003) (arguing that diversity can be used in ways to avoid questions on race and class); Stephen M. Rich, What Diversity Contributes to Equal Opportunity, 89 S. CAL. L. REV. 1011, 1017–18 (2016) (arguing that the rationale of Grutter v. Bollinger, 539 U.S. 306 (2003), underserves equal opportunity by deferring to institutional constructions of diversity’s benefits, naively equating the achievement of numerical diversity with the accomplishment of those benefits).
within its workplace\textsuperscript{239} and despite evidence published about the widespread pay inequity allegedly suffered by Coinbase’s Black and female employees.\textsuperscript{240}

Our point is that it is, of course, useful and important to increase the Diversity of corporate boards and the C-Suite. But these issues are just the beginning, not the end, of the conversation. Unfortunately, legislating bright line, \textit{ex ante} commitments to workforce-wide inclusion, to fairness and equity, to treating fellow employees and customers with respect regardless of their identity, and to providing equal service to all communities is difficult. And, perhaps for that reason, the pending reforms also do not even purport to address issues like them. They are silent on other important issues such as the willingness of corporations to provide their services and products to all communities who can benefit from them, be they urban communities with a major minority population or struggling predominately white rural communities. They evade any interrogation of issues like corporate recruitment policies, and whether and how corporations should extend searches to not only historically Black universities but also community colleges. And they do not begin to contemplate DEI commitments corporations should expect or require of the businesses that they contract with.

For all these reasons, we find it improbable that external law alone will induce the full scope of required corporate action. At least as currently conceived, external regulation does not have a method to bake into the bones of corporations a deep commitment to equality, inclusion, tolerance and an ethos of valuing all employees, customers, business partners, and communities, regardless of race, gender, religion, or sexual orientation.\textsuperscript{241} At best, they encourage boards themselves to be a bit more representative, which is worthy but should not be oversold as close to sufficient.


\textsuperscript{240} Nathaniel Popper, \textit{Cryptocurrency Start-Up Underpaid Women and Black Employees, Data Shows}, N. Y. TIMES (Dec. 29, 2020), https://www.nytimes.com/2020/12/29/technology/coinbase-pay-employees.html#--text=The%20data%2C%20recently%20obtained%20by%20employees%20at%20Coinbase%20were%20paid%20an%20average%20of%20$13,000%2C%20or%208%20percent%2C%20less%20than%20men%20at%20comparable%20jobs%20and%20ranks%20within%20the%20company%20(	extquotedblleft%20[W]omen%20at%20Coinbase%20were%20paid%20an%20average%20of%20$13,000%2C%20or%208%20percent%2C%20less%20than%20men%20at%20comparable%20jobs%20and%20ranks%20within%20the%20company%20	extquotedblright).

IV. **The Fundamental Principles of Fiduciary Duty Governing Corporate Directors and Officers**

As iconic scholars like Adolf Berle and cutting-edge thinkers like Elizabeth Anderson have made clear, corporations occupy a central role in the lives of most Americans. A good deal of our lives is spent under the dominion of our employer.\(^{242}\) Whether we are respected and are treated as worthy of equal respect with each other during our time at work is critical to whether we have a life that is fulfilling. Likewise, for better or worse, the United States is a commercial nation, and the respect with which we are treated by the businesses we depend on for products and services matters greatly, not just for how we feel about ourselves and our society, but for corporations themselves. For that reason, thinkers like Berle and Anderson have, from different perspectives in different centuries, come to the powerful conclusion that the fulfillment of the American ideal cannot occur unless powerful corporations themselves embed a commitment to equality and respect in their way of doing business.\(^{243}\)

The expanding universe of state corporate law reforms and public company disclosure requirements surveyed in the previous Section are sparking a much-needed conversation about Diversity, business, and the proper role of corporations in society. But, as we addressed, they are unlikely to achieve in isolation the comprehensive changes to broader corporate culture needed to assure corporate reputations, to protect all corporate stakeholders from discrimination and inequity, and to capitalize on the business advantages of Diversity, Equity, and Inclusion for investors.

The authority, and indeed, impetus, provided by corporate fiduciaries under corporate law offers an important additional tool for moving the dial. In

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\(^{242}\) The role that corporations play in creating an environment that is tolerant and inclusive is especially important given that Americans spend a major part of their lives at work: in 2019, an American worked, on average, 7.9 hours at his or her workplace and a total of 1,779 hours annually. See American Time Use Survey—2019 Results, Bureau of Labor Statistics, June 25, 2020; Average annual hours actually worked per worker, OECD, retrieved Dec. 30, 2020, https://stats.oecd.org/Index.aspx?DataSetCode=ANHRS.

243 As production in the U.S. became concentrated in corporations, Berle observed that the dominance by corporations of the American economic scene changed the relationship between corporations and the modern state. Large corporations amassed sufficient economic power to materially invade an individual’s constitutional rights, and therefore, as creations of the state, corporations have to carry out functions, such as applying the Bill of Rights and the Fourteenth and Fifteenth Amendments, “for which in modern life by community demand the government is held ultimately responsible.” Berle described that this doctrine “constitutionalizes” corporations. Adolf A. Berle Jr., *Constitutional Limitations on Corporate Activity—Protection of Personal Rights from Invasion Through Economic Power*, 100 U. PA. L. REV. 933 (1952). Philosopher Elizabeth Anderson takes a Berle-like perspective on the need for corporations to embed constitutional values of equality and tolerance in their treatment of their workers in particular. As Anderson shows, Americans spend a huge portion of their lives in environments controlled by their employers, and unless these employers create a workplace that allows them to feel respected and valued, regardless of their origin, the full promise of equality cannot be realized. See Elizabeth Anderson, *Private Government: How Employers Rule Our Lives (and Why We Don’t Talk About It)*, Princeton University Press (2017).
this Section, we begin to connect the dots by providing a foundational theory of how corporate law of fiduciary duty applies to corporate Diversity, Equity, and Inclusion policies. Specifically, we situate fiduciary duty along a spectrum of mandatory and discretionary actions that speak to core obligations fiduciaries have to pursue the best interests of shareholders and the corporation. In a first step, we explain the foundational directive embedded in the corporate duty of loyalty as one that while comprising a substantive body of legal duties, norms, decisions, and traditions, is not a field of law operating in hermetic isolation of others. Instead, it is as much outwardly facing as internal and creates obligations to take affirmative steps to comply with laws that are of critical importance to the company and society. In a second step, we then outline another key element of corporate law relevant to any social question relevant to corporations: the wide discretion afforded to fiduciaries under the business judgment rule to go beyond mere law compliance. We show that this discretion provides a safe harbor for corporate leaders to embrace effective and ambitious Diversity, Equity, and Inclusion strategies that they believe will ensure their corporations’ respectful engagement with all stakeholders; improve corporate decisionmaking, productivity, and reputation; and enhance the firm’s sustained profitability and long-term value.

A. The Legal Pursuit of Profit

1. The Negative and Positive Components of the Duty of Loyalty

Although corporate law practitioners, judges, and scholars often enjoy complicating the fiduciary duties owed by the directors and managers of corporations, the foundational principles are, in fact, quite focused. Indeed, it can be fairly said that there is really one fiduciary duty — that of loyalty — and that properly understood, even the duty of care itself can be understood as a subsidiary requirement of the basic duty of loyalty, as we shall explain. In any event, both the duty of loyalty and duty of care have important implications for corporations addressing DEI, as both duties impose certain mandatory obligations that fiduciaries must take to address DEI, and both enable them to take discretionary actions to implement effective DEI policies if they believe that is in their company’s best interest.

To understand why, a brief review of the duty of loyalty is necessary. The duty of loyalty prohibits the director and officer from self-dealing, bad faith, and fraud at the expense of the corporation, a negative check on director infidelity. But even more, the duty of loyalty has a positive or affirmative component that demands that directors and officers make a good faith effort to promote the sustained profitability of the corporation and the welfare of its stockholders.244 Thus, a loyal fiduciary must make a good faith effort to attend carefully to corporate affairs and make decisions. For that reason, the duty of

244 Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) (the duty of loyalty “embodies not only an affirmative duty to protect the best interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them of profit or advantage”).
care flowing from that obligation has itself emerged as the other most salient
duty in corporate jurisprudence.

The duty of care’s implications for corporate fiduciaries are meaningful, even if the damages club to enforce it is comparatively weak. Under common corporate law formulations, the normative duty of care requires directors and officers to the corporation and its shareholders to exercise “the care an ordinarily prudent person in a like position would exercise under similar circumstances.”\(^\text{245}\) This normative duty was largely just that for most of corporate law history, because there were no cases holding directors liable for monetary damages for breaches of the duty of care.\(^\text{246}\) But the duty of care was always important because normative duties, even without liability potential, still had an important effect on behavior, and that is particularly so of reputationally and mission-driven people like corporate directors.\(^\text{247}\)

But, in the last century, the normative “soft law” operation of the duty of care was buttressed by the “stick approach” adopted in \textit{Francis v. United Jersey Bank} and \textit{Van Gorkom}, and monetary liability was imposed on directors for a lack of due care.\(^\text{248}\) Even though \textit{Van Gorkom} set the liability bar at gross negligence for the purpose of avoiding directors being too risk-averse because of liability risk, the decision in \textit{Van Gorkom} still generated great controversy over the fairness and wisdom of holding independent directors liable for negligence-based conduct.\(^\text{249}\) The Delaware General Corporation


\(^{246}\) See, e.g., William T. Allen, \textit{The Corporate Director’s Fiduciary Duty of Care and the Business Judgment Rule Under U.S. Corporate Law}, \textit{Comparative Corporate Governance} 307, 321 (Klaus J. Hopt et al. eds., 1998) (“The long history that was inconsistent with courts directly imposing liability on corporate directors for violation of the objective standard of care was interrupted by the decision of the Delaware Supreme Court in \textit{Smith v. Van Gorkom}.’’); Joseph W. Bishop, Jr., \textit{Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers}, 77 \textit{Yale L.J.} 1078, 1099 (1968) (“The search for cases in which directors of industrial corporations have been held liable in derivative suits for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack.”).

\(^{247}\) One of corporate law’s long-standing techniques, exemplified by \textit{Caremark}, which we will discuss, is to use normative duties to drive behavior even when there is no personal monetary consequence for the fiduciary in failing to live up to those obligations. For an interesting discussion of the importance of norms in corporate governance, see Edward B. Rock & Michael L. Wachter, \textit{Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation}, 149 U. PA. L. REV. 1619 (2001).

\(^{248}\) See \textit{Francis v. United Jersey Bank}, 432 A.2d 814, 844-845 (N.J. 1981) (holding the estate of a director of an insurance company liable for her failure of due care in monitoring the corporation’s officers, who included her husband and her sons, and detecting that the sons were engaged in improper practices to the detriment of the corporation’s clients); \textit{Smith v. Van Gorkom}, 488 A.2d 858, 893 (Del. 1985) (finding outside directors liable for monetary damages because they were allegedly grossly negligent in their approval process of a premium-generating merger).

\(^{249}\) \textit{Van Gorkom} was met with strong criticism for narrowing the business judgment rule and the resulting consequences. See, e.g., Daniel R. Fischel, \textit{The Business Judgment Rule and the Trans Union Case}, 40 \textit{Bus. Law.} 1437 (1985) (explaining that directors will be less likely to take risks and less willing to serve on corporate boards post-\textit{Van Gorkom});
Law was therefore amended to provide corporations with the ability to adopt charter provisions exculpating directors from liability for even gross negligence. Most other states took similar action and institutional investors supported corporations in adopting them, and thus such provision are now ubiquitous and render due-care damages remedies against directors rare to nonexistent.

But, as a matter of director reputation and public scrutiny, the directors’ normative duty to act with due care still has great importance, and is also relevant when independent directors’ deliberative process and efforts are important to the standard of review applied in transactions involving conflicts of interests of management, contested takeover attempts, or sales of corporate control. Moreover, and as we will discuss, directors’ actions in exercising care—again, the deliberative process in which they engaged—bear on their state of mind and whether they acted in good faith to fulfill their duty of loyalty. For these reasons, complying with both the duty of loyalty and the duty of care is constantly the focus of corporate boards, officers, and their advisors.

In case law, the negative component of the duty of loyalty has typically attracted most of the attention because it addresses the important obligation on the part of fiduciaries to avoid causing harm to the corporation by acts, such as unfair self-dealing or the usurpation of corporate opportunities. The

Lynn A. Howell, Post Smith v. Van Gorkom Director Liability Legislation with a Proactive Perspective, 36 CLEV. ST. L. REV. 559, 560 (1988) (observing that Van Gorkom was considered to have “triggered the dramatic increases in the number of shareholder suits filed, director and officer (hereinafter D & O) insurance policy cancellations, skyrocketing premiums, and the flight of the outside directors”).


251 Cory A. McKenna, FDIC v. Rippy: Due Care And the Business Judgment Rule in the Fourth Circuit and the Potential Implications for the Banking Industry, 20 N.C. BANK. INST. 189, 215 (2016). See also MODEL BUS. CORP. ACT ANN. § 2.02, Statutory Comparison, note 6.

252 See Kahn v. M & F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014) (applying the business judgment rule standard of review to a merger between a controlling stockholder and its subsidiary where the merger was approved from the beginning by a committee of independent directors and an informed vote of a majority of the minority stockholders).

253 E.g., Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (finding that the directors’ show of good faith and reasonable investigation was enhanced by the approval of a board of directors that was comprised of a majority of independent directors).

254 E.g., Paramount Communications v. QVC Network, 637 A.2d 34 (Del. 1994) (noting that “the role of outside, independent directors becomes particularly important because of the magnitude of a sale of control transaction and the possibility, in certain cases, that management may not necessarily be impartial”).

255 “Unjust Enrichment and the Fiduciary’s Duty of Loyalty” 84 LQR 472 (1968), E.M. For an iconic Delaware case involving this principle in the conflicted merger context, see Weinberger v. UOP, Inc., 457 A. 2d 701 (Del. 1983).

intention is to prevent any possible self-interest exercising an influence that interferes with discharging one’s duty to the best interests of the corporation and shareholders. Indeed, it is in these negative loyalty cases where the independent directors’ obligation of care has often been the subject of most attention.257

The importance of the negative component’s role in addressing conflicts of interests and self-dealing has, however, left the affirmative component too often overlooked. Although it is widely understood that fiduciaries should refrain from conduct that harms the corporation—such as by unfair self-dealing or entrenchment of themselves in office—the fiduciary duty of loyalty demands more: that directors and officers make a good faith effort to advance the best interests of the corporation and its stockholders.258 This affirmative component is not new, but has long been understood as central to the duty of loyalty in the corporate law.259

This affirmative obligation has at its core the requirement that directors and officers act to promote the best interests of the corporation and its sustained profitability, within the limits of their legal discretion and their sense of ethics.260 This obligation of loyalty does not in fact put the pursuit of profit above all else. Rather, the most fundamental requirement is that the directors and officers be loyal to the corporation’s basic license from society, which allows the corporation to seek profit, but only conducting lawful business by lawful means. “Law compliance … comes ahead of profit-seeking as a matter of the corporation’s mission and directors owe a duty of loyalty to that

257 For recent cases where the diligence of a special committee was relevant to a duty of loyalty claim against conflicted parties, see In re Rural Metro Corp., 88 A.3d 54 (Del. Ch. 2014); In re Southern Peru Copper Corp., 52 A.3d 761 (Del. Ch. 2011).
258 In re Walt Disney Co. Derivative Litig. (“Disney III”), 2004 WL 2050138, at 5 n. 49 (the “‘duty of loyalty … imposes an affirmative obligation to protect and advance the interests of the corporation…””) quoting BelCom, Inc. v. Robb, 1998 WL 229527 at 3 (Del. Ch. Apr. 28, 1998).
259 E.g., Thomas W. Waterman, 1 A Treatise On the Law of Corporations, 420 (New York, Bakers, Voorhis & Co. 1888) (“A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporations, whose affairs they are conducting.”). See generally Leo E. Strine, Jr., Lawrence A. Hamermesh, R. Franklin Balotti, & Jeffrey M Gorris, Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law, 98 GEO. L.J. 629, n. 9 at 633, n. 10 at 635 (2009) (gathering sources demonstrating the lineage of this affirmative duty).
260 E.g., TW Services, Inc. v. SWT Acquisition Corp., 1989 WL 20290, at 7 (Del. Ch. Mar. 2, 1989) (fiduciary duty of loyalty requires “manag[ing] the corporation within the law, with duty care, and in a way intended to maximize the long-run interests of the shareholders”).
hierarchy." Thus, “[o]ne cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey.”

This affirmative obligation to honor society’s laws is the foundation that permits the principled use of the enabling form of current American general corporation statutes. Even under the capacious flexibility of the Delaware General Corporation Law, the most important example of an enabling statute, the law is not just enabling, but, at the same time, prescriptive, allowing corporations only to “conduct or promote any lawful business or purposes.” Similarly, certificates of incorporation may enable corporations to engage in any business line or activity, but subject to an important bottom line: law compliance. Thus, certificates of incorporation may provide that the corporation may engage in any “lawful act or activity for which corporations may be organized” and “all lawful acts and activities shall be within the purposes of the corporation.” At the same time, charters can be revoked when there is an abuse of the corporate privilege.

2. Caremark legal compliance, norms and their relationship to corporate value and reputation

Corporate law’s emphasis on law compliance is more than a recitation of ultra vires doctrine and requires more than that directors and officers not consciously cause the corporation to break the law in pursuit of profit. The duty of loyalty demands that the directors make a good faith effort—i.e., genuinely “try”—to ensure that the corporation has in place compliance and ethics policies that promote adherence to the laws constraining its conduct.

261 Loyalty’s Core Demand, supra note 258 at 651. For an important application of this insight to the law of sexual harassment, see Daniel Hemel & Dorothy Lund, Sexual Harassment and Corporate Law, 118 COLUM. L. REV. 1583 (2018) 1630 (explaining how courts have recognized that illegal corporate conduct is not loyal corporate conduct, and can usually only be justified as a matter of necessity). That said, as the authors note, scholars including Stephen Bainbridge have observed that a de minimis principle may apply that recognizes that, like human beings, corporations and their employees will sometimes commit minor violations of law (e.g., occasional parking or speeding tickets), and that the Caremark duty should be focused on material violations of positive law that pose a threat of harm to society, people the corporation’s activities affect, or the corporation’s stakeholders (e.g., its workers or consumers). Id.


263 8 Del. C. § 101(b).

264 8 Del. C. § 103(a)(3).

265 8 Del. C. § 284(a).

266 Craven v. Fifth Ward Republican Club, 146 A.2d 400, 402 (Del. Ch. 1958) (“continuing serious criminal violations by corporate agents in the course of the discharge of their duties could very well constitute the misuse of a charter”).

267 For incisive discussions of the importance of law compliance to proper fiduciary behavior, see Elizabeth Pollman, Corporate Oversight and Disobedience, 72 VAND. L. REV. 2013 (2019); Elizabeth Pollman, Corporate Disobedience, 68 DUKE L.J. 709 (2019).
This duty is famously associated with Chancellor Allen’s decision in *Caremark*\(^\text{268}\) and is now central to the functioning of any effective board of directors and management team.\(^\text{269}\) The case is canonical, though the underlying facts still bear repeating: A health care company had been indicted for felony violations. Following the indictment, Caremark stockholders initiated several derivative class actions claiming Caremark’s directors failed to adequately supervise or correct the conduct of Caremark employees, thereby allowing a situation to develop and continue, exposing Caremark to enormous fines and liability.\(^\text{270}\)

To provide context for his opinion considering the parties’ presentation of a settlement, Chancellor Allen first evaluated the stockholder claims and cited various examples of the kind of conduct satisfying this standard, and made note of *Caremark*’s installation of a monitoring system; the publication of an updated guide designed to ensure compliance with applicable laws; and instituted a policy requiring officers directly approve certain contractual relationships in order to ensure compliance with federal regulations.\(^\text{271}\) The court then offered a baseline framework for assessing these steps taken for the directors, and held that whether a judge or jury considered the decisions of directors as “substantively wrong, or degrees of wrong extending through ‘stupid’ to ‘egregious’ or ‘irrational’”—so long as the court determines that the “process employed was either rational or employed in a good faith effort to advance corporate interests.”\(^\text{272}\)

Chancellor Allen took an innovative approach to this important fiduciary responsibility. He intentionally eschewed a negligence-based approach to liability for a board’s failure to monitor the company’s law compliance, placing it out of the reach of *Van Gorkom*’s gross negligence standard and requiring plaintiffs to prove more than that to obtain relief. To do that, he formulated a standard based on the affirmative obligation of directors

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\(^{268}\) *In Re Caremark International Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

\(^{269}\) For literature on the importance of *Caremark*, see generally Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 967 (2009) (“Even though the Delaware Supreme Court did not formally adopt Allen’s approach until over a decade later, lawyers and compliance providers responded to *Caremark* by expanding the level of services available to help directors ensure that proper systems were in place to prevent and detect criminal violations.”); Claire A. Hill, *Caremark as Soft Law*, 90 TEMP. L. REV. 681 (2018) (understanding *Caremark* as a “soft law” that promotes social interests and corporate social responsibility); Pollman, *supra* note 266 (noting that Caremark and its subsequent case law led to the evolution of the doctrines of oversight and obedience within the duty of good faith); Leo E. Strine, Jr., Kirby Smith & Reilly Steel, *Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy*, 106 IOWA L. REV. (forthcoming May 2021) (explaining the close linkage of EESG to *Caremark*’s duty to implement and monitor compliance programs and the utility of integrating these efforts); Lund & Hemel, *supra* note 261 at 1630 (discussing how *Caremark* duties can prove significant in sexual harassment claims).

\(^{270}\) *Caremark* at 963-65.

\(^{271}\) *Caremark* at 963.

\(^{272}\) *Caremark* at 967.
to make an effort to act in the best interests of the corporations.\textsuperscript{273} Thus, he held that liability for failing to monitor would turn on whether the directors failed to make a good faith effort to set up and attend to a rational system of monitoring.\textsuperscript{274} If they did not, directors violated their duties of good faith to the corporation,\textsuperscript{275} and by extension, their duty of loyalty.\textsuperscript{276}

For the court, however, satisfying such claims involves advancing one of the most difficult theories “in corporation law upon which a plaintiff might hope to win a judgment.”\textsuperscript{277} And when applying the standards to the facts at hand, the court held that the record showed no evidence that the director defendants were guilty of a sustained failure to exercise their oversight function.\textsuperscript{278} To the contrary, the court observed, the corporation’s information systems represented a good faith attempt to be informed of relevant facts. Thus, Chancellor Allen concluded, if the directors did not know the specifics of the activities that lead to the indictments, they could not be faulted.\textsuperscript{279}

Though ultimately ruling in favor of the defendants, the \textit{Caremark} decision’s doctrinal importance is substantial. Under the preexisting standard established under \textit{Graham v. Allis-Chalmers}, directors’ duties were “say no evil, see no evil:” as long as no problems were flagged for directors, they could assume everything was fine with no threat of liability.\textsuperscript{280} \textit{Caremark} institutes an explicit affirmative duty, resuscitating foundational duty of loyalty principles, to be proactive in compliance efforts.\textsuperscript{281} Additionally, \textit{Caremark} makes clear that corporate law comprises a substantive body of legal duties, norms, decisions, and traditions, and is not a field of law operating in hermetic isolation from others. Instead, the very DNA of corporate law’s most foundational duty, that of loyalty, is outwardly facing and designed to operate symbiotically with the legal constraints and dictates of society to confine corporations to conduct that does not harm society. Loyalty flows to the corporation’s legally chartered mission, which is predicated on a statutory requirement that the company will only do lawful business by lawful means.\textsuperscript{282} Fidelity to that statutory mandate that fiduciaries make a good faith effort to identify and understand the laws that are of material relevance to the company and how its operations affect the legally protected interests of its stakeholders, communities of operation, and society. And the duty of loyalty therefore

\begin{itemize}
\item \textsuperscript{273} \textit{Caremark} at 966-67.
\item \textsuperscript{274} \textit{Caremark} at 967-68.
\item \textsuperscript{275} \textit{Caremark} at 968.
\item \textsuperscript{276} See Leo E. Strine, Jr., Kirby Smith, and Reilly Steel, \textit{Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and ESG Strategy}, 106 IOWA L. REV. (forthcoming May 2021) (“As a textual matter, we of course must admit that \textit{Caremark} never firmly places this new liability standard within the broader rubric of the traditional duty of loyalty. But that is the clear import of the decision when it is read in context, as it must be, with Chancellor Allen’s prior related jurisprudence.”).
\item \textsuperscript{277} \textit{Caremark} at 967.
\item \textsuperscript{278} \textit{Caremark} at 972.
\item \textsuperscript{279} \textit{Caremark} at 972.
\item \textsuperscript{280} \textit{Graham v. Allis-Chalmers Mfg. Co.}, 188 A.2d 125 (Del. 1963).
\item \textsuperscript{281} Shapira, \textit{Caremark Era}, 5.
\item \textsuperscript{282} \textit{DEL. CODE ANN.} tit. 8 § 102(a)(3); \textit{MODEL BUS. CORP. ACT ANN.} § 3.01(a).
\end{itemize}
creates the prospect of liability arising from the breach of such duties falling squarely on the independent directors as monitors. Thus, although external social welfare laws are not incorporated by reference into corporate law itself, the act of incorporation imposes compliance duties that cannot be disregarded, especially where they relate to key functions, operations or activities of the firm that may have material effects on others.

In the more than two decades since Caremark, Delaware courts have largely required that in order to satisfy a claim against directors for a failure to monitor, a stockholder plaintiff must show one of two forms of deficient board effort to carry out their law compliance responsibilities. One option is that the plaintiff demonstrate that the board “utterly failed to implement any reporting information restrictions or controls.” Alternatively, plaintiffs must demonstrate that the board, having implemented controls, “consciously failed to monitor or oversee their operations, thus disabling themselves from being informed of risks or problems requiring their attention.” These are both ways of showing bad faith disloyalty: the first by showing a bad faith lack of effort to address corporate compliance at all, the second by showing a conscious failure to monitor corporate activities.

These standards are routinely acknowledged by Delaware courts as difficult to satisfy—echoing Chancellor Allen’s statement to that effect in Caremark itself. They are not impossible, however, and recent suits have met the basic pleading threshold. In the 2019 case Marchand vs. Barnhill, for example, the Delaware Supreme Court held that a derivative action brought under the first Caremark prong could proceed against the directors of Blue Bell Creameries, one of the nation’s largest ice cream manufacturers, after the company had been fined and the CEO had been indicted on various criminal charges following a deadly 2015 listeria outbreak. The Court in Marchand ruled that the shareholder complaint had alleged facts from which it could be inferred that Blue Bell’s directors had failed to institute any board-level oversight system for food safety—which was “mission critical” for the monoline company—and, as a result, had not received official notices of food safety concerns for several years. The Marchand parties ultimately agreed to a $60 million settlement, ten days before trial was set to commence. Since Marchand, there have been at least three additional Caremark cases Delaware courts have permitted to proceed past initial pleading stages—in cases ranging from failing to oversee the clinical trial of a company’s flagship lung cancer

284 Id.
287 Id.
In each, the defendant corporation’s management faces the prospect of removal or other penalties. Additionally, the defendant corporations are faced with the prospect of millions of dollars of additional fines, along with harmful consumer and public backlash. As important, failures in law compliance companies have subjected corporations to huge corporate fines, management removals, and reputational damage.290

We do not want to overestimate the liability club of Caremark, however, nor do we believe that Caremark’s sole or necessarily most important function. Rather, we, like Chancellor Allen himself, believe that Caremark’s primary value is in the incentives it provides to corporate fiduciaries to take proactive, preventative action to ensure that the corporation complies with society’s fundamental expectations.291 When a company’s board faces a Caremark case, the company has almost always already suffered severe reputational, stakeholder, and regulatory costs. By way of example, in cases where a board managed to get a Caremark case dismissed, the record reveals that the company had already experienced management replacements, adverse publicity harmful to its reputation for integrity with key constituencies like customers, and regulatory fines and injunctions.292

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290 See, e.g., Dean Seal, McKesson Settles Derivative Suit Over DOJ Fine For $175M, LAW360 (Apr. 22, 2020), https://www.law360.com/articles/1266395/mckesson-settles-derivative-suit-over-doj-fine-for-175m (reporting that the DOJ hit McKesson with a $150 million fine for allegedly violating the Controlled Substances Act, following which the shareholders filed a derivative suit that settled for $175 million); Nandita Rose, Walmart to pay $282 million to settle seven-year global corruption probe, REUTERS (June 20, 2019), https://www.reuters.com/article/us-doj-walmart-anti-corruption-scanon-reuters-walmart-to-pay-282-million-to-settle-seven-year-global-corruption-probe-idUSKCN1TL27J (Walmart agreed to pay $282 million—$144 million to the SEC and $138 million to the DOJ—to settle investigations related to the Foreign Corrupt Practices Act and its alleged failure to maintain a sufficient anti-corruption compliance program).
291 Chancellor Allen’s view that normative duties of care can be important in influencing behavior and his view that going too far in enforcing the duty of care by actions for monetary damages is reflected at length in William T. Allen, et. al., Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and its Progeny as a Standard of Review Problem, 96 NW. U. L. REV. 449 (2002).
292 See, e.g., In re MetLife Inc. Derivative Litigation, 2020 WL 4746635, at *10. 19 (Del. Ch. Aug. 17, 2020) (dismissing Caremark claims against MetLife for failing to monitor its compliance with its obligations to pay annuitants in a timely and complete manner, even though the company had failed to pay retirement benefits in a timely way to 13,500 retirees, overstated its earnings substantially as a result and had to restate, paid regulatory fines, and replaced its CEO); Mike Leonard, MetLife Board Dodges Lawsuit Over $500 Million Annuity Error, BLOOMBERG LAW (Aug. 18, 2020), https://news.bloomberglaw.com/corporate-governance/metlife-board-dodges-lawsuit-over-500-million-annuity-error (MetLife paid a $10 million fine to resolve related SEC charges); Lananh Nguyen and Katherine Chiglinsky, MetLife Names Khalaf CEO, Replacing Kandarian After Stock Slump, BLOOMBERG NEWS, Jan. 8, 2019, https://www.bnnbloomberg.ca/metlife-names-khalaf-ceo-replacing-kandarian-after-stock-slump-1.1194913 (MetLife’s CEO resigned following the company’s stock price tumble caused by investigations in connection with which the company publicly
These costs usually only grow with litigation, which may be more likely over time. Scholars and practitioners have taken note of the uptick in the successful number of cases escaping motions to dismiss and searched for explanations for it. One factor cited for the trend is the greater use of Section 220 of the Delaware General Corporation Law, which grants stockholders a qualified right to inspect the corporation’s books and records. Delaware courts have long advocated that plaintiffs in a derivative suit use this tool before bringing a complaint, so that they can meet their pleading burden under doctrines like Caremark.

Given evolutions in how boards do business, this tool assists plaintiffs’ lawyers in accessing valuable information in seeking support for a Caremark claim, especially given that a petitioner in a § 220 action only has to show a credible basis to infer fiduciary wrongdoing to get access. With boards of directors acting in more informal ways and the ease of information flow by electronic means, the books and records relevant to investigating a potential Caremark claim has expanded, not just in form, but in utility. For that reason, petitioners have been able to procure emails, text, and other more informal communications when a petitioner shows that the board in question relied on those means to conduct its business. Given that Caremark requires good faith efforts, corporate books and records that are devoid of efforts can themselves help a plaintiff meet its burden to plead facts supporting an inference that the defendants failed to make the good faith effort at monitoring required to identify and address key compliance risks in the first instance, or were aware of a major compliance issue and failed to make a good faith effort

acknowledged material weakness in its internal controls); In re General Motors Company Derivative Litigation, 2015 WL 3958724, at *49 (Del. Ch. June 26, 2015) (dismissing Caremark claim for failing to monitor where ignition switches in cars were unsafe, had to be recalled, multiple deaths occurred, and the company suffered over a billion dollars in financial losses and a $35 million fine, which was the highest fine paid as a result of a National Highway Traffic Safety Administration investigation into a recall). See also In re Citigroup Inc Shareholder Derivative Litigation, 964 A.2d 106, 113, 139 (Del. Ch. 2009) (dismissing Caremark claim for failing to oversee company’s participation in the subprime markets, but undisputed that the company suffered billions of dollars of losses as a result of underwater loans); Dan Wilchins and Jonathan Stempel, Citigroup CEO Prince to resign: reports, REUTERS, Nov. 2, 2007, https://www.reuters.com/article/us-citigroup-boardmeeting/citigroup-ceo-prince-to-resign-reports-idUSN0233640620071103 (Citigroup’s CEO resigned as the bank’s losses from the subprime mortgage crisis continues to grow).


294 AmerisourceBergen Corp. v. Lebanon County Employees’ Retirement Fund, et al., No. 60, 2020 (Del. Dec. 10, 2020) (“But where a stockholder meets this low burden of proof from which possible wrongdoing or mismanagement can be inferred, a stockholder’s purpose will be deemed proper under Delaware law.”). Some scholars view the Delaware courts as having relaxed this standard even more in practical terms. Shapira, Caremark Era, at 18.

295 KT4 Partners LLC v. Palantir Technologies Inc., 203 A.3d 738 (Del. 2019) (holding that the trial court abused its discretion by excluding email communications from the stockholder’s demand for the company’s books and records given that the company conducted formal corporate business through informal electronic communications).
to address it. Of important note is another reality: even if a complaint does not survive, public revelation of corporate monitoring practices that, although not sufficient to support an inference of bad faith, fall short of best practices can be embarrassing for the defendants and harmful to the corporation’s reputation.

In fact, it has long been understood that corporate law decisions, even ones that ultimately find no liability, can reflect poorly on corporate fiduciaries in ways that are hard to shake. Given the increasing focus of investors on ESG and other issues of social responsibility—which typically arise in areas where the corporation most affects others and thus are integrally related to issues of legal compliance, boards are likely to be under continuing pressure to put in place effective monitoring policies and to actively address material legal risks that could endanger the company’s value and reputation. Not only that, to the extent that regulators take a more assertive enforcement posture during the Biden Administration than during the Trump Administration, the salience of preventive compliance by directors and managers may grow even more.

B. Fiduciary Law’s Safe Harbor For Rational Business Judgments

Corporate law goes beyond requiring corporate fiduciaries to ensure that adherence to the law is taken seriously. The business judgment rule gives them substantial room to create a corporate culture with higher standards of integrity, fairness, and ethics than the law demands, if they believe that will increase the corporation’s value, enhance its reputation, or otherwise rationally advance the best interests of the corporation and its stockholders. So long

296 For example, in Marchand, the absence of records showing the board had any reporting or other policies to ensure the company was acting to ensure its compliance with food safety laws helped the plaintiffs convince the Delaware Supreme Court they had stated a claim. Marchand v. Barnhill, 212 A.3d 805, 822-23 (Del. 2019).


298 Leo E. Strine Jr., Kirby Smith, and Reilly Steel, Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and ESG Strategy, 106 IOWA L. REV. (forthcoming May 2021) (“A variety of domestic and international sources have put pressure on companies to adopt corporate policies and plans for sustainable governance.”).

299 See Principles of Corporate Governance: Analysis and Recommendations § 2.01 and accompanying comments, AMERICAN LAW INSTITUTE (observing that business decisions made based on ethical considerations are “not only appropriate, but desirable”). See also Christine A. Hemingway and Patrick W. MacLagan, Managers’ Personal Values as Drivers of Corporate Social Responsibility, 50 JOURNAL OF BUSINESS ETHICS 13 (considering that personal values make a difference in the adoption and implementation of corporate social responsibility initiatives). A recent survey found that the values of the majority of Americans align with supporting DEI, as documented by their response that
as the directors believe in good faith that such standards are in the best interests of the corporation, the business judgment rule protects them from judicial second-guessing at the instance of a complaining stockholder.

For example, under Delaware law, the test under the business judgment rule is the lenient one of bare rationality.\(^{300}\) This forgiving test means boards have wide discretion to promote corporate norms that treat employees and consumers with respect, and that connect a reputation for integrity and fairness to long-term sustained profitability. Thus, under Delaware law, if the board believes that action benefiting stakeholders like workers or creditors has a rational relationship to the best interests of the stockholders,\(^{301}\) the business judgment rule protects the board from stockholders seeking to overturn their judgment in litigation.

This discretion bears emphasis. That the empirical evidence is mixed on an issue or even tilts the other way on a decision, does not deprive that decision of the protection of the business judgment rule. Rather, so long as there is a rational basis for the board’s decision, it must be respected. Perhaps the most controversial illustration of that principle came in the high-profile drama over Time’s decision to stick to buying Warner Communications for a premium rather than accepting a gigantic \$200 per share offer from Paramount, a bid that involved a premium exceeding \$75 per Time share. In his decision—known as *Time-Warner*—denying Paramount’s bid for an injunction, Chancellor Allen famously said:

> It may be that in a well-developed stock market, there is no discount for long-term profit maximizing behavior except that reflected in the discount for the time value of money. It may be the case that when the market valued the stock of Time at about \$125 per share following the announcement of the merger, an observer blessed with perfect foresight would have concurred in that value now of the future stream of all returns foreseen into eternity. Perhaps wise social policy and sound business decisions ought to be premised upon the assumptions that underlie that view. But just as the Constitution does not enshrine Mr. Herbert Spencer’s social statics, neither does the common law of directors’ duties elevate the theory of a single, efficient capital market to the dignity of a sacred text.

Directors may operate on the theory that the stock market valuation is “wrong” in some sense, without breaching faith with shareholders. No one, after all, has access to more

300 *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000).

301 *Revlon*, 506 A.2d at 180.

information concerning the corporation’s present and future condition. It is far from irrational and certainly not suspect for directors to believe that a likely immediate market valuation of the Time-Warner merger will undervalue the stock.\footnote{302 Paramount Communications, Inc. v. Time, Inc., 1989 WL 79880 at *19 (Del. Ch. 1989), aff’d, 571 A.2d 1140 (Del. 1989).}

Chancellor Allen recognized that there was a strong chance that the Time stockholders would be disadvantaged by the board’s decision not to abandon the combination with Warner and accept the lucrative $200 offer from Paramount, but held that the directors’ fiduciary judgment had to be respected even under the heightened reasonableness standard of \textit{Unocal}, stating:

The value of a shareholder’s investment, over time, rises or falls chiefly because of the skill, judgment and perhaps luck—for it is present in all human affairs—of the management and directors of the enterprise. When they exercise sound or brilliant judgment, shareholders are likely to profit; when they fail to do so, share values likely will fail to appreciate. In either event, the financial vitality of the corporation and the value of the company’s shares is in the hands of the directors and managers of the firm. The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders, are charged with the duty to manage the firm.\footnote{303 Id. at *30 (footnote omitted).}

On appeal, Chancellor Allen was affirmed in a decision that went even further in emphasizing the deference that courts had to give to boards’ decisions about debatable issues, even in the less forgiving context of reviewing their actions defending against a takeover.\footnote{304 571 A.2d at 1154 (“Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.”).}

\textit{Time-Warner} emphasizes our core conclusion that the business judgment rule provides a corporate law safe harbor for directors to pursue their own vision for what is good for the company so long as there is a rational basis for their course of action. Even more than in cases involving heightened scrutiny, the business judgment rule commands that courts not intrude on decisions about a corporation’s business philosophy and strategy. For that reason, Professor Bainbridge has rightly called the business judgment rule an abstention doctrine,\footnote{305 See generally Stephen M. Bainbridge, The Business Judgment Rule as Abstention Doctrine, 57 VAND. L. REV. 83 (2019).} which leaves stockholders dissatisfied with the board with recourse to the corporate ballot box, not the courthouse.
Distilled down, these principles support this succinct summary of the duty of loyalty under Delaware law:

The duty of loyalty requires fidelity to the corporation’s best interests, which requires that good faith effort to:

i) first and foremost, ensure that the corporation honors its charter to conduct only lawful business within lawful means;

ii) within the limits of its legal discretion and ethical judgment, to seek to promote the sustainable profitability of the company for the best interests of its stockholders.

And properly understood, the obligation to try to act with skill and prudence — i.e., to exercise due care — is itself a fundamental requirement of the duty of loyalty. “A faithful fiduciary is duty-bound to try to act with care.”

Delaware law also provides directors and officers protection if they take good faith action that unintentionally causes the corporation to be found to have overstepped its legal bounds. For starters, any suit for damages for a breach of the duty of care is governed by a forgiving gross negligence standard, one selected specifically to free corporate leaders from fearing that their good faith actions will be subject to liability at the instance of second-guessing litigants and courts. And, as we discussed, liability under that standard is likely to be unavailable for plaintiffs, because of the prevalence of exculpation provisions barring due care damages actions against directors.

In many other states, both the flexibility, and by extension the protections afforded fiduciaries are even greater. Statutes exist that allow directors to govern their corporations in a multi-stakeholder manner in which constituencies such as workers, communities, and customers can be treated as an equal end of corporate governance. In these jurisdictions, even the weak rational relationship test of Delaware law connecting action benefiting stakeholders to stockholder welfare need not be satisfied. Other goals recognized in the statutes — in particular, the respectful treatment and welfare of key stakeholders like employees, customers, and communities can be an end in itself. Similarly, there is an emerging for-profit entity form, the Public

306 Loyalty’s Core Demand, supra note 260 at 636.
307 Chancellor Allen’s discussion of the policy basis for limiting due care liability and for the business judgment rule in Gagliardi v. TRO Foods, Int’l Inc., 683 A.2d 1049 (Del. Ch. 1996), is one of the most coherent and convincing. For similar reasoning, see In re Lear Corp. S’holder Litig., 967 A.2d 640, 651–52 (Del. Ch. 2008).
Benefit Corporation, that requires boards to govern in a way that is socially responsible and respectful of all stakeholders. Under these statutes, directors have a “shall” duty toward society and stakeholders, and actions can be brought to enforce that duty. In addition, under the Delaware PBC statute and statutes like it, a PBC director is afforded the full protections of the business judgment rule and deemed to have satisfied the director’s fiduciary duties if such choices are “both informed and disinterested and not such that no person of ordinary, sound judgment would approve.” This statutory standard affords substantial discretion to PBC directors in making decisions and is widely understood as enabling them to balance the promotion of public benefits, fair stakeholder treatment, and shareholder value in good faith, without fear of judicial intrusion. As a result, outside of Delaware, and in PBCs in Delaware and outside, fiduciary duty law is more, not less, supportive of other-regarding corporate policies, like those calling for more Diversity, Equity, and Inclusion.

V. Corporate Law’s Value for Corporate Efforts to Promote Diversity, Equity, and Inclusion

The affirmative obligations underpinning the corporate duty of loyalty, along with the discretion afforded to directors and managers in the exercise of their duties and pursuit of the best interests of shareholders and the corporation, have important implications for corporate Diversity policy. First, the corporation is charged with an expectation of lawful conduct—and Delaware corporate law explicitly identifies legal compliance as a core feature of the duty of loyalty. As such, it requires fiduciaries to ensure corporate compliance strategies exist to assure compliance with key civil rights legislation and anti-discrimination mandates that go to the heart of their operations. Fiduciaries are also not excused from ignoring red flags indicating widespread discrimination; should they do so, not only do companies risk liability accompanying such violations, but directors too face possible derivative suits and liability.

Second, the business judgment rule affords directors who view Diversity, Equity, and Inclusion as important values with enormous flexibility to advance such goals, and to do so on firm legal footing as a matter of corporate law. Simply put, beyond the moral call to right past wrongs, or the statutory and Caremark-based interests in ensuring that corporate policies do not fall afoul of anti-discrimination and civil rights laws, there are rational evidence and logical arguments for believing that there is money to be made,
and saved, for corporations that take DEI seriously, and thus that there is the
required nexus to the best interests of stockholders required in Delaware. This
business rationale for effective DEI policies, invokes the protections of the
business judgment rule and enables a wide range of policy reforms that go
beyond statutory minimal protections embodied in longstanding civil rights
laws—or the recently announced targeted reforms — to address the full range
of equity issues in which corporations affect their stakeholders and society.

A. Corporate Law’s Anti-discrimination Obligations

Given the obvious materiality to society of civil rights laws and the
reputational and economic harm that arises where they are ignored, there is no
rational basis to argue that Caremark duties do not attach to adherence with
them. Some, like Title VII of the Civil Rights Act, require that companies
avoid discriminating on the basis of race, sex, sexual orientation, and other
bases not relationally connected to hiring or serving the consuming public.
Similar laws also apply in many of the global markets in which American
corporations operate and constrain corporate discrimination. 312

As such, these laws are foundational and affect the corporation’s
employment practices and its relationships with customers and contractors. So
do laws like ECOA or the FHA that require corporations to provide equal
access to important services, such as banking and credit, and to not discriminate
in the provision of those services. 313 As such, they lay at the heart of capital
access, and in doing so, target business operations, practices and strategies at
the core of regulated markets or industries in which companies operate.
Virtually all impose penalties and fines where they are ignored, or can form the
basis of class action litigation. They also, as discussed earlier, carry the
potential of serious reputational damage, especially in this moment where
customers, clients, and workers are more willing than ever to hold corporate
actors to account for failures in equal treatment. The adverse publicity and
regulatory scrutiny that attends these kinds of violations can cause obvious
harm to a corporation and its shareholder value. 314

312 E.g., Council on Gender Equality in Education, Employment and Entrepreneurship,
OECD Publishing. The 2013 Gender Recommendation also calls on members to cooperate
with relevant stakeholders, including the public and private sectors, to elaborate and
implement guidelines and practices to promote gender equality. Id. More recently, the
OECD Council adopted the Recommendation of the Council on Gender Equality in Public
Life, which focuses on greater accountability and oversight for gender equality in
employment in the public sector. OECD (2016), 2015 OECD Recommendation of the
Council on Gender Equality in Public Life, OECD Publishing.

313 See supra notes [165-68] and accompanying text.

314 See Elizabeth Pollman, Corporate Social Responsibility, ESG, and Compliance,
Cambridge Handbook of Compliance (D. Daniel Sokol & Benjamin van Rooij eds.)
showing the potential utility of high-quality EESG practices in mitigating risks from
lawsuits and regulators, and consumer and employees backlash, and lowering cost of
capital). Indeed, Jamillah Williams has presented evidence suggesting that civil rights law,
with a deeper historical, political, and moral grounding, appears to exert a stronger

Electronic copy available at: https://ssrn.com/abstract=3788159
To comply with their Caremark duties, corporate boards must thus make a good faith effort to make sure the company has policies in place to monitor compliance with the laws that exist requiring corporations provide equal opportunities to job applicants, employees, contractors, and customers regardless of their race or gender or sexual orientation. For all major corporations, by way of example, Title VII, prohibits discrimination based on not only race, color, and sex (including pregnancy, sexual orientation, or gender identity), but also national origin, disability and genetic information (including family medical history). Employers must also create a poster informing employees of their rights, and respond promptly and consistently to discrimination complaints. Employers may additionally be required to provide reasonable accommodations (changes to the way things are normally done at work) because of an applicant’s or employee’s religious beliefs or disability. Caremark requires good faith efforts by directors to ensure their companies have policies designed to promote compliance with these legal requirements.

In other instances, Caremark compliance may require monitoring systems tied to a company’s industry-specific DEI legal duties. For financial institutions, for example, ECOA not only prohibits discriminating against borrowers based on race, color, religion, national origin, sex, family status and age, but are central tenets to the very business of banking. It also imposes a range of disclosure requirements, including notices for applicants of consumer and business credit to ensure that they are aware of the ECOA’s prohibitions and communications informing them as to reasons why they were denied credit. For firms engaged in retail lending, from deposit-taking institutions to marketplace lending platforms, ECOA’s substantive requirements and disclosure obligations imposed on creditors are part of their business; failure to incorporate and comply can expose companies to stiff punitive sanctions that can reach up to one percent of the creditor’s net worth in class actions. Compliance with these important duties thus comprises an essential aspect of protecting the long-term value of any lender. Caremark would thus require systems for ensuring that proper disclosure practices are adhered to, and that the board was able to, and did, monitor the information gleaned from those systems or reported to them.


317 Many labor laws include a requirement that employers post notices about employees’ rights in the workplace. For various posting requirements, see Workplace Posters, U.S. DEPARTMENT OF LABOR, https://www.dol.gov/general/topics/posters.
320 See Marchand.
321 Chris Brummer, FINTECH LAW IN A NUTSHEL, 336 (1st ed. 2020).
the Community Reinvestment Act, a federal law requiring federal regulators to assess how well banks fulfill obligations to service low- and moderate-income neighborhoods. Like ECOA, compliance with the CRA is a core feature of effective banking operations, in large measure because federal regulators develop scores to evaluate applications for future approval of bank mergers, charters, acquisitions, branch openings, and deposit facilities. Banks are required to inform customers of their scores when such information is requested, and their scores are also publicly available online in a Federal Reserve database, thereby creating significant pressure for banks to comply given public relations pressures. Additionally, failure to meet CRA obligations exposes banks to a range of penalties, including curbs on new branch openings and otherwise growing their business. The degree to which a bank adheres to the CRA as a result can directly harm a bank’s reputation, profits, and overall shareholder value. Fiduciaries, by extension, are thus required to ensure that a system for CRA compliance exists, and that material developments and information generated from it can be shared with and disseminated to them.

Corporations have increasingly recognized that effective DEI compliance efforts are required by Caremark and are increasingly expected by all corporate stakeholders. This confluence has itself given rise to new legal theories by corporate plaintiffs’ lawyers, arguing that fiduciaries have not only failed to comply with Caremark in their DEI policies, but have misled investors by overstating their adherence to their own stated DEI goals.

Thus, in a spate of new complaints, stockholder plaintiffs have alleged that companies are making untrue statements about their commitment to DEI in their public disclosures, and thereby violating securities law. In some of these complaints, the plaintiffs also allege that directors have breached their fiduciary duties by failing to ensure that that their corporations had in place

324 Eight board diversity lawsuits were filed in 2020. Most were filed against technology companies with operations based in California (such as Oracle, Qualcomm, and Facebook), although there were also lawsuits filed involving non-technology companies and companies located outside California as well (such as Danaher Corporation). The last of the lawsuits was filed against Cisco Systems, on September 25, 2020, just days before California Governor Gavin Newsom signed AB 979 into law. One commentator speculates that the enactment of the California legislation seems to have interrupted the filings of the lawsuits, perhaps because the new statute requires at least part of the relief the claimants sought in filing the suits. Kevin LaCroix, The Top Ten D&O Stories of 2020, THE D&O DIARY (Jan. 4, 2021), https://www.dandodiary.com/2021/01/articles/director-and-officer-liability/the-top-ten-do-stories-of-2020/. See Complaint, City of Pontiac Gen. Emps. v. Bush, No. 5:20-cv-6651 (N.D. Cal. Sept. 30, 2020); Complaint, Falat v. Sacks, No. 8:20-cv-1782 (C.D. Cal. Sept. 18, 2020); Complaint, City of Pontiac Gen. Emps. v. Joyce Jr., No. 1:20-cv-02445 (D.D.C. Sept. 1, 2020); Complaint, Lee v. Fisher, No. 3:20-cv-6163 (N.D. Cal. Sept. 1, 2020); Complaint, Esa v. Pilette, No. 5:20-cv-5410 (N.D. Cal. Aug. 5, 2020); Complaint, Kiger v. Mollenkopf, No. 3:20-cv-1355 (S.D. Cal. July 17, 2020); Complaint, Ocegueda v. Zuckerberg, No. 3:20-cv-4444 (N.D. Cal. July 2, 2020); Complaint, Klein v. Ellison, No. 3:20-cv-4439 (N.D. Cal. July 2, 2020).
effective compliance programs and efforts addressing key nondiscrimination laws. Along with monetary damages, the lawsuits typically seek a variety of remedial measures, including adding African American directors to the defendant companies’ boards, the creation of a fund to promote diversity and inclusion in the defendant company’s workforce, tying executive compensation to specific hiring goals, and instituting periodic board diversity training. Thus, not only the claims, but the forms of relief sought, are novel for corporate and securities law cases.

We want to emphasize again that allegations are just that, allegations, and that the claims, which have been filed in California, but will involve Delaware corporate law, may not even survive motions to dismiss. And in many, if not most cases, plaintiffs face substantial pleading challenges not only for derivative lawsuits based on failures duties to monitor, but also for claims premised on defendants making untrue statements of material fact—and which by extension require plaintiffs to plead with particularity facts supporting an inference the defendants acted with scienter in describing their corporate DEI policies and actions.

But the allegations underscore our earlier observations that deserve highlighting. Plaintiffs are picking up on the fact that compliance with civil rights laws is important for corporations not only as a moral matter, or as a function of a company’s public law obligations, but also as a matter of

325 In Ocegueda v. Zuckerberg, for example, plaintiffs sued Mark Zuckerberg and the board of Facebook alleging that the company’s directors had violated their fiduciary duties by their inaction on diversity and inclusion issues. The complaint alleges a range of other corporate law violations relating to an alleged failure to implement and monitor a reasonable system of internal controls and policies relating to compliance with a HUD complaint against Facebook alleging that Facebook violated the FHA by allowing advertising on its platform which discriminates based on race, ethnicity, gender, and other protected categories.

326 See LaCroix, Top Ten D&O Stories of 2020, supra note 323.

327 The plaintiffs in most of the lawsuits are forwarding a novel and quite aggressive breach of fiduciary claim on the basis of what is ultimately a failure to diversify, and argue that the “conscious failure to perform their fiduciary obligations.” Yet, the plaintiffs seem to disclaim these claims arise under Caremark. The plaintiffs instead argue that the defendants know they should be taking more assertive action to promote Diversity, but have consciously failed to do so. This is a theory that comes into stark tension with the business judgment rule. The proxy disclosure claims have their own difficulties, and will require a showing of intent, loss causation and damages under the federal securities law precedent in order to be successful.

328 Ocegueda, for example, was recently dismissed for misstating underlying facts—perhaps most importantly by missing the fact that two of Facebook’s nine directors are Black. Ocegueda v. Zuckerberg, No. 20-cv-0444-LB, 2021 WL 1056611 (N.D. Cal. Mar. 19, 2021).

329 Federal law requires plaintiffs to plead “with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” 15 U.S.C. § 78u-4(b)(2); see also Ricker v. Zoo Ent., Inc., 534 F. App’x 495, 499 (6th Cir. 2013) (“’strong’ inference of scienter ‘must be more than merely plausible or reasonable it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.’”).
corporate law. Civil rights laws comprise material, systemically important bedrock rules that are essential for corporations to honor under their charters from society to conduct only lawful business by lawful means. And they are critical for directors and managers who must take a good faith effort to observe and monitor corporate compliance as part of their fiduciary duties. The consequences of failures to perform their duties are, of course, as varied as the facts (and damages) that can arise from it. But what is certain is that the press will often cover claims of failed civil rights compliance intensively, the defense will be expensive, and that there is the potential for additional unfavorable information arising that will compound the harm already suffered as a result of the underlying issues that had previously drawn adverse attention.

But for our purposes, suits like these underscore the point that for the risk-averse fiduciary who is simply trying to avoid negative consequences for the company and herself, fiduciary duty law requires attention to a range of DEI issues. A failure to try to ensure that the company complies with core anti-discrimination laws not only exposes the company to fines and other regulatory harm if there are violations, but also exposes fiduciaries to Caremark suits in Delaware or similar duty of loyalty claims forwarded in other jurisdictions. To dwell just on whether or not the plaintiffs prevail misses our basic point and that of Caremark itself. By the time cases like these are brought, the corporation has already lost, through adverse regulatory action, internal tumult, and a damaged reputation.

For these reasons, the prudent, risk-averse director seeking to promote the best interests of the corporation will engage at the board level to make sure that the board and management are working together to comply with the important DEI-relevant laws requiring corporations to provide equal treatment of their workers, customers, and communities of operation.

B. Corporate Law’s Protections—and Transformative Potential

We now address another important role of corporate law principles: supporting corporate DEI policies that go beyond mere good faith efforts at law compliance, and that embrace a comprehensive approach that makes Diversity, Equity, and Inclusion integral to the company’s business strategy, culture, and stakeholder relationships. That is, we address corporate leaders who genuinely support Diversity and believe that their companies should embrace it fully, but who might harbor concern that attention to DEI is somehow improper as a matter of fiduciary duty. For academics the concern may seem remote, but for corporate managers and directors, and their advisors, it is very real. For many generations now, some have argued that boards of directors should be narrowly focused on maximizing corporate profits, as exemplified by leaders like the CEO of Coinbase, who at best may grudgingly accept that corporate boards have to devote some attention to law compliance, but nothing more. Instead of spending any time on Diversity, Equity, and Inclusion, boards should just get hell-bent for leather to increase

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profits, do the legal minimum, and let external regulation be the sole impetus for social progress. Corporate fiduciaries should not worry whether their companies have higher-than-required ethical standards and try to make profits in a manner respectful of employees, customers, and the communities in which they operate. That is, we cannot avoid dealing with those who adhere to the view of Milton Friedman.

But this blinkered view is not even persuasive under the corporate law of Delaware, the state corporate law largely understood to be focused on stockholder welfare. As we have explained, Delaware law not only requires directors to put law compliance ahead of profits, it gives directors wide discretion to determine what is in the long-term best interests of stockholders. Directors are entitled to govern on the view that a corporation that has hiring and promotional practices that seek to tap the full potential of the available workforce, and to include people of Diverse backgrounds, perspectives and talents, will have an employee base that is more creative, more capable of relating to Diverse customers, more content, and therefore more likely to productively increase the firm’s effectiveness. Directors are entitled to take the view that customers, strategic allies, and institutional investors will be more likely to want to have an ongoing relationship with a company they perceive as committed to high standards of inclusion and non-discrimination, and that is more representative of society’s overall Diversity. Directors are entitled to take the view that the harm that can flow from poor DEI practices far outweighs the costs of committing their company to doing things the right way and spending the costs necessary to do so.

Under the business judgment rule in Delaware, judgments of this kind are protected, as they have a rational relationship to stockholder welfare. In states that allow boards to govern with a multi-stakeholder focus, there is even

Commentators and scholars continue to hew to Milton Friedman’s view that companies should focus narrowly on profit, and not issues like their own environmental or broader social impact. See, e.g., Bradford Cornell and Aswath Damorodan, Valuing ESG: Doing Good or Sounding Good?, NYU STERN SCHOOL OF BUSINESS, https://ssrn.com/abstract=3557432. Typically, they argue that addressing issues like climate change or DEI should be the province of external laws, not voluntary corporate action. Id. But, they typically ignore the role corporate power has had in eroding external protections for stakeholders, including workers, and the reality that without internal change within corporations, the political dynamic to make sure there are robust, across-the-board protections for society will not exist. In fact, Friedman himself opposed the New Deal and the civil rights laws of the 1960s, rendering his nod to external laws a thin beard for his support of 19th century economics and social policies. See Milton Friedman, CAPITALISM AND FREEDOM, University of Chicago Press (1962), pp. 111 (opposing civil rights legislation), 115 (opposing labor rights legislation). For more discussion about Friedman’s opposition to civil rights and labor rights legislation and the flaws in his doctrine, see Leo E. Strine, Jr. and Joey Zwillinger, What Milton Friedman Missed About Social Inequality, N. Y. TIMES (Sept. 10, 2020), https://www.nytimes.com/2020/09/10/business/dealbook/milton-friedman-inequality.html (“Not only that, Mr. Friedman sought to weaken the rules of the game by opposing basic civil rights legislation, unions, the minimum wage and other measures that protected workers, Black people, and the environment.”); Colin Mayer and Leo E. Strine, Jr., The Purpose of Business Is to Solve Not Cause Problems (Sept. 1, 2020).

less basis for an argument that promoting good DEI practices is improper, as directors in these states need not put profit ahead of customers and workers. And under the emerging public benefit corporation model, and its “shall” obligation to treat all stakeholders with respect, a failure to have sound DEI policies itself can expose the board to possible suit for injunctive relief, for example, if a board duty bound to treat workers and consumers with respect is found to have allowed corporate conduct that undermines Diversity, Equity, and Inclusion to the detriment of the workforce, communities of operations, or consumers.

The logic and rationale for DEI is not only a matter of cost avoidance. Rather, as we have shown, there is, at a minimum, a rational basis for business leaders to conclude that effective DEI policies will help them create and sustain smarter, thoughtful, resilient, respected, and thus sustainably resilient and profitable corporations. The information base suggests that attention to DEI issues does not conflict with a proper respect for stockholders’ interest in a sound, long-term return; indeed, given the evidence, there is a basis to infer that inattention and insensitivity to important DEI issues bearing on corporate relationships with employees, customers, and business partners is what risks firm value in the 21st Century economy.

These empirics and logical arguments are also supported by market behavior. As we have noted, institutional investors representing diversified investors acknowledge that corporate DEI practices bear on their ability to create sustainable profits in a domestic and international economy, where the diversity of the available workforce, consumers, and strategic partners is growing, not narrowing. Investors not only expect companies to embrace the full range of talent, consumers, and possible partners available to maximize value creation, but to also avoid the harm that comes from being perceived as adverse to inclusion. And without consumers, corporate profits are hard to come by, and we have also shown consumers, and particularly the younger consumers who will determine the long-term fate of today’s businesses, increasingly want to buy from companies that share their values.

Corporate law supports corporate leaders in acting on this information. Even in shareholder-friendly Delaware, the business judgment rule affords directors substantial room to determine the best way to create value, and to put in place a corporate culture with higher standards of integrity, fairness, and ethics than the law demands. Corporate law also gives fiduciaries protection if they decide that the best way to avoid violations of law and negative reputational harm to the corporation, and achieve longer-term value, is for the corporation to embrace policies and goals that go beyond the legal minimum

335 For this reason, former CFTC Commissioner Sharon Bowen has advocated including the absence of diversity as a risk factor for companies in the public and periodic disclosures.
336 See supra Part III.D.
337 See supra Part II.A.
and to strive for the exemplary, even at the cost of short-term shareholder value. Fiduciaries may reasonably conclude that in order to create a prudent safety margin against law violations, a robust DEI program is necessary to instill trust in regulators and the public that can help if there is a situational lapse in compliance, and promote confidence in the workforce and customer base that will inspire their loyalty and greater productivity.

Other protections deserve note as well. Importantly, Delaware treats a Caremark claim for failure to make good faith efforts to comply with key anti-discrimination laws like Title VII differently than if a corporation’s good faith effort to achieve Diversity, Equity, and Inclusion results in an unintentional violation of law. If a board failed to make any good faith effort to ensure corporate compliance with civil rights laws, and thereby exposed the firm to lawsuits crippling the company, that would expose them to Caremark liability and no exculpation or indemnification would be available because the conduct involved bad faith, disloyalty action, not subject to statutory immunization. By contrast, when a corporation takes good faith action to redress long-standing inequality, corporate law principles provide protection to the directors and officers against personal liability; indeed, Delaware law provides directors and officers protection if they take good faith action that causes the corporation to be found to have overstepped its legal bounds. This is relevant as it is, of course, conceivable that a corporation that undertook a comprehensive DEI strategy designed to promote greater inclusion of women and minorities in the company’s workforce could face suit if someone who did not get hired or promoted alleged that particular programs or policies resulted in unlawful “reverse” discriminatory practices. Under Delaware law, directors and officers may be indemnified so long as their actions were intended to benefit the corporation, and even in a criminal case, so long as there was no reasonable cause to believe their actions were unlawful. In defending themselves in litigation and in seeking indemnification, corporate directors are entitled to rely upon advice they receive from expert advisors in management and from outside advisers, such as law firms and firms that specialize in Human Resources issues, as evidence of their good faith. For these reasons, corporate leaders who address DEI issues in a thoughtful way, with the advice of key managers and qualified advisers, have no rational basis to fear liability.

In a very real sense, then, corporate law empowers fiduciaries to adopt ambitious policies aimed at achieving greater Diversity, Equity, and Inclusion that they believe are in the corporation’s best interests. This empowerment does not just extend to issues within the workplace but authorizes action to embed a commitment to DEI in all the company’s relationships with its

338 8 Del. C. § 141(e).
Corporate leaders may take steps to embed a commitment to DEI in all the company’s relationships. Notably, such conduct would be voluntary. But non-action would not be free of market consequences insofar as business rationality may in fact compel a faithful fiduciary who seeks to promote the sustainable profitability of the company to focus on good DEI policies and practices. As we have shown, there is a rational basis to conclude that companies with more diverse workforces and boards perform better, and at least as well, as those which do not. We have also shown that the racial and ethnic diversity of workforce and customer bases is growing, and there is thus a rational basis to conclude that companies that access all avenues of talent and can relate to a broader array of stakeholders and partners will be more successful. As a pure matter of business, directors cannot blind themselves to change in a dynamic world, and the trends toward globalization and domestic diversity are economic realities that a director faithful to his affirmative duty of loyalty must bear in mind.

Put bluntly, there is money to be made by companies that take DEI seriously, expand their hiring and promotional pools, and increase their customer base by seeking in an equal and inclusive way to get the most out of their workforces and profitably expand their services and product sales to as many customers and communities as feasible. Furthermore, there is evidence that corporate action to promote equality will increase overall economic growth by generating more consumers and consumption, and create a more virtuous environment for long-term wealth creation, to the benefit of corporate profits. For this reason, a loyal fiduciary may conclude that she is duty-bound to make a good faith effort to foster good DEI policies and practices as an integral part of a rational strategy to promote a sustainably profitable corporation.

The purpose of this Article is not to advocate best practices for how to do that. But others have done so and have argued for embedding DEI and other EESG goals in executive compensation, special efforts to make cross-racial group meeting integral to corporate decisionmaking, recruiting at educational institutions that serve more minority and less affluent students, and ensuring that company. See e.g., Peter Eavis, Want More Diversity? Some Experts Say Reward C.E.O.s for It, N.Y. TIMES (July 14, 2020), https://www.nytimes.com/2020/07/14/business/economy/corporate-diversity-pay-compensation.html; Leo E. Strine Jr., Kirby Smith, and Reilly Steel, Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy, 106 IOWA L. REV. (forthcoming May 2021). And, in an incisive new article, scholars have argued that institutional investors should hold companies accountable for moving toward quality DEI practices and outcomes, and have suggested useful metrics to better enable that. See generally Martinez and Fletcher, supra note 46.

For an example of a successful company who believes that a commitment to DEI is fully consistent with its duties to its stockholders, see the policies of JPMorgan Chase & Co., Our Path Forward, JPMorgan Chase & Co., https://www.jpmorganchase.com/impact/path-forward.

See Section II.A supra.

See Section II.C supra.

See Deloitte, supra note 145 (“Leaders / / / should recognize purpose-led actions taken by their organizations can have a threefold impact: Those initiatives can not only help society—they can help business and have a positive influence on employees’ concerns.
CONCLUSION

The clarification of corporate law that this Article offers will not, in itself, cure the lack of representativeness of American corporate boards and management teams. Nor does it provide a simple answer to the broader equity challenges that must be met if the corporate sector is to meet the growing expectation that it treat all its stakeholders with equal respect. It is, however, a piece to help solve the larger puzzle, and a vital legal and policy tool to help our nation live up to its ideals in vital economic activities essential to human freedom and dignity. Internal corporate action can address critical issues current external reforms either overlook or will be unable to solve without operating in concert with internal corporate action. We applaud in principle the emerging external law efforts to spur greater Diversity, Equity, and Inclusion in the behavior of American companies. But, as we have explained, these external efforts have important limitations in terms of their application only to public companies, their inability to address the full range of issues where sensitivity to DEI issues is important to corporate treatment of stakeholders, and the difficulty any external regulation has in embedding values and norms in a complex organization, unless the leaders of that organization support that themselves. The full promise of Diversity, Equity, and Inclusion in creating not only a fairer nation, but stronger, more resilient, and sustainably profitable American businesses can only be realized if corporations themselves embrace these values in all the important ways in which they affect their stakeholders and society. Our goal in this Article is therefore focused, but important. We hope to have shown that corporate law itself has a positive role to play in supporting corporations in taking ambitious actions to promote Diversity, Equity, and Inclusion and contributing to a more inclusive and fair economy and nation.

For too long, corporate law has been misunderstood when it comes to important social matters that happen to make business sense. Diversity is one area where a course correction is needed. In the current moment, that is being slowly recognized by businesses themselves. But history shows that our ability to stay focused on issues of inequality is erratic, and that there remains substantial resistance to Diversity, Equity, and Inclusion in our society. What we demonstrate is this important reality: that corporate law is no island to itself, and that the corporate law of fiduciary duty does not constrain directors and managers from promoting Diversity, Equity, and Inclusion. If anything, fiduciary duty pushes corporate managers legally, financially, and reputationally to focus on these important issues as part of their duty to promote the best interests of the corporation, increase its sustainable profitability for the benefits of its stockholders, and to ensure that the corporation honors the laws of the society that chartered it.

In sum, corporate law allows and in fact encourages corporate leaders to do the right thing. Whether they do it is up to them and the institutional

Some potential activities: . . . Ensuring diversity and inclusion across the organization, and promoting compensation structures that reduce income inequality and create a fair distribution of wealth.”).
investors to which they owe their positions, because fiduciary duty law leaves them with no excuses. Thus, the ultimate question is not whether business leaders can implement effective Diversity, Equity, and Inclusion policies, but “will they?”
Duty and Diversity

Posted by Chris Brummer (Georgetown University) and Leo E. Strine, Jr. (Wachtell, Lipton, Rosen & Katz and Harvard Law School), on Thursday, March 4, 2021

Compliance & ethics, Corporate purpose, Delaware articles, Diversity, ESG, Shareholder primacy, Stakeholders

More from: Chris Brummer, Leo Strine

Chris Brummer is Professor at Georgetown Law; and Leo E. Strine, Jr., the former Chief Justice of the Delaware Supreme Court, is a Senior Fellow at the Harvard Law School Program on Corporate Governance; Ira M. Millstein Distinguished Senior Fellow at the Ira M. Millstein Center for Global Markets and Corporate Governance at Columbia Law School; Michael L. Wachter Distinguished Fellow in Law and Policy at the University of Pennsylvania Carey Law School; and Of Counsel at Wachtell, Lipton, Rosen & Katz. This post is based on their recent paper. Related research from the Program on Corporate Governance includes The Illusory Promise of Stakeholder Governance by Lucian A. Bebchuk and Roberto Tallarita (discussed on the Forum here); For Whom Corporate Leaders Bargain by Lucian A. Bebchuk, Kobi Kastiel, and Roberto Tallarita (discussed on the Forum here); and Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy—A Reply to Professor Rock by Leo E. Strine, Jr. (discussed on the Forum here).

Fifty years ago, Milton Friedman told corporate fiduciaries that they should narrowly focus on generating profits for stockholders. Less focused upon, but explicit, was his view that corporations should not have a “social conscience” and take action to “eliminat[e] discrimination,” which he trivialized as a “watchword[ ] of the contemporary crop of reformers.”[1] Since then, Friedman and his adherents have espoused this cramped vision of fiduciary duty within the debate over corporate purpose. Even worse, while arguing that issues like DEI should be left to external law to address, they have simultaneously sought to erode the external laws promoting equality and inclusion.

In 2021, the problem Milton Friedman trivialized remains central. The inequality gap between Black and white Americans has grown since 1980, the period in which Friedman’s views became influential with directors and policymakers. And the ongoing pandemic’s unequal impact on minorities has underscored the persistence of profound inequality. So has ongoing violence against Black people like the killing of George Floyd. Likewise, economic inequality continues to adversely affect women.

Demands are growing for corporate leaders to address these serious issues by promoting effective practices to treat their employees, communities of operation, and service and customers with respect—and to take affirmative steps to ensure equal opportunity, create an inclusive and tolerant workplace, and embrace the full diversity of humanity. This commitment to Diversity, Equity, and Inclusion (“Diversity” or “DEI” for short) is not just one corporations are being asked to make internally, but is also one requiring that companies evaluate how they treat their consumers and the communities in which they have an impact.
Although the present moment has momentarily muted most of those who view corporate action to address issues like Diversity as an improper diversion from the pursuit of shareholder profits, history shows that will not last for long. Those who share Friedman’s worldview will argue that corporate fiduciaries are on unstable ground if they commit their companies to Diversity, Equity, and Inclusion policies that go beyond the legal minimum of nondiscrimination, and will suggest they face possible legal risk for failing to focus solely on corporate profit. Indeed, even in a year when issues of racial equality have been central and leading members of the corporate community are recognizing their obligation to do better, some business leaders have openly taken Friedman’s position and have admonished their employees to stay focused on profits and not to raise issues of Diversity, Equity, and Inclusion within the workplace. When the current moment passes, these voices may multiply and distort corporate law to argue that corporate leaders may not go beyond the bare legal minimum to promote these important values, because by doing so they would be improperly diverting their focus from profit maximization.

In a new article called Duty and Diversity, we explain why arguments of that type have no grounding in American corporate law, and in particular the important principles of fiduciary duty that govern the equitable expectations of corporate directors and officers. We show that, even under the nation’s most stockholder-focused corporate law, that of Delaware, Friedman’s normative view is not one that American corporate law embraces, and that corporate law presents no barrier to voluntary corporate efforts to increase equality and diversity.

Rather, corporate fiduciary duties authorize corporations to implement effective DEI policies. In fact, fiduciary duty requires boards to monitor company policies and practices that assure the company’s compliance with important DEI laws that focus on the equal treatment of diverse applicants, employees, customers, communities, and business partners. We also show that the fiduciary duty of loyalty requires affirmative efforts to promote the sustainable success of the corporation, and thus directors and managers must try to promote the best interests of the company. Substantial evidence exists that companies with good DEI practices will not only be less likely to face adverse legal, regulatory, worker, community and consumer backlash from their conduct, but that their boards and workforces will be more effective, their reputation with increasingly diverse customer bases and public will grow, as will trust from institutional investors increasingly focused on sustainable profitability and the avoidance of harmful externalities costly to their clients, who have diversified portfolios tracking the entire economy.

As a matter of fiduciary duty, therefore, we show that corporate leaders not only have broad authority to promote an inclusive and diverse corporate culture, their affirmative obligation to act in the best interests of the corporation can be understood to require it, given the important legal requirements for corporations to avoid invidious discrimination and growing societal and investor expectations that business will contribute to reducing racial and gender inequality. As important, corporate law principles like the business judgment rule protect and support directors and managers who believe that committing their companies to help improve Diversity, Equity, and Inclusion is the right way to do business.
This legal reality is important to ensuring that the accountability debate over whether corporate leaders, and the institutional investors who control public companies, are doing what they should to promote these values proceeds with clarity. All too often, the issue of Diversity is viewed as a cost center, or something external to the mission of the modern firm—driving criticisms of Diversity-oriented corporate reforms as “virtue signaling at the expense of someone else.” [2] But our Article advances a different theory—that the pursuit of Diversity, Equity, and Inclusion is authorized by the operation of traditional corporate law principles, and even squares with the views of those who embrace what has come to be known as “shareholder primacy.” Put simply, we do not debate what corporate law “should be,” but instead explain what corporate law already “is”—and offer an old answer to the novel question of what tools and obligations managers and directors must contemplate when grappling with the challenge and opportunity of Diversity.

We demonstrate that the case for Diversity has not just a strong moral basis, but a sound business rationale that makes it relevant solely as a matter of traditional corporate law principles. We also show that the internal/external dichotomy of the Friedman view is misleading: corporate law’s most foundational duty, that of loyalty, is as much outwardly facing as it requires corporations to comply with laws—including core civil rights legislation—that are of critical importance to the company, its stakeholders, and society. These clarifications enable important interventions for refining current DEI reforms and enabling new ones within even our legacy corporate law framework. This important reality therefore poses a substantial question to American business leaders, and the institutional investors who wield power over them: If corporate law not only enables directors and the board to address important DEI issues, but requires them to do so, will they meet this urgent moment with correspondingly comprehensive and effective action, or will they incur the high financial, reputational and legal causes of failing to do so?

The complete paper is available for download here.

**Endnotes**


Toward Racial Equality: The Most Important Things The Business Community Can Do

Leo E. Strine, Jr.

Working Paper No. 635

October 29, 2020
Toward Racial Equality: The Most Important Things The Business Community Can Do

Leo E. Strine, Jr.

University of Pennsylvania Carey Law School
Columbia University School of Law
Harvard Program on Corporate Governance

This paper can be downloaded without charge from the Social Science Research Network Electronic Paper Collection: http://ssrn.com/abstract=3723950.
Toward Racial Equality: The Most Important Things The Business Community Can Do

Conference Kickoff: Remarks by Leo E. Strine, Jr.*

October 29, 2020

Conference on Racial Equity in Corporate Governance

Co-Sponsored by:

Ira M. Millstein Center for Global Markets and Corporate Governance
Columbia Law School

The Institute for Law & Economics
University of Pennsylvania

Arthur and Toni Rembe Rock Center for Corporate Governance
Stanford University

Stanford Center for Racial Justice
Stanford Law School

* Ira M. Millstein Distinguished Senior Fellow at the Ira M. Millstein Center for Global Markets and Corporate Governance at Columbia Law School; Michael L. Wachter Distinguished Fellow in Law and Policy at the University of Pennsylvania Carey Law School; Senior Fellow, Harvard Program on Corporate Governance; Henry Crown Fellow, Aspen Institute; Of Counsel, Wachtell, Lipton, Rosen & Katz; former Chief Justice and Chancellor of the State of Delaware.
I am honored to kick off this important series of discussions about what corporate governance and corporate America can do to reduce racial inequality and, more specifically, to help black people finally achieve equality after 400 years of systemic racism.

My only regret about this series is that it did not happen long ago. For most of the period since 1980, there has been a steady erosion of our willingness to admit what a grievous injury we as a nation did to black people and the inadequacy, in both magnitude and durational commitment, of our nation’s efforts to remedy that harm.

To be candid, all elements of the political spectrum and corporate America are to blame for that. Focusing on race was uncomfortable for white people of all political persuasions, and corporate leaders in particular. For certain people — like the members of the U.S. Supreme Court who struck down the Voting Rights Act and the ability of school districts to promote integration — two decades of remediation were more than enough, and it was time for black people to get over racial oppression themselves. For others, particularly on the left and in corporate America, there was a tendency to obscure discrimination against black people, and our failure to address racial inequality, by using the term diversity in a manner that was not wholly constructive but often more than a tad deceptive.
Instead of promoting diversity and equal opportunity in general, but recognizing the compelling reasons why the United States had to make equality and opportunity for black people the most urgent priority, corporations and universities celebrated themselves for including elites who were not white and who did not suffer from the legacy of racial discrimination in the U.S. But, being blunt, hiring Ivy League law, business, and STEM graduates who had not suffered from the African-American experience and putting them – along with a bunch of white women and one black person – on the cover of glossy brochures did not help redress America’s history of racism against black people. In many ways, branding of this kind was a way to put off dealing with it. For darn sure, it’s great that the children of, for example, Asian and even black immigrants could take advantage of the equal opportunity provided by the Civil Rights Act of 1964, as could many within the African-American community’s “talented tenth” who were fortunate enough to have college educations and more wealth, albeit while never being close to a tenth of African Americans. Ditto for the amazing progress of women and the LGBTQ community; it’s tremendous and long overdue. But this progress did not heal the deeper wounds of our history of racism against black people. Rather, it just reflected the reality that our post-civil rights world did provide much greater opportunities for diverse people who had access to the right ladders of progress.
For the bulk of black Americans, however, these ladders were beyond their grasp and thus a reminder of how unfair our society continued to be. And rather than continuing to shrink, as it had done when the New Deal/Great Society consensus was in place, racial inequality has grown sharply since the U.S. and our corporate governance system moved to embrace the belief systems of people who viewed racism and its effects as over and who put pleasing the stock market above all else.

Nothing in 2020 about these realities is new:

- Black people have incomes far lower than those of white and Asian Americans and depend almost wholly on their wages to survive and build wealth;
- Black people’s wealth is even lower than that of white and Asian Americans, and black people have little stock ownership;
- Black children are more likely to rely on public schools;
- Black children are less likely to have experienced teachers and go to schools with adequate funding; and
- Black students are less likely to go to and complete college.

And this is to say nothing of how racism, sprawling and excessively punitive criminal codes, and the cruelty of poverty itself leads to a disproportionate number of black Americans being subject to the criminal justice system.
2020 did not reveal anything new but did make it impossible for us to avoid a momentary mirror test:

- That people like George Floyd and Ahmaud Arbery were murdered;
- That essential workers necessary for our economy to function were paid far less than those of us who are not essential;
- That black workers were more likely to be essential and have to endanger themselves to keep a roof over their heads;
- That black workers suffered more unemployment; and
- That COVID-19 hit black people even harder than the rest of us.

Any moral person can’t deny the persistent inequality of our society now, and to be even more direct, all who did not understand that before should reflect on why it took this level of new suffering for black Americans to make them do so now.

Corporations and institutional investors are waking up, too. Finally, they embrace the need to include black people in the benefits of capitalism as a priority. Finally, they admit that economic inequality and its effect on black people matters.

So in the spirit of doing something positive about persistent racial inequality, three great centers of corporate governance at Columbia, Penn, and Stanford got out of their comfort zone and came together with the Stanford Racial Justice Institute to shed a little light. These influential institutions have brought policy
experts, business leaders, and institutional investors together to help our corporate governance system in general, and corporations and institutional investors in particular, do their part to reduce racial inequality. I was proud to play a role in inspiring this collaboration, and applaud the leaders of the Millstein, Rock, ILE, and Racial Justice centers for putting together such an amazing array of talent to address this urgent issue.

Let me now underscore why the topic of this conference is so fundamentally important to the cause of racial justice.

Realizing how much more likely black people are to be among the working and lower-middle classes and how less likely they are to have investments in stock, imagine what progress might have been achieved had institutional investors and corporations made sure that workers continued to get their fair share of the gains from their hard work during the last 40 years? If the same share as workers had gotten in the era from 1945 to 1980 had been maintained, imagine how much that would have helped black people climb the economic ladder?

Imagine how better wages of that kind would have improved their chances to put their kids through college and build wealth to be passed on to the next generation? If corporations had given all workers, after paying a fair wage, $1,000 toward their 401(k) and a match for the next $2,500? Imagine just how much that could have closed the wealth gap?
Realizing how much more likely black children are to depend on the public schools, imagine what progress might have been achieved if corporations had been willing to pay their school taxes as they did in the era before 1980? How much better could we have done by black students had corporations continued to pay their fair share instead of systematically seeking to exempt themselves from funding the public schools?

Realizing how much more likely black people and their children are to be segregated into urban and rural communities with high concentrations of poverty, imagine the progress that would have been made if businesses had made it a priority to put operations there, to fund their schools and give back to these communities?

Realizing how much economic insecurity contributes to the success of racially and ethnically divisive appeals, imagine if corporate America had supported a living wage, cooperated with instead of crushed unions, and given all workers their fair share of productivity gains in the former of higher pay, thus helping black people disproportionately while helping all struggling American workers? Imagine how that would have helped knit together the diverse fabric of our nation instead of tearing it apart?

Realizing how much more likely black Americans and white Americans without wealth are to be students at public universities, community colleges, and
historically black colleges, imagine if corporate America had made real diversity a priority and sought to include American college graduates who were most economically disadvantaged?

Finally, realizing that the experience of being black in America is meaningfully different from that of being a recent immigrant since the Civil Rights Era, imagine if corporate America had kept a focus on achieving equality for black people first and foremost and not concealed their lack of progress toward that goal?

The sad truth is that, simply because institutional investors and corporations supported policies that shorted workers and the funding of public schools, racial inequality has grown.

So, as this constructive and novel series goes forward, let’s not lose sight of the most important and fundamental things our business sector can do to help black people and our society become more equal. Include black people fairly in your recruiting, hiring, and promotional decisions. Recruit at the higher education institutions where black and less affluent Americans go. Pay fair wages, provide safe working conditions and family-friendly schedules, and help workers build wealth. Fund the public schools that black families depend on for their children to climb the economic ladder. Locate your operations in the communities where black people live and give back to them. And if you are an institutional investor,
realize your duty to support these policies and fairness for all American workers, without whose sweat and productivity our capitalist system cannot work.

Sometimes it is that simple. What’s hard is not determining the what, it’s whether we all have the moral fiber to work together to make it happen.
I. 2020.09.10, WHAT MILTON FRIEDMAN MISSED ABOUT SOCIAL INEQUALITY, NYT

Since the economist wrote his influential essay on capitalism, the “haves” have gained much — and everyone else has missed out.

Since Milton Friedman, left, won the Nobel Memorial Prize in Economics in 1976, wealth has accrued overwhelmingly to the top layer of society, leaving others behind. Credit...Pool photo by Peter Knopp

By Leo E. Strine Jr. and Joey Zwillinger
Sept. 10, 2020

Fifty years ago, the economist Milton Friedman warned in his seminal essay, “The Social Responsibility of Business Is to Increase Its Profits,” that corporate executives would undermine the “basis of a free society” if they acted as if “business has a ‘social conscience’ and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution and whatever else may be the watchwords of the contemporary crop of reformers.”

Instead of operating in a manner that treated all stakeholders fairly, Mr. Friedman argued, every corporation should seek solely to “increase its profits within the rules of the game.” Not only that, Mr. Friedman sought to weaken the rules of the game by opposing basic civil rights legislation, unions, the minimum wage and other measures that protected workers, Black people, and the environment. Mr. Friedman’s cramped vision enhanced the power of the stock market and silenced the voice of workers, leading to profound inequality.

After the publication of his essay in The New York Times Magazine, Mr. Friedman’s adherents gained influence in government and the business community. At the same
time as Mr. Friedman’s adherents disparaged government’s role, they sought enormous tax subsidies, greatly reducing the share of taxes that corporations paid. The promise of vital legislative protections against the excesses of unconstrained capitalism — including the National Labor Relations Act, minimum wage laws, the Clean Air Act, the Clean Water Act, antitrust regulations and consumer safety laws, to name a few — were undercut by two generations of ceaseless attack.

The concerns Mr. Friedman lampooned as obsessions of the “contemporary crop of reformers” in 1970 remain urgent problems.

As would be expected when business leaders were told not to worry about “providing employment,” wages stagnated and inequality grew. In the past 50 years, instead of gains for stockholders and top management tracking gains for workers — as characterized by the period when Mr. Friedman wrote — the returns of our capitalist system have become skewed toward the haves.

From 1948 to 1979, worker productivity grew by 108.1 percent and wages grew by 93.2 percent, with the stock market growing by 603 percent. By contrast, from 1979 to 2018, worker productivity rose by 69.6 percent, but the wealth created by these productivity gains went predominately to executives and stockholders. Worker pay rose by only 11.6 percent during this period, while compensation for chief executives grew by an enormous 940 percent and the stock market grew by 2,200 percent.

As would be expected when corporate leaders were told not to worry about “eliminating discrimination,” corporate political spending was used to help seat elected officials who opposed measures designed to reduce racial disparities in education, pay and wealth, and to support gerrymandering and voter suppression efforts.

As would be expected when corporations were told not to worry about “avoiding pollution,” they used their muscle to undermine environmental protection and to conceal the dangers of climate change. As a result of environmental policy distorted by corporate money and misinformation, the entire future of humanity is now at risk.

To reverse the Friedman paradigm, companies should embrace an affirmative duty to stakeholders and society. This requires tangible, publicly articulated goals, such as paying living wages to their workers, respecting workers’ right to join a union, promoting racial and gender inclusion and pay equity, enhancing safety protocols, and reducing carbon emissions. By committing to goals of responsible citizenship, companies allow stakeholders, institutional investors and the public to hold them accountable to their inclusive ideals. In doing so, corporate leaders will also set an example that institutional investors should be required to follow in their own investing and voting policies.

But adopting a stakeholder-centric governance model is only half the battle. Business leaders must support the restoration of fair rules of the game by government; respect the need for strong and resilient public institutions to govern a complex society; pay their fair share of taxes; and stop using corporate funds to distort our nation’s political
process. That means ending corporate political spending without shareholder consent, and not contributing to dark money or political party committees. It also means ensuring that spending plans recommended to shareholders only allow contributions to candidates whose views on issues like racial inequality, climate change and fairness to workers are consistent with the corporation’s stated values.

There is a rueful irony in this anniversary. Mr. Friedman wrote the influential essay at a time when economic security was strong, as the New Deal’s principles produced widespread prosperity, reduced poverty and helped Black Americans take their first real strides toward economic inclusion. Since then, the United States has gone backward in economic equality and security — a situation that the Covid-19 pandemic has exposed for all to see.

By contrast, America’s economic allies in market economies like Germany, the Netherlands and in Scandinavia have remained true to those fundamental principles, refusing to embrace the Friedman Doctrine. As a result, they have benefited from less economic insecurity, greater equality and a more effective response to the pandemic. America’s business community should heed these lessons of history and help restore the ideals of fairness, equality and economic common sense that showed that a capitalist economy could work for the many.

Leo E. Strine Jr. is the former chief justice of Delaware, a distinguished fellow at the Columbia and Penn Law Schools, and Of Counsel in the corporate department at Wachtell, Lipton, Rosen & Katz. Joey Zwillinger is the co-founder and co-C.E.O. of Allbirds.

II. 2020.10.01, DEALBOOK DEBRIEF, IS IT TIME TO RETHINK MILTON FRIEDMAN?

Leo Strine, the former Delaware chief justice, and Joey Zwillinger of the shoe brand Allbirds discuss whether the economist’s influential essay ignored social inequality.

An influential essay on free-market capitalism was the subject of a DealBook Debrief call with Leo Strine, the former Delaware chief justice, and Joey Zwillinger, a founder of Allbirds. Credit...PBS

By Dealbook
Oct. 1, 2020

To commemorate the 50th anniversary of Milton Friedman’s influential essay, “The Social Responsibility of Business Is to Increase Its Profits,” DealBook teamed up with
The New York Times Magazine to collect thoughts from executives, political leaders and Nobel Prize winners on its legacy.

Among those we heard from were Delaware’s former chief justice Leo Strine Jr. and the Allbirds co-founder Joey Zwillinger, who joined us for a DealBook Debrief call on what Mr. Friedman missed about social inequality.

Listen to the conversation in the player above.

**Highlights of the conversation**

**We might need a “truth and reconciliation commission” for capitalism, Mr. Strine suggested.**

The commission, composed of institutional investors and business leaders, would reflect on the issues that companies now say they champion: social injustice, climate change and the minimum wage, among others. “Could we now reflect on what we did not care about before?” Mr. Strine asked.

**Mr. Zwillinger of Allbirds said he wasn’t sure about the idea.**

He put the onus on the institutional investors who run pension funds on behalf of millions of Americans: “They should get together and advocate for companies to do things on behalf of those workers, not just to create the maximal profit but to create a just society that helps everybody.”

**The most effective solution may be the law (said the former judge).**

“No doctrine of corporate law in the United States of America has made companies reduce the share of productivity and profit gains that go into the pockets of their workers,” Mr. Strine said. Instead, he noted, “the strong pressures that have grown from the market system” have resulted in “a natural shift toward the more powerful interests from the correspondingly less powerful ones — that is really the framework we have to change.”
Dear Fellow Shareholders,

J.P. Morgan Letter to Shareholders
Re Black and Latinx Communities (April 2021)

Jamie Dimon,
Chairman and
Chief Executive Officer

2020 was an extraordinary year by any measure. It was a year of a global pandemic, a global recession, unprecedented government actions, turbulent elections, and deeply felt social and racial injustice. It was a year in which each of us faced difficult personal challenges, and a staggering number of us lost loved ones. It was also a year when those among us with less were disproportionately hurt by joblessness and poverty. And it was a time when companies discovered what they really were and, sometimes, what they might become.

Watching events unfold throughout the year, we were keenly focused on what we, as a company, could do to serve. As I begin this annual letter to shareholders, I am proud of what our company and our tens of thousands of employees around the world achieved, collectively and individually. As you know, we have long championed the essential role of banking in a community – its potential for bringing people together, for enabling companies and individuals to reach for their dreams,
VI. PUBLIC POLICY
AMERICAN EXCEPTIONALISM, COMPETITIVENESS AND LEADERSHIP: CHALLENGED BY CHINA, COVID-19 AND OUR OWN COMPETENCE

We need proper immigration policies.
Thirty percent of foreign students who receive an advanced degree in science, technology or math (300,000 students annually) have no legal way of staying here, although many would choose to do so. Most students from countries outside the United States pay full freight to attend our universities, but many are forced to take the skills they learned here back home. From my vantage point, that means one of our largest exports is brainpower. We need more thoughtful immigration policies that will prevent such a brain drain. In addition, 43% of the growth of our workforce over the past 10 years has come from immigrants. Today, we have 10 million undocumented people living and working in our country; on average, they have resided in the United States for more than 15 years. Most Americans would like a permanent solution to DACA (Deferred Action for Childhood Arrivals), as well as a path to legal status for law-abiding, tax-paying undocumented immigrants. Americans also would like to see, and deserve to see, border security, and there would be far more support for immigration reform if it included proper border security. These issues are tearing the body politic apart. The Congressional Budget Office estimates that the failure to pass immigration reform earlier this decade is costing us 0.3% of GDP a year. Immigration has been one of the great strengths of this country – and we should never forget that.

Affordable housing remains out of reach for too many Americans.
Prior to the COVID-19 pandemic, the demand for affordable housing significantly outpaced supply in nearly every U.S. county. In addition, rising home prices made it increasingly difficult for individuals and families to live near their workplace or within easy access to grocery stores, pharmacies and other essential services. There are many legislative actions that could dramatically increase the availability and affordability of housing (offering tax credits and changing local zoning laws are two examples). While the subprime mortgage crisis and the recession that followed were terrible, the overreaction to it made housing too costly for many individuals (without creating more safety). Excessive origination/service and securitization requirements have increased the cost of the average mortgage by approximately 20 basis points. This has mostly affected smaller mortgages and lower-income individuals who have a slightly higher delinquent rate, but who still deserve a mortgage. In fact, J.P. Morgan analysis shows that, conservatively, more than $1 trillion in additional loans might have been made over a five-year period had we reformed our mortgage system. Our analysis also indicates that the cost of not reforming the mortgage markets could be as high as 0.2% of GDP per year. We believe that percentage includes an additional $500 billion a year in mortgages that could be written predominantly for lower-income households. This alone could dramatically lead to growth in America and help lower-income individuals build wealth.

We need to implement several additional programs and policies specifically to assist Black and Latinx communities.
We need to address hiring and advancement targets, help develop minority-owned small businesses and improve financial education products for the unbanked. In addition, minority-owned small businesses, which employ nearly 9 million people and generate $1 trillion in annual economic output, have been hit especially hard by COVID-19 and will need serious assistance going forward, including capital to restart and run their businesses. We should consider requiring companies, such as grocery stores, pharmacies and other retailers, to provide locations in low-income neighborhoods, as banks must do (this would reduce the cost of goods purchased by minority individuals and increase local hiring and engagement). These efforts would be a form of redress for the low-income community that is sustainable and reinforcing.
Companies can go further by building a more diverse and inclusive workforce, including in their top ranks; tying executive compensation to diversity commitments; developing a more robust pipeline of diverse talent; improving supplier diversity; cutting ties with customers who make racist comments and treat employees disrespectfully; helping young men and women of color get ahead personally and professionally; and increasing the diversity of businesses with whom they partner. Above all, it means building a company culture that respects and listens to everyone. Companies might not always get it right, but they should keep trying. The feature in The Path Forward in Section 1 outlines many of the specific efforts underway at JPMorgan Chase to help advance racial equity.

The cumulative, multi-year effect of doing just some of the measures mentioned above would lead to a healthier, more resilient and robust, and fairer America.

It is my belief that the underlying U.S. economy is so strong that it could overcome many of the things we have failed to do and still grow at 2%. If we could grow at 3% versus 2% over a 10-year period, that would lead to $2.3 trillion in additional GDP by the end of the decade or an increase in household income of about $18,000. A 3% growth rate is what we used to have – and it is achievable again. This growth will help all Americans, but particularly poor and disadvantaged citizens (even before implementing special assistance programs) by increasing opportunities for better jobs, higher incomes, affordable housing and other benefits.

We owe it to ourselves to restore our competitiveness, our common purpose and our true sense of civility in the pursuit of building a more perfect union.

5. America’s global role and engagement are indispensable to the health and well-being of America.

One of the biggest uncertainties today is America’s role on the world stage. A more secure and prosperous world is not only good for the rest of the world but also for our country’s long-term security and prosperity. Our role in building that more secure world has been, and will likely continue to be, indispensable. It is a complex role, and if we don’t fulfill it, others will – and not with our best interests in mind. It is even more complex now because since the Cold War, the United States has not had to deal with another great world power. Now we have the relentless rise of China, which will likely overtake America in the next 20 years as both the world’s largest economy and the largest financial market. Throughout history, the rise of a second great power has always been disruptive. Increasingly and appropriately, most of the world, including Americans, looks at our global position, particularly our economic and military strength, and compares it with that of China. There is no question that the relationship with (and intense competition between) the United States and China will be the most critical relationship for the next 100 years so it is important to deeply understand all of China’s strengths and weaknesses.

China has done a good job in building its economy – but it still has a way to go.

Over the last 40 years, China has done a highly effective job of maneuvering itself to this point of economic development. China’s leadership has been strategic, consistent
I. 2020.02.04, GOLDMAN SACHS’ COMMITMENT TO BOARD DIVERSITY: NEW STANDARD FOR TAKING COMPANIES PUBLIC: AT LEAST ONE DIVERSE BOARD MEMBER.

At Davos, our CEO David Solomon announced a new standard for taking companies public: at least one diverse board member.

At Goldman Sachs, we are committed to driving diversity in our work with our clients and in our core commercial activities. We recognize that diversity is a shared priority among many of our clients and stakeholders and we are further encouraged by the feedback we have received since David’s announcement.

As a trusted advisor, conversations with our clients have often centered around governance and board best practices. This announcement standardizes advice we regularly give to our clients – increased diversity of experience, gender identity, race, ethnicity, and sexual orientation on boards reduces the risk of groupthink and unlocks creative and impactful solutions for their
companies. As a continuation of these conversations, our ecosystem should call attention to how we are defining ‘board-ready’ candidates. Limiting the definition of ‘board-ready’ candidates to CEOs, CFOs, and other executives with former public board experience excludes a large part of the pool who are qualified, but took a different path to get there.

Over the past 18 months since we announced Launch With GS, conversations have frequently come back to board diversity. It is apparent that there is a strong pipeline of diverse, board-ready candidates and a network of corporates looking to develop the best board for their company. As a firm, we are committed to providing access and introductions to this extensive network of strong potential candidates. Given the essential role networks play in board candidate selection, we will continue to leverage Goldman’s convening power to make a real impact for our clients.

Thank you for continuing to join us in this work and please see below for more about the firm’s commitment from our CEO:

A. Diverse Leadership Is Needed More Than Ever – Here’s What We’re Doing

by David Solomon

“At Goldman Sachs, we’ve made a commitment to driving inclusive growth through our work with our clients. This plan we announced this past December, ambitious as it is, is just a part of what we strive to do.

Today in Davos at the World Economic Forum, I announced another component of our firm’s holistic approach to driving sustainable, inclusive economic growth. Effective July 1, Goldman Sachs will only underwrite IPOs in the US and Europe of private companies that have at least one diverse board member. And starting in 2021, we will raise this target to two diverse candidates for each of our IPO clients.

This decision is rooted first and foremost in our conviction that companies with diverse leadership perform better. Consider this: since 2016, US companies that have gone public with at least one female board director outperformed companies that do not, one year post-IPO. But in addition to the real commercial benefits, it’s clear that changing the stereotypes associated with corporate decision-making will have many positive effects for society as a whole.

I myself have benefited enormously from the honest counsel of the Goldman Sachs Board of Directors, where our Lead Director is a black man from Nigeria, and four of our 11 seats are held by women. I know that together, we are able to come to wiser decisions for the long-term success of Goldman Sachs than any of us would be capable of alone.

In the last two years, more than 60 companies went public in the US and Europe without a diverse board member. Part of this has to do with the simple fact that the pool of candidates has traditionally been focused on those with CEO or CFO or other board experience. As the corporate world has been painfully slow in moving on promoting talented people of diverse
backgrounds, this has impeded the opportunity set for many individuals with decades of experience and important skills that could help companies make better decisions, driving enhanced returns for their shareholders.

We at Goldman Sachs want to change that. Our goal as always is to provide our clients with the best possible advice to help them achieve their goals. An IPO is a complicated process unique to each company, but in some respects it’s rather simple: Diverse leadership leads to better performance. Getting that right – before the IPO – is the right thing for all companies going public.”

This article originally appeared on LinkedIn.

II. 2021.04.17, AT GOLDMAN SACHS, WE BELIEVE IN THE POWER OF BLACK VOICES AND IN COMMITTING CAPITAL TOWARDS CREATING CHANGE.

Where those come together is where we can make progress towards racial equity.

That’s why we are investing in the power of Black communities.

Supporting the power of Black businesses.

Recognizing the power of an inclusive workforce.

As a firm focused on sustainable and inclusive growth, we are channeling the power of capital to drive economic prosperity for more people.

We have long been committed to promoting inclusion, diversity and equity within our own firm, throughout our industry, and in the communities in which we live and work. Last summer, in response to the recent senseless acts of racism and violence against Black people, we renewed this dedication, and since then we have continued our focus. We believe the effort needed to truly bridge gaps in inequality is ongoing – we know there is more to be done, and we continue to aim higher.

As our Chairman and CEO, David M. Solomon told a US House subcommittee in June 2020, “We must stand up and support organizations dedicated to the fight for a more just and equitable society.”
III. CHANNELING THE POWER OF CAPITAL

Investing in the Power of HBCUs
At Goldman Sachs, we believe in the power of Historically Black Colleges and Universities (HBCUs) and their students. That’s why we started the Goldman Sachs Market Madness: HBCU Possibilities Program, a focused effort to provide HBCU student participants with access to hands-on comprehensive training, networking opportunities, and sustained coaching relationships with Goldman Sachs colleagues.

Learn More

For over a decade, we have also been investing capital and resources in minority owned businesses through our 10,000 Small Businesses program and Urban Investment Group. More recently, we have leveraged our expertise and deep relationships with Community Development Financial Institutions and other mission-driven lenders to swiftly deploy targeted capital towards communities of color, including an additional $250 million in emergency relief to fund the Small Business Administration’s Paycheck Protection Program via loans through these partners, taking our total support since the start of COVID-19 to $1 billion.

Increasing Our Small Business Commitment to $1 Billion
At the end of 2020, we announced an additional $250 million of funding for the 10,000 Small Businesses program, which will ensure the program can reach another 10,000 entrepreneurs with the training and support they need to realize opportunities for growth. This announcement brought Goldman Sachs’ total commitment to small businesses to over $1 billion in 2020, having previously committed $775 million in capital and grants to Community Development Financial Institutions and other mission-driven lenders.

Read More
Promoting Inclusive Lending During the Pandemic
Read Promoting Inclusive Lending During the Pandemic: Community Development Financial Institutions and Minority Depository Institutions, the submission from Goldman Sachs Chairman and Chief Executive Officer David Solomon to the U.S. House of Representatives Committee on Financial Services Subcommittee on Consumer Protection and Financial Institutions Hearing.

Read Statement

Urban Investment Group (UIG)
UIG is our domestic multi-asset class investing and lending business that deploys over $1 billion annually to close the opportunity gap for underserved places and people through real estate projects, social enterprises, and lending facilities for small businesses. Over 80% of the team’s investing is in minority communities.

Learn More

Driving Inclusive Growth Through Sustainable Finance
As part of our $750 billion commitment to sustainable finance, we’re supporting underserved populations by leveraging our capabilities to improve access and affordability. Inclusive growth supports communities by drawing on innovative finance and partnerships to mitigate unequal access and affordability among underserved populations.

Learn More
IV. SUPPORTING THE POWER OF COMMUNITIES

In 2020, we created the Goldman Sachs Fund for Racial Equity to support the vital work of leading organizations addressing racial injustice, structural inequity and economic disparity.

The $10 million Fund for Racial Equity builds upon more than $200 million Goldman Sachs has granted over the last decade to organizations serving communities of color. Most recently, as part of the Goldman Sachs COVID-19 Relief Fund, the firm deployed $17 million to organizations supporting relief efforts in communities of color.

Goldman Sachs Fund for Racial Equity
We’ve created the $10 million Goldman Sachs Fund for Racial Equity to support the vital work of leading organizations addressing racial injustice, structural inequity and economic disparity.

Read More

Social Impact, Racial Equity and the Current Environment
Asahi Pompey, global head of Corporate Engagement and president of the Goldman Sachs Foundation, sat down for a conversation with Dr. Mitchell Katz, president & CEO of NYC Health + Hospitals, and Kimberly Bryant, founder & CEO of Black Girls Code, to discuss nonprofit leadership and resilience in times of crisis, the pandemic’s impact on communities of color, and actionable steps toward racial equity and equality.
Analyzing the Obstacles of Black Entrepreneurship
Black business owners face significantly more challenges in starting, maintaining and growing their businesses than their white counterparts, according to new research from Goldman Sachs’ 10,000 Small Businesses program, which analyzes more than 10 years of data from more than 9,700 program graduates.

V. INVESTING IN THE POWER OF DIVERSE TEAMS
Launch With GS

Launch With GS is Goldman Sachs’ $500 million investment strategy grounded in the belief that teams with diverse leadership drive stronger returns. As we enter our third year deploying capital, we remain committed to facilitating connections and increasing access to capital for women, Black, Latinx and other diverse entrepreneurs. In early May 2020, we welcomed 14 companies into the Launch With GS Black and Latinx Entrepreneur Cohort, an eight-week virtual experience providing high-touch access and resources.

Learn More

A More Sustainable and Diverse Supply Chain

A key priority for our firm is fostering opportunities for businesses which are women- and minority-owned with the aim of achieving a supply chain that reflects the diversity of our people and our clients. Our Vendor Diversity Program gives us a platform to engage with small and diverse enterprises around the world.

Learn More

VI. CATALYZING THE POWER OF REPRESENTATION AND INCLUSION

Driving Diversity in Recruiting and Developing Talent

The strength of our culture, the execution of our strategy and our relevance to our clients depend on a truly diverse workforce. We have set clear, quantifiable diversity goals around our entry-level hiring, and are equally committed to career development to ensure diverse representation at all levels of the firm.

Read about our aspirational goals

Learn about our 2020 Campus Analyst Class and Its Diverse Representation

Learn about our 2020 Partner Class and Its Diverse Representation

Learn about our 2019 Campus Analyst and Managing Director Classes
Recognition of Our Commitment to Diversity and Inclusion
Our firm and our people have been honored for diversity and inclusion over the years by leading organizations and media, respectively. Human Rights Campaign, Asia Society and Disability:IN are some of the organizations that have recognized the firm as an employer of choice. *EBONY* and *Fast Company*, along with others, have honored our people for leadership and dedication to addressing inequality.

Read More

Confronting Inequality and Injustice
Margaret Anadu, head of Goldman Sachs’ Urban Investment Group, discusses inequality, racial injustice and other issues that are impacting underserved communities around the country.
Margaret appeared on *The Daily Check-In*. [Watch Video](#)

Being Black in America
Gizelle George-Joseph, chief operating officer of Global Investment Research, reflects on racism and discrimination in the US from her perspective as a Black woman. [Read More](#)

To Everyone Who’s Asked, ‘How’s It Going?’
Fred Baba, a managing director in Global Markets, reflects on a raw and honest email he wrote about his experience with racism and discrimination as a Black man in America, as well as how his co-workers can best support the Black community moving forward. Fred spoke on the firm’s *Exchanges at Goldman Sachs* podcast. [Listen Now](#)
In Conversation with Our Newest Black Partners
Our Firmwide Black Network hosted a panel discussion featuring its newly named Black partners. Each partner discussed their career growth, personal role models, as well as ways to deliver commercial impact for the firm. Watch Video

Message to All Goldman Sachs People
David Solomon, Chairman and CEO of Goldman Sachs, shares his message on inclusion to all Goldman Sachs people. Read More
I submit this statement for the record before the Subcommittee regarding our experience in supporting small businesses nationally during this crisis through partnerships with Community Development Financial Institutions (CDFIs). Your leadership in Congress, others in the federal government, the Centers for Disease Control and Prevention, state and local authorities, and the financial authorities acted swiftly and with care to this unprecedented medical emergency. This is without a doubt one of the most unique and challenging periods in history – one that’s shaping our neighborhoods, cities and country in historic ways.

On top of the pandemic, another issue plagues our nation and I want to acknowledge it. I (along with the Goldman Sachs community) continue to grieve for the lives of George Floyd, Ahmaud Arbery, Breonna Taylor and countless other victims of racism. These recent horrific and senseless acts of racism and violence in Minnesota, Louisville, and Georgia have no place in our country, and highlights just how far we need to go to create a more just and tolerant society. It’s been almost 60 years since Dr. King envisioned a future where his children would not be judged “by the color of their skin,” and it is tragic that there’s been so little progress toward making his dream a reality. The awful events of the past few weeks show that now is not the time to be silent, and that we must redouble our efforts to build a more equitable society.

Given the nature of this crisis, its uncertain duration, the disparities it has highlighted and the anger it has unleashed, it is clear that the government and the private sector together must work to cushion the blow to our economy and chart a path to rebuild communities. The troubling reality is that minority communities have been hit disproportionately hard by the pandemic. This moment is a crisis within a crisis for black Americans especially. COVID-19 presents a disproportionately deadly threat to black Americans. Recent data from American Public Media Research Lab indicates that roughly 13,000 black Americans would still be alive today if they
had died of coronavirus at the same rate as white Americans. And Black Americans are disproportionately represented in the essential worker population and unemployed population.

One way we are trying to do our part to heal this wound and support black communities, as well as other minority and underserved communities around the country, is to support CDFIs, Minority Depository Institutions (MDIs) and other mission-driven lenders so that they can provide the necessary funding to small businesses who are trying to keep their businesses alive and employees on the payroll. Over the last 10 years, we partnered with CDFIs and made a $250 million commitment, the largest single commitment to CDFIs at the time. Through these partnerships, we have seen firsthand how important and effective these institutions are in reaching businesses and communities often overlooked by traditional banks.

Goldman Sachs Partnerships with CDFIs Before the Paycheck Protection Program (PPP)

When the COVID-19 crisis first started to emerge in the United States, we reached out to small businesses through our 10,000 Small Businesses program and local leaders, as well as to our CDFI partners across the country. It quickly became clear that small businesses needed capital immediately and that federal relief would take time to make its way through Congress. In order to provide immediate funding to these small businesses, we developed city-level partnerships with a CDFI (Minneapolis-based Community Reinvestment Fund, USA) and a similar mission-driven lender (New York-based Pursuit). Of course financial capital was needed, but also philanthropic capital, and human capital. These efforts materialized into two emergency small business loan funds for New Yorkers and Chicagoans in partnership with the mayors’ offices and CDFIs. These CDFI-administered funds, which occurred before the CARES Act was passed, provided 0% or low interest rate loans to small businesses. These emergency loan funds helped bridge the gap for local businesses in the weeks leading up to the passage of the CARES Act.

Small Business Voices that Guided Our Approach

Knowing how rapidly the crisis was expanding and evolving, we wanted to ensure that our efforts would reach businesses most in need by relying on data. In April, we decided to send a survey to thousands of small business owners who graduated from our 10,000 Small Businesses program. From this group we heard that there was incredible interest in and optimism about PPP:

- More than 90% of respondents had applied for a PPP loan in the first few weeks
- For those who were approved, nearly 80% said they were confident their business would survive the pandemic, despite interim disruptions and lay-offs

For those business owners who were aware of the PPP, understood its nuances, and had a bank to turn to for a PPP loan, the PPP seemed to be hugely beneficial. Unfortunately, this was not the reality for all small businesses. The data also highlighted a glaring disparity: the application rate and approval rates for black-owned small businesses both were 12% lower than the overall rate.

This troubled us at Goldman Sachs. It was clear we needed to do better. We decided to commit $500 million in capital for PPP loans across the country solely through CDFIs and mission-driven lenders, building upon our decade of partnerships together, including in times of crisis like Hurricane Sandy in 2012 and Hurricane Harvey in 2017. We were very intentional with the
CDFIs we partnered with. Ultimately we provided lending facilities to six organizations, four of whom were minority-led, including two of the most active black-led CDFIs in the country. Specifically, we have partnered with HOPE, Lendistry, CDC Small Business Finance, LiftFund, Pursuit, and Community Reinvestment Fund, USA. Sensing that the enormous demand for PPP loans would strain CDFIs, as it would any institution, we also provided $25 million in grants to build additional capacity as soon as possible not only to our six PPP lending partners, but to a broad range of organizations supporting small businesses, including CDFIs, MDIs and grassroots technical assistance providers.

**Who Our Capital Has Reached via PPP Loans**

Now that nearly two months have passed since our efforts began, below is a brief snapshot of what we have accomplished with our community lending partners.

- **First**, the capital has reached very small businesses, as we hoped it would. Across the nearly $500 million and 10,000 loans approved to date around the country through our CDFI partnerships, the median employee count is just three. In some geographies the median employee number was lower: New Orleans was 1, Texas and Ohio and several others just two employees.
- **Second**, our average loan size to date nationally has been about $57,500, which is roughly half the size of the average PPP loan nationwide ($114,144 as of May 29, 2020)
- **Third**, we’ve been able to reach businesses who serve underserved communities with over 33% of the capital going to businesses in low-income neighborhoods.
- **In addition**, while the vast majority of local borrowers did not share their race or gender, we do know that nearly half (approximately 48%) was deployed to businesses in majority-minority areas.
- **And in total**, our capital has reached businesses that employ over 72,000 Americans.

Below is an illustrative summary of who our capital has reached in the past 10 weeks through our partnerships with CDFIs:
We and our CDFI partners have received numerous notes from business owners across the country who were surprised and even sometimes overwhelmed that CDFIs would spend significant time with them to understand the program, fill out the application, and be there as a resource throughout the process. One of our CDFI partners, Mississippi-based HOPE (which is run by CDFI pioneer Bill Bynum) reached out to churches across the south to offer assistance in an effort to ensure that as many churches as possible received loans not only to support their own finances and employees through this crisis, but also because of the important role these same institutions would play in raising awareness about PPP loans and in the recovery. We all agreed that these faith-based institutions will need to be as strong as ever to help heal their communities. One success story from HOPE’s efforts includes providing a PPP loan to a small, predominantly black church in Alabama. When the church leader submitted the articles of incorporation as part of the loan application, the document was handwritten and over 120 years’ old. Without the concerted effort of CDFIs like HOPE, long-standing institutions such as these may not survive this pandemic at this crucial and unprecedented time.

Looking Ahead
To further reach minority-run institutions and businesses like this who sometimes struggle to access financial services, we are proud to announce that we are launching two new partnerships alongside our CDFI partners this week.

First, we are launching a partnership with the National Urban League to increase awareness of and provide access to the PPP. Alongside three CDFIs and the twelve Urban League Entrepreneurship Centers around the country, we are hosting a series of webinars tailored to address specific feedback, questions, and concerns we have heard from black small business owners. We have also created a direct PPP loan application channel for NUL members. With the backing Goldman Sachs loan capital as well as grant funding, the CDFIs will work closely with the local Urban League teams to provide individualized technical assistance throughout the

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<th>State</th>
<th>Total Loan Approvals ($mn)</th>
<th>Number of Businesses Reached</th>
<th>Average Loan Size</th>
<th>Median # of Employees Served</th>
<th>% of Loans in Majority Areas</th>
<th>% of Loans in LMI Areas</th>
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application and loan forgiveness process. The webinar content and technical assistance will have a specific segment on sole proprietorships, given that at least 94% of black-owned businesses are structured as such.

Second, this week we are also launching a similar partnership with the US Hispanic Chamber of Commerce, through which mission-driven lender CDC Small Business Finance will provide similar access to PPP capital provided by Goldman Sachs lending facilities, technical assistance provided in English or Spanish, and a webinar to address frequently asked questions about the program.

There is a lot more work that must be done across the country. And we are excited that our CDFI partners are still lending and working to reach and support as many small businesses as possible.

For information helpful to U.S. small businesses to obtain funding, visit the Goldman Sachs U.S. Small Business Resource Center at https://www.goldmansachs.com/citizenship/10000-small-businesses/US/small-business-resources/. Thank you for allowing me to share our experience at Goldman Sachs with you and do not hesitate to reach out if we can provide any additional information or answer any questions you have.
Robert Mundheim, of counsel, Shearman & Sterling, and former Dean, University of Pennsylvania Carey Law School

Robert Mundheim is Of Counsel in the Capital Markets practice. He focuses on corporate governance issues and has counseled special committees in the buy-outs of HCA, Aramark and Bright Horizons. He also chaired the Special Committee in the buy-out of Quadra Realty Trust. He advised the Review Committee of the JPMorgan Chase Board of Directors in connection with its review of the issues arising out of the London Whale matter, as well as the independent members of the Board of Directors of Wells Fargo in connection with sales practice issues. He is also the Ombudsman for KGS-Alpha Capital Markets LP and Amherst Pierpont Securities LLC. He was formerly Executive Vice President and General Counsel of Salomon Inc. and later Senior Executive Vice President and General Counsel of Salomon Smith Barney Holdings Inc. Prior to joining Salomon Inc. in September 1992, Robert was Co-Chairman of the New York law firm of Fried, Frank, Harris, Shriver & Jacobson and University Professor of Law and Finance at the University of Pennsylvania Law School, where he had taught since 1965. He served as Dean of that institution for seven and a half years (1982-1989). He presently serves as the Professor of Corporate Law & Finance at the University of Arizona James E. Rogers College of Law.

Hari M. Osofsky, Dean, Penn State Law and the School of International Affairs

Hari M. Osofsky is Dean of Penn State Law and the Penn State School of International Affairs and Distinguished Professor of Law, Professor of International Affairs, and Professor of Geography. As dean, she is deeply committed to collaboratively building legal and international affairs education for a changing society, and is leading initiatives in mentoring, technology, and interdisciplinary and international partnerships. She has been recognized for her technology leadership by the American Bar Association’s Legal Technology Resource Center as one of the 2019 Women of Legal-Tech. She also has been very involved nationally in supporting more women and people of color to consider law school and
university leadership. Dean Osofsky’s over 50 publications focus on improving governance and addressing injustice in energy and climate change regulation. Her scholarship includes books with Cambridge University Press on climate change litigation, textbooks on both energy and climate change law, and articles in leading law and geography journals. Dean Osofsky’s Emory Law Journal article, Energy Partisanship, was awarded the 2018 Morrison Prize, which recognizes the most impactful sustainability-related legal academic article published in North America during the previous year. Dean Osofsky has collaborated extensively with business, government, and nonprofit leaders to make bipartisan progress on these issues through her leadership roles and teaching. Her professional leadership roles have included, among others, serving as President of the Association for Law, Property, and Society; chair of the American Association of Law School’s Section on Property; and a member of the Executive Council of the American Society of International Law and the International Law Association’s Committee on the Legal Principles of Climate Change. She also is a member of the Board of Governors of the Society of American Law Teachers and the editorial board of Climate Law. Her leadership and mentorship work was recognized by the Association for Law, Property, and Society’s 2016 Distinguished Service Award and the University of Minnesota 2015 Sara Evans Faculty Woman Scholar/Leader Award. Dean Osofsky received a Ph.D. in geography from the University of Oregon and a J.D. from Yale Law School. Prior to joining the Pennsylvania State University, Dean Osofsky served on the faculties of University of Minnesota Law School, Washington and Lee University School of Law, the University of Oregon School of Law, and Whittier Law School.

Leo Strine, Jr. of counsel, Wachtell Lipton, and former Chief Justice on Delaware Supreme Court

Leo E. Strine, Jr., is Of Counsel in the Corporate Department at Wachtell, Lipton, Rosen & Katz. Prior to joining the firm, he was the Chief Justice of the Delaware Supreme Court from early 2014 through late 2019. Before becoming the Chief Justice, he had served on the Delaware Court of Chancery as Chancellor since June 22, 2011, and as a Vice Chancellor since November 9, 1998. In his judicial positions, Mr. Strine wrote hundreds of opinions in the areas of corporate law, contract law, trusts and estates, criminal law, administrative law, and constitutional law. Notably, he authored the lead decision in the Delaware Supreme Court case holding that Delaware’s death penalty statute was unconstitutional because it did not require the key findings necessary to impose a death sentence to be made by a unanimous jury. Mr. Strine holds long-standing teaching positions at Harvard and University of Pennsylvania, where he has and continues to teach diverse classes in corporate law addressing, among other topics, mergers and acquisitions, the role of independent directors, valuation, and corporate law theories. He is a member of the American Law Institute, and currently serves as an advisor on the project to create a restatement of corporate law. Mr. Strine also serves as the Michael L. Wachter Distinguished Fellow in Law and Policy at the University of Pennsylvania Carey Law School, the Ira M. Millstein Distinguished Senior Fellow at the Ira M. Millstein Center for Global Markets and Corporate Ownership at Columbia Law School and a Senior Fellow of the Harvard Program on Corporate Governance. From 2006 to 2019, Mr. Strine served as the special judicial consultant to the ABA’s
Committee on Corporate Laws. He also was the special judicial consultant to the ABA’s Committee on Mergers & Acquisitions from 2014 to 2019. Mr. Strine speaks and writes frequently on the subjects of corporate and public law, and particularly the impact of business on society, and his articles have been published in The University of Chicago Law Review, Columbia Law Review, Cornell Law Review, Duke Law Journal, Harvard Law Review, University of Pennsylvania Law Review, and Stanford Law Review, among others. On several occasions, his articles were selected as among the Best Corporate and Securities Articles of the year, based on the choices of law professors. Before becoming a judge in 1998, Strine served as Counsel and Policy Director to Governor Thomas R. Carper, and had also worked as a corporate litigator at Skadden, Arps, Slate, Meagher & Flom from 1990 to 1992. He was law clerk to Judge Walter K. Stapleton of the U.S. Court of Appeals for the Third Circuit and Chief Judge John F. Gerry of the U.S. District Court for the District of New Jersey. Mr. Strine graduated magna cum laude from the University of Pennsylvania Law School in 1988, and was a member of the Order of the Coif. In 1985, he received his Bachelor’s Degree summa cum laude from the University of Delaware and was a member of Phi Beta Kappa and a Truman Scholar. In 2000, Governor Carper awarded Mr. Strine the Order of the First State. In 2002, President David Roselle of the University of Delaware presented him with the University’s Presidential Citation for Outstanding Achievement. In 2006, he was selected as a Henry Crown Fellow at the Aspen Institute. In 2019, he was awarded an honorary degree from Washington College in Chestertown, Maryland.
Perspectives on Minority Business Development

Tuesday, April 20, 4:00-8:45 p.m. EDT

Session 2: Perspectives of a Leading Economist on Inequality
4:45 - 5:15 p.m. EDT

Discussion Leader: Barry W. Ickes, Professor of Economics and Head, Department of Economics, Penn State

Presenter: Robert Fairlie, Professor of Economics, University of California, Santa Cruz

Event Co-Chairs:

Samuel C. Thompson Jr.
Professor and Arthur Weiss Distinguished Faculty Scholar at Penn State Law

Sabrina Conyers
Partner at Nelson Mullins Riley & Scarborough

pennstatelaw.psu.edu/events/mbd-perspectives
## Materials for: Session 2: Perspective of a Leading Economist on Inequality:

Discussion Leader: Barry W. Ickes, Professor of Economics and Head, Department of Economics, Penn State

Presenter: Robert Fairlie, Professor of Economics, University of California, Santa Cruz

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**Session 2: Biographies**
The impact of COVID-19 on small business owners: Evidence from the first 3 months after widespread social-distancing restrictions

Robert Fairlie

Department of Economics, University of California, Santa Cruz, California

Correspondence
Robert Fairlie, Department of Economics, University of California, Santa Cruz, CA, 95064; Stanford University (Visiting Scholar), and NBER. Email: rfairlie@ucsc.edu

Abstract
Social-distancing restrictions and health- and economic-driven demand shifts from COVID-19 are expected to shutter many small businesses and entrepreneurial ventures, but there is very little early evidence on impacts. This paper provides the first analysis of impacts of the pandemic on the number of active small businesses in the United States using nationally representative data from the April 2020 Current Population Survey—the first month fully capturing early effects. The number of active business owners in the United States plummeted by 3.3 million or 22% over the crucial 2-month window from February to April 2020. The drop in active business owners was the largest on record, and losses to business activity were felt across nearly all industries. African-American businesses were hit especially hard experiencing a 41% drop in business activity. Latinx business owner activity fell by 32%, and Asian business owner activity dropped by 26%. Simulations indicate that industry compositions partly placed these groups at a higher risk of business activity losses. Immigrant business owners experienced substantial losses in business activity of 36%. Female business owners were also disproportionately affected (25% drop in business activity). Continuing the analysis in May and June, the number of active business owners remained low—down by 15% and 8%, respectively. The continued losses in May and June, and partial rebounds from April were felt across all demographic groups and most industries. These findings of early-stage losses to small business activity have important implications for policy, income losses, and future economic inequality.

1 | INTRODUCTION

The widespread closing of stores and businesses in the United States and around the world due to the coronavirus is unprecedented. Stores, factories, and many other businesses have closed by policy mandate, downward demand shifts, health concerns, or other factors. Many of these closures may be permanent because of the inability of owners to pay ongoing expenses and survive the shutdown. The impact on small businesses around the world is likely to be severe.

The early effects of COVID-19 on small business and entrepreneurs are not well known because of the lack of timely business-level data released by the government. This paper addresses this limitation by creating estimates of the number of business owners from monthly Current Population Survey (CPS) microdata files. Using these timely data,
I examine how COVID-19 impacted small business owners in mid-April 2020—the first month to capture the widespread shelter-in-place restrictions in the United States. I then expand the analysis to include the next 2 months as many states that had restrictions started to relax those restrictions.

The CPS data are used by the Bureau of Labor Statistics (BLS) to track unemployment rates, and have been used in previous research to study determinants of business ownership (e.g., recently, Fairlie & Fossen, 2019; Levine & Rubenstein, 2017; Wang, 2019). The CPS captures the current work activity of the business owner, and whether that business owner is currently operating the business. Thus, the number of active business owners can be captured in the data, but there is no way of telling whether these are temporary or permanent business closures. Many of the inactive business owners, however, are likely to permanently close their businesses especially if the COVID-19 induced recession is prolonged. Even temporary closures caused by the pandemic are problematic because they reflect income losses to business owners in those inactive months.

This study provides the first estimates of the early-stage effects of COVID-19 on small business owners from April 2020 CPS microdata.1 I find that the number of working business owners plummeted from 15.0 million in February 2020 to 11.7 million in April 2020 because of COVID-19 mandates and health- and economic-driven demand shifts. The loss of 3.3 million active business owners (or 22%) was the largest drop on record. When conditioning on working roughly 2 or 4 days/week, the losses are even larger (28% and 31%, respectively). Total hours worked by all business owners dropped by 29%. Although incorporated businesses are more growth-oriented and stable, they experienced a drop of 20% from February to April 2020.

Patterns across gender, race, and immigrant status reveal alarming findings. African-Americans experienced the largest losses, eliminating 41% of active business owners. Latinx also experienced major losses with 32% of business owners halting activity between February and April 2020. Immigrant business owners suffered a large drop of 36% in business activity, and female business owners suffered a disproportionate drop of 25%.

Building on these findings, this paper extends the analysis of COVID-19 impacts into the second and third months following widespread shelter-in-place restrictions across the country—May and June 2020. The analysis answers the question of whether there was further closing of small businesses or instead a partial rebound as small business owners tried to reopen or partially reopen. The findings indicate that there was a partial rebound from April 2020 numbers in May and an additional rebound in June. The number of active business owners bounced back by 7 percentage points resulting in a 15% drop in business activity from February to May 2020, and an additional 5 percentage points rebound in June resulting in an 8% drop in business activity from February to June 2020.

Patterns across gender, race, and immigrant status reveal that the disproportionate impacts from COVID-19 lingered into May and June. African-Americans continued to experience the largest losses, eliminating 26% of active business owners in May and 19% in June. Latinx also experienced major losses with 19% of business owners inactive in May and 10% inactive in June. Immigrant business owners suffered a large drop in business activity of 25% in May and 18% in June.

Most major industries faced large drops in the number of active business owners in April with the only exception being agriculture. Construction, restaurants, hotels, transportation, and personal/laundry services all faced large declines in the number of active business owners due to COVID-19. Simulations reveal that the concentrations of female, black, Latinx, and Asian businesses in industries hit hard by the pandemic contributed to why losses in business activity were higher for these groups than the national average loss in April. May and June brought a partial rebound for most industries.

Overall, these first estimates of impacts of COVID-19 on small businesses from the April 2020 CPS indicate that losses were spread across demographic groups and types of business—no group was immune to negative impacts of social-distancing policy mandates and demand shifts. But, they also reveal a partial bounce back for all groups. Although there is no way to know at this time if these business closures will be permanent each month of inactivity has an impact on the revenues, profits, and employees of these businesses.

These results build on the findings from a few related studies of the early effects of the coronavirus on small businesses in the United States.2 Employer business applications as measured by the U.S. Census weekly Business

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1The findings for April 2020 were initially released as a working paper in early May (Fairlie, 2020) and were covered widely in the press and news (e.g., Washington Post, NY Times, WSJ, PBS, CNBC, and BBC). The findings were also used in testimony to the U.S. Senate (Evans, 2020), Busby (2020), a new Senate Bill (U.S. Senate, 2020), arguments for the shop at black-owned businesses movement, and other policies.

2Estimates for Canada show a decrease in business ownership between February 2020 and May 2020 of 15% and 10% for incorporated and unincorporated businesses, respectively (Beland, Fakorede, & Mikola, 2020).
Formation Statistics (BFS) fell in the 5 weeks from mid-March to mid-April by over 27% relative to the previous year (Wilmoth, 2020). Examining more recent data from the BFS there is some evidence of a bounce back, but weekly estimates show a lot of variation (U.S. Census Bureau, 2020). Estimates from the weekly U.S. Census Small Business Pulse Survey indicate that roughly 50% of businesses report having a large negative effect from the COVID-19 pandemic and that only 15%–20% of businesses have enough cash on hand to cover 3 months of operations (Bohn, Mejia, & Lafortune, 2020; U.S. Census Bureau, 2020). Another weekly survey indicates that decreased demand is more problematic than supply factors, such as accessing materials and goods (Desai & Looze, 2020). Bartik et al. (2020) conducted a survey in late March of nearly 6,000 small businesses that were members of the Alignable business network. They find that 43% of businesses is temporarily closed, large reductions in employees, and the majority of businesses has <1 month of cash on hand. The Stanford Latino Entrepreneurship Initiative (2020) surveyed 224 high-revenue Latinx-owned businesses and found that 86% of respondents reported immediate negative effects, such as delayed projects and closure from the pandemic. This paper builds on the previous work by focusing on early-stage effects in April–June using CPS data, and by exploring differential effects for female, minority, and immigrant business owners, which is potentially important for targeting government aid to preserve small businesses and the jobs they create.3

2 | DATA

2.1 | Current Population Survey

Although research on small businesses and entrepreneurship is growing rapidly, there are very few national data sets that provide information on ownership with additional information on demographic characteristics of the owners. Using microdata from the basic monthly files of the CPSs, I measure self-employed business ownership at the individual owner level. These surveys, conducted monthly by the US Bureau of the Census and the US BLS, are representative of the entire US population and contain observations for more than 130,000 people.

The CPS has been conducted monthly since 1940 and is the underlying source of official government statistics on employment and unemployment. Data are collected by personal interviews. The data cover all persons in the civilian noninstitutionalized population of the United States living in households. The CPS is the only source of monthly estimates of employment, self-employed persons, wage and salary employees, and unemployment. Although the main purpose of the CPS is to collect information on the employment situation, a secondary purpose is to collect information on the demographics of the population.

Measures of business ownership are available from only a handful of other large, nationally representative government data sets, such as the Survey of Business Owners (SBO), Census PUMS files, and the American Community Survey (ACS). Measures of business ownership based on these cross-sectional data, however, cannot capture recent patterns because there is often a 1–2-year delay in release. The CPS releases microdata within a month of the survey week.

To estimate business ownership in the CPS data, I identify all individuals who own a business as their main job in the survey month (based on the class of worker question and monthly labor force recode). The main job is defined as the one with the most hours worked during the survey week. Thus, individuals who start side businesses will not be counted if they are working more hours on a wage and salary job. The CPS captures the current work activity of the business owner, and whether that business owner is currently operating the business. Thus, the number of active business owners can be captured in the data, but there is no way of telling whether these are temporary or permanent business closures. But, inactive business owners regardless of whether the business is temporary or permanently closed are suffering losses in business income during those months of nonoperation. The measure of business ownership in the CPS captures all business owners including those who own incorporated or unincorporated businesses, and those who are employers or nonemployers. Although some business owners own large businesses the predominant types are small businesses. I interpret the data as predominately covering small business owners. In addition to providing information on business ownership and current activity, the CPS data include

3Large literatures explore the causes and consequences of disparities in ownership and success of minority-, female-, and immigrant-owned businesses. For broader discussions and reviews of these literatures, see, for example, Dávila and Mora (2013), Fairlie and Robb (2008), Jennings and Brush (2013), Fairlie and LoFlostra (2015), Kerr and Kerr (2020), and Parker (2018).
information on detailed demographic information, including gender, race, and immigrant status of the owner. The data also include information on the industry and incorporation status of the business. The CPS data have been used in previous research to study self-employment, business ownership, and entrepreneurship (e.g., see, Chatterji, Chay, & Fairlie, 2014; Fairlie & Chatterji, 2013; Fairlie & Fossen, 2019; Hipple & Hammond, 2010; Levine & Rubenstein, 2017; Wang, 2019).

2.2 Survey timing and social-distancing restrictions

The CPS survey reference period is generally the calendar week that contains the 12th day of the month. The CPS survey reference period is generally the calendar week that contains the 12th day of the month. For April, the week was Sunday, April 12 through Saturday, April 18. The March survey reference week was March 8 through March 14. For May, the week was Sunday, May 10 through Saturday, May 16, and for June, the week was Sunday, June 14 to Saturday, June 20. Given that shelter-in-place restrictions started after this reference week, the April 2020 release is the first CPS survey fully covering the early-stage impacts of COVID-19. On March 16, 2020 San Francisco Bay Area imposed shelter-in-place restrictions followed by the State of California on March 19. New York State followed the next day. By early April most states imposed social-distancing restrictions. The analysis below mostly relies on comparisons between February 2020 (before social-distancing policy mandates) and April, May, or June 2020 (the first 3 months after policy mandates).4

3 RESULTS

3.1 Number of business owners

I first examine small business ownership patterns over time to determine the impacts of COVID-19. Long-term trends in the number of business owners are displayed in Figure 1 (and recent months in Table 1). The number of business owners actively working any amount is displayed in Figure 1. Over the past two decades, the number of active business owners in the United States has shown a relatively smooth pattern over time with a slight upward trend. What is clear, however, is the dramatic drop in the number of active business owners in April 2020 and the partial rebound in May and continuing rebound in June. The number of working business owners dropped from 15.0 million in February 2020 to 11.7 million in April 2020 because of COVID-19. March 2020 only shows a small drop in business owners likely because of the limited effect from shelter-in-place restrictions. May 2020 shows a partial rebound from April 2020 adding back 1.1 million active business owners (7 percentage points relative to February levels). The losses due to COVID-19 from February remain high at 15%, but the rebound suggests that not all of the losses of active business owners in April 2020 were permanent closures. June experienced a further rebound with business activity being down 8% from February levels.

The loss of 3.3 million active business owners (or 22%) from February to April 2020 was the largest drop on record. When conditioning on working at least 15 hr in the survey week, the losses were even larger. The choice of 15 hr is made to approximate 2 days/week and accommodate lumpy hours reporting (i.e., often 10, 15, 20, etc.). There were 13.6 million business owners working 15+ hours in February 2020 and only 9.8 million in April 2020. The drop of 3.8 million business owners or 28% was unprecedented. Conditioning on 30 or more hours worked results in losses of 3.4 million or 31% (see Table 1). The losses conditioning on hours worked were also larger in May relative to February (19% for 15+ hours and 21% for 30+ hours). Both measures, however, show partial rebounds in May from April 2020. From 9 to 10 percentage points of the drops in active business owners were added back in May. Further rebounds occurred in June with losses to 15+ hours worked business activity at 11% and 30+ hours worked business activity at 13%.

Table 1 also reports the total number of hours worked in the survey week among all business owners by month. Figures are reported in 1,000 s. From February to March there was a drop in total hours worked in businesses by owners of 29%. From February to April there was a drop in total hours worked by business owners, but the drop was not as large at 20%. From February to June total hours worked dropped by 12%. These reductions in business hours worked

4In most analyses March 2020 is not included because of partial effects. On March 11, the World Health Organization (WHO) declared COVID-19 a pandemic which might have resulted in early demand shifts over health concerns predating shelter-in-place restriction policies.
have important ramifications for take home earnings for business owners. Business owners are likely to have experienced large reductions in income. Unfortunately, the CPS data do not provide information on these losses to income. The latest data available from the Census on business revenues indicate that average sales and receipts of businesses are $440,000/year (U.S. Census Bureau, 2016).

Separating the number of business owners into unincorporated and incorporated status indicates large drops in activity for both groups (see Table 1). Incorporated businesses are viewed as more growth-oriented, committed, procyclical, and entrepreneurial (e.g., Fairlie, Miranda, & Zolas, 2020; Levine & Rubinstein, 2017, 2018). The number of active unincorporated business owners dropped 28% from February to April but then rebounded 10 percentage points in May and a further 9 percentage points in June. Incorporated business owners realized a smaller drop in active business owners of 14% from February to April, and a smaller rebound of 3 percentage points in both May and June. The losses remain large, however, with 17% of unincorporated business owners and 11% of incorporated business owners not operating in May, and 9% of unincorporated and 7% of incorporated not operating in June.

### 3.2 Demographic patterns

The CPS data provide detailed information on gender, race, and immigrant status. Figure 2 (Table 2) displays the number of active female and male business owners in February, April, May, and June 2020. Female businesses were especially hit hard by COVID-19 in April. The number of active female business owners dropped from 5.4 million to 4.0 million in the crucial 2-month window. The decline of one-fourth of active female business owners is unprecedented.

### Table 1 Number of active business owners before and after COVID-19

<table>
<thead>
<tr>
<th>Month</th>
<th>Worked in survey week</th>
<th>Percent change from Feb. 2020</th>
<th>Worked 15+ hours</th>
<th>Worked 30+ hours</th>
<th>Total hours worked in business (000 s)</th>
<th>Unincorporated</th>
<th>Incorporated</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 2020</td>
<td>13,794,081</td>
<td>−8</td>
<td>12,021,520</td>
<td>9,614,237</td>
<td>490,842</td>
<td>8,065,557</td>
<td>5,728,523</td>
</tr>
<tr>
<td>May 2020</td>
<td>12,809,946</td>
<td>−15</td>
<td>11,040,149</td>
<td>8,808,505</td>
<td>448,786</td>
<td>7,292,477</td>
<td>5,517,469</td>
</tr>
<tr>
<td>April 2020</td>
<td>11,710,360</td>
<td>−22</td>
<td>9,821,255</td>
<td>7,684,501</td>
<td>394,678</td>
<td>6,392,480</td>
<td>5,317,880</td>
</tr>
<tr>
<td>March 2020</td>
<td>14,475,704</td>
<td>−4</td>
<td>12,803,107</td>
<td>10,392,909</td>
<td>523,558</td>
<td>8,545,156</td>
<td>5,930,548</td>
</tr>
<tr>
<td>February 2020</td>
<td>15,012,692</td>
<td>0</td>
<td>13,582,876</td>
<td>11,086,054</td>
<td>558,440</td>
<td>8,828,513</td>
<td>6,184,179</td>
</tr>
<tr>
<td>January 2020</td>
<td>14,832,717</td>
<td>−1</td>
<td>13,293,991</td>
<td>11,093,877</td>
<td>551,153</td>
<td>8,649,659</td>
<td>6,183,059</td>
</tr>
</tbody>
</table>

Notes: Estimates form Current Population Survey (CPS) microdata. Monthly sample sizes are roughly 55,000 for the labor force and 5,000 for business owners.
Male business owners also suffered major losses in business activity with a reduction of 2 million representing 20% of previous levels.

Continuing into May, both male and female business owners were hit hard by COVID-19 relative to February levels, before the social-distancing restrictions. The number of active female business owners dropped from 5.4 million to 4.5 million (16%), and the number of active male business owners dropped from 9.6 million to 8.3 million (14%). However, both female and male business owners bounced back from April losses. Female business owners bounced back resuming work by 9 percentage points and male business owners bounced back by 7 percentage points. In June, the rebound for both female and male owners continued. The number of active business owners was down by 10% for women and 7% for men relative to pre-COVID levels.

In terms of the share of total active business owners, female business owners only experienced a slight loss in shares. Table 3 reports estimates of the share of total business owners represented by each demographic group. The female share of active business owners was 36% in February and declined slightly to 35% in April–June.

FIGURE 2 Number of active business owners by gender before and after COVID-19 [Color figure can be viewed at wileyonlinelibrary.com]

### TABLE 2 Number of active business owners by demographic group

<table>
<thead>
<tr>
<th>Group</th>
<th>Feb. 2020 Number</th>
<th>Apr. 2020 Number</th>
<th>May 2020 Number</th>
<th>June 2020 Number</th>
<th>Feb.–Apr. change Number</th>
<th>Feb.–Apr. change Percent</th>
<th>Feb.–May Percent</th>
<th>Feb.–June Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>15,012,692</td>
<td>11,710,360</td>
<td>12,809,946</td>
<td>13,794,081</td>
<td>–3,302,331</td>
<td>–22</td>
<td>–15</td>
<td>–8</td>
</tr>
<tr>
<td>Female</td>
<td>5,389,399</td>
<td>4,048,205</td>
<td>4,517,965</td>
<td>4,876,392</td>
<td>–1,341,194</td>
<td>–25</td>
<td>–16</td>
<td>–10</td>
</tr>
<tr>
<td>Male</td>
<td>9,623,293</td>
<td>7,662,156</td>
<td>8,291,981</td>
<td>8,917,689</td>
<td>–1,961,137</td>
<td>–20</td>
<td>–14</td>
<td>–7</td>
</tr>
<tr>
<td>Black</td>
<td>1,079,116</td>
<td>637,769</td>
<td>798,668</td>
<td>872,717</td>
<td>–441,347</td>
<td>–41</td>
<td>–26</td>
<td>–19</td>
</tr>
<tr>
<td>Latinx</td>
<td>2,070,896</td>
<td>1,412,925</td>
<td>1,668,254</td>
<td>1,855,026</td>
<td>–657,971</td>
<td>–32</td>
<td>–19</td>
<td>–10</td>
</tr>
<tr>
<td>Asian</td>
<td>888,528</td>
<td>657,896</td>
<td>700,393</td>
<td>798,811</td>
<td>–230,632</td>
<td>–26</td>
<td>–21</td>
<td>–10</td>
</tr>
<tr>
<td>White</td>
<td>10,553,415</td>
<td>8,761,531</td>
<td>9,373,304</td>
<td>10,001,462</td>
<td>–1,791,884</td>
<td>–17</td>
<td>–11</td>
<td>–5</td>
</tr>
<tr>
<td>Immigrant</td>
<td>3,120,275</td>
<td>2,009,597</td>
<td>2,329,820</td>
<td>2,545,926</td>
<td>–1,110,677</td>
<td>–36</td>
<td>–25</td>
<td>–18</td>
</tr>
<tr>
<td>Native</td>
<td>11,892,417</td>
<td>9,700,763</td>
<td>10,480,126</td>
<td>11,248,155</td>
<td>–2,191,654</td>
<td>–18</td>
<td>–12</td>
<td>–5</td>
</tr>
</tbody>
</table>

Note: Estimates are from Current Population Survey (CPS) microdata.
Turning to racial patterns, Figure 3 (Table 2) displays the number of active business owners by major racial groups. The findings are alarming. The number of African-American business owners plummeted from 1.1 million in February 2020 to 640,000 in April. The drop of 440,000 black business owners actively working in their businesses, representing 41% of the previous level, is disconcerting. Although there was a partial rebound, the number of actively working African-American business owners remains 26% lower in May than that in February 2020, which is the largest drop for any major racial/ethnic group. The implications for lost income from having 41% of business owners not working in April, 26% not operating in May, and 19% not operating in June will have longer-term negative consequences on savings and wealth. Average business sales and receipts among black-owned businesses are $58,000/year (U.S. Census Bureau, 2016).

Latinx business owners also suffered major losses in business activity. The number of active Latinx business owners dropped from 2.1 million to 1.4 million (32%) from February to March. These losses in business activity from COVID-19 continued into the second and third months after widespread shelter-in-place restrictions. The number of active Latinx business owners dropped by 19% from February to May and 10% from February to June. Although there was a partial

<table>
<thead>
<tr>
<th>Group</th>
<th>Feb. 2020 Share (%)</th>
<th>Apr. 2020 Share (%)</th>
<th>May 2020 Share (%)</th>
<th>June 2020 Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Female</td>
<td>36</td>
<td>35</td>
<td>35</td>
<td>35</td>
</tr>
<tr>
<td>Male</td>
<td>64</td>
<td>65</td>
<td>65</td>
<td>65</td>
</tr>
<tr>
<td>Black</td>
<td>7</td>
<td>5</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Latinx</td>
<td>14</td>
<td>12</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>Asian</td>
<td>6</td>
<td>6</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>White</td>
<td>70</td>
<td>75</td>
<td>73</td>
<td>73</td>
</tr>
<tr>
<td>Immigrant</td>
<td>21</td>
<td>17</td>
<td>18</td>
<td>18</td>
</tr>
<tr>
<td>Native</td>
<td>79</td>
<td>83</td>
<td>82</td>
<td>82</td>
</tr>
</tbody>
</table>

Note: Estimates are from Current Population Survey (CPS) microdata.
rebound from April, these losses continue to be large and contribute to lost income for owners. Average business sales and receipts among Hispanic-owned businesses are $143,000/year (U.S. Census Bureau, 2016).

Asian business owners suffered losses in business activity of 230,000 representing 26% of February levels. Even with the rebounds in May and June, the number of Asian business owners who were actively running their businesses dropped by 21% and 10%, respectively. Consumer discrimination against Asian-owned businesses was a concern because of the coronavirus first appearance in China (CDC, 2020a). The losses to revenues among Asian business owners are large with average sales and receipts of $365,000 (U.S. Census Bureau, 2016).

The drop in business activity from February to April for whites were also large at 1.8 million business owners, but smaller as a percentage of starting levels (17%). White business owners experienced declines in operating businesses of 11% in May and 5% in June. Average sales and receipts of white-owned businesses are $546,000 (U.S. Census Bureau, 2016).

The drop in business activity from February to April for whites were also large at 1.8 million business owners, but smaller as a percentage of starting levels (17%). White business owners experienced declines in operating businesses of 11% in May and 5% in June. Average sales and receipts of white-owned businesses are $546,000 (U.S. Census Bureau, 2016).

The black and Latinx business owner shares declined from February to April by two percentage points (Table 3). Blacks represented 5% of active business owners in the nation in April and Latinx represented 12% of active business owners. The share bounced back but only partially by June (6% for blacks and 13% for Latinx). The Asian share remained relatively stable over the 4 months, whereas the white share of total business owners increased.

Focusing on immigrants, the number of active business owners dropped from 3.1 million to 2.0 million from February to April (Figure 4 and Table 2). The loss of over 1 million active immigrant business owners is alarming. It represents a drop of 36% from February levels. The losses in business activity continue to be large for immigrants with a 25% reduction in May and an 18% reduction in June. Although active business owner numbers partially bounced back in May and June relative to April for immigrants the levels did not return to anything close to pre-COVID-19 levels. For comparison, the number of active US born (native) business owners dropped by much lower levels during the first 3 months (18% in April, 12% in May, and 5% in June). These patterns led to the share of immigrant business owners dropping from 21% in February to 17%–18% in April–June (Table 3).

Comparing back to April 2019 levels, the conclusions do not differ. For all of the demographic groups, the number of business owners dropped precipitously from April 2019 to April 2020. In general, the number of self-employed business owners for each group does not change substantially over time especially during stable economic conditions, and thus February 2020 is an accurately captures previous levels. April 2020 is clearly an unprecedented shock to business owners that hit all groups hard throwing active business totals off relatively stable longer-term levels.

**FIGURE 4** Number of active business owners by nativity before and after COVID-19 [Color figure can be viewed at wileyonlinelibrary.com]
3.3  Industry patterns

Table 4 reports estimates by major industry groups. Almost every industry experienced sizeable drops in the number of active business owners from February to April. The only exception was Agriculture for which the number of active business owners increased slightly. Construction which is one of the largest industries for business ownership experienced a major decline of nearly 670,000 (27%) active business owners in the United States from February to April. Although Construction partially bounced back in May and June losses in business activity continued to be large. Although construction businesses experience a lot of swings in demand, it is not clear how many of these business owners will be able to come back over the next several months.

Store fronts across the country had been closed due to COVID-19 mandated restrictions especially in April. Retail trade showed a decline of 108,000 business owners in April representing 10% of February 2020 levels. Active business owners in Retail Trade are only slightly down, however, in May and June. Restaurants experienced a decline of 22% in April even though many of those remaining open turned to take-out or delivery services. The sector has experienced continuing low levels of business activity over the next 2 months. The broad sector of Arts, Leisure, and Accommodations was hit especially hard losing 35% of active business owners in April and essentially no rebound in May or June.

Both high- and less-skilled services were hit hard by COVID-19. Personal and Laundry Services were especially hard hit with losses of 79% of business owner activity in April and continuing losses of 48% in May and 26% in June. Transportation services which includes taxi and some uber drivers dropped by 22% in April, but partially rebounded in subsequent months. Higher-skilled services, such as Financial Activities and Professional and Business Services, lost

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**Table 4**  Number of active business owners by industry

<table>
<thead>
<tr>
<th>Industry</th>
<th>February 2020</th>
<th>Changes in number</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percent</td>
<td>Feb.–April (%)</td>
<td>Feb.–May (%)</td>
<td>Feb.–June (%)</td>
</tr>
<tr>
<td>Agriculture</td>
<td>869,661</td>
<td>6</td>
<td>7</td>
<td>16</td>
<td>14</td>
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<tr>
<td>Construction</td>
<td>2,436,057</td>
<td>16</td>
<td>−27</td>
<td>−19</td>
<td>−8</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>566,192</td>
<td>4</td>
<td>−11</td>
<td>−26</td>
<td>−2</td>
</tr>
<tr>
<td>Wholesale trade</td>
<td>260,151</td>
<td>2</td>
<td>−14</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Retail trade</td>
<td>1,068,484</td>
<td>7</td>
<td>−10</td>
<td>−2</td>
<td>−1</td>
</tr>
<tr>
<td>Transportation</td>
<td>798,325</td>
<td>5</td>
<td>−22</td>
<td>−12</td>
<td>−1</td>
</tr>
<tr>
<td>Information</td>
<td>235,847</td>
<td>2</td>
<td>−10</td>
<td>−19</td>
<td>−20</td>
</tr>
<tr>
<td>Financial activities</td>
<td>1,301,769</td>
<td>9</td>
<td>−12</td>
<td>−6</td>
<td>−1</td>
</tr>
<tr>
<td>Professional and business services</td>
<td>3,295,875</td>
<td>22</td>
<td>−18</td>
<td>−10</td>
<td>−7</td>
</tr>
<tr>
<td>Educational services</td>
<td>329,544</td>
<td>2</td>
<td>−39</td>
<td>−10</td>
<td>−25</td>
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<tr>
<td>Health services</td>
<td>1,238,335</td>
<td>8</td>
<td>−16</td>
<td>−18</td>
<td>−8</td>
</tr>
<tr>
<td>Arts, leisure, hotels</td>
<td>685,009</td>
<td>5</td>
<td>−35</td>
<td>−35</td>
<td>−31</td>
</tr>
<tr>
<td>Restaurants</td>
<td>409,605</td>
<td>3</td>
<td>−22</td>
<td>−24</td>
<td>−13</td>
</tr>
<tr>
<td>Repair and maintenance</td>
<td>512,403</td>
<td>3</td>
<td>−25</td>
<td>−22</td>
<td>−29</td>
</tr>
<tr>
<td>Personal and laundry services</td>
<td>926,409</td>
<td>6</td>
<td>−79</td>
<td>−48</td>
<td>−26</td>
</tr>
<tr>
<td>&quot;Nonessential&quot; industry</td>
<td>3,675,939</td>
<td>24</td>
<td>−38</td>
<td>−28</td>
<td>−17</td>
</tr>
<tr>
<td>&quot;Essential&quot; industry</td>
<td>11,336,752</td>
<td>76</td>
<td>−17</td>
<td>−10</td>
<td>−5</td>
</tr>
</tbody>
</table>

Notes: Estimates from Current Population Survey (CPS) microdata. Essential industries are defined using the classification provided by Delaware State for essential and nonessential businesses.

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Although farmers and other agricultural business owners might have continued to work during the pandemic they might have experienced large losses in sales and revenues due to supply chain shutdowns from the closing of regular buyers (e.g., schools and restaurants).
12% and 18%, respectively. Even health services experienced a drop of 16%. All three experienced partial rebounds in May and June.

It is also possible to categorize industries into essential versus nonessential according to state or local government guidelines, although there is a lot of variation across these guidelines in terms of specific industries. Delaware State provides the most detailed and comprehensive list of essential businesses at the 4-digit industry level and follows the same 4-digit industry codes as the CPS (North American Industry Classification System, NAICS).6 The classification is likely to be imperfect, however, because definitions, enforcement, business owner compliance, and health- and economic-related consumer reactions vary across the country. Using this categorization, “essential” industries comprise 76% of business owners. Losses in the number of active business owners are lower for essential industries at 17% in April compared with 38% among nonessential industries (as expected). Although both groups of business owners experienced partial rebounds, the number of active business owners in essential industries was down by 10% in May and 5% in June, and the number in nonessential industries was down by 28% in May and 17% in June.

3.3.1 Importance of industry distributions

Did the industry distribution of businesses owned by different demographic groups place them at a higher or lower risk of COVID related shutdowns? To explore this question I simulate the total number of business owners for each demographic group by switching their industry distribution for the US national industry distribution. The industry distributions are both measured in February 2020. The expression for the simulated change in the number of business owners for group \( j \) from February to April is

\[
\sum_{i=1}^{K} S_{i}^{US} \left( N_{i}^{j, Apr} - N_{i}^{j, Feb} \right),
\]

where \( S_{i}^{US} \) is the share of all business owners represented by major industry \( i \) using the US national industry distribution, and \( N_{i}^{j, Month} \) is the number of business owner for group \( j \), industry \( i \), and the defined month. The simulation essentially uses the national industry shares and multiplies them by the group-specific changes in the number of active business owners between the 2 months.

Table 5 reports estimates from the simulations. The number of active female business owners declined by 25% from February to April 2020. The industry distribution of female business owners was partly responsible for relatively large business activity losses from February to April. When switching to the US national industry distribution the decline in active business owners is lower at 19%. Thus, the female industry distribution was “unfavorable” in terms of placing them at a higher risk of business activity losses in April 2020. A similar finding holds for May and June. For both months, the drop in active business owners is smaller for women when switching to the US national industry distribution.

By definition, the opposite is true for male business owners. Relative to the US total (and thus female business owners), the male industry distribution partly protected them from larger losses due to COVID-19. Switching industry distributions to the national distribution results in a higher predicted decline in business owner activity of 23% in April, 15% in May, and 8% in June.

The industry distribution of black business owners placed them at a higher risk of business activity losses due to COVID-19. The percent change in the number of active black business owners becomes considerably smaller when simulations are run with the national industry distribution. The change is from a loss of 41% to 35% in April. The patterns are similar in May and less pronounced in June.

A similar pattern is found for Latinx. When switching the Latinx industry distribution to the US national industry distribution the predicted number of active Latinx business owners drops from 32% to 28% for April. Latinx business owners had an “unfavorable” industry distribution partly placing them at higher risk of business activity losses. For May and June, the “unfavorable” industry distribution also placed Latinx business owners at a higher risk of business activity losses.

6Delaware’s list can be accessed at “List of Delaware Business Categories that are Essential and Non-Essential (March 22, 2020),” https://coronavirus.delaware.gov/resources-for-businesses/.
Asian business owners show a similar pattern in April, but not in May and June. For April, I also find that Asian business owners were more concentrated in industries placing them at a higher risk of losses in business activity. But, when switching to the national industry distribution in May and June Asian business owners are predicted to have larger losses in business activity, which implies the opposite pattern. In these months, business activity losses switched to industries that Asian business owners were less concentrated.

Interestingly, the large loss in the number of immigrant business owners does not appear to be due to a less favorable industry distribution. The loss of 36% of active immigrant business owners remains essentially unchanged when switching to the national industry distribution in April. The same pattern is found in June. For May there is some evidence of a less favorable industry distribution based on the losses in business activity in that month relative to February.

Another way to estimate industry impacts is to examine the percentage of each demographic group that is in “essential” industries. As noted above the classification is not perfect and other factors, such as differences in customer demand, enforcement, and compliance by businesses also influence whether they are open. The percentage of black business owners in essential industries is 66% which is lower than the national percentage of 76%, and consistent with the less “favorable” industry distribution placing them at higher risk of losses due to COVID-19. Similarly, female-owned businesses are less concentrated in essential businesses at 61%. On the other hand, using the Delaware codes, Latinx and immigrant business owners are slightly more likely to be concentrated in essential industries (79%–80%), and Asian business owners have the same concentration in essential industries as the national average (76%). The classification is likely to be imperfect and does not line up entirely well with patterns of group-specific losses.

4 | CONCLUSIONS

The first estimates of the effects of COVID-19 on the number of business owners from nationally representative April–June 2020 CPS data indicate dramatic early-stage reductions in small business activity. The number of active business owners in the United States plunged from 15.0 million to 11.7 million over the crucial 2-month window from February to April 2020. No other 1-, 2-, or even 12-month window of time has ever shown such a large change in business activity. For comparison, from the start to end of the Great Recession the number of active business owners decreased by 730,000, representing only a 5% reduction. In general, business ownership is relatively steady over the business cycle (Fairlie, 2013; Parker, 2018). The loss of 3.3 million active business owners (or 22%) was comprised of large drops in important subgroups, such as owners working roughly 2 days/week (28%), owners working 4 days/week (31%), and incorporated businesses (20%). When viewed as total hours worked by all business owners there was a drop of 29%.
Estimates from nationally representative May 2020 CPS data—the second month into social-distancing restrictions—continue to indicate large reductions in small business activity. The number of active business owners in the United States dropped by 15% from February to May. The number of business owners in May actually rebounded somewhat from the April low of 11.7 million. The partial rebound resulted in an increase of 1.1 million business owners or 7 percentage points from February levels. The rebound continued in June 2020 adding back another 7 percentage points. The decline in business owner activity from February to June is 8%. Although the rebound shows widespread reopening of small businesses, it continues to indicate an extremely large decrease in business activity over a short period of time. Importantly, the drops in business activity in April, May, and June represent large income losses to business owners that cannot be fully recovered.

African-American business owners were hit the hardest by COVID-19. The first estimates from April 2020 for black business owners in the United States indicate a massive drop of 41% in business activity. Black business owners were also disproportionately negatively affected in May and June relative to national levels with declines in business activity of 26% and 19%, respectively. Simulations indicate that the industry distribution of blacks was partly responsible, placing black business owners at greater risk of losses in business activity due to the pandemic. Latinx businesses were also hit hard by COVID-19 losing 32% of active business owners in April, 19% in May, and 10% in June. Asian business owners experienced a 26% decline in business activity over the critical 2-month window, and continued losses of activity of 21% in May and 10% in June. Simulation estimates also point to unfavorable industry distributions for Latinx, but the evidence is less clear for Asians. Immigrant business owners were also devastated with losses of 36% of business activity in April. Continued disproportionate losses were felt in May (25%) and June (18%). Although industry distributions placed some groups at higher risk of closures in the pandemic, differences in the scale of businesses are likely a major cause of disproportionate losses among minority-owned businesses, which are smaller on average (Fairlie & Robb, 2008; U.S. Census Bureau, 2016). Larger businesses are more likely to have the resources, business, and legal structure, and returns to scale to implement procedures to address social-distancing regulations for operating and reopening during the pandemic.

The negative early-stage impacts on minority- and immigrant-owned businesses, if prolonged, could be problematic for broader racial inequality because of the importance of small businesses for local job creation (disproportionately hiring other minorities), economic advancement, and longer-term wealth inequality (Boston, 1999, 2006; Bradford, 2003, 2014; Fairlie & Robb, 2008; Stoll, Raphael, & Holzer, 2001). With major losses in business activity in April and continued losses in May and June, even though these losses were smaller, business owners have already lost substantial amounts of income from their businesses. If a more complete rebound does not happen soon the long-term economic consequences could be severe. Many minority business owners will not have the resources to weather prolonged closures, reduced demand from health concerns, and a more comprehensive recession. The latest Census data indicate that the median level of wealth among black families is $13,000 and Latinx families is $20,000 compared with $139,000 among white families (U.S. Census Bureau, 2015).

The first estimates of early-stage impacts on active female business owners are also worrisome. Female business ownership is substantially lower than male business ownership and female-owned businesses have lower revenues, employees, and profits on average (U.S. Census Bureau, 2016). The disproportionate losses in the first 3 months to the number of active female business owners will only further increase gender inequality in business ownership and perhaps broader economic inequality.

The next important question is whether the shutdowns of small businesses are temporary or permanent. The government has been responding to concerns over longer-term effects on small businesses through several programs. The largest program is the Paycheck Protection Program (PPP) which has thus far allocated over $650 billion to help businesses. Another large program is the Economic Injury Disaster Loan program by the Small Business Administration, which provided over $150 billion as of July 2020. Foundations and private companies are also starting to contribute to relief efforts. For example, Magic Johnson Enterprises is providing a $100 million commitment to minority- and female-owned businesses left out of the PPP program. Another recent example, is that PayPal, in partnership with the Association for Enterprise Opportunity, created a $10 million fund to help black-owned businesses, and Google is pledging $175 million on financing and supporting black-owned businesses. Can these programs help small businesses survive the setbacks and shutdowns due to the coronavirus pandemic, or will more assistance be needed? More permanent mass closures of small businesses in the United States are likely to have a dramatic effect on employee job losses, further income inequality, and contributing to a prolonged recession. But, the tradeoffs from lifting restrictions on reopening of businesses on health impacts are unknown and of concern given that COVID-19 cases have been increasing over the summer (CDC, 2020b).
ACKNOWLEDGMENTS
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DATA AVAILABILITY STATEMENT
The microdata used in the analysis are publicly available.

ORCID
Robert Fairlie http://orcid.org/0000-0002-8634-9785

REFERENCES


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Did the $660 Billion Paycheck Protection Program and $220 Billion Economic Injury Disaster Loan Program Get Disbursed to Minority Communities in the Early Stages of COVID-19?

Robert Fairlie¹ and Frank M. Fossen²

December 2020

Abstract

Social distancing restrictions and health- and economic-driven demand shifts from COVID-19 shut down many small businesses with especially negative impacts on minority owners. Is there evidence that the unprecedented federal government response to help small businesses – the $659 billion Paycheck Protection Program (PPP) and the related $220 billion COVID-19 Economic Injury Disaster Loans (EIDL) – which had a stated goal of helping disadvantaged groups, was disbursed evenly to minority communities? In this descriptive research note, we provide the first detailed analysis of how the PPP and EIDL funds were disbursed across minority communities in the country. From our analysis of data on the universe of loans from these programs and administrative data on employer firms, we generally find a slightly positive relationship between PPP loan receipt per business and the minority share of the population or businesses, although funds flowed to minority communities later than to communities with lower minority shares. PPP loan amounts, however, are negatively related to the minority share of the population. The EIDL program, in contrast, both in numbers and amounts, was distributed positively to minority communities.

Keywords: Small business, entrepreneurship, business owners, self-employment, Paycheck Protection Program, PPP, Economic Injury Disaster Loans, EIDL, COVID-19, coronavirus, shelter in place restrictions, social distancing restrictions, minority business, racial inequality

JEL Codes: J15; L26

¹ Department of Economics, University of California, Santa Cruz, Stanford University (Visiting Scholar), and NBER (rfairlie@ucsc.edu). ²Department of Economics, University of Nevada, Reno (ffossen@unr.edu). We would like to thank Karen Mills and participants at the NBER Entrepreneurship Workshop, the PPIC California labor market workshop, and the Kauffman Foundation Entrepreneurship Issue Forum for comments and suggestions. The research project has also benefited from numerous conversations with the press and policymakers. Special thanks go to Zach Mider, Jason Grotto and Cedric Sam for discussions of the data and analysis, research assistance by Ian Allen and Ege Can, and thanks go to participants in the Axios/Google Small Business Matters Expert Panel and JPMorgan Chase Institute Data Dialogue meetings for their comments and questions.
1. Introduction

The widespread closing of stores and businesses in the United States and around the world due to the coronavirus is unprecedented. Stores, factories and many other businesses have closed by policy mandate, downward demand shifts, health concerns, or other factors. The number of working business owners in the United States plummeted from 15.0 million in February 2020 to 11.7 million in April 2020 and has only partially rebounded since then (Fairlie 2020). The impacts have also been disproportionately felt by race: business owner activity fell in the early-stages of the pandemic by 41 percent among African-Americans and 32 percent among Latinx compared with 17 percent among whites.

Given the impact of the pandemic the federal government provided a response of larger magnitude than ever seen before in terms of providing financial assistance to small businesses. The largest program providing funds to small businesses is the $650 billion Paycheck Protection Program (PPP). The Small Business Administration (SBA) administered program provides loans to small businesses through banks, credit unions, and other financial institutions with the stated goal of keeping small businesses open and retaining employees on the payroll. Loan amounts were generally equal to 2.5 months of average payroll costs, and can be forgiven if the business retains its employees. The program started providing loans on April 3, 2020, which was after most states imposed social distancing restrictions in response to COVID-19, and ran through August 8, 2020 providing more than 5 million total loans. The $220 billion Economic Injury Disaster Loan Program (EIDL) program, which is also administered by the SBA, is designed to provide either loans or advances to small businesses that are losing revenues and sales due to COVID-19. Nearly 3.6 EIDL loans for $200 billion and nearly 5.8 million EIDL advances for $20 billion have been provided to small businesses. EIDL loans can be used to cover up to 6 months of a wide array of expenses.

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1 These findings prompted a large policy response, for example, new U.S. Senate bills (U.S. Senate 2020) and California State bills (Newsom 2020) to provide assistance to minority and small businesses during the pandemic.
2 Cash balances and revenues of small businesses also fell substantially in the early stages of the pandemic (Farrell, Wheat and Mac 2020).
3 The Coronavirus Aid, Relief, and Economic Security (CARES) Act also provided stimulus payments to households and expanded unemployment insurance benefits to households. See Bhutta et al. (2020) for an analysis of whether this cash assistance will help families cover expenses over a six month period of lost income (i.e. April through September 2020), relative to a counterfactual where families would have had to rely solely on their own liquid savings and standard UI benefits (e.g., benefits available in the absence of CARES).
4 On March 11, 2020, the World Health Organization (WHO) declared COVID-19 a pandemic. On March 16, the San Francisco Bay Area imposed the first shelter-in-place restrictions in the country followed by the State of California on March 19. New York State followed the next day. By early April most states imposed social distancing restrictions.
working capital and normal operating expenses, such as continuation of health care benefits, rent, utilities, and fixed debt payments. EIDL advances are grants and do not have to be repaid, but are for smaller amounts ($1,000 per employee up to a maximum of $10,000). EIDL advances are subtracted from the forgiveness amount of their PPP loan if they are received in addition to PPP loans.

One of the stated goals in the CARES Act which included the PPP and EIDL programs was to prioritize serving “underserved markets” and businesses owned by “socially and economically disadvantaged individuals” (U.S. Congress 2020). Did the PPP and EIDL programs, which provided 15 million loans or advances worth more than $850 billion to small businesses, get disbursed to minority communities benefitting the businesses and employees in those communities? Given the larger negative effects of COVID-19 on business inactivity among minority businesses (Fairlie 2020) targeting these relief funds to minority communities might be especially important.

In this descriptive research note we provide the first detailed analysis of how the PPP and EIDL funds were disbursed across minority communities in the United States. Using administrative data on the universe of PPP loans, EIDL loans, and EIDL advances, we explore whether loans and advances were evenly distributed or not. We find that minority communities received a large share of PPP loans. We generally find a slightly positive relationship between PPP loan receipt per business and the minority share of the population. There is some evidence, however, that the first round of funds was disproportionately disbursed to non-minority communities and the second round of funds was disproportionately disbursed to minority communities. When we focus on the minority share of employer businesses in an area we find similar results. Focusing on PPP loan amount per employee, however, we find a negative relationship with minority share of the population. In contrast, EIDL loans and advances, in both number and amounts, were provided positively to minority communities. We find a strong positive relationship in the receipt of these loans and advances by minority share of the population.

These results build on the findings from a few related working papers on the PPP program. Granja et al. (2020) find that the first round of PPP funds flowed to areas more adversely affected by the economic effects of the pandemic, but that the early PPP did not have a substantial effect on local economic outcomes. Neilson et al. (2020) report based on survey data that the smallest businesses were less aware of the PPP, less likely to apply, and conditional on applications filed
later, faced longer processing times, and were denied more often. Bartik et al. (2020) using firm-level data and an instrumental variables approach find that PPP loans led to an increase in a business’ expected survival, and a positive but imprecise effect on employment. Focusing on race, Lederer et al. (2020) conducted matched-pair audit testing of financial institutions in Washington, D.C. for PPP loans and find disparities between black and white testers in encouragement in applying for a loan, products offered, and information provided by the bank representative. Additionally, Erel and Liebersohn (2020) find that FinTech is disproportionately used to disburse PPP funds in high minority share ZIP codes. This paper builds on the previous research by providing the first comprehensive analysis of the relative disbursement of PPP and EIDL small business funds to minority communities, and the first study, to our knowledge, of the EIDL program. The findings are potentially important for future targeting and oversight of government aid to preserve minority businesses and the jobs they create.

2. Data

Partly in response to a Freedom of Information Act (FOIA) request and law suit threat by the media, the SBA released complete loan-level microdata for the PPP and EIDL programs. The PPP data cover the universe of loans provided through the program, which was from April 3, 2020 to August 8, 2020. The PPP is divided into two rounds. The first round ran from April 3 to April 16 and consisted of $342 billion across about 1.6 million loans. The second round ran from April 27 to August 8 and included more than 3.5 million loans with a total value of roughly $180 billion. In total there are 5.2 million loans and $522 billion.

The loan microdata include information on the amount of the loan for loans under $150,000. For larger loans, only ranges are reported ($150,000-350,000, $350,000-1 million, $1-2 million, $2-5 million, and $5-10 million). Geographical information down to the zip code is provided in the smaller loan data, whereas exact address and even the name of the business is included in the larger loan data. The data also include information on industry, business type, jobs retained self-

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5 Alstadsæter et al. (2020) use Norwegian administrative data to simulate the effects of Norwegian government support and the U.S. PPP program to help businesses during the COVID-19 pandemic and find that these policies supporting payroll can be partly effective.

6 A large literatures explores the causes and consequences of disparities in ownership and success of minority-owned businesses. For broader discussions and reviews of these literature, see, for example, Davila and Mora (2013); Fairlie and Robb (2008); Kerr and Kerr (2020); Parker (2018). See Fairlie (2020) and Stanford Latino Entrepreneurship Initiative (2020) for evidence of COVID-19 impacts on minority-owned businesses.
reported by the business, and name of the lender. Information on the race, gender and veteran status of the owner are incomplete. The application did not ask for demographic information on the owners (see U.S. SBA 2020 for application form) and relied on banks to report the information. The result is that only 10 percent of loans provide race information, and these are heavily concentrated among a few banks.

The SBA also released loan and advance data from the EIDL program. The EIDL program data are separated into the loans and advances. There were 3.6 million loans and 5.8 million advances administered through the program. As of 9/14/20 $190 billion of the allocated $200 billion in loans have been handed out to small businesses. All of the $20 billion for EIDL advances has been provided to small businesses.

To normalize the number of PPP or EIDL loans by zip code we calculate loans per employer business. We use data from County Business Patterns (CBP) on business establishments with employees. The data are provided by the U.S. Census Bureau at the zip code level as well as other geographical levels. The CBP data on employer establishments do not include counts of farms and nonprofits. We acquire farm data by zip code from the U.S. Department of Agriculture’s National Agricultural Statistics Service (NASS). From the PPP loan data, we exclude nonprofit businesses, which represent 3.5 percent of loans, businesses with a nonclassifiable industry (1.7 percent of the loans), self-employed persons (4.5 percent), and independent contractors (3.0 percent).

To normalize loan amounts we calculate average loan amounts per business employee in each zip code. CBP data also includes employment levels for employer business establishments down to the zip code level. The normalization adjusts for loan amount differences due to differences in employment size by location, which is the general basis for loan amounts. Because only ranges are reported for larger loans in the PPP administrative data we use the midpoint of each range for each loan (e.g. we use $250,000 for a recorded range value of $150,000-350,000). Using alternative assumptions such as 1/3 the range instead of the midpoint does not change the relationship by minority share. EIDL loan and advance amounts are complete.

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7 The top banks providing PPP loans were Bank of America (7%), JPMorgan Chase (5%), Cross River Bank (4%), Kabbage (4%), and Wells Fargo (4%).
We compare these measures of loan receipt per employer business establishment and loan amounts per employee to data from the Census of Population on the minority share of the population across communities. We measure minority share of the population primarily by zip code but also by county. In addition to analyzing the relationship between PPP and EIDL loan receipt per business by the minority share of the population we examine the relationship by minority share of employer businesses. We use data from the Annual Business Survey (ABS) on employer businesses at the county level to calculate the minority share of employer businesses in each location. Data from the ABS are not available at the zip code level.

Table 1 provides mean values (weighed by population and unweighted) for the main variables of interest. Across zip codes, the average number of PPP loans per employer establishment is 0.489. The average loan amount per employee (unconditional on receiving a loan) is $4,404. EIDL loan receipt and amounts are lower. EIDL advances went out to more firms but the amounts were much smaller than other funds. The minority share of the population across zip codes has a mean of 0.389 and the minority share of employer businesses has a lower mean of 0.180 reflecting substantially lower business ownership rates among minorities.

Table 1: Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>Weighted Mean</th>
<th>Unweighted Mean</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>PPP loans per employer establishment</td>
<td>0.489</td>
<td>0.347</td>
<td>31,952</td>
</tr>
<tr>
<td>PPP average loan amount per employee</td>
<td>$4,404</td>
<td>$4,892</td>
<td>30,356</td>
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<tr>
<td>EIDL loans per employer establishment</td>
<td>0.256</td>
<td>0.154</td>
<td>31,952</td>
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<tr>
<td>EIDL average loan amount per employee</td>
<td>$1,515</td>
<td>$2,488</td>
<td>30,356</td>
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<tr>
<td>EIDL advances per employer establishment</td>
<td>0.577</td>
<td>0.335</td>
<td>31,952</td>
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<tr>
<td>EIDL average advance amount per employee</td>
<td>$192</td>
<td>$262</td>
<td>30,356</td>
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<tr>
<td>Minority share of the population</td>
<td>0.389</td>
<td>0.229</td>
<td>32,670</td>
</tr>
<tr>
<td>Minority share of the population (county)</td>
<td>0.389</td>
<td>0.235</td>
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</tr>
<tr>
<td>Minority share of employer businesses (county)</td>
<td>0.180</td>
<td>0.116</td>
<td>1,031</td>
</tr>
</tbody>
</table>

Notes: The statistics are at the zip code level if not otherwise indicated. The weighted means are weighted by population. Areas with unobserved minority shares are excluded. The PPP average loan amount per employee excludes loans to agriculture due to a lack of data on farm employees.
3. Results

3.1 Regional Patterns in PPP Loans and EIDL

PPP loans were spread across the country and not limited to a few regions. Figure 1, Panel A, provides a state heat map of PPP loan receipt per employer business establishment. A few states had levels of above 0.55 loans per employer business and a few states had levels between 0.27 and 0.34 loans per employer business. States on the East Coast tended to have higher rates of loan receipt per business, and states in the Midwest tended to have lower rates of loan receipt per business. EIDL loan receipt per business (Panel B) also was generally spread across the country. The patterns are somewhat stronger regionally, however, with the coasts having higher levels of loan receipt per business than the middle of the country. EIDL advances (Panel C) show a somewhat similar pattern across states. The main takeaway from these figures, however, is that PPP loan, EIDL loan and EIDL advances receipt per business was spread across the country and not limited to only a few states or regions.

Figure 1: Distribution of loan receipts per employer establishment across states
Panel A: PPP loans
3.2 PPP Loan Receipt Patterns by Minority Communities

We turn to analyzing how PPP loan receipt was distributed across minority communities. Figure 2 displays PPP loan receipt per employer establishment by minority share of the population at the...
zip code level. Panel A shows the relationship weighted by the total population and Panel B shows the relationship without population weights. The figure also includes plotted quadratic regression lines to help show the relationship. Before discussing the results, two important points are noted. First, we do not report confidence intervals (i.e. “whiskers”) because we use the universe of PPP loans and administrative data on employer firms based on the Census Business Register. Second, we focus on the raw relationship between PPP loan receipt and minority share of the population without controlling for other factors because we are trying to capture the influences of these neighborhood characteristics. For example, if minority communities have higher poverty rates and that is correlated with receipt of PPP loans then we want to include that in our measurement. Even if the driver of loan receipt is income it is reflected in race and that is what we are trying to capture.

Figure 2: PPP loans per employer establishment by minority share
Panel A: Weighted by population          Panel B: Unweighted

Notes: The charts show the mean number of PPP loans per employer establishment in zip codes by minority share of the population. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

The relationship appears to be mostly flat between loan receipt and minority population share. Both weighted and unweighted figures show a slight positive relationship between loan receipt per business and the minority share of the population across zip codes in the United States. Most of the averages by minority share fall within the range of half a standard deviation from the
median, as indicated by the double arrow on the Y-axis. Using the weighted figure, moving from the 25th percentile minority share of the population (16 percent minority) to the 75th percentile minority share of the population (59 percent minority) loan receipt only increases from 0.49 to 0.52 PPP loans per employer business establishment.

The PPP disbursed funds in two rounds with adjustments and awareness about the program changing between the two. The first round was April 3 to April 16, 2020 and consisted of 1.6 million loans. The second round ran from April 27 to August 8 and consisted of 3.6 million loans. Figure 3 displays the first round relationship, and Figure 4 displays the second round relationship. Different patterns are revealed when separating by rounds. In the first round, loan receipt went disproportionately to non-minority communities. The figure shows a stronger negative relationship, with a decline of 0.05 loans per business between the 25th and 75th percentiles in minority shares. The second round of funding, however, showed the opposite pattern. In this case, there is an unequivocal positive relationship between loan receipt and minority population share. Moving from the first quartile to the third quartile in minority share is associated with an increase of 0.08 PPP loans per firm.

**Figure 3: PPP loans per employer establishment by minority share in the 1st round**

Panel A: Weighted by population  
Panel B: Unweighted

*Notes:* The charts show the mean number of PPP loans per employer establishment in zip codes by minority share of the population in the first round of the PPP program (April 3-April 16, 2020). Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± \( \frac{1}{2} \) standard deviation.
In terms of the different rounds of the PPP, the first $349 billion was exhausted after just two weeks of being available. Given unmet need by small businesses for assistance, Congress approved an additional $310 billion. The change in the slope of the relationship between the two rounds might be caused by a few factors. First, applying for PPP loans early on favored having long established relationships with banks which minority businesses were less likely to have (Mills 2020). Second, much of the early money flowed through smaller community banks which were often in rural areas because these banks were nimbler at accessing the aid (Bloomberg 2020). In the second round larger banks with more urban and racially diverse customer bases caught up. Third, minority-owned businesses tend to be smaller than non-minority-owned businesses (Census 2016; Fairlie and Robb 2008), and smaller businesses typically took longer to complete required paperwork because they often did not have in-house accountants, legal help, or other support. Finally, FinTech and other online lenders were brought in and approved by the SBA, and these lenders were often active in minority areas (Liu and Parilla 2020). It is unclear how costly the delay was in receiving loans to minority businesses and communities.
We turn to analyzing the relationship between PPP loans per business and the minority share of businesses in the community. To measure the minority share of businesses we use data from the Annual Business Survey (ABS) on employer businesses at the county level. Data are not available at the zip code level. Figure 5 displays the relationship. The unweighted numbers do not indicate a clear pattern and are mostly consistent with a flat relationship. The weighted numbers by population size indicate a slight positive relationship. The relationship is not strong however. For example, moving from the 25th percentile of counties in the minority share of businesses (9 percent minority share) to the 75th percentile (25 percent) is associated with an increase of 0.02 PPP loans per employer business.

Figure 5: PPP loans per employer establishment by minority share of businesses
Panel A: Weighted by population       Panel B: Unweighted

Notes: The charts show the mean number of PPP loans per employer establishment in counties by minority share of businesses. Loans to agricultural businesses are excluded. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the county level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

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8 We exclude PPP loans to agricultural businesses here due to a lack of data on the minority status of farmers.
9 We also examine the relationship between PPP loans per employer business by minority share of the population at the county level. The results are similar to those at the zip code level.
Figures 6 and 7 display the relationship between loan receipt and minority business share for the first and second rounds, respectively. Similar to our findings using the minority share of the population, again we find that in the first round there appears to be a negative relationship between loan receipt and minority business share, and in the second round the relationship switches to being positive.

**Figure 6: PPP loans per employer establishment by minority share of businesses in the 1st round**

Panel A: Weighted by population  
Panel B: Unweighted

Notes: The charts show the mean number of PPP loans per employer establishment in counties by minority share of businesses in the first round of the PPP program (April 3-April 16, 2020). Loans to agricultural businesses are excluded. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the county level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.
**Figure 7: PPP loans per employer establishment by minority share of businesses in the 2nd round**

Panel A: Weighted by population  
Panel B: Unweighted

*Notes: The charts show the mean number of PPP loans per employer establishment in counties by minority share of businesses in the second round of the PPP program (April 27-August 8, 2020). Loans to agricultural businesses are excluded. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the county level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.*

**PPP Loan Amounts**

The disbursement of PPP funds across communities by minority share might differ when measured by loan amounts instead of number of loans. Figure 8 displays average loan amounts per business employee by minority share in the population at the zip code level. We standardize the Y-axis by reporting the range of ± ½ standard deviations around the median loan size (cutting off at zero in case of the unweighted chart). We find a slight downward relationship with minority share. Moving from the 25th to the 75th percentile in minority share is associated with a decrease from $4652 to $4204 in average loan amount per employee.
### Figure 8: PPP loan amounts per employee by minority share

Panel A: Weighted by population  
Panel B: Unweighted

**Notes:** The charts show the mean amounts of PPP loans per employee in zip codes by minority share of the population. Loans to agricultural businesses are excluded. Loans reported as a range are approximated by using the interval midpoint. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

### 3.3 Economic Injury Disaster Loan (EIDL) Programs

Although the PPP program has received a lot of attention, the federal government also approved the $220 billion EIDL program, which also provides aid to small businesses during COVID-19, but has received much less attention. There are two programs, EIDL loans and EIDL advances. EIDL loans are not forgivable and must be paid back in full. EIDL advances are grants and do not have to be repaid, but are for smaller amounts ($1,000 per employee up to $10,000 total).

Figure 9 displays EIDL loan receipt per employer establishment by minority share of the population across zip codes. The relationship between loan receipt and minority population share shows a clear upward pattern. If we move from the lowest quartile minority share (16 percent) to the highest quartile minority share (59 percent) loan receipt increases from 0.20 to 0.31 EIDL loans per employer business establishment.
Figure 9: EIDL loans per employer establishment by minority share

Panel A: Weighted by population       Panel B: Unweighted

Notes: The charts show the mean number of EIDL loans per employer establishment in zip codes by minority share of the population. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

Figure 10 displays EIDL advance receipt per employer establishment by minority share of the population in zip codes. The relationship between advance receipt and minority population share shows a similarly strong upward pattern. Movement from the lowest quartile to the highest quartile minority share loan receipt increases from 0.42 to 0.69 EIDL advances per employer business establishment.
Figure 10: EIDL advances per employer establishment by minority share

Panel A: Weighted by population

Panel B: Unweighted

Notes: The charts show the mean number of EIDL advances per employer establishment in zip codes by minority share of the population. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

EIDL Loan Amounts

Figure 11 displays EIDL loan amounts per employee by minority share of the zip code. Similar to the number of loans we find a positive relationship between loan amounts and minority share of the population based on the weighted chart. An increase in EIDL loans per employee from $1404 to $1624 is associated with the interquartile range in minority share across zip codes. Figure 12 displays EIDL advances per employee by minority share. We also find a positive relationship for EIDL advances increasing from a weighted average of $148 to $198 per employee when moving from the 25th to the 75th percentile in minority share.
**Figure 11: EIDL loan amounts per employee by minority share**

Panel A: Weighted by population  
Panel B: Unweighted

*Notes:* The charts show the mean EIDL loan amounts per employee in zip codes by minority share of the population. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

**Figure 12: EIDL advance amounts per employee by minority share**

Panel A: Weighted by population  
Panel B: Unweighted

*Notes:* The charts show the mean EIDL advance amounts per employee in zip codes by minority share of the population. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.
4. Conclusions

Given the shutdown of the economy to slow down the spread of the novel coronavirus Congress agreed to a massive level of expenditures in the 2020 CARES Act to help small businesses stay open and retain employees. Two components directly providing loan and grant assistance to small businesses, the PPP and EIDL programs, provided a total of nearly 15 million separate loans or advances, and a staggering level of expenditures of roughly $850 billion. The total number and amount of support for small businesses in the United States is unprecedented. Given that the programs were to help disadvantaged businesses (U.S. Congress 2020) we provide the first study of whether loans and advances from these programs were indeed distributed positively to minority communities.

Using administrative data on the universe of PPP loans, EIDL loans, and EIDL advances, we explore how loans and advances were distributed. We find that funding from these programs both flowed to minority communities and away from minority communities. Focusing first on PPP loans, we generally find a slightly positive relationship between PPP loan receipt per business and the minority share of the population. There is some evidence, however, that the first round of funds was disproportionately disbursed to non-minority communities and the second round of funds was disproportionately disbursed to minority communities. When we focus on the minority share of employer businesses in an area we find similar results: slightly positive relationship but differential relationships by disbursement rounds. Focusing on PPP loan amount per employee we find a negative relationship with minority share of the population. EIDL loans and advances, in both number and amounts, were provided positively to minority communities. We find a strong positive relationship in the receipt of these loans and advances by the minority share of the population.

Although analyzing patterns of PPP and EIDL funding receipt across minority communities by using the universe of loan-level data across minority communities is important, the loan-level data are limited by not having information on loan receipt by race and ethnicity. To be sure, there is some information in the PPP loan data, but only 10 percent of loans include race and ethnicity (and in a non-representative way by lender), and none of the loans in the EIDL data provide information on race and ethnicity. There is always the possibility that minority businesses did not evenly receive loans in geographical areas even with high minority shares of the population or high minority shares of businesses. The federal government has been criticized heavily for not
collecting this information and plans on collecting demographic information when processing forgiveness on the PPP loans. Future research needs to address this critical question.

Another criticism of the programs is that there was no collection of information on applications for loans that were denied. There is no way to gauge demand and unmet need for these loans by minority businesses and in minority communities. Although there is currently no information by race, the Census Bureau’s Small Business Pulse Survey indicates that by early August most businesses in their survey who asked for PPP or EIDL funds reported receiving them (U.S. Census Bureau 2020). But, this is an important concern. There might exist large disparities by race, and there is a major difference in potential policy response between whether minority businesses needed these loans but faced barriers (e.g. lack of established bank relationships, lack of information about loans, digital divide, or discrimination) or if they did not need loans or needed smaller loans. Another concern is that many minority businesses did not have employees and the programs were primarily focused on serving employer businesses. Finally, many minority businesses might have been reluctant to apply for PPP loans because of uncertainty over future revenues due to entering the pandemic in a weakened position (Mills and Battisto 2020).

The findings presented in this research note have implications for trends in broader inequality. Minority-owned businesses are important for local job creation (as minority owners disproportionately hire minority workers), economic advancement, and longer-term wealth inequality (Boston 1999, 2006; Stoll et al. 2001; Bradford 2003, 2014; Fairlie and Robb 2008). With major losses in business activity among minority businesses in the early stages of the pandemic (Fairlie 2020) minority business owners have already lost substantial amounts of income from their businesses. If the pandemic continues over a long period of time the long-term economic consequences on minority businesses could be severe. Many minority business owners will not have the resources to weather prolonged closures, reduced demand from health concerns, and a more comprehensive recession. Just prior to the pandemic when small business owners were asked what actions they would take if faced with a two-month revenue loss roughly half said they would use their own funds and 17 percent said they would close or sell the business (Mills et al. 2020). But, the latest Census data indicate that the median level of wealth among black families is $13,000 and Latinx families is $20,000 compared with $139,000 among white families possibly making it difficult to use their own funds for an extended period of time (U.S. Census Bureau 2015).
The government just passed a new $892 billion COVID relief package, and private foundations and companies are promising to help. Can these programs help small businesses survive the setbacks and shutdowns due to the coronavirus pandemic, or will more assistance be needed? Furthermore, will an added shift in consumer behavior away from large online retailers towards small businesses be needed? In light of the Black Lives Matter movement there has been an unprecedented push to support black-owned stores around the country, and states have promoted shopping local (e.g. California’s #ShopSafeShopLocal). In the end, getting the virus in check and restoring customer, owner and employee confidence in health risks is likely the first real step to a full recovery for small businesses.
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COVID-19, Small Business Owners, and Racial Inequality

Robert Fairlie

The widespread closing of businesses in the United States and around the world due to the coronavirus has been unprecedented. Stores, factories, and many other businesses have closed as a result of policy mandates, downward demand shifts, health concerns, or other factors. Although many have reopened since social distancing restrictions were relaxed, the revenues lost from the closures, the limited scale of current reopenings, and the potential for further closures in the future may lead to a wave of permanent small business closures with disproportionate impacts by race, gender, and nativity.

In several recent papers, I examine the impacts of COVID-19 on small business owners, using timely microdata from the Current Population Survey (CPS) and administrative data from the Small Business Administration. These new papers build on my longstanding research agenda on entrepreneurship, racial inequality, and small business policy. This summary reviews selected papers from both recent and earlier work.

Early Stages of the Pandemic

On March 19, 2020, the state of California imposed shelter-in-place restrictions, with New York State following the next day. By early April, most states had imposed social distancing restrictions that closed “nonessential” businesses and added to consumer health concerns in the emerging pandemic. Using CPS microdata, I examine how COVID-19 impacted small business owners in mid-April, the first month to capture these changes. Figure 1 shows that the number of working business owners plummeted from 15 million in February 2020 to 11.7 million in April 2020, the largest drop ever; the entire Great Recession only resulted in a drop of 5 percent. Even incorporated business owners, who tend to be more stable and growth-oriented than unincorporated owners, experienced a drop in work activity of 20 percent from February to April 2020.
Losses for businesses owned by women, racial minorities, and immigrants were especially severe [Figure 2]. African Americans experienced the largest losses: a 41 percent drop in the number of active business owners. Latinx business owners also experienced major losses: 32 percent. Immigrant business owners suffered a 36 percent drop, and female business owners 25 percent. Concentrations of female, Black, Latinx, and Asian businesses in industries hit hard by the pandemic, such as personal services, partly explain why the losses were higher for these groups than the national average. Extending the analysis into the second and third months following widespread shelter-in-place restrictions — May and June 2020 — business owner activity partially rebounded, but the disproportionate impacts from COVID-19 by gender, race, and immigrant status lingered. African Americans continued to experience the largest losses, with 26 percent of formerly active business owners still not reactivated in May and 19 percent not active in June. Job losses were also higher for minority workers.²

Figure 1

Number of Active Business Owners in the US, 2005–2020

Overall, these early estimates of the impact of COVID-19 on small businesses indicate that losses were spread across demographic groups and types of business — no group was immune — but some groups were hit harder than others. Although there is no way to determine at present whether these business closures will be permanent, each additional month of inactivity has an impact on the revenues, profits, and employees of these businesses, and on their likelihood of ever reopening.3

Policy Response to COVID-19

Given the severity of the pandemic, the federal government provided more financial assistance to small businesses than ever previously seen. The largest programs providing funds to small businesses were the $660 billion Paycheck Protection Program (PPP) and the $220 billion Economic Injury Disaster Loan (EIDL) program. One of the goals stated in the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which included the PPP and EIDL programs, was to prioritize assistance to underserved markets and disadvantaged business owners.
But did the PPP and EIDL programs get disbursed to minority communities? Frank Fossen and I explore this question using administrative data on the universe of PPP loans, EIDL loans, and EIDL advances. We generally find a slightly positive relationship between PPP loan receipt per business and the minority share of the population. There is some evidence that the first round of funds was disproportionately disbursed to nonminority communities and that the second was disproportionately disbursed to minority communities. Focusing on PPP loan amounts per employee, we find a negative relationship with the minority share of the population. In contrast, EIDL loans and advances, in both number and amounts, were provided positively to minority communities.

Ties to Broader, Long-Term Racial Inequality

In earlier research, I explore the link between racial inequality in business outcomes and broader racial inequality. Research on earnings inequality almost exclusively focuses on the wage and salary sector and ignores the other major way to make a living — owning a business. Ten percent of the workforce, or 12 million people, own a business rather than holding a wage or salaried job. These owners hold a disproportionate amount of total wealth and create jobs for others.

Racial disparities in business formation raise concerns about lost economic efficiency. If minority entrepreneurs face liquidity constraints, discrimination, or other barriers to creating new businesses or expanding current ones, there will be efficiency losses in the economy. Barriers to entry and expansion are potentially costly to productivity and local job creation, especially as minorities represent a growing share of the population.

In a series of papers, I use various datasets to study the causes of racial and ethnic disparities in business ownership, formation, and outcomes, focusing on the constraints that limit productivity and cause inefficiencies in the economy. Work with Alicia Robb draws on confidential, restricted-access, business-level data from the US Census Bureau to explore why Asian American-owned firms perform well in comparison to White-owned businesses, while Black-owned firms typically do not. We find differential access to financial capital to be the largest factor. Family business experience also plays a role in explaining differences in outcomes. In more recent work, I examine potential barriers created by human capital, wealth, demographic, geographic, and industry constraints for each group using CPS and American Community Survey data. I find that low levels of wealth contribute to lower rates of Black and Latinx business ownership, and that high levels of wealth increase Asian business ownership rates. Low levels of education contribute to lower business income for Blacks and Latinx, and high levels of education increase Asian business income. The Black, Latinx, and Asian populations are all relatively young compared to the White population; this also contributes to lower business ownership rates in these groups.

Using confidential and restricted-access panel data from the Kauffman Firm Survey, along with matched administrative data on credit scores, Robb, David Robinson and I explore disparities in capital use between Black- and White-owned startups. We find
that Black-owned startups start smaller and stay smaller over the first eight years of their existence. Black startups face more difficulty in raising external capital, especially external debt. We find that disparities in creditworthiness constrain Black entrepreneurs; perceptions of treatment by banks also hold them back. Black entrepreneurs apply for loans less often than White entrepreneurs largely because they expect to be denied credit, even when they have a good credit history and in settings where strong local banks favor new business development.

Christopher Woodruff and I study why Mexican-American entrepreneurship is low in the United States even though self-employment rates are very high in Mexico. We find that low levels of education and wealth explain the entire gap between Mexican immigrants and non-Latinx Whites in business formation rates; together with language ability, these factors explain nearly the entire gap in business income. Legal status represents an additional barrier for Mexican immigrants.

Using census microdata from the United States, Canada, and the United Kingdom, Harry Krashinsky, Julie Zissimopoulos and I provide the first comparative examination of the education levels, business ownership, and business performance of Asian immigrants. We find that business ownership rates of Asian immigrants in the United States and Canada are similar to the national averages, and in the UK they are substantially higher than the national average and the highest among the three countries. Asian immigrants even from the same source country are generally much more educated in the United States than in Canada or the United Kingdom. Although there are many institutional, structural, and historical differences between the countries that might be responsible, one possibility is that the higher returns to education in the United States result in a more selective immigrant pool. Bruce Meyer and I study how groups interact in business ownership and find evidence of crowd-out between immigrant and native owners.
Governments and donors spend billions of dollars subsidizing entrepreneurship training and development programs around the world. Arguments for subsidizing training are manifold, and span theories of allocative and/or redistributive frictions in credit, labor, insurance, and human capital markets. DeanKarlan, Jonathan Zinman and I explore the effectiveness of entrepreneurship training programs by working with US Department of Labor data from the largest random experiment ever conducted evaluating entrepreneurship training. After controlling for selection into training, we find that entrepreneurship training has a sizable short-term impact on increasing business ownership and reducing unemployment, but no effect on business ownership or any business outcome such as sales, exit rates, profits, or employment in the medium and long term.

Policymakers have sought to improve success among minority business owners. In the United States, for example, although they are sometimes controversial, a variety of federal, state, and local government programs offer contracting goals, price discounts, and loans to businesses owned by minorities, women, and other groups that are
historically underrepresented among business owners. Aaron Chatterji, Kenneth Chay and I examine the effectiveness of affirmative action contracting programs for businesses owned by African Americans by using the staggered introduction of these contracting programs across cities in the 1980s. \textsuperscript{12} Black business ownership rates increased significantly after program initiation. On average, the Black-White gap fell 3 percentage points. Black gains were concentrated in industries heavily affected by contracting programs, and they mostly benefited those who were better educated.

**NBER Today**
Lessons from Pandemic-Related Debt Forbearance
Robert Fairlie is a professor of economics at the University of California, Santa Cruz and an NBER research associate affiliated with the Economics of Education and Productivity, Innovation, and Entrepreneurship Programs. He is a regular participant in the Entrepreneurship Working Group and Economics of Education meetings, and plans on participating in the new Race and Stratification in the Economy Working Group.
Fairlie’s research interests include entrepreneurship, education, racial inequality, information technology, labor economics, and immigration. Recent research projects explore questions around causes and consequences of racial inequality, barriers to business creation and growth, whether technology helps students, constraints in higher education, whether there have been disproportionate impacts of COVID-19 by race and gender, and water conservation policy.

Fairlie received his PhD and MA from Northwestern University and BA with honors from Stanford University. He has held visiting positions at Stanford, Yale University, UC Berkeley, and Australian National University. He has received funding for his research from numerous government agencies and foundations and has testified to the US Senate, US House of Representatives, the Department of Treasury, and the California State Assembly regarding the findings of his research, and received a joint resolution of appreciation from the California legislature. He is regularly contacted by major news media to comment on economic, small business, inequality and policy issues.

Footnotes


Racial inequality in business ownership and income

Robert Fairlie*

Abstract: The large and persistent racial and ethnic disparities found in business ownership and performance contribute to broader economic inequality. Using the latest US Census household microdata and statistical decomposition techniques, I explore several potential barriers to minority business ownership and income. I examine patterns for the four major racial and ethnic groups in the United States: African-Americans, Latinos, Asians, and non-Latino whites. I find that low levels of wealth contribute to why blacks and Latinos have lower business ownership rates, and high levels of wealth increase Asian business ownership rates. Low levels of education contribute to why blacks and Latinos have lower business income, and high levels of education increase Asian business income. Blacks, Latinos, and Asians are relatively young compared to whites, reducing business ownership rates.

Keywords: entrepreneurship, race, ethnicity, self-employment, business ownership, inequality, diversity

JEL classification: J15, L26

I. Introduction

Income inequality is one of the most pressing societal issues. A major component of income inequality that has been documented and studied extensively is earnings inequality by race and ethnicity (Altonji and Blank, 1999). Recent estimates from the US Bureau of Labor Statistics (BLS), for example, indicate that African-American workers earn 77 per cent of white workers, and Latino workers earn 72 per cent of white workers.

Racial differences in business ownership and income also contribute to income inequality and in many cases are larger than income differences (Fairlie and Robb, 2008). Although these disparities have received much less attention in the literature, they are alarming because of their magnitude and the importance of business ownership as a way to make a living. Roughly one out of 10 workers, or 12m people, in the United States are self-employed business owners. These 12m business owners hold roughly 40 per cent of total US wealth (Bucks et al., 2006).

* University of California, Santa Cruz, and NBER; e-mail: rfairlie@ucsc.edu

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Policy-makers have been concerned for many years about improving success among minority business owners. In the United States, for example, although they are sometimes controversial, a variety of federal, state, and local government programmes offer contracting goals, price discounts, and loans to businesses owned by minorities, women, and other disadvantaged groups (Joint Center for Political and Economic Studies, 1994; Boston, 1999; Chatterji et al., 2014). One of the goals of these programmes is to foster minority business development, which may have implications for reducing earnings and wealth inequality (Bradford, 2003). Disadvantaged business owners have more upward income mobility and experience faster earnings growth than disadvantaged wage and salary workers (Holtz-Eakin et al., 2000; Fairlie, 2004). It has also been argued that some disadvantaged groups historically facing discrimination or blocked opportunities in the wage/salary sector, such as Chinese, Greek, Italian, Japanese, and Jewish people, have used business ownership as a source of economic advancement.¹

Another concern is the loss in economic efficiency resulting from blocked opportunities for minorities to start and grow businesses.² Business formation is associated with the creation of new industries, innovation, job creation, improvement in sector productivity, and economic growth (Reynolds, 2005). If minority entrepreneurs face liquidity constraints, discrimination, or other barriers to creating new business or expanding current businesses, there will be efficiency losses in the economy. Although it would be difficult to determine the value of these losses, barriers to entry and expansion that minority-owned businesses face are potentially costly to productivity, especially as minorities represent a growing share of the population in many industrialized countries. Barriers to business growth may be especially damaging for job creation in low-income neighbourhoods (Boston, 1999, 2006).

In this paper, I use the latest available microdata from the US Census Bureau to document business ownership and income patterns across the four major racial and ethnic groups in the United States: African-Americans, Latinos, Asians, and non-Latino whites. I next explore the causes of disparities in business ownership and income. Using statistical decomposition techniques, I examine potential barriers created by human capital, wealth, demographic, geographic, and industry constraints for each group.

The paper provides three main contributions to the previous literature on the potential barriers limiting business ownership and performance among minorities. Previous studies have identified wealth disparities, access to financial capital, discrimination in lending, other types of discrimination, human capital, family business background, social capital, and other factors as limiting minority business creation and success.³ First, instead of focusing on one or two hypothesized constraints, I use one overarching model to estimate the separate and independent contributions of several potential barriers. This is important because many potential factors (e.g. education, wealth, age, geography) are correlated with each other, and thus a separate analysis could be misleading. Second, much of the previous evidence focuses on constraints particular to

¹ See Glazer and Moynihan (1970), Loewen (1971), Light (1972, 1979), Baron et al. (1975), Bonacich and Modell (1980), and Sowell (1981).
² Hsieh et al. (2016) find that falling occupational barriers for minority workers may explain one-fourth of aggregate growth in per capita GDP from 1960 to 2010.
³ For broader discussions and reviews of this literature, see Fairlie and Robb (2008), Bates (2011), Dávila and Mora (2013), for example.
African-American entrepreneurs, with fewer studies focusing on constraints faced by Latino entrepreneurs, and even fewer studies focusing on Asian entrepreneurs. In this paper, I use the same model to simultaneously examine constraints faced by African-Americans and Latinos and whether they mirror possible advantages experienced by Asians in business ownership and outcomes. The analysis of all four major racial and ethnic groups sheds new light on barriers to successful business ownership.

Third, I use the most recent data and an extremely large dataset to examine whether wealth, education, and other constraints identified in the previous literature continue to bind. The 2011–15 American Community Survey (ACS) includes a nationally representative sample of nearly 10m observations providing extremely precise estimates for all analyses.

The remainder of the paper is organized as follows. The next section describes the ACS data used in the analysis. Section III documents business ownership and income patterns among blacks, Latinos, Asians, and whites. Section IV provides estimates of the contributions of Latino entrepreneurs to the US economy. Section V concludes.

II. Data

The dataset used in this study is the latest 5-year sample of the American Community Survey (ACS), 2011–15. The ACS is a household survey and provides information on business ownership, income, and industries at the owner level. The ACS also provides information on immigration status. The ACS is one of the only nationally representative Census Bureau datasets that provides a large sample size of black, Latino, and Asian business owners.

The ACS includes over 9m observations for working-age adults (ages 20–64). Even after conditioning on business ownership, the sample size is very large, allowing one to explore the causes of differences in net business income. The ACS includes more than half a million observations for business owners.

In the ACS microdata, business ownership is measured by using the class-of-worker question that refers to the respondent’s main job or business activity (i.e. activity with the most hours) at the time of the interview. Business owners are individuals who report that they are (i) ‘self-employed in own not incorporated business, professional practice, or farm’, or (ii) ‘self-employed in own incorporated business, professional practice, or farm’. This definition includes owners of all types of businesses—incorporated, unincorporated, employer, and non-employer firms. The samples used in this analysis include all business owners aged 20–64 (i.e. working-age adults) who work 15 or more hours per week in their businesses. To rule out very small-scale businesses, disguised unemployment, or casual sellers of goods and services, only business owners with 15 or more hours worked are included.\footnote{Some unemployed individuals may report being self-employed if they sell a small quantity of goods or services while not working at their regular jobs.} Fifteen hours per week is chosen as the cut-off because it represents a reasonable amount of work effort in the business (roughly 2 days per week). Note that self-employed business ownership is defined as the individual’s main job activity, thus removing the potential for counting side businesses owned by
wage-and-salary workers. Also, estimates are reported with and without the 15-hour restriction to show the robustness of disparities in business ownership rates. Finally, the self-employment information is self-reported and not based on tax or business registration filings, and thus may capture a wide range of self-employment activities depending on the respondent.  

Business income is calculated from survey questions about income sources. The main question used is: ‘Self-employment income from own nonfarm businesses or farm businesses, including proprietorships and partnerships. Report NET income after business expenses.’ Most business owners report this type of income, but incorporated business owners report their earnings from the business as wage and salary earnings. For simplification and consistency in treatment the responses to self-employment income and wage and salary earnings are combined for all business owners. The questions refer to annual income and capture the past 12 months.

The ACS provides the most comprehensive data available on business owners by the race and ethnicity of owners. The four major racial and ethnic groups are defined for comparison: blacks, Latinos, Asians, and non-Latino whites. Multiple race individuals are included in each racial and ethnic category.

III. Business ownership and income patterns

Estimates of the number of business owners, business ownership rates, and business income are first presented. All estimates are from the ACS (2011–15), which as noted above is the latest available household data from the US Census Bureau on business ownership and income. Table 1 reports estimates for blacks, Latinos, Asians, and non-Latino whites. There are roughly 800,000 black and Asian business owners in the United States, and 1.8m Latino business owners. In comparison, there are nearly 9m non-Latino white business owners. The total number of business owners is 12.2m.

Blacks are the most underrepresented group in business ownership. Out of the population only 3.0 per cent of blacks own a business. Latinos have the next lowest level of business ownership relative to population at 5.8 per cent. The Asian business ownership to population rate is 6.6 per cent and the non-Latino white rate is 7.3 per cent.

Focusing on business owners with a work commitment of 15 or more hours worked per week, the total number of business owners is lower, but not substantially lower. There are roughly 700,000 black business owners, 1.7m Latino business owners, 750,000 Asian business owners, and 8.3 million white business owners after using this restriction. The total number of business owners in the United States that work 15+ hours per week is 11.4m. Imposing the hours-worked restriction is useful for removing individuals who might be partly unemployed and just have part-time self-employment work as a method of generating some income.

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5 There also could be underreporting of self-employment activities in the ACS.
6 It is assumed that undocumented immigrants are captured in the ACS. The ACS immigrant population is compared to Department of Homeland Security data to estimate the size of the undocumented population in the United States (see Hoefer et al., 2012, for example).
Another commonly used measure of the rate of business ownership conditions on being in the workforce. The percentage of the workforce that owns a business is 4.5 per cent among blacks and 7.9 per cent among Latinos. The business ownership to workforce rates are higher for Asians (9.0 per cent) and non-Latino whites (9.6 per cent). For all groups conditioning on being in the workforce increases business ownership rates, but the rankings across groups does not change. In particular, the relatively low rates of business ownership among blacks and Latinos are not due to higher levels of unemployment or not being in the labour force, but instead are driven by lower propensities to own businesses.

(i) Business income

Among business owners there are large disparities in business income across racial and ethnic groups. Table 2 reports estimates of business income across groups. Blacks and Latinos have substantially lower levels of business income than Asian and non-Latino whites. Mean business income is $34,475 for Latinos and $39,170 for blacks. The mean level of business income for Latinos is roughly $30,000 lower than mean business income among non-Latino whites. Black business owners have an average business income that is roughly $25,000 lower than the white level. The disparity in business income is much larger than the disparity in business ownership rates for blacks and Latinos.

When comparing parts of the distribution, blacks and Latinos are disadvantaged in business income. Table 2 also reports the median, 25th percentile, and 75th percentile levels of business income. For all three points along the distribution, black and Latinos have lower business income levels than do whites.

Table 2: Business income by race and ethnicity, ACS 2011–15

<table>
<thead>
<tr>
<th>Group</th>
<th>Black</th>
<th>Latino</th>
<th>Asian</th>
<th>Non-Latino whites</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business owners</td>
<td>773,448</td>
<td>1,817,236</td>
<td>794,606</td>
<td>8,820,771</td>
</tr>
<tr>
<td>Mean business income</td>
<td>$39,170</td>
<td>$34,475</td>
<td>$60,950</td>
<td>$63,329</td>
</tr>
<tr>
<td>75th percentile</td>
<td>$45,070</td>
<td>$37,558</td>
<td>$63,563</td>
<td>$70,088</td>
</tr>
<tr>
<td>Median</td>
<td>$23,608</td>
<td>$20,192</td>
<td>$31,297</td>
<td>$35,335</td>
</tr>
<tr>
<td>25th percentile</td>
<td>$10,429</td>
<td>$10,429</td>
<td>$16,096</td>
<td>$15,643</td>
</tr>
<tr>
<td>Business owners (15+ hours)</td>
<td>709,536</td>
<td>1,692,007</td>
<td>751,493</td>
<td>8,277,854</td>
</tr>
<tr>
<td>Mean business income (15+ hours)</td>
<td>$41,694</td>
<td>$36,246</td>
<td>$63,492</td>
<td>$66,618</td>
</tr>
<tr>
<td>75th percentile</td>
<td>$48,289</td>
<td>$40,051</td>
<td>$66,083</td>
<td>$73,815</td>
</tr>
<tr>
<td>Median</td>
<td>$25,442</td>
<td>$20,857</td>
<td>$33,893</td>
<td>$37,558</td>
</tr>
<tr>
<td>25th percentile</td>
<td>$12,303</td>
<td>$12,015</td>
<td>$18,023</td>
<td>$18,672</td>
</tr>
</tbody>
</table>
Low mean business income among blacks and Latinos is also not driven by business owners working few hours. Table 2 also reports mean business income conditioning on working 15+ hours per week. Using this restriction, mean business income among Latinos is $36,246 and $41,694 for blacks. Mean business income among non-Latino whites is $66,618. Using both measures, Asian mean business income is only slightly lower than white levels.

IV. Potential explanations for differences in business ownership rates and income

To investigate what causes differences in business ownership rates I first examine differences in population characteristics. Differences in population characteristics such as education and wealth levels may explain why blacks and Latinos have much lower business ownership rates than whites. Furthermore, differences in these same characteristics among business owners might explain why blacks and Latinos have lower business income. Some of these characteristics may be more important in contributing to the disadvantages for blacks than for Latinos or vice versa.

(i) Differences in education, wealth, and other characteristics

Table 3 presents differences in education, wealth, and other characteristics for the working-age population by ethnic/racial group. There are major differences in characteristics across racial and ethnic groups.

Latinos are younger on average than non-Latino whites. Blacks and Asians are also younger on average, but the differences from white levels are smaller. This pattern of a younger average age poses a disadvantage because business ownership has been found
to be positively associated with age. The only age difference that appears to be large, however, is the one between Latinos and whites.

Latinos are less educated: only 10 per cent have a college degree (without a further degree) and 4 per cent have a graduate degree, whereas 21 per cent of whites have a college degree and 10 per cent have a graduate degree. The percentage of high school drop-outs among Latinos is 31 per cent, which is considerably higher than for whites. Blacks also have lower levels of education, with 13 per cent high school drop-outs and only 12 per cent with a college degree and 6 per cent with a graduate degree. Among non-Latino whites only 6 per cent are high school drop-outs and 22 per cent have college degrees and 11 per cent have graduate degrees. Asians, however, have the highest levels of higher education degrees, with 30 per cent having a college degree and 20 per cent having a graduate degree.

Another major difference across racial and ethnic groups is wealth. The ACS includes information on home ownership, house values, and interest/dividend income. Home values represent the largest component of wealth for most individuals. Interest and dividend income represents another good measure of wealth. Blacks and Latinos are much less likely than whites to own houses, and the houses they own have lower values on average. The disparities are substantial, with only 43 per cent of blacks owning a house with those houses being worth $190,266 on average. In contrast, 70 per cent of whites own a house and those houses are worth $273,811 on average. Latinos also have low rates of home ownership (48 per cent) and home values (at $227,229). Both black and Latinos have much less interest and dividend income than whites. Asians have lower rates of home ownership (70 per cent) and interest income ($1,050), but much higher average home values (at $439,066).

Another major difference across racial and ethnic groups is their geographical concentrations across the country. The majority of blacks live in the South, whereas the South captures no more than 37 per cent of the population for any other group. Nearly half of all Asians live in the West, and 40 per cent of Latinos live in the West. The Midwest captures 26 per cent of the white population, which is the highest of all groups.

Focusing on family characteristics, marriage rates are substantially lower among blacks than whites. Latinos also have lower marriage rates than whites, but Asians have higher rates. The average number of children is higher among Latinos than other groups. Both marriage and children have been found to be associated with business ownership.

Overall, there exist major differences in education, wealth, geography, and other characteristics across racial and ethnic groups. Both blacks and Latinos generally have disadvantaged socioeconomic characteristics. Previous research, which is discussed below, indicates that many of these characteristics are important in determining business ownership and outcomes.\(^8\)

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7 The survey question asks about income from: ‘Interest, dividends, net rental income, royalty income, or income from estates and trusts. Report even small amounts credited to an account.’

(ii) Industry distributions of business owners

Industry distributions of business owners differ across racial and ethnic groups. Table 4 reports industry distributions for business owners. Latino business owners are concentrated in construction (23.4 per cent), professional services (20.8 per cent), and other services (19.5 per cent). The distribution across industries is not substantially different from the distribution across industries for non-Latino white men. The main exception is that only 10.8 per cent of white business owners are in other services. Black business owners are less concentrated in construction (11.9 per cent) and more concentrated in transportation (10.5 per cent), health care and social assistance (14.7 per cent), and other services (18.0 per cent). Asian business owners have the most dissimilar industry distribution, with much higher concentrations in retail (14.3 per cent) and accommodation, recreation, and entertainment (13.7 per cent), and a much lower concentration in construction (5.1 per cent).

The patterns across industries might contribute to differences in mean business income. The decompositions presented in the next section shed direct light on this question.

(iii) Decomposition technique

The comparison of average characteristics across ethnic/racial groups identifies several potential barriers to business ownership and income. Although there are large differences in many of these characteristics we do not know how much they contribute directly to business ownership and income disparities. To explore this question I perform a decomposition technique that allows one to estimate the separate contributions from differences between groups in education, home ownership, and other characteristics to the racial and ethnic gaps in business ownership rates and income.

The advantage of this technique is that it allows for a precise estimate of how much a factor contributes to the disparity. For example, the technique can answer the question of what percentage of the gap in business ownership between blacks and whites is due

### Table 4: Industry distribution of business owners by race and ethnicity, ACS 2011–15

<table>
<thead>
<tr>
<th>Group</th>
<th>Blacks</th>
<th>Latinos</th>
<th>Asians</th>
<th>Non-Latino whites</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of businesses</td>
<td>709,422</td>
<td>1,691,501</td>
<td>751,358</td>
<td>8,273,387</td>
</tr>
<tr>
<td>Agriculture/extraction (%)</td>
<td>0.7</td>
<td>1.3</td>
<td>1.0</td>
<td>5.9</td>
</tr>
<tr>
<td>Construction (%)</td>
<td>11.9</td>
<td>23.4</td>
<td>5.1</td>
<td>17.7</td>
</tr>
<tr>
<td>Manufacturing (%)</td>
<td>1.6</td>
<td>2.2</td>
<td>3.2</td>
<td>3.9</td>
</tr>
<tr>
<td>Wholesale (%)</td>
<td>1.2</td>
<td>1.9</td>
<td>3.8</td>
<td>2.5</td>
</tr>
<tr>
<td>Retail (%)</td>
<td>5.6</td>
<td>6.8</td>
<td>14.3</td>
<td>7.7</td>
</tr>
<tr>
<td>Transportation (%)</td>
<td>10.5</td>
<td>5.3</td>
<td>5.8</td>
<td>3.5</td>
</tr>
<tr>
<td>Information/finance (%)</td>
<td>8.0</td>
<td>4.9</td>
<td>7.3</td>
<td>10.0</td>
</tr>
<tr>
<td>Professional services (%)</td>
<td>19.7</td>
<td>20.8</td>
<td>16.1</td>
<td>21.7</td>
</tr>
<tr>
<td>Educational services (%)</td>
<td>1.7</td>
<td>0.8</td>
<td>1.8</td>
<td>1.7</td>
</tr>
<tr>
<td>Health care and social assistance (%)</td>
<td>14.7</td>
<td>7.8</td>
<td>11.9</td>
<td>8.4</td>
</tr>
<tr>
<td>Accommodation, recreation, and entertainment (%)</td>
<td>6.4</td>
<td>5.4</td>
<td>13.7</td>
<td>6.2</td>
</tr>
<tr>
<td>Other services (%)</td>
<td>18.0</td>
<td>19.5</td>
<td>16.0</td>
<td>10.8</td>
</tr>
</tbody>
</table>
to education disparities. Similarly, the technique can estimate this percentage for each of the other factors included in the multivariate regression model.

The decomposition technique is extremely useful for identifying causes of group disparities in outcome variables such as business ownership and income. Specifically, we ‘decompose’ inter-group differences in a dependent variable into those due to different observable characteristics across groups (sometime referred to as the endowment effect) and those due to different ‘prices’ of characteristics of groups (see Blinder (1973) and Oaxaca (1973)). The Blinder–Oaxaca decomposition of the white/minority gap in the average value of the dependent variable, \( Y \), can be expressed as:

\[
\bar{Y}^W - \bar{Y}^M = \left[ (\bar{X}^W - \bar{X}^M) \hat{\beta}^W \right] + \left[ \bar{X}^M (\hat{\beta}^W - \hat{\beta}^M) \right]
\] (1)

Similarly to most recent studies applying the decomposition technique, I focus on estimating the first component of the decomposition that captures contributions from differences in observable characteristics or ‘endowments’. I do not report estimates for the second or ‘unexplained’ component of the decomposition because it partly captures contributions from group differences in unmeasurable characteristics and is sensitive to the choice of left-out categories, making the results difficult to interpret. I also weight the first term of the decomposition expression using coefficient estimates from a pooled sample of all groups (see Oaxaca and Ransom (1994), for example).

It is becoming increasingly popular when studying racial differences to use the full sample of all races to estimate the coefficients, instead of one group such as whites (see Fairlie (2017) for more details). It is advantageous in that it incorporates the full market response and does not exclude rapidly growing groups of the population (i.e. Hispanics and Asians). It is also advantageous in situations with multiple group comparisons because it creates a common base.

The contribution from ethnic/racial differences in the characteristics can thus be written as:

\[
(\bar{X}^W - \bar{X}^M) \hat{\beta}^W
\] (2)

where \( \bar{X}^j \) are means of firm characteristics of race \( j \), \( \hat{\beta}^W \) is a vector of pooled coefficient estimates, and \( j=W \) or \( M \) for white or minority, respectively. Equation (2) provides an estimate of the contribution of ethnic/racial differences in the entire set of independent variables to the racial gap. Separate calculations are made to identify the contribution of group differences in specific variables to the gap.

The Blinder–Oaxaca decomposition represented in equation (2) is used to identify the causes of differences in business income. For business ownership, which is equal to 0 or 1, an alternative non-linear decomposition technique is used (Fairlie, 1999).

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9 Dummy variables for each race/ethnic group are also included in the underlying regression.

10 In the Blinder–Oaxaca technique the contribution estimates are insensitive to the choice of the left-out category. For example, the percentage explained by education would be the same if the lowest education category is the left-out category in the underlying regressions or if the highest education category is the left-out category in the underlying regressions.
Decomposition results for business ownership

Table 5 reports estimates from the procedure for decomposing gaps in business ownership between whites and blacks, Latinos, and Asians separately. The decompositions provide estimates of how much each gap is due to differences in characteristics between whites and the minority group of comparison. Column 1 reports estimates for the factors contributing to the difference in business ownership rates between non-Latino whites and blacks. For convenience, the first two rows repeat group business ownership rates previously reported in Table 1. The black business ownership rate is 2.8 per cent and the white rate is 6.8 per cent, forming a gap of 4.0 percentage points. The decomposition reveals that one of the most important contributing factors is wealth. Relatively low levels of wealth among blacks explains 0.86 percentage points (or 21.2 per cent) of why business ownership rates are lower for this group.

Another important factor is age. The younger average age of blacks in the working-age population contributes to why they have lower business ownership rates than

Table 5: Decompositions of business ownership rate gaps

<table>
<thead>
<tr>
<th></th>
<th>Blacks</th>
<th>Latinos</th>
<th>Asians</th>
</tr>
</thead>
<tbody>
<tr>
<td>White business ownership rate</td>
<td>0.0681</td>
<td>0.0681</td>
<td>0.0681</td>
</tr>
<tr>
<td>Minority business ownership rate</td>
<td>0.0277</td>
<td>0.0541</td>
<td>0.0626</td>
</tr>
<tr>
<td>White/minority group gap</td>
<td>0.0404</td>
<td>0.0140</td>
<td>0.0055</td>
</tr>
<tr>
<td>Contributions from racial differences in:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Age</td>
<td>0.0039</td>
<td>0.0069</td>
<td>0.0042</td>
</tr>
<tr>
<td>(0.0000)</td>
<td>49.2%</td>
<td></td>
<td>(0.0000)</td>
</tr>
<tr>
<td>Education</td>
<td>–0.0004</td>
<td>–0.0009</td>
<td>0.0003</td>
</tr>
<tr>
<td>(0.0000)</td>
<td>–1.1%</td>
<td>–6.7%</td>
<td>(0.0000)</td>
</tr>
<tr>
<td>Wealth</td>
<td>0.0086</td>
<td>0.0068</td>
<td>–0.0067</td>
</tr>
<tr>
<td>(0.0001)</td>
<td>48.7%</td>
<td></td>
<td>(0.0001)</td>
</tr>
<tr>
<td>Region</td>
<td>–0.0007</td>
<td>–0.0010</td>
<td>–0.0004</td>
</tr>
<tr>
<td>(0.0000)</td>
<td>–1.8%</td>
<td>–7.1%</td>
<td>(0.0001)</td>
</tr>
<tr>
<td>Family characteristics</td>
<td>0.0028</td>
<td>–0.0014</td>
<td>–0.0017</td>
</tr>
<tr>
<td>(0.0000)</td>
<td>7.0%</td>
<td>–9.9%</td>
<td>(0.0000)</td>
</tr>
<tr>
<td>All included variables</td>
<td>0.0141</td>
<td>0.0104</td>
<td>–0.0042</td>
</tr>
<tr>
<td>35.0%</td>
<td>74.1%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes: (i) All decomposition specifications use pooled coefficient estimates from the full sample of all races (and include a full set of race dummies in the logit models). (ii) Sampling weights are used in all specifications. (iii) Standard errors are reported in parentheses below contribution estimates.

11 See Appendix Table 1 for underlying logit regression estimates.
12 There is also evidence from different data that minority businesses experience higher loan denial probabilities and pay higher interest rates than white-owned businesses, even after controlling for differences in credit-worthiness, and other factors (Cavalluzzo et al., 2002; Coleman, 2002, 2003; Blanchflower et al., 2003; Mitchell and Pearce, 2004, 2011; Cavalluzzo and Wolken, 2005; Blanchard et al., 2008; Bates and Robb, 2015).
whites. Business ownership increases with age as individuals gain experience and general skills. Family characteristics also contribute to the gap in business ownership rates between whites and blacks. Low marriage rates and a positive association between marriage and business ownership partly contributes to why blacks have lower business ownership rates.

Interestingly, education disparities do not contribute to why blacks are less likely to own businesses. This is because higher education is not found to be a strong predictor of business ownership rates. It is important to keep in mind that these results hold for business ownership which for many individuals captures a form of ‘necessity’ employment. Many individuals turn to business ownership when they cannot find a job in the wage and salary sector. The results differ for business income, as shown below.

For Latinos the decomposition reveals that the most important contributing factor is wealth. Relatively low levels of wealth among Latinos explain 0.68 percentage points (or 48.7 per cent) of why business ownership rates are lower for this group. Another very important factor for Latinos is age. The younger average age of Latinos in the working-age population contributes to why they have lower business ownership rates than whites.

Both regional and family characteristic differences are favourable for Latinos relative to whites, as evidenced by the negative contribution estimates. The contribution estimate of –0.14 percentage points (or –9.9 per cent) for family characteristics indicates that Latinos have higher marriage rates and marriage is positively associated with business ownership. Thus, this characteristic is favourable for Latinos relative to whites. Also, it suggests that the gap between Latino and white business ownership rates would be 0.14 percentage points higher if Latinos had similar marriage rates as whites. Latinos also have a ‘favourable’ regional distribution, living in regions of the country that have higher than average business ownership rates. For example, Latinos are much more likely to live in the West which has relatively high business ownership rates.

The results are generally consistent with previous research that decomposes gaps in business ownership or transitions into and out of business ownership for blacks and Latinos. Fairlie (1999), using the Panel Study of Income Dynamics, finds that wealth and education disparities are important for black men. Fairlie and Woodruff (2010), using the Current Population Survey and earlier ACS data, find evidence that low Mexican-American business ownership and formation are partly due to education and wealth disparities. Lofstrom and Wang (2009), using Survey of Income and Program Participation data, also find that low levels of wealth for Mexican-Americans and other Latinos works to lower self-employment entry rates. Interestingly, using the same underlying regression coefficients, the contribution for African-Americans is higher for wealth than the contribution for Latinos. But, because the gap is smaller for Latinos, wealth disparities explain a higher percentage of the gap.

Column 3 reports decomposition estimates for Asians. There is essentially no business ownership gap between whites and Asians (and thus percentage contributions are not reported because of the small base). Although there is no gap to ‘explain’ from group differences in characteristics, nevertheless decomposition results can be informative about advantages and disadvantages faced by Asians relative to whites. The most important factor relevant for this exercise is wealth. The large negative contribution estimate on wealth indicates that Asians have an advantage in that they have higher
wealth on average than whites. The contribution estimate implies that without this wealth advantage the Asian business ownership rate would be 0.67 percentage points lower. On the other hand, the working-age Asian population is younger than the white working-age population, holding business ownership rates down by 0.42 percentage points.

(v) Decomposition results for business income

I now turn to discussing the decomposition results for business income. The business income gaps were consistently large. Table 6 reports estimates from the procedure for decomposing the white-minority group gaps in business income into differences in characteristics.\(^\text{13}\) The included variables are the same as before with two important exceptions. First, wealth is not included in the models for business income because more successful business owners are likely to accumulate more wealth. Thus, this reverse causality would create a problem for estimating the effects of differences in wealth on differences in business income. Second, industry was not included in the models for business ownership because starting a business and its industry is a joint decision, whereas for business income the decision has already been made and there are important differences in income levels across industries. The decompositions include the same 12 industry classifications as listed in Table 4.

Column 1 reports estimates for blacks. The underlying regression models estimated for the decompositions use log business income which is common in working with earnings or income data because it improves the fit of the model and limits the influence of large outliers.\(^\text{14}\) The log business income of blacks is 9.92 which is 42 log points (or roughly 42 per cent) lower than the white level of 10.33. The most important factor explaining the business income difference is education. Low levels of education among black business owners explain 7 log points (or 18 per cent) of the gap in business income. The next largest contribution is from family characteristics. Relatively low marriage rates among black business owners explain part of the gap in business income. Industry differences explain 5 per cent of the business income gap. Black business owners are concentrated in lower-income industries, although the explanatory power of industry differences is not large.

Among Latinos mean log business income is 9.89, which is 44 log points (or roughly 44 per cent) lower than the white level. The most important factor explaining the business income difference is education. Low levels of education among Latino business owners explain 20 log points (or 46 per cent) of the gap in business income. Industry concentrations make a small contribution to the gap (5 per cent). The finding for industry is important and suggests that business income is not low overall among Latino business owners.

\(^{13}\) See Appendix Table 2 for underlying linear regression estimates.

\(^{14}\) One problem, however, with using logs is that very small and zero income observations tend to overly influence the estimates. To address this issue I right and left censor the data at + or – $1,000. Thus, any business income value from 0 to 1,000 is given a value of \(\log(1,000)\) and from –1,000 to 0 is given a value of \(-\log(1,000)\). Negative values of income are reversed in sign prior to taking logs to avoid problems with taking logs of negative values (e.g. –10,000 would be \(-\log(10,000)\)) In no case do I remove any business income observations. The general idea is that a business owner with less than $1,000 in business income has business income that is indistinguishable from $0. I find that using alternative cut-offs does not change the results.
business owners because they are concentrated in a few industries. As noted above, Latinos are younger than non-Latino whites on average. The relative youth of Latinos contributes to the gap in business income, explaining 4.4 per cent of the gap. Regional differences and family characteristics differences do not contribute to the gap in business income.

Column 3 reports decomposition estimates for Asians. There is essentially no business income gap between whites and Asians (and thus per cent contributions are not reported because of the small base). Although there is no gap to 'explain' from group differences in characteristics, nevertheless decomposition results can be informative about relative advantages and disadvantages faced by Asians relative to whites. The two factors that are relevant for this exercise are education and industry. The negative contribution estimate on education indicates that Asians have an advantage in that they are more educated on average than are whites. The contribution estimate implies that without this educational advantage Asian business income would be 4.9 log points lower. On the other hand, Asian business owners are concentrated in lower-income industries, holding business income down by 5.7 log points.

Education differences are the most important factor across all major racial and ethnic groups in explaining business income patterns. Low levels of education among blacks and especially among Latinos explain a part of why these groups have lower business income. In this case, the explanatory power of education disparities is larger in both absolute and percentage terms for Latinos compared to African-Americans. Working in the opposite direction, higher levels of education among Asian business owners place upward pressure on their business income relative to whites.

### Table 6: Decompositions of log business income gaps

<table>
<thead>
<tr>
<th></th>
<th>Blacks</th>
<th>Latinos</th>
<th>Asians</th>
</tr>
</thead>
<tbody>
<tr>
<td>White log business income</td>
<td>10.3324</td>
<td>10.3324</td>
<td>10.3324</td>
</tr>
<tr>
<td>White/minority group gap</td>
<td>0.4167</td>
<td>0.4432</td>
<td>0.0177</td>
</tr>
<tr>
<td>Contributions from racial differences in:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Age</td>
<td>0.0122</td>
<td>0.0196</td>
<td>−0.0059</td>
</tr>
<tr>
<td></td>
<td>(0.0008)</td>
<td>(0.0013)</td>
<td>(0.0006)</td>
</tr>
<tr>
<td></td>
<td>2.9%</td>
<td>4.4%</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>0.0733</td>
<td>0.2024</td>
<td>−0.0487</td>
</tr>
<tr>
<td></td>
<td>(0.0007)</td>
<td>(0.0029)</td>
<td>(0.0009)</td>
</tr>
<tr>
<td></td>
<td>17.6%</td>
<td>45.7%</td>
<td></td>
</tr>
<tr>
<td>Region</td>
<td>−0.0050</td>
<td>−0.0070</td>
<td>−0.0098</td>
</tr>
<tr>
<td></td>
<td>(0.0013)</td>
<td>(0.0015)</td>
<td>(0.0014)</td>
</tr>
<tr>
<td></td>
<td>−1.2%</td>
<td>−1.6%</td>
<td></td>
</tr>
<tr>
<td>Family characteristics</td>
<td>0.0260</td>
<td>−0.0039</td>
<td>−0.0171</td>
</tr>
<tr>
<td></td>
<td>(0.0012)</td>
<td>(0.0014)</td>
<td>(0.0006)</td>
</tr>
<tr>
<td></td>
<td>6.2%</td>
<td>−0.9%</td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>0.0195</td>
<td>0.0225</td>
<td>0.0567</td>
</tr>
<tr>
<td></td>
<td>(0.0015)</td>
<td>(0.0012)</td>
<td>(0.0016)</td>
</tr>
<tr>
<td></td>
<td>4.7%</td>
<td>5.1%</td>
<td></td>
</tr>
<tr>
<td>All included variables</td>
<td>0.1260</td>
<td>0.2336</td>
<td>−0.0248</td>
</tr>
<tr>
<td></td>
<td>30.2%</td>
<td>52.7%</td>
<td></td>
</tr>
</tbody>
</table>

Notes: (i) All decomposition specifications use pooled coefficient estimates from the full sample of all races (and include a full set of race dummies in the regressions). (ii) Sampling weights are used in all specifications. (iii) Standard errors are reported in parentheses below contribution estimates.
The results are generally consistent with findings from the previous literature. For example, Fairlie and Woodruff (2010) find that Mexican-American business owners have lower incomes than non-Latino white business owners, and that most of the difference is due to low levels of education among Mexican-American owners. Fairlie and Robb (2008) find, using the 1992 Characteristics of Business Owners (CBO) data, that African-American-owned businesses are less successful, partly because of lower owner education levels, and Asian-owned businesses are more successful, partly because of higher owner education levels.

V. Conclusions

The analysis of the latest available household microdata from the US Census Bureau provides several new findings on racial and ethnic disparities in business ownership and income. Minority groups make up large numbers of business owners in the United States and other countries. There are 600,000 black business owners, 1.8m Latino business owners, and 800,000 Asian business owners in the United States. Total business income generated by these businesses is $30 billion for black business owners, $63 billion for Latino business owners, and $48 billion for Asian business owners.

Using a decomposition technique that simultaneously explores various potential barriers to minority business ownership and income, I find that wealth is the most important factor contributing to racial and ethnic patterns in business ownership. Across the three measures of wealth used here, blacks have 16–69 per cent of white levels. Wealth disparities alone (controlling for everything else) explain 0.86 percentage points (or 21 per cent) of the gap in business ownership rates between blacks and whites. Latinos also have low levels of wealth, ranging from 20 to 83 per cent of white levels, which explains 0.68 percentage points (or 49 per cent) of the gap in business ownership. Asians, on the other hand, have relatively high levels of wealth increasing their business ownership rates (0.67 percentage points).

Education is the most important factor explaining racial and ethnic patterns in business income. Only 18 per cent of blacks and 14 per cent of Latinos have a college or higher degree. Asians have the highest college graduate rate at 50 per cent (whites have a college graduate rate of 33 per cent). Putting these patterns together, low levels of education hold blacks and Latinos back in business income, but high levels of education increase business income among Asians. Using the same underlying model, I find that educational disparities are the most detrimental for Latino business income.

Age is also found to be an important factor in the decompositions for business ownership and to a lesser degree business income. Older workers have more work and business experience which is valuable in business ownership and outcomes. Blacks, Latinos, and Asians have younger population distributions than whites, representing a disadvantage faced by all three minority groups relative to whites. But, age differs from traditional constraints related to inequality, such as financial capital and human capital. Further research needs to uncover why age is important to guide policy solutions.

15 Minority-owned businesses also represent a large and rapidly growing share of businesses in many other developed countries. For example, minority-owned businesses grew by 84 per cent from 2002 to 2012 in Germany (compared with non-minority growth rate of 5 per cent (Fossen, 2015). In the United Kingdom, the ethnic minority share of businesses was 7 per cent for employers and 5 per cent for non-employers (UK Department for Business, Innovation & Skills, 2015).
These findings across the three major minority groups in the United States are important and novel because the separate group contributions are estimated within the same embedded model. Thus, the scale of contributions can be compared directly. For example, I find that educational disparities have a nearly three times larger explanatory power for Latinos than for blacks in contributing to business income differences. In contrast, most of the previous research on minority entrepreneurship focuses on one group, making it difficult to compare results across groups because it requires also making comparisons across different studies, datasets, models, and definitions. More research taking a comparative race approach instead of narrowly focusing on one group is needed to better understand what drives entrepreneurial inequality.

To reduce racial and ethnic disparities, policies to improve wealth, credit scores, and the general financial health of minority business owners may be helpful. Wealth inequality may be directly addressed through expanding asset building programmes such as financial education programmes, individual development accounts (IDAs), and first-time home ownership programmes. Access to financial capital can be increased through government programmes and community banks. Policies to promote educational attainment in general and among business owners more specifically would also be helpful. Programmes targeted at increasing educational opportunities for minorities may result in better business outcomes among minority business owners. These policies are also likely to have an indirect long-term effect on business ownership and success through reducing wealth inequality. Higher levels of education are associated with higher levels of wealth. More research on the impacts of specific educational programmes, however, is needed. But certainly any policies that increase high school and college graduation rates will not only be useful in increasing business income directly, but also indirectly through their impacts on wealth.

**Appendix Table 1:** Logit regressions for business ownership, ACS 2011–15

<table>
<thead>
<tr>
<th>Variable</th>
<th>Marginal effect</th>
<th>Standard error</th>
<th>T-statistic</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Black</td>
<td>−0.0403</td>
<td>0.0003</td>
<td>−117.64</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Latino</td>
<td>−0.0029</td>
<td>0.0003</td>
<td>−11.32</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Asian</td>
<td>−0.0086</td>
<td>0.0003</td>
<td>−25.23</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Native American</td>
<td>−0.0162</td>
<td>0.0007</td>
<td>−23.39</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Other race</td>
<td>0.0070</td>
<td>0.0015</td>
<td>4.64</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Age</td>
<td>0.0015</td>
<td>0.0000</td>
<td>185.93</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>HS graduate</td>
<td>0.0013</td>
<td>0.0003</td>
<td>4.12</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Some college</td>
<td>−0.0036</td>
<td>0.0003</td>
<td>−11.48</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>College</td>
<td>−0.0033</td>
<td>0.0003</td>
<td>−9.81</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Grad school</td>
<td>−0.0032</td>
<td>0.0004</td>
<td>−8.66</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Home owner</td>
<td>−0.0107</td>
<td>0.0003</td>
<td>−40.69</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>House value</td>
<td>0.0107</td>
<td>0.0001</td>
<td>132.88</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>House value squared</td>
<td>−0.0004</td>
<td>0.0000</td>
<td>−84.62</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Interest income</td>
<td>0.0040</td>
<td>0.0001</td>
<td>43.69</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Interest income</td>
<td>−0.0001</td>
<td>0.0000</td>
<td>−20.36</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Midwest</td>
<td>0.0029</td>
<td>0.0003</td>
<td>10.51</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>South</td>
<td>0.0081</td>
<td>0.0002</td>
<td>33.45</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>West</td>
<td>0.0068</td>
<td>0.0003</td>
<td>26.52</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Married</td>
<td>0.0150</td>
<td>0.0002</td>
<td>76.24</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Children</td>
<td>0.0060</td>
<td>0.0002</td>
<td>37.00</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Children squared</td>
<td>−0.0004</td>
<td>0.0000</td>
<td>−10.87</td>
<td>&lt;.0001</td>
</tr>
</tbody>
</table>

**Notes:** (i) The sample size is 9,086,560. (ii) The dependent variable is business ownership (0,1). (iii) Sampling weights are used in all specifications.
### Appendix Table 2: Regressions for log business income, ACS 2011–15

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>T-statistic</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Black</td>
<td>-0.2782</td>
<td>0.0111</td>
<td>-25.00</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Latino</td>
<td>-0.2015</td>
<td>0.0082</td>
<td>-24.55</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Asian</td>
<td>-0.0345</td>
<td>0.0109</td>
<td>-3.17</td>
<td>0.0015</td>
</tr>
<tr>
<td>Native American</td>
<td>-0.2810</td>
<td>0.0223</td>
<td>-12.59</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Other race</td>
<td>-0.0636</td>
<td>0.0479</td>
<td>-1.33</td>
<td>0.184</td>
</tr>
<tr>
<td>Age</td>
<td>0.0802</td>
<td>0.0020</td>
<td>40.32</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Age squared</td>
<td>-0.0008</td>
<td>0.0000</td>
<td>-37.08</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>HS graduate</td>
<td>0.1864</td>
<td>0.0100</td>
<td>18.58</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Some college</td>
<td>0.2661</td>
<td>0.0100</td>
<td>26.53</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>College</td>
<td>0.5905</td>
<td>0.0108</td>
<td>54.76</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Grad school</td>
<td>1.0921</td>
<td>0.0121</td>
<td>90.55</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Midwest</td>
<td>-0.1395</td>
<td>0.0087</td>
<td>-16.13</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>South</td>
<td>-0.0752</td>
<td>0.0076</td>
<td>-9.85</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>West</td>
<td>-0.0760</td>
<td>0.0081</td>
<td>-9.36</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Married</td>
<td>0.1703</td>
<td>0.0062</td>
<td>27.65</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Children</td>
<td>0.0485</td>
<td>0.0051</td>
<td>9.51</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Children squared</td>
<td>-0.0045</td>
<td>0.0012</td>
<td>-3.85</td>
<td>0.0001</td>
</tr>
<tr>
<td>Construction</td>
<td>0.1133</td>
<td>0.0138</td>
<td>8.20</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>0.1042</td>
<td>0.0187</td>
<td>5.58</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Wholesale</td>
<td>0.3468</td>
<td>0.0210</td>
<td>16.52</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Retail</td>
<td>-0.1793</td>
<td>0.0155</td>
<td>-11.57</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Transportation</td>
<td>0.2459</td>
<td>0.0176</td>
<td>13.94</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Information</td>
<td>0.0005</td>
<td>0.0249</td>
<td>0.02</td>
<td>0.9833</td>
</tr>
<tr>
<td>Finance</td>
<td>0.2585</td>
<td>0.0158</td>
<td>16.37</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Professional services</td>
<td>0.0927</td>
<td>0.0138</td>
<td>6.72</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Educational services</td>
<td>-0.4493</td>
<td>0.0244</td>
<td>-18.40</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Health care and social assistance</td>
<td>0.0299</td>
<td>0.0156</td>
<td>1.91</td>
<td>0.0566</td>
</tr>
<tr>
<td>Accommodation, recreation, and entertainment</td>
<td>-0.1959</td>
<td>0.0161</td>
<td>-12.16</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>Other services</td>
<td>-0.2880</td>
<td>0.0144</td>
<td>-20.00</td>
<td>&lt;.0001</td>
</tr>
</tbody>
</table>

Notes: (i) The sample size is 572,350. (ii) The dependent variable is log business income. (iii) Sampling weights are used in all specifications.

### References


FINANCING MINORITY ENTREPRENEURSHIP

CARLOS BERDEJÓ*

Racial disparities pervade America’s socioeconomic fabric: minorities lag in educational attainment, employment, income, and wealth. Minorities are also underrepresented in the entrepreneurial space. For example, although minorities account for thirty-eight percent of the population, they own just nineteen percent of businesses. Despite numerous initiatives to promote minority business ownership, racial disparities in entrepreneurship have been stubbornly persistent over time.

This Article analyzes one of the major barriers that minorities face in undertaking entrepreneurial ventures. Informational asymmetries are especially pronounced when entrepreneurs attempt to raise money for their nascent businesses. Traditionally, social networks have offered an effective way to address the informational asymmetries that potential investors face when evaluating startup investments. Most minority entrepreneurs, however, lack access to these kinds of helpful social networks.

Recognizing the links between startup financing, information asymmetry, and social networks offers an analytic framework that can explain why minority entrepreneurs struggle in financing their businesses. This framework also suggests why current programs designed to address racial disparities in entrepreneurship have failed and offers guidance for new kinds of programs that are more likely to succeed in facilitating the financing of minority-owned businesses.

* Professor of Law and J. Howard Ziemann Fellow, Loyola Law School, Los Angeles. I would like to thank Brian Broughman, Benjamin Edwards, Ofer Eldar, Michael Guttentag, Justin Levitt, Elizabeth Pollman, and Lauren Willis for their extremely valuable and helpful comments on earlier drafts and the members of the Wisconsin Law Review for their wonderful editorial assistance. All errors and omissions are my own.
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INTRODUCTION

Racial disparities pervade the socioeconomic fabric of twenty-first century America: minorities lag in educational attainment, employment, income, and wealth.¹ The average net worth of white households ($139,300) is over ten times the average net worth of African American households ($12,780) and almost seven times that of Hispanic households

($19,990). White households are over 50% more likely to own equity in their own homes than African American or Hispanic households. Unemployment rates also vary substantially along racial lines: the unemployment rate for African Americans (7.5%) is twice that of whites (3.8%), with Hispanics (5.1%) in between these two groups. Individuals belonging to minority groups are less likely to have a bachelor’s degree: while 40% of white individuals graduate from four-year colleges, only 30% of African Americans and 20% of Hispanics do.

Disparities along racial lines also characterize the entrepreneurial space, where minorities are significantly underrepresented. This is evident not only in disparate business ownership rates but also in the share of the self-employed population and in the comparative success rates of entrepreneurial ventures. According to census data, minorities, which form 38% of the U.S. population, own just 19% of businesses. This gap is more pronounced in inner cities, where minorities make up 67% of the population but own 23% of businesses. Self-employment statistics provide a similar perspective: the self-employment rate among whites


3. Id. According to census data, 71.2% of white households own equity in their own home, which is substantially higher than the 40.7% and 46.6% ownership rates of African American and Hispanic households. Id. On average, white households own $100,000 in home equity, while African American and Hispanic households own $56,000 and $65,000, respectively. Id.


5. Id. at 3.


9. Id.

10. Id.
(10.9%) is twice that of African Americans (5.2%).

Notably, there are significant differences in entrepreneurship across minority groups, as African Americans tend to have the lowest self-employment rates, followed by Hispanics and Asians.

Not only are minorities less likely to start and own their own businesses, but those who do financially underperform their non-minority counterparts. Minority-owned firms earn, on average, less than half of the revenue earned by non-minority firms, are less profitable, and experience higher failure rates. As with startup rates, there are notable differences in the financial performance of small businesses across minority groups. Despite numerous initiatives to promote minority
business ownership, racial disparities in entrepreneurship stubbornly persist.  

What explains the long-standing comparative difficulties faced by minorities in succeeding in entrepreneurial ventures? One of the major hurdles faced by minority entrepreneurs is access to capital, a challenge also faced by non-minority entrepreneurs but to a lesser degree. This Article explores why financing new businesses may be especially challenging for minority entrepreneurs. First, it describes why minority-owned startups are especially likely to face informational asymmetry problems when raising capital. Second, it expands on a theory grounded in behavioral economics literature that highlights the importance of social networks in addressing the informational asymmetries inherent in the financing of small businesses, particularly minority-owned ones. Third, it reviews evidence that many minority entrepreneurs have been excluded from crucial social and professional networks. Building upon these three insights, the Article proposes a policy intervention to facilitate minority entrepreneurs’ access to capital.

The framework developed in this Article also explains why private markets have been unable to meet the financing needs of minority-owned businesses and why government programs meant to facilitate minority entrepreneurs’ access to capital have instead fallen short. This Article shows that these programs have failed for two reasons: their reliance on debt as a financing mechanism and their reliance on large, hierarchical institutions as gatekeepers, despite those institutions’ inability to confront certain types of informational asymmetries. Although private equity’s organizational structure and investment strategies are ideally suited for addressing the informational asymmetries associated with investing in minority-owned businesses, the lack of diversity in their ranks has rendered these tools ineffective, leaving fund managers to fall prey to implicit biases. Crowdfunding, which many had hoped would level the

18. See Efrat, supra note 12, at 98 (“[M]inorities remain significantly underrepresented in the self-employment sector.”); Fairlie & Robb, supra note 7, at 291 (“The 3 to 1 ratio of white to black self-employment rates noted above has remained roughly constant over the past 90 years.”); FAIRLIE & ROBB, supra note 11, at 14 (“These ethnic and racial disparities have also existed throughout the past two decades and trends in average gross receipts do not indicate recent improvements.”).

19. See infra Section I.B.3.

20. See infra notes 82–92 and accompanying text.

21. See infra notes 93–99 and accompanying text.

22. See infra notes 100–105 and accompanying text.

23. See infra Part III.A.


25. See infra notes 103–104, 208–211 and accompanying text.
playing field, has also failed because well-intentioned investors seeking a financial return cannot individually overcome informational issues.\(^\text{26}\)

The Article proposes a program that addresses the shortcomings of prior initiatives in this area through the creation of venture capital style funds (referred to as Local Impact Small Business Investment Companies or LISBICs) that focus their investment efforts on minority-owned businesses and the geographical areas where they are often located. To promote the development of these LISBICs, this Article proposes a series of policy interventions grounded on the existing regulatory framework of the Small Business Administration’s Small Business Investment Company program (SBIC). The proposed LISBIC program borrows various elements from former SBIC initiatives, which should facilitate its implementation both from an administrative and political standpoint.

Current events have added to the urgency of addressing racial disparities in entrepreneurship. The COVID-19 pandemic has devastated small businesses and local communities.\(^\text{27}\) To survive in a post-pandemic world, minority-owned businesses’ access to capital will need to improve considerably.\(^\text{28}\) Encouraging the survival and growth of minority-owned businesses would also help rebuild low-income minority communities and address some of the long-standing racial injustices highlighted by recent events.\(^\text{29}\) More generally, this Article illustrates how long-standing racial

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\(^{26}\) See infra notes 251–257 and accompanying text.


\(^{28}\) See Fairlie, supra note 27, at 5 (finding that the number of African-American and Hispanic business owners dropped by 41\% and 32\%, respectively); Kristopher J. Brooks, 40% of Black-Owned Businesses Not Expected to Survive Coronavirus, CBS News (June 12, 2020), https://www.cbsnews.com/news/black-owned-businesses-close-thousands-coronavirus-pandemic [https://perma.cc/SCE2-GXHJ] (describing the difficulties faced by African-American owned businesses during the COVID-19 pandemic, including their inability to raise capital).

\(^{29}\) See, e.g., James Thorne, Funds, Recruiting and Support: VCs Address Diversity and Inequality, PitchBook (June 8, 2020), https://pitchbook.com/news/articles/vcs-address-diversity-institutional-bias [https://perma.cc/TT39-W8NL] (“Against a backdrop of widespread protests over the killings of black Americans, the venture capital industry has been forced to reckon with its own staggering lack of diversity.”); Zoë Bernard & Kate Clark, As Silicon Valley Turns Attention to Race, Black Entrepreneurs Detail Prejudice, The Info. (June 11, 2020),
disparities and inequities in society migrate into the entrepreneurial space—a process that feeds into the cycle of poverty that continues to shatter minority communities.\textsuperscript{30}

This Article proceeds as follows. Part I summarizes the existing evidence describing the causes and effects of racial disparities in entrepreneurship, highlighting the critical role of access to capital and the reasons why minority entrepreneurs may struggle to finance their businesses. Building upon this evidence, the Article develops a theoretical framework centered on informational asymmetries and the “soft” nature of information relevant to many minority businesses to explain observed disparities. Part II describes existing programs and initiatives that seek to facilitate minority entrepreneurs’ access to capital and uses the framework developed in Part I to explain why these have generally been unsuccessful. Informed by this application of the theoretical framework, Part III proposes a policy initiative that addresses the key shortfalls of the programs discussed in Part II and discusses the potential challenges raised by its implementation.

I. THE STATE OF MINORITY ENTREPRENEURSHIP

This Part first describes the critical role of entrepreneurship in society and its untapped potential to develop the economies of distressed minority communities. It then discusses the main challenges faced by minority entrepreneurs, particularly in raising capital, and develops a framework to explain the racial disparities that characterize the entrepreneurial space. This framework is then used to evaluate existing initiatives in Part II and to inform the policy proposals outlined in Part III.

A. Why Minority Entrepreneurship Matters

The benefits to society and the economy from entrepreneurship are well documented: new businesses generate employment and income, introduce innovative products and services, and can act as engines of

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Nationally, minority-owned businesses play these macro-economic roles, contributing to income and employment, as well as introducing new products and services. But, minority-owned businesses also play a key role in developing local economies and improving neighborhoods, especially in socioeconomically distressed areas where poverty and unemployment levels are historically higher than the national average, like inner cities. In these communities, entrepreneurship presents an alternative means to generate and accumulate wealth, thus providing a mechanism to bridge the wealth gap.

At a personal level, entrepreneurship is critical for individuals for whom self-employment represents the most attractive employment option. Self-employment is especially attractive for groups that have traditionally faced obstacles in pursuing advanced degrees, that have suffered discrimination in the labor market, and whose social networks lack those connections that can serve as sources of job opportunities.

This source of economic growth and social development has remained untapped due to the relatively low number of minority-owned businesses and the exceptional difficulties faced by minorities that engage in the entrepreneurial space. As noted earlier, the self-employment rate among whites is twice that of African Americans. Not only are minorities less likely to start their own businesses, but minority-owned businesses also tend to be less profitable than non-minority businesses and experience the following:

33. See KLOOSTERMAN & RATH, supra note 32, at 2–3; ICIC REPORT, supra note 8, at 3.
34. See ICIC REPORT, supra note 8, at 3.
35. See Ivan Light, Disadvantaged Minorities in Self-Employment, 20 INT’L J. COMPAR. SOCIO. 31, 35–38 (1979); Pyon Gap Min & Mehdi Bozorgmehr, United States: The Entreprenurial Cutting Edge, in IMMIGRANT ENTREPRENEURS 17, 30 (2003) (noting that labor market disadvantages stimulate minority members to become self-employed); cf. Rachel S. Shinnar & Cheri A. Young, Hispanic Immigrant Entrepreneurs in the Las Vegas Metropolitan Area: Motivations for Entry into and Outcomes of Self-Employment, 46 J. SMALL BUS. MGMT. 242, 244 (2008) (noting the relationship between factors that push individuals to self-employment, such as discrimination and inadequate education, as well as factors that pull individuals to self-employment, such as higher earnings and enhanced professional standing).
36. See supra note 30 and accompanying text.
37. See supra notes 8–11 and accompanying text.
higher failure rates. The next section discusses how scholars have grappled with these disparities.

B. Challenges Faced by Minority Entrepreneurs

This section explains why minority entrepreneurs are, on average, less successful than non-minority entrepreneurs. It begins by discussing how an entrepreneur’s socioeconomic characteristics (such as human capital and wealth) and the nature of the businesses they operate can affect their fortunes. These two factors interact between themselves and are also closely related to the third, and most critical, factor: access to capital.

1. ENTREPRENEUR CHARACTERISTICS

Some scholars have sought to explain racial disparities in entrepreneurial outcomes by focusing on socioeconomic variables, arguing that underlying disparities in human capital and wealth between minority and non-minority entrepreneurs lead to differences in entrepreneurial success. This has led some to conclude that addressing these underlying disparities is the best way to bridge the entrepreneurial gap, though there is no universal consensus as to the true explanatory power of these demographic variables.

a. Human Capital

Starting and operating a business is not a trivial endeavor. An entrepreneur must have a good understanding of the relevant product and geographic market, be able to negotiate with suppliers, customers and investors, and, most importantly, have the capacity to make effective managerial decisions in a fast-moving environment rife with uncertainty. These complexities explain why an entrepreneur’s formal education is a key determinant of the entrepreneur’s ability to successfully start and operate a business and why those with lower levels of education are consequently disadvantaged. Education might also indirectly affect

38. See supra notes 13–16 and accompanying text.
40. See id. at 456–58; infra notes 45, 56.
42. See FAIRLIE & ROBB, supra note 11, at 22 (“Education has . . . been found in the literature to be a major determinant of business ownership.”); Rafael Efrat, The Tax Burden and the Propensity of Small-Business Entrepreneurs to File Bankruptcy, 4 HASTINGS BUS. L.J. 175, 176 (2008) (“[W]hereas a quarter of the general population earned a bachelor’s degree or more, small-business owners are twice as likely to have earned the degrees.”).
entrepreneurial success by facilitating the development of valuable social and professional networks that improve future access to business and financing opportunities. The fact that minorities tend to have lower levels of education than non-minorities can thus explain part of the racial disparities in entrepreneurship rates and firm performance. Some scholars, however, question the importance of education as a determinant of entrepreneurial success and the extent to which racial disparities in the entrepreneurial space are the result of an educational gap.

Like formal education, prior business experience is a key determinant of entrepreneurial success. The knowledge gained from prior business exposure helps an entrepreneur evaluate the financial risks associated with starting a company. Limited business experience can lead to over-optimism and unrealistic expectations regarding risks and financial adversities. Equally important in this sense is an individual’s informal exposure to business experience via family and social networks.

Since individuals belonging to minority groups are less likely to have a self-employed family member or acquaintance, they have limited opportunities.

43. See Miller McPherson, Lynn Smith-Lovin & James M. Cook, Birds of a Feather: Homophily in Social Networks, 27 ANN. REV. SOCIO. 415, 426–27 (2001) (explaining why individuals tend to have relationships with others of the same level of education); infra note 100 and accompanying text.

44. See Fairlie & Robb, supra note 7, at 297 (noting that small business outcomes are positively associated with the owner’s education level and that Black business owners generally had lower education levels); FAIRLIE & ROBB, supra note 11, at 22–23 (arguing that lower levels of education limit minority business ownership rates by “challenging the business performance of some minority entrepreneurs”).


46. See Efrat, supra note 42, at 179; Harner, supra note 41, at 485.

47. See Harner, supra note 41, at 478 (“Identifying and properly assessing these multi-faceted risks would be difficult for even the most sophisticated risk managers. The task often is Herculean for small business entrepreneurs either because of their lack of experience, resources or professional guidance; or . . . their entrepreneurial characteristics.”).

48. See id. at 479–80 (“Overconfidence is one of several cognitive biases that commentators suggest can affect decision-making and, consequently, success in the business context.”).

49. See FAIRLIE & ROBB, supra note 11, at 24 (stressing the importance of family business backgrounds and composition of social networks in determining self-employment and that “the probability of self-employment is substantially higher among the children of the self-employed”); Fairlie, supra note 45, at 84 (“[T]here is a strong intergenerational link in self-employment due to the transmission of informal business or managerial experience.”).
to receive the type of informal training that takes place in a family business and its related social networks.\textsuperscript{50}

\textit{b. Wealth}

Starting and operating a business requires money. The primary building blocks of an entrepreneur’s investment capital are the entrepreneur’s own personal assets, followed by those of family and friends.\textsuperscript{51} As noted earlier, minorities, particularly Hispanics and African Americans, have lower levels of wealth and own fewer financial assets than non-minorities.\textsuperscript{52} Not only do minorities have fewer liquid assets that can readily be used as startup capital, but they also lack non-liquid assets, such as real estate, that could be used to secure a line of credit.\textsuperscript{53} Scholars have found that these economic disparities are likely to be a major factor in explaining low startup rates among minority entrepreneurs,\textsuperscript{54} though there is no universal consensus on whether differences in wealth are a major determining factor of entrepreneurial disparities.\textsuperscript{55}

2. BUSINESS CHARACTERISTICS

The size and form of minority-owned businesses can also help explain their relatively poor performance. Smaller businesses are more likely to perform poorly than bigger ones,\textsuperscript{56} and minority-owned businesses are, on average, smaller than non-minority-owned businesses,
both in terms of the number of employees and revenues. Business organization also appears to correlate with the success of an enterprise: incorporated businesses tend to outperform sole proprietorships, and minority-owned businesses tend to be organized as the latter.

Macro-economic factors also explain the relative underperformance of minority-owned businesses. Minority entrepreneurs are generally more likely to engage in low-value and non-growth industries, like services and retail, that are less profitable and more prone to failure. Moreover, minority entrepreneurs tend to operate in low-income neighborhoods with a less affluent client base and, as a result, generate lower profits, are more prone to failure, and have less ready access to financing.

3. ACCESS TO CAPITAL

Accessing capital is a critical challenge faced by all small businesses. Entrepreneurs need capital to fund operations, inventory, wages, and other

57. See Efrat, supra note 12, at 101–02.
59. See Efrat, supra note 12, at 102 (“[M]inority entrepreneurs would seem to be more prone to business failure compared to White entrepreneurs because minority entrepreneurs are underrepresented in the high-value and growth industry sectors.”); Fairlie & Robb, supra note 7, at 311 (noting that black-owned businesses appear to be overrepresented in less successful industries relative to white-owned businesses); Efrat, supra note 42, at 178 (noting that business failure is more common in the retail and service industry). It could be that minority entrepreneurs focus on these industries because these are not capital intensive and so their lack of access to capital is less of a barrier. See ICIC REPORT, supra note 8, at 8 (“Entrepreneurs of color are also more likely to enter industries with low capital requirements and high failure rates instead of high-growth sectors.”); Lofstrom & Bates, supra note 45, at 83–84.
60. See Timothy Bates & Alicia Robb, Analysis of Young Neighborhood Firms Serving Urban Minority Clients, 60 J. ECON. & BUS. 139, 144–46 (2008) (finding that businesses that serve local minority communities were substantially more likely to close, possibly because their clientele may have less access to outside capital); FAIRLIE & ROBB, supra note 11, at 22 (“[M]inority-owned businesses are all more likely to serve a local market... and are much more likely to sell to a minority clientele than are white businesses, which may reflect more limited market access.”).
expenses associated with starting and operating a business.\textsuperscript{62} Since early-stage businesses are not likely to generate these funds internally, securing external debt or equity financing becomes crucial especially if the entrepreneur lacks adequate personal financial resources.\textsuperscript{63} Raising capital presents an even bigger challenge for businesses owned by minority entrepreneurs for several reasons.\textsuperscript{64}

Minority businesses are more likely to be denied credit than non-minority businesses.\textsuperscript{65} These disparities in loan denial rates are robust even when controlling for personal and business factors that affect an applicant’s creditworthiness, such as wealth and credit history.\textsuperscript{66} Those minority-owned businesses that are approved for credit are still at a disadvantage: loans received by minority-owned businesses are smaller than those received by non-minority businesses and often carry higher interest rates, even after controlling for factors affecting applicants’


\textsuperscript{63} Cf. id.

\textsuperscript{64} See Shinnar & Young, supra note 35, at 247 (“[O]btaining financing for start-up and capital for growth has been listed as one of the biggest challenges for minority-owned businesses.”); FAIRLIE & ROBB, supra note 11, at 17 (“Financial constraints are the most significant issue affecting minority business ownership and business performance.”); KAUFFMAN REPORT, supra note 7, at 10 (“Capital access is also marked by striking differences across racial and ethnic groups . . . . Minority-owned firms are found to face significant barriers to capital.”); Michael Porter, The Competitive Advantage of the Inner City, 73 HARV. BUS. REV. 55, 64 (1995).

\textsuperscript{65} See MEls DE ZEEUW, Fed. Resrv. Bank of Atlanta, Small Business Credit Survey: 2019 Report on Minority-Owned Firms iv–v (finding that approval rates for loans or lines of credit sought by minority-owned firms at small banks or online lenders were lower than those for white-owned firms); FAIRLIE & ROBB, supra note 11, at 20; ICIC REPORT, supra note 8, at 8. But see Robert Watson, Kevin Keasey & Mae Baker, Small Firm Financial Contracting and Immigrant Entrepreneurship, in IMMIGRANT BUSINESS 70, 80 (Jan Rath ed., 2000).

\textsuperscript{66} See Ken S. Cavalluzzo, Linda C. Cavalluzzo & John D. Wolken, Competition, Small Business Financing, and Discrimination: Evidence from a New Survey, 75 J. BUS. 641, 676 (2002) (“We found evidence of substantial differences across demographic groups . . . even after controlling for a broad set of characteristics describing the firm and owner.”); Ken Cavalluzzo & John Wolken, Small Business Loan Turndowns, Personal Wealth and Discrimination, 78 J. BUS. 2153, 2154 (2005); David G. Blanchflower, Minority Self-Employment in the United States and the Impact of Affirmative Action Programs, 5 ANNALS FIN. 361, 386–87 (2009) (finding that minority-owned firms are more likely to be denied credit and be charged higher interest rates, a pattern that is only partially explained by creditworthiness); Minority Entrepreneurship: Assessing the Effectiveness of SBA’s Programs for the Minority Business Community: Hearing Before the Comm. on Small Bus. & Entrepreneurship, 110th Cong. 27 (2007) [hereinafter Senate Hearings] (statement of Jon Wainwright, Vice President, National Economic Research Associates, Inc.) (“[M]inority-owned firms are substantially and statistically significantly more likely to be denied credit than are white-owned firms with similar balance sheets and similar credit histories.”).
Minority entrepreneurs also face difficulties in obtaining equity financing from venture capital firms and angel investors, despite the fact that funds specializing in minority firms provide returns that are at least as large as those offered by mainstream funds.68

As a result, minority and non-minority businesses are financed quite differently.69 Minority entrepreneurs rely less on formal funding sources like banks and private equity financing for their startup capital and instead turn to informal funding sources, such as personal savings, loans from friends and family, and credit card debt.70 These sources, however, tend to be limited and expensive, making it more difficult for minority entrepreneurs to start their businesses.71 Moreover, the resulting undercapitalization reduces the ability of new minority businesses to thrive and survive.72

67. See ICIC REPORT, supra note 8, at 8; FAIRLIE & ROBB, supra note 11, at 20–21; Senate Hearings, supra note 66, at 27 (statement of Jon Wainwright, National Economic Research Associates, Inc.) (“[W]hen minority-owned firms do receive loans, they are obligated to pay higher interest rates than comparable white-owned firms.”); Alan Greenspan, Chairman, Bd. of Governors of the Fed. Rsv. Sys., Keynote Address: Changes in Small Business Finance, in Summary: Business Access to Capital and Credit, March 8–9, 1999, at 39, 43 (noting that higher denial rates for minority-owned businesses are not “readily explained by income, balance sheet factors, or credit histories”).

68. See infra notes 200–205 and accompanying text.

69. See FAIRLIE & ROBB, supra note 11, at 20 (“Minority and non-minority entrepreneurs differ in the types of financing they use for their businesses.”); KAUFMAN REPORT, supra note 7, at 10 (“Owner equity for black owners is more than half of total financial capital while white owners put up less than one-third. Outside equity accounted for 1.5 percent and 17 percent of total financial capital in black- and white-owned new businesses, respectively. And, outside debt accounted for close to one-third and more than half of total financial capital in black- and white-owned new business, respectively.”).

70. See Shinnar & Young, supra note 35, at 247 (“Hispanic entrepreneurs tend to rely on informal funding sources for business start-up rather than banks and venture capital. . . . This reliance on informal sources may be attributed to the higher rates of denials for Hispanic loan applicants, which may deter individuals from approaching financial institutions in order obtain loans.”); FAIRLIE & ROBB, supra note 11, at 20 (“African American entrepreneurs rely less on banks than whites for startup capital” and that “African American business owners are more likely to rely on credit cards for startup funds than are white business owners.”); de Zeeuw, supra note 65, at IV–V (reporting that minority owners relied to a greater extent on personal funds); KAUFMAN REPORT, supra note 7, at 10 (noting that minority entrepreneurs have to rely more on credit cards to fund their businesses and that high interest rates on credit cards make them a costly form of capital).

71. See de Zeeuw, supra note 65, at V (reporting that minority-owned firms more frequently applied for potentially higher-cost and less-transparent credit products, such as merchant cash advance and factoring).

72. See Efrat, supra note 12, at 100 (“[M]inority entrepreneurs’ higher failure rate has been blamed on limited access to credit. . . . Higher levels of capitalization have a positive effect on survival rates of small businesses.”); FAIRLIE & ROBB, supra note 11, at 19 (“Undercapitalized businesses will likely have lower sales, profits and employment and will be more likely to fail than businesses receiving optimal levels of startup capital.”).
C. Overcoming Informational Asymmetries

What explains the lack of outside financing available to minority entrepreneurs? The studies cited in the previous section suggest that non-economic factors certainly play an important role. Even though the existence of racial bias is undeniable, the full picture is likely more nuanced and complex. This section tries to untangle this complexity by exploring the role of informational asymmetries in racially disparate access to capital.

Investing in young, small businesses is risky: the vast majority of startups fail. This high rate of failure, coupled with the lack of easily available information about these businesses, subjects potential investors to significant risks. Though the use of collateral by borrowers can

73. See supra notes 66–67 and accompanying text (providing evidence that racial disparities in financing are present even after controlling for various entrepreneur characteristics); Efrat, supra note 12, at 100 (“The limited access to financial capital is partly due to the lower asset levels the minority entrepreneurs have accumulated, the discrimination they face from some financial institutions, fewer ties to financial institutions, lower loan application submissions, and a higher financing rejection rate.”); Watson, Keasey & Baker, supra note 65, at 79–80; Fairlie & Robb, supra note 11, at 21 (“A factor posing a barrier to obtaining financial capital for minority-owned businesses is racial discrimination in lending practices.”); Cavalluzzo & Wolken, supra note 66, at 2154 (arguing that lending patterns are consistent with a finding of racial discrimination in the credit market by banks).


75. See KAUFFMAN REPORT, supra note 7, at 12 (“The persistence of information asymmetry in capital markets between the supply of capital (investors) and the demand for capital (entrepreneurs) gives rise to barriers faced by entrepreneurs.”).


77. See Watson, Keasey & Baker, supra note 65, at 77; Claudia Lin-Yung Zhang, How to Solve the Dilemma of Small Business Finance: A Proposal for Creditors’ Statutory Information Right, 13 U. C. DAVIS BUS. L.J. 128, 129–30 (2012) (noting that small businesses have difficulties communicating value to potential lenders because their contracts are generally not publicly available and they lack audited financial statements).
reassure potential creditors, this use does not effectively solve the inherent informational asymmetry problems, and the resulting overleveraging can adversely impact a business’s performance and development. Loan applications by small startups are often denied as a result. For these same reasons, raising capital via equity can also be prohibitively expensive and often is not a realistic alternative for many small enterprises. The discussion that follows explains how the effects of these informational asymmetries are exacerbated in the context of minority-owned businesses.

1. UNTANGLING “SOFT” INFORMATION

This high degree of informational asymmetries is due to the lack of reliable and verifiable information about young, small businesses: there are no detailed financial statements about past performance, for example. Individuals and entities investing in these businesses must then rely on subjective or “soft” information, “information that cannot be directly verified by anyone other than the [person] who produces it.” For example, “knowing” that a firm manager is honest and hardworking is an intangible fact that can be gained through personal experience, but one that cannot be as easily documented and credibly communicated as a financial report, a resume, or another form of “hard,” “objective,” or “verifiable” information. The critical role of soft information in the assessment of the

78. See Zhang, supra note 77, at 137 (“Collateral is also a useful way to deliver private information and overcome borrower/lender incentive conflicts.”).

79. See id. at 136 (“Collateral may impose opportunity costs on borrowers by drying up assets that might otherwise be put into more productive uses.”); Efrat, supra note 42, at 178 (noting that small firms that receive financing can fail because they tie up their assets or the debt overwhels them).

80. See infra note 190. See also Watson, Keasey & Baker, supra note 65, at 80; Zhang, supra note 77, at 130 (“The information costs, with the concomitant free-rider problem, severely impair small banks’ lending ability, especially when they are new entrants in the local market.”).

81. See Nancy Huyghebaert & Linda M. Van de Gucht, The Determinants of Financial Structure: New Insights from Business Start-Ups, 131 EUR. FIN. MGMT. 101, 110 (2007) (“Start-ups, however, cannot access public equity and . . . are also not likely to attract venture capital.”); Stewart Myers, The Capital Structure Puzzle, 39 J. FIN. 574, 584–85 (1984) (arguing that the value of debt, by virtue of being a more senior security than equity, is less sensitive to private information); FAIRLIE & ROBB, supra note 11, at 17.

82. See Hédia Fourati & Habib Affes, The Capital Structure of Business Start-Up: Is There a Pecking Order Theory or a Reversed Pecking Order?, 4 TECH. & INV. 244, 247 (2013) (noting that due to their lack of historical and reputation effects, new firms are informationally opaque, which reduces the availability of external finance).


84. See Stein, supra note 83, at 1892.
risks and prospects of investing in a small business explains several patterns documented in the corporate finance literature. Loan applications by small businesses are more likely to be approved by lenders that operate within a decentralized decision-making system, like one where local branch managers make approval decisions. Studies that have examined lending patterns of big and small banks indicate that small, local banks have a comparative advantage in lending to small businesses based on soft information, while big banks prefer to lend to larger businesses and rely on hard information to make their lending decisions. As it turns out, “soft information loans” can be profitable for the banks that are able to make them—these loans do not have higher default rates, and the borrowers are as productive as other firms. Unfortunately, the continuing trend of bank consolidation and concentration has complicated matters for small businesses, as small local banks are disappearing and being replaced by bigger banks less suited to deal with soft information.

The importance of soft information in assessing small businesses also explains patterns in equity investments. Individuals active in the public

85. See Fourati & Affes, supra note 82, at 247 (noting that credit relationships are “based on ‘soft’ information generated by the banking experience with the lender and by a continuous contact”); Allen N. Berger & Gregory F. Udell, Small Business and Debt Finance, in HANDBOOK OF ENTREPRENEURSHIP RESEARCH 299, 300 (Zoltan J. Acs & David B. Audretsch eds., 2003).

86. In a hierarchical setting, soft information loses its value as local managers cannot credibly transmit the information to their decision-making superiors and thus have less incentive to produce it. See Stein, supra note 83, at 1893; Jose M. Liberti & Atif R. Mian, Estimating the Effect of Hierarchies on Information Use, 22 REV. FIN. STUD. 4057, 4060 (2009) (finding that sensitivity of credit decisions to objective information is higher at higher levels of approval, while sensitivity to subjective information is lower); Atif R. Mian, Distance Constraints: The Limits of Foreign Lending in Poor Economies, 61 J. FIN. 1465, 1467–68 (2006) (finding that greater cultural and geographical distance between a bank’s headquarters and its local branches leads to less lending to informationally difficult yet fundamentally sound firms requiring relational contracting, such as small firms).

87. See Allen N. Berger, Nathan H. Miller, Mitchell A. Petersen, Raghuram G. Rajan & Jeremy C. Stein, Does Function Follow Organizational Form? Evidence from the Lending Practices of Large and Small Banks, 76 J. FIN. ECON. 237, 240–41 (2005). A study using data from the National Survey of Small Business Finance (which covers firms with fewer than 500 employees and a median asset value of $680,000) found that large banks lend primarily to larger firms with good accounting records while smaller banks lend to businesses for which creditworthiness is more difficult to assess with “hard” information. Id. Large banks lend at a greater distance, interact more impersonally, and have shorter and less exclusive relationships than smaller banks. See id.

88. See Mian, supra note 86, at 1498–99.

89. See Stein, supra note 83, at 1891; Cavalluzzo, Cavalluzzo & Wolken, supra note 66, at 643 (“The level of concentration in banking markets is of particular interest because small businesses tend to borrow locally, rather than nationally. A recent and continuing wave of mergers in the banking industry suggests that these local markets are becoming more concentrated.”).
equity markets tend to invest more in nearby companies.\textsuperscript{90} This local bias is stronger for small and highly leveraged companies that produce locally consumed goods and services, exactly the type of firm that one expects local investors to have better access to soft information and for which this information would be most valuable.\textsuperscript{91} More generally, private equity investors rely heavily on relationship-driven and geographically focused screening and monitoring mechanisms, as well as sophisticated contractual provisions, to gather and exploit soft information when investing in small, young businesses.\textsuperscript{92}

2. MINORITY-OWNED BUSINESSES AS SOURCES OF SOFT INFORMATION

For minority entrepreneurs, informational asymmetries present an even greater obstacle to raising capital. Minority entrepreneurs often cannot take advantage of traditional strategies used to mitigate investors’ informational concerns, as these strategies require personal wealth and resources that minority entrepreneurs often do not have.\textsuperscript{93} For example, personal assets can serve as collateral in securing a loan or a home equity line of credit can be obtained using the entrepreneur’s house.\textsuperscript{94} Relatedly, outside equity investors prefer that the entrepreneur has some “skin in the game” by investing enough personal resources as firm capital.\textsuperscript{95}

\textsuperscript{90} See Gur Huberman, Familiarity Breeds Investment, 14 Rev. Fin. Stud. 659, 660–61 (2001) (finding that investors are more likely to hold shares of their local regional phone company than of any other regional phone company); Joshua D. Coval & Tobias J. Moskowitz, Home Bias at Home: Local Equity Preference in Domestic Portfolios, 54 J. Fin. 2045, 2047 (1999) [hereinafter Coval & Moskowitz, Home Bias] (finding that fund managers invest in companies which are around 10\% closer than the average firm they could have held); Joshua D. Coval & Tobias J. Moskowitz, The Geography of Investment: Informed Trading and Asset Prices, 109 J. Pol. Econ. 811, 812–13 (2001) (finding that mutual fund managers outperform in their local investments and concluding that there is some valuable information about these firms that these managers are getting on the ground).

\textsuperscript{91} See Coval & Moskowitz, Home Bias, supra note 90, at 2047–48.

\textsuperscript{92} See supra notes 83–84 and accompanying text.

\textsuperscript{93} See Fairlie & Robb, supra note 11, at 19 (“[L]ow levels of personal wealth and liquidity constraints also limit the ability of minority entrepreneurs to raise adequate levels of startup capital.”); Robert B. Avery, Raphael W. Bostic & Katherine A. Samolyk, The Role of Personal Wealth in Small Business Finance, 22 J. Banking & Fin. 1019, 1021 (1998) (finding that the majority of all small business loans have personal commitments).

\textsuperscript{94} See Fairlie & Robb, supra note 11, at 17 (“Low levels of wealth and liquidity constraints create a substantial barrier to entry for minority entrepreneurs because the owner’s wealth can be invested directly in the business, used as collateral to obtain business loans or used to acquire other businesses.”); Cavalluzzo & Wolken, supra note 66, at 2154 (finding that personal wealth, primarily through home ownership, decreases the probability of loan denials among existing business owners).

\textsuperscript{95} See Fairlie & Robb, supra note 11, at 17 (“Investors frequently require a substantial level of owner’s investment of his/her own capital as an incentive, commonly referred as ‘skin in the game.’”).
Collecting and digesting available information thus becomes crucial for those seeking to invest in minority-owned businesses. In this respect, minority-owned businesses face two disadvantages relative to non-minority-owned businesses. First, soft information might be even more important for assessing a minority-owned business due to a greater unavailability of hard, verifiable information. Minority-owned businesses tend to be organized as sole-proprietorships rather than corporations and often lack a formal business plan. Such informality is not conducive to producing hard, verifiable information that can be easily accessed and assessed by investors. Second, investors might have a more difficult time producing and digesting soft information for minority-owned businesses, a premise explored next.

3. PROFESSIONAL INVESTORS AS RECIPIENTS OF SOFT INFORMATION

Large hierarchical institutions, a label that describes most banks and institutional investors, are ill-suited to make investment decisions based on soft information. Even in flat hierarchical settings, socioeconomic and cultural differences between investors and entrepreneurs complicate the production and digestion of soft information. For example, it is easier for an investor to uncover and interpret soft information when that investor enjoys cultural proximity with the entrepreneur. Common networks are also critical for the collection, dissemination, and interpretation of soft information, as many investors informally rely on acquaintances to act as “gatekeepers” for potential financings.

96. See Efrat, supra note 42, at 179; Shinnar & Young, supra note 35, at 247, 251. These disparities in business formalities suggest that there exists a role for pro bono or easily accessible legal services. Although some county bar associations have placed a focus on helping small businesses address legal issues, only a handful of these programs exist nationwide. See The ACBA Public Service Committee, Public Service Committee Starts Small Business Legal Assistance Program, LAWS.J., Sept. 20, 2013, at 4. Law school clinics could also step in to address these disparities. See generally Jared Nicholson, Offering Transactional Legal Aid to Low-Income Entrepreneurs, 6 IND. J.L. & SOC. EQUAL. 1 (2018).

97. See Fourati & Affes, supra note 82, at 248 (“The legal form of organization provides . . . a signal that indicates credibility and formality of operations and ensures future growth . . . . There is, then, a positive correlation between debt and organization in incorporation.”); Gavin Cassar, The Financing of Business Start-Ups, 19 J. BUS. VENTURING 261, 262, 268 (2004) (arguing that the fact that “both outside and bank finances appeared to increase as a result of the firm’s incorporation” evidences that incorporation is a signal that portrays credibility and formality of operations); Fairlie, supra note 27, at 5 (“Incorporated businesses are viewed as more growth-oriented, committed, pro-cyclical and entrepreneurial . . . .”).

98. See supra notes 85–89 and accompanying text.

99. See Watson, Keasey & Baker, supra note 65, at 79.

100. See Julia S. Rubin, Venture Capital and Underserved Communities, 45 URB. AFFS. REV. 821, 824–25 (2010) (“Venture capitalists heavily rely on their networks in
The fact that professional investors—most of whom are non-minority—and minority entrepreneurs belong to different networks increases the costs for the former in identifying, assessing, and monitoring businesses owned by the latter. Investors lacking the required knowledge and connections to assess soft information may resort to the use of heuristics, using, for example, an entrepreneur’s race (an observable attribute) as a proxy for business risk (an unobservable attribute). In this context, implicit biases can lead investors to make decisions that systematically disfavor minority entrepreneurs.

Recent Federal Reserve data on small business lending helps illustrate this point. Among low credit risk applicants, minority and identifying investment opportunities, conducting due diligence on those opportunities, and monitoring investment performance . . .


102. See Rubin, supra note 100, at 824–25 (“Since traditional venture capitalists’ networks include few women and people of color, they have limited access to and understanding of companies owned by these populations. This translates into higher search costs in identifying, conducting due diligence on, and monitoring firms owned by women and people of color . . .”).

103. For an overview of the sources of implicit biases, see Anthony G. Greenwald & Linda Hamilton Krieger, Implicit Bias: Scientific Foundations, 94 CALIF. L. REV. 945, 952–57 (2006); Christine Jolls & Cass R. Sunstein, The Law of Implicit Bias, 94 CALIF. L. REV. 969, 969–70 (2006) (providing examples of both explicit and implicit bias). Implicit biases are closely related to the concept of statistical discrimination. See Cavalluzzo, Cavalluzzo & Wolken, supra note 66, at 642 (“[L]enders may be unable to observe, or it may be costly to collect, economically relevant information that is correlated with demographic group. If these lenders use demographic attributes as a proxy for missing information, then the resulting disparate treatment has an economic basis. This form of disparate treatment is called statistical discrimination . . .”). Kenneth Arrow, What Has Economics to Say About Racial Discrimination?, 12 J. ECON. PERSP. 91, 96–97 (1998) (describing the statistical discrimination model); Ian Ayres & Peter Siegelman, Race and Gender Discrimination in Bargaining for a New Car, 85 AM. ECON. REV. 304, 317 (1995) (“Statistical discrimination’ is based not on a psychological distaste for associating with blacks or women, but rather on sellers’ use of observable variables (such as race or gender) to make inferences about a relevant but unobservable variable.”).

104. See Daniel Applewhite, Founders & Venture Capital: Racism Is Costing Us Billions, FORBES (Feb. 15, 2018, 8:00 AM), https://www.forbes.com/sites/forbessnonprofitcouncil/2018/02/15/founders-and-venture-capital-racism-is-costing-us-billions/?sh=1ab3726c2e4a [https://perma.cc/3CTT-53EE] (“Pattern recognition has enabled VC’s to mitigate risk but has also limited their profit potential and created an inherent funding bias. This bias stems from barriers to early-stage capital, a lack of representation in the investing space and is perpetuated by systems of racism that destroy opportunity within communities of color.”); Benjamin P. Edwards & Ann C. McGinley, Venture Bearding, 52 U.C. DAVIS L. REV. 1873, 1877 (2019) (“[U]ncorrected implicit biases pervade the business environment, tilting the investment decisions made by venture capitalists toward men. Because venture capitalists are overwhelmingly white and male, they may be particularly vulnerable to implicit bias in favor of white male founders in evaluating investment opportunities.”).

105. See DE ZEEIJ, supra note 65, at 11.
white business owners are denied at the same rate (15%). Racial disparities arise once we look at riskier applicants for whom the available verifiable information by itself is not reassuring. In the pool of medium credit risk applicants, minority applicants are denied 34% of the time, while white applicants are denied 25% of the time—an eleven-point difference. Examining the riskier set of applicants reveals even greater disparities: white applicants are denied 46% of the time, while minority applicants are denied 73% of the time—a twenty-seven-point difference. The fact that race seems to play a role in situations where there is less reliable verifiable information about an entrepreneur suggests that an entrepreneur’s race is being employed as a proxy for business risk.106

II. WHY EXISTING PROGRAMS HAVE FAILED

This Part explores major initiatives aimed at helping small businesses raise capital and the manner in which these have been tailored to target minority-owned businesses. The federal government plays an important role in these initiatives, though its role and the nature of its involvement has varied from directly guaranteeing loans to indirectly enhancing access to capital by relaxing regulatory requirements.

A. Government-Led Programs

The U.S. Small Business Administration (SBA) directly supports entrepreneurs and small businesses through a three-pronged strategy.107 First, the SBA facilitates access to capital by providing a government-backed guarantee on loans granted by financial institutions to qualifying small businesses.108 Second, the SBA oversees the federal government’s efforts to deliver a percentage of federal contracts to certain small businesses.109 These patterns produced by implicit biases have been observed in other areas where racial disparities in outcomes have been identified, such as in criminal law. See Carlos Berdejo, Criminalizing Race: Racial Disparities in Plea-Bargaining, 59 B.C. L. Rev. 1187, 1240–41 (2018) (finding that racial disparities in plea-bargaining are driven by “low information” cases in which defendants have no prior convictions or are accused of less serious offenses and arguing that these patterns suggest that race is being used as a proxy for recidivism and inherent criminality).

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107. The SBA is one of two U.S. government agencies that are involved in promoting minority-owned businesses. See Min & Bozorgmehr, supra note 35, at 34. The other agency, the Minority Business Development Agency (MBDA), is part of the Department of Commerce. See Eugene Boyd, Cong. Rsch. Serv., R45015, Minority Business Development Agency: An Overview of Its History and Current Issues 1 (2017). This Article will not focus on the MBDA for two reasons. First, this agency plays a limited role in financing, as it mainly provides technical and managerial support to minority-owned businesses. Id. at 6. Second, it primarily focuses on businesses with annual revenues of at least $1 million operating in high-growth areas, such as technology and biomedicine. Id.

108. See infra notes 120–126 and accompanying text.
Finally, the SBA provides counseling to small businesses via a network of local offices.110

1. SBA BUSINESS DEVELOPMENT AND LOAN PROGRAMS

a. Business Development Programs

The SBA’s 8(a) Business Development Program provides support to small businesses owned by “socially and economically disadvantaged” individuals.111 Socially disadvantaged individuals are “those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities.”112 Members of certain designated groups, including African Americans, Hispanics, and Native Americans, are entitled to a rebuttable presumption of social disadvantage.113 Economically disadvantaged individuals include those “whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same or similar line of business.”114 To initially qualify as economically disadvantaged, applicants must have a net worth lower than $250,000, among other requirements.115

Businesses that meet the 8(a) Program’s eligibility requirements enjoy limited competition for federal government contracts known as set-aside and sole-source contracts.116 Participants in the 8(a) Program are also

109. See infra note 116 and accompanying text.
110. See infra notes 117–119 and accompanying text.
111. 13 C.F.R. § 124.101 (2020). For an overview of the 8(a) program, see ROBERT JAY DILGER, CONG. RSCH. SERV., R44844, SBA’S “8(A) PROGRAM”: OVERVIEW, HISTORY, AND CURRENT ISSUES (2019).
112. 13 C.F.R. § 124.103(a).
113. § 124.103(b).
114. § 124.104(a).
115. § 124.104(c)(2).
eligible to receive assistance through the 7(j) Management and Technical Assistance Program,117 be assigned a business opportunity specialist to help navigate federal contracting and obtain general business development assistance,118 and participate in a mentor-protégé program.119

b. SBA Loan Guarantee Programs

The SBA does not act as a lender to small businesses but rather provides guarantees for small business applicants. Depending on the program, loans are provided by intermediaries such as banks (SBA 7(a) loans) or Certified Development Companies (CDCs) (SBA 504 loans) that interact with the small business applicant and make credit decisions.120 These two programs are available for small businesses that have a tangible net worth lower than $15 million and an average net income of $5 million or less for the preceding two years.121

Amounts borrowed under the 7(a) loan program can be used for any business purpose, including working capital, inventory, financing leasehold improvements, and refinancing debt.122 Although borrowers may use the 7(a) program to fund capital investments, the SBA’s 504 loan program offers certain advantages for small businesses to fund these capital investments.123 The 504 program offers borrowers a fixed rate for 10 or 20 years, generally with lower fees than the 7(a) program, which typically have shorter maturities and variable interest rates.124

117. This program provides support such as training, executive education, and consulting in areas such as marketing, accounting, opportunity development and capture, contract management, compliance, and financial analysis. 13 C.F.R. §§ 124.701–03.

118. See § 124.704.

119. § 124.520. The mentor-protégé program is designed to “improve [a small business’] ability to successfully compete for contracts” by providing assistance through mentor businesses, including technical or management training, financial assistance, trade education, and assistance in competing for or performing prime contracts with the federal government. 13 C.F.R. § 125.9.


121. See CONG. RSCH. SERVS., R41146, SMALL BUSINESS ADMINISTRATION 7(A) LOAN GUARANTY PROGRAM 21 (2021) [hereinafter CRS 7(A) REPORT]; CONG. RSCH. SERVS., R41184, SMALL BUSINESS ADMINISTRATION 504/CDC LOAN GUARANTY PROGRAM 5 n.19 (2020) [hereinafter CRS 504 Report].

122. § 120.120. For information on the terms, conditions, and eligibility of SBA loans, see 7(a) Loan Program: Terms, Conditions and Eligibility, U.S. SMALL BUS. ADMIN., https://www.sba.gov/partners/lenders/7a-loan-program/terms-conditions-eligibility [https://perma.cc/4L2N-R77A] (last visited Feb. 18, 2021); CRS 7(A) REPORT, supra note 121, at 4.

123. See CRS 504 REPORT, supra note 121, at 6–7.

124. See id. at 9–10; CRS 7(A) REPORT, supra note 121, at 4–6.
under the 504 program require a down payment of 10%, whereas the 7(a) loan program requires certain loans to be fully collateralized.

The overall effectiveness of these SBA loan programs has been widely questioned. Some have argued that the policy rationales underlying these programs are unsound, highlighting the opaqueness of the selection process and maintaining that the ultimate winners are big banks who do not need financial support from taxpayers. Setting that policy question aside, it is debatable whether debt financing is the most appropriate vehicle to fund certain early-stage businesses, as it can be relatively expensive and cause undue financial strains in the short term.

Indeed, for some early-stage businesses, the temporal flexibility of equity financing and the advice and involvement of equity investors often provide a more attractive alternative.

The performance of these SBA programs is even more troubling if we look at their effects on minority-owned businesses. SBA programs have not increased minority entrepreneurship. Minority-owned businesses are less likely to receive loans under the SBA programs, and those who do receive loans receive smaller loans relative to non-minority-owned businesses. The failure of these SBA lending programs is not surprising given the importance of soft information in assessing minority-owned businesses and the fact that most SBA lenders are large banks.
precisely the type of institution that has a comparative disadvantage in that informational setting.\footnote{133}

2. SMALL BUSINESS INVESTMENT COMPANIES

Small Business Investment Companies (SBICs) are privately-owned companies, licensed and regulated by the SBA, that make long-term investments in small businesses.\footnote{134} To fund their investments, SBICs raise regulatory capital from private investors, generally institutional investors such as banks, insurance companies, pension funds, and university endowments, as well as high net-worth individuals.\footnote{135} These funds are supplemented by the SBA mainly in the form of guaranteed debt: for every $1 an SBIC raises from a private investor, the SBA typically provides $2

\footnote{133. See Editorial Board, supra note 128 (stating that lenders in the SBA programs are large banks); supra notes 98–106 and accompanying text (discussing the importance of soft-information and which institutions are best positioned to rely on it). Notably, the ever-growing concentration of the banking sector has rendered it even less able to meet the capital needs of minority-owned businesses. See supra note 89 and accompanying text; Cavalluzzo, Cavalluzzo & Wolken, supra note 66, at 676 (“Small businesses that were owned by African Americans were more likely to be denied credit and have unmet credit needs as the level of lender market concentration increased. In addition, African American owners were less likely to apply for credit with increases in lender market concentration.”).}

\footnote{134. See John Paglia & David T. Robinson, Fed. Rsch. Div., Lib. of Cong., Measuring the Representation of Women and Minorities in the SBIC Program 8 (2016) (“[T]he SBIC Program’s mission is to stimulate and supplement the flow of private equity capital and long-term loan funds for the growth, expansion, and modernization of small businesses for which such capital and loan funds are not available in adequate supply . . .”); Ethan D. Dunn, Early Stage SBICs: A New Source of Capital for Private Investors, Equity for Start-Ups, and Possible Volker Rule Exemption for Banks, N.C. BANKING INST. 357, 361 (2013) (“SBICs] lend or invest [a] mixture of private and SBA-guaranteed capital to early stage small businesses with hopes of profits above their borrowed rates. The availability of government-backed debt and equity improves small business access to long-term debt and private equity, in turn financing operations and expansion.”).}

of debt capital, up to $175 million ("leverage capital"). Once capitalized, SBICs act as managed investment funds that invest capital raised from private investors in businesses operating in sectors and industries where the fund managers have expertise.

a. SBIC Programs

Active SBICs are licensed to participate in one of four main programs: the Debenture Program, the Participating Securities Program, the Bank-Owned/Non-Leveraged Program, and the Specialized SBIC Program. As of September 30, 2018, there were 305 licensed SBICs, of which 227 belonged to the Debenture program; 25 belonged to the Participating Securities program; 47 belonged to the Bank-Owned/Non-Leveraged Program; and 6 belonged to the Specialized SBIC Program.

Under the Debenture Program, an SBIC receives SBA leverage in the form of a guaranteed debenture (i.e., loan obligations), which allows the SBIC to borrow at favorable terms. There are a number of capital requirements that need to be satisfied by an SBIC participating in the Debenture Program, but a detailed discussion of these is not necessary for our purposes. Notably, Debenture SBICs can only invest in businesses with a tangible net worth under $19.5 million.

136. See CONG. R.SCH. SERV., R41456, SBA SMALL BUSINESS INVESTMENT COMPANY PROGRAM 1–2 (2020) [hereinafter CRS SBIC REPORT].

137. See id. SBICs can be organized under state law as corporations, a limited partnerships or limited liability companies. See id. at 4. SBICs are organized as limited partnerships with the SBIC managers acting as the general partner. See OCC SBIC REPORT, supra note 135, at 1.


140. CRS SBIC Report, supra note 136, at 1. When an SBIC wants to draw leverage, it notifies the SBA and issues a debenture, which the SBA temporarily holds (providing funds in the interim to the SBIC) and then sells the debentures to the public pooled with others (to receive the funds back). See U.S. SMALL BUS. ADMIN., MEMORANDUM OF INSTRUCTIONS APPLICATION FOR COMMITMENT OF SBIC DEBENTURES 1, 7 (2016), https://www.sba.gov/document/policy-guidance--commitment-instructions [https://perma.cc/9M38-3XWS].

141. Debenture SBICs are required to have a private capital investment of at least $5 million. 13 C.F.R. § 107.210 (2020). At least 30% of a debenture SBIC’s regulatory and leverageable capital must come from three people unaffiliated with the fund’s management and unaffiliated with each other. § 107.150.

142. See Dunn, supra note 134, at 364; SBIC Overview, supra note 135, at 2.
The fixed and periodic nature of the payments that an SBIC must meet under the Debenture Program makes startup and early-stage businesses less attractive investment targets for SBICs as compared to older, more established businesses.143 Investing in young, small businesses generally requires the ability to purchase equity interests in them, interests which are unlikely to provide a predictable stream of returns.144 As a result, SBICs in the Debenture Program focus on debt instruments and mezzanine financing and prefer to invest in later-stage businesses with larger cash flows.145

To facilitate the formation of SBICs that would make equity investments in startups and early-stage companies, the SBA established the Participating Securities Program in 1994.146 Unlike the Debenture Program, where the SBA is practically a creditor of the SBIC, the Participating Securities Program allows the SBA to guarantee equity-type securities, requiring SBICs to pay the SBA a prioritized payment (or preferred return) and a profit share when the SBIC realizes profits.147 Due to mounting losses associated with this Program, the SBA terminated it in October 2004 and stopped issuing new commitments for participating securities leverage or licensing new SBICs using that leverage.148 In the following years, congressional and market actors expressed interest in reviving a similar program to assist startup and early-stage small businesses.149

One such program was part of the Obama Administration’s 2011 Startup America Initiative, under which the SBA established a five-year, $1 billion early-stage SBIC program.150 Early-stage SBICs were required to invest at least 50% of their financings in early-stage small businesses, businesses that have never achieved positive cash flow from operations in

143. Debenture SBICs must make semiannual payments to cover interest and other charges. See CRS SBIC REPORT, supra note 136, at 12.
144. See infra notes 189–191 and accompanying text.
145. See CRS SBIC REPORT, supra note 136, at 11; Dunn, supra note 134, at 365. Of the $5,159 million financed by SBICs in 2018, $3,221 million (66.33%) was in the form of straight debt, $945 million was in the form of equity (18.32%) and $791.8 million was in the form of hybrid securities (15.35%). See SBIC QUARTERLY REPORT, supra note 139, at 2.
147. Participating securities are redeemable, preferred, equity-type securities issued by SBICs in the form of limited partnership interests, preferred stock, or debentures with interest payable only to the extent of earnings. See CRS SBIC REPORT, supra note 136, at 7.
148. See id. at 7.
149. Id.
In recognition of the higher risk associated with investments in these early-stage small businesses, the initiative included “several new regulatory provisions intended to reduce the risk that an early-stage SBIC would default on its leverage and to improve SBA’s recovery prospects should a default occur.” Since the program was not renewed, the SBA stopped accepting new applicants for the early-stage SBIC initiative in 2017.

b. Efforts Targeting Minority-Owned Businesses

Two SBIC programs have sought to encourage SBIC investment in minority-owned businesses and facilitate the latter’s access to capital: the Specialized SBIC (SSBIC) Program and the Impact Investment SBIC Initiative. Although neither of these programs still exists, their history provides valuable insights for the design of alternative approaches to address minority entrepreneurs’ difficulties in accessing capital.

The SSBIC Program was designed to target small business entrepreneurs “whose participation in the free enterprise system is hampered because of social or economic disadvantage,” a category meant to capture minority-owned small businesses. The program, however, was repealed in 1996 and no new SSBIC licenses have been issued since. During the existence of the program, the SBA issued 288 SSBIC licenses. In 1997, there were 77 active SSBICs. As of 2018, only 6 remained. Some have argued that the decline of the SSBIC program resulted in a corresponding decline of SBIC financings to minority-owned small businesses.

151. See id. at 25,051–53.
152. Id. at 25,043.
155. CRS SBIC REPORT, supra note 136, at 3.
156. See PAGLIA & ROBINSON, supra note 134, at 9.
157. Id.
158. See SBIC QUARTERLY REPORT, supra note 139, at 1.
159. See PAGLIA & ROBINSON, supra note 134, at 9.
The Impact Investment SBIC Initiative was a $1 billion effort established by the SBA in 2011. Under the terms of the program, an impact investment SBIC was required to target at least 50% of their investments in “areas of critical national priority including underserved markets and communities facing barriers to access to credit and capital.” These areas initially included businesses located in underserved communities, as well as in sectors like education and clean energy. Nine impact investment SBICs were licensed, and, as of September 30, 2018, they managed $905 million in assets and had investments in 81 businesses.

Yet, this program was also short-lived. In September 2017, the SBA announced that it would no longer accept new applications for impact investment SBIC licenses and withdrew a proposed rule that would have provided impact investment SBICs additional benefits “to encourage qualified private equity fund managers with a focus on social impact to apply to the SBIC program.” The SBA indicated that the cost of the proposed additional benefits was “not commensurate” with the benefits, particularly because so few qualified SBICs had applied to participate in the program and that many of the program’s participants would have applied to the SBIC program regardless.

160. CRS SBIC Report, supra note 136, at 8.
164. Id.
166. See Impact SBICs Withdrawal, supra note 165 at 26,874–75. The SBA indicated that due to the risk associated with this class of SBICs the proposed rule was expected to increase the cost to all SBICs by increasing the annual fee by approximately 6.1 basis points. Id.
c. Assessing SBICs’ Performance

Overall, the SBIC program has been successful. From the SBIC Program’s inception to December 31, 2018, SBICs provided approximately $97.6 billion of funding in more than 181,185 financings to businesses, including companies like Amgen, Apple Computer, Costco, Federal Express, Intel, Tesla, and Whole Foods. The SBIC Program also laid the foundation for the modern venture capital industry, as the risk involved in these investments was quite substantial for the private sector to absorb without initial government support. More recently, however, SBIC programs have focused on providing debt financing to mid-stage companies, greatly neglecting the needs of small, early-stage companies. This neglect is primarily due to the type of leverage provided by the SBA: mainly debt, which induces SBICs to invest in debt instruments issued by relatively stable companies. Moreover, as discussed later, raising capital via debt is generally not the best choice for small, early-stage companies.

Whether the SBIC program has helped develop minority businesses is debatable. At a 2007 congressional hearing, the SBA recognized that “minority representation in [the SBIC program] is low.” The situation has not improved since. As of 2018, Black- and Hispanic-owned businesses were involved in only 1.9% and 1.0%, respectively, of SBICs financings. Non-minority businesses, on the other hand, were involved in 95.2% of the financings. Looking at the aggregate amount of funds

168. Rubin, supra note 100, at 829; Sean Silverthorne, Government’s Positive Role in Kick-Starting Entrepreneurship, HARV. BUS. SCH. (Dec. 7, 2009), http://hbswk.hbs.edu/item/6318.html [https://perma.cc/8MKD-MWHN] (citing Josh Lerner as stating that the SBIC program “led to the formation of the infrastructure for much of the modern venture capital industry”); JOSH LERNER, BOULEVARD OF BROKEN DREAMS 68–69 (Princeton Univ. Press 2009) (“[M]any pioneering venture funds have garnered . . . low [financial] returns” and “that no matter how promising the returns of entrepreneurial activity ultimately are, in a venture market’s early years, low returns are likely.”).
169. See supra notes 143–145 and accompanying text.
170. Id.
171. See infra notes 189–199 and accompanying text.
173. See CRS SBIC Report, supra note 136, at 23. Other minority groups have similar numbers: Asians (1.8%) and Native Americans (0.0%). Id.
174. CONG. RSCH. SERV., R41456, SBA SMALL BUSINESS INVESTMENT COMPANY PROGRAM 23 (2019) [hereinafter CRS SBIC Report 2019]. See also PAGLIA & ROBINSON, supra note 134, at 18 (finding that about 4% of the SBIC financings between June 1, 2013 and September 30, 2015 involved portfolio companies with a minority chief executive officer or president).
disbursed reveals a similar pattern. Black-owned businesses received 0.6% of the total disbursed funds, while Hispanic-owned businesses received 0.2%.\(^{175}\) Non-minority businesses, on the other hand, received a striking 97.6% of the total financing.\(^{176}\)

Although the SBA has acknowledged the problematic nature of these figures, it ultimately has no control over the SBICs’ decision-making process and cannot mandate racially-based investment quotas.\(^{177}\) Establishing programs to aid minority entrepreneurs is tricky, as the SBA does not have the statutory authority to proactively target racially diverse companies, and SBICs must provide financing to all qualifying small enterprises on an equal opportunity basis.\(^{178}\) As a result, the SBA instead focuses its efforts on encouraging SBICs to finance racially diverse portfolio companies and encouraging private equity funds with women or minority partners to apply to the SBIC Program.\(^{179}\)

That second effort is of particular interest, as funds led by minorities would be better suited to produce and digest the type of soft information necessary to invest in minority-owned businesses.\(^{180}\) As in private equity, the diversity of the SBIC investor base (i.e., the decisionmakers) mirrors the diversity of the businesses that receive funding.\(^{181}\) A 2016 study found that of the 303 active funds, 272 (89.8%) were non-racially diverse and 31 (10.2%) had at least one minority investment partner.\(^{182}\) Racially diverse SBICs were more likely to invest (and invest more) in minority-owned businesses than non-racially diverse SBICs.\(^{183}\) Despite these differences in their investment strategies, there were no significant differences in the financial performance of racially diverse and non-racially diverse SBICs.\(^{184}\)

\(^{175}\) CRS SBIC REPORT 2019, supra note 174, at 23.

\(^{176}\) Id. at 24.

\(^{177}\) See id. at 23–24.

\(^{178}\) See PAGLIA & ROBINSON, supra note 134, at 8–9.

\(^{179}\) Id. at 9.

\(^{180}\) This argument has been made by market actors, including the Small Business Investor Alliance (formerly known as the National Association of Small Business Investment Companies). See Full Committee Hearing on Increasing Capital for Small Business, Before the H. Comm. on Small Business, 111 Cong. 51–89 (Oct. 14, 2009).

\(^{181}\) See infra notes 208–211 and accompanying text.

\(^{182}\) PAGLIA & ROBINSON, supra note 134, at 17. These patterns are fairly stable across different types of funds. Of the 205 active debenture funds, only 21 (10.2%) were racially diverse. Id. To measure the racial diversity, the authors considered whether a SBIC’s investment team had at least one member from an ethnic or racial minority. Id. at 15.

\(^{183}\) Id. at 24–25.

\(^{184}\) See id. at 33 (concluding that “there is no apparent difference in performance between diverse SBIC funds and other funds”).
B. Broadening the Investor Base

Two common attributes of the government-sponsored programs discussed above render them ill-suited to meet the financing needs of small businesses, particularly those owned by minority entrepreneurs. First, these programs rely on large financial intermediaries to act as gatekeepers, and these types of institutions are not well adapted to collect and assess soft information from minority-owned businesses. The second limitation relates to each program’s heavy reliance on debt financing as a tool to promote entrepreneurship. As discussed below, for many small and young firms, debt is not necessarily the best source of financing. Moreover, innovative technological-driven schemes that were expected to help minority-owned businesses access equity financing have fallen short.

1. Private Equity

The first sources of financing used by entrepreneurs are personal funds (e.g., savings) and contributions from friends and family. Once these sources of capital are exhausted, the entrepreneur needs to seek external financing. Although established firms seeking outside financing often prefer to issue debt before equity, relying heavily on debt is often not the best choice for young firms. First, the cash-flow uncertainty faced by young businesses makes it difficult for them to commit to a schedule of fixed payments, as is expected under debt

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185. See supra notes 83–87 and accompanying text.

186. The reliance on debt for the SBA’s loan programs flows directly from the SBA guarantee of the loans made by banks to small businesses. See supra Section II.A.1. The reliance on debt instruments by SBICs when investing in small businesses is the result of the manner in which SBICs are capitalized and leveraged. See supra Section II.A.2.

187. Pollman, supra note 83, at 170 (“[F]ounders often ‘bootstrap’ the business using their own funds, and those of family and friends, to finance development efforts and early operations.”); Fourati & Affes, supra note 82, at 247 (noting that due to their lack of “historical and . . . reputation effects,” new firms are “informationally opaque” and this complicates attracting external financing).

188. See Pollman, supra note 83, at 170 (noting that once personal funds are exhausted start-ups must seek alternate sources of capital).

189. See Stuart Paul, Geoff Whittam & Janette Wyper, The Pecking Order Hypothesis: Does It Apply to Start-Up Firms, 14 J. SMALL BUS. & ENTER. DEV. 8, 9 (2007) (“[I]n the majority of cases . . . entrepreneurs move from self-funding to external equity as a means of financing their businesses in preference to, or instead of, bank finance.”); Fourati & Affes, supra note 82, at 246 (“Literature has recently introduced a revised version of the [pecking order theory], where external equity is preferred over external debt in the case of innovative firms.”); Paolo Fulghieri, Diego Garcia & Dirk Hackbarth, Asymmetric Information and the Pecking (Dis)Order, 24 REV. FIN. 961, 968–73, 991–92 (2020) (presenting a model explaining why small firms may prefer equity over debt financing when informational asymmetries are severe).
instruments. Second, the type of informational asymmetries that characterize small, young firms can actually make debt more expensive than equity, a reversal of the traditional pecking order.

For small, young businesses, raising equity capital from the public is not practical—the informational asymmetries and related transaction costs of a public offering are just too high. Entrepreneurs seeking external equity financing must thus turn to private equity investors, such as angel investors and venture capital firms, that specialize in funding startups. Sales of securities to these private equity investors are exempt from the registration requirements of securities laws, which reduces transaction costs. To manage the informational asymmetries involved in investing in a small business, private equity investors rely on informal relationship-based and geographically-focused screening and monitoring devices that are well-suited for the collection of soft information. Generally, these investors rely on their social and professional networks to identify and screen potential opportunities before personally assessing them, and then take an active role in managing their investments by providing contacts, strategic advice, and follow-on funding that can take a company.

190. See George Deeb, Comparing Equity, Debt and Convertibles for Startup Financings, FORBES (Mar 19, 2014, 2:25 PM), https://www.forbes.com/sites/georgedeeb/2014/03/19/comparing-equity-vs-debt-vs-convertibles-for-startup-financings/#6bd21c6169ff [https://perma.cc/Q782-LGXH]; Pollman, supra note 83, at 170 (“Traditional banks do not lend to startups, particularly in their early stages, due to their lack of a track record, negative cash flow, lack of tangible assets, and high failure rate.”); Huyghebaert & Van de Gucht, supra note 81, at 110 (“The reason is that debt generally is not a suitable financing source for high-growth firms: to finance their growth, firms need to make large investments upfront whereas cash flows will only realise in the future. As a result, it is difficult for firms to pay off their debts from internally generated sources and equity is a more suitable financing source.”).

191. See Paul, Whittam & Wyper, supra note 189, at 9 (“The evidence presented shows that in the majority of cases a bridged pecking order applies in that entrepreneurs move from self-funding to external equity as a means of financing their businesses in preference to, or instead of, bank finance.”); Carmen Cotei & Joseph Farhat, The Evolution of Financing Structure in U.S. Startups, 19 J. ENTREPRENEURIAL FIN. 1, 12 (2017) (“[I]nformationally opaque firms are less likely to use outsiders’ debt, credit line, credit card, and bank loan capital injections. . . . [Attributable to the fact that] informationally opaque firms are less likely to access debt financing due to severe frictions in the debt markets.”).

192. For a discussion of the rules governing the public offering process and their disparate impact on small businesses see infra notes 223–231 and accompanying text.

193. See Pollman, supra note 83, at 170 (“Two types of investors specialize in financing startups: angel investors and VCs.”).

194. See id. at 163–65.

195. See infra notes 223–231 and accompanying text.

196. See Pollman, supra note 83, at 171–73.

197. See supra notes 100–102 and accompanying text.
on an entirely different trajectory. This last point highlights a key advantage of having an equity investor for young, small businesses, as creditors lack the ability or incentives to provide the valuable ongoing business advice and networking opportunities that equity investors do.

Although private equity’s organizational structure and investment strategy are tailor-made for the collection and assessment of soft information—precisely the type of information that those seeking to invest in minority-owned businesses would need to rely on—minority entrepreneurs do not appear to enjoy ready access to this financing channel. Minority-owned startups are significantly less likely to obtain equity financing from venture capital firms and angel investors. Consequently, an extremely low percentage of minority businesses are backed by private equity: only 1% of venture-capital-backed startups are led by African Americans. Remarkably, these racial disparities do not reflect the profitability of venture capital funds that specialize in minority-


199. See Paul, Whitam & Wyper, supra note 189, at 9 (“Rather than the external equity being regarded as expensive, it is viewed as good value as a well-chosen investor can add business skills and social capital in the form of commercial contacts and access to relevant networks.”); Timothy Bates & William D. Bradford, Venture-Capital Investment in Minority Business, 40 J. MONEY, CREDIT & BANKING 489, 501–02 (2008) (finding that active guidance and assistance by minority-focused venture capital funds adds value to the portfolio company, thus increasing the funds’ rate of return).

200. See John K. Paglia & Maretno A. Harjoto, The Effects of Private Equity and Venture Capital on Sales and Employment Growth in Small and Medium-Sized Businesses, 47 J. BANKING & FIN. 177, 189 (2014) (finding that small and mid-sized minority-owned businesses were less likely to receive private equity (-21.7%) and venture capital (-22.2%) funding); ICIC REPORT, supra note 8, at 8 (“While a similar share of minority- and nonminority-owned businesses tried to raise capital, only half of the minority-owned businesses that tried to raise equity were successful, compared to 84 percent of nonminority-owned businesses.”).

owned businesses, which earn returns that are at least as large as those offered by mainstream funds. The undeniable reality, however, is that few private equity funds target minority-owned businesses. Even venture capitalists now acknowledge their failures to fund non-white enterprises and the resulting lack of diversity in their portfolio companies.

Multiple factors explain why minority businesses are underserved by private equity. Minority businesses tend to be located in inner cities, geographically removed from venture capital networks, which complicates relationship-driven screening and monitoring. Moreover, the venture capital industry has traditionally focused on companies engaging in innovation or technology, not the types of activities generally pursued by minority entrepreneurs.

A third explanation also fits within the framework developed in this Article. Private equity firms are not diverse themselves: racial disparities

202. The MESBIC program (the predecessor of the SSBIC) gave birth to a small minority-focused venture capital industry. See Bates & Bradford, supra note 199, at 492.

203. See Fairlie & Robb, supra note 11, at 20; Bates & Bradford, supra note 199, at 490 (“Overall, the measured investment returns generated by the minority-focused VC funds were broadly consistent with those of mainstream funds.”); Timothy Bates, William Bradford & Julia Sass Rubin, The Viability of the Minority-Oriented Venture-Capital Industry Under Alternative Financing Arrangements, 20 Econ. Dev. Q. 178, 186–87 (2006) (finding that minority-focused venture capital funds had financial returns that were comparable to or better than those of conventional venture capital); Rubin, supra note 100, at 824–25 (“These funds’ strong financial performance undermines the possibility that companies owned by entrepreneurs of color attract fewer venture capital investments because they do not represent a financially attractive investment opportunity.”).


207. See supra note 59 and accompanying text; Pollman, supra note 83, at 166 (“Early-stage startups are highly entrepreneurial and focused on innovation and technology.”); Gompers & Lerner, supra note 198, at 190 (“[Venture capitalists focus] on high-technology firms (e.g., communication, computers, electronics, biotechnology, and medical/health).”).
in venture capital financing mirror disparities in investors’ demographics.208 As a result, private equity investors—mostly white males—and minority-entrepreneurs belong to different social, cultural, and professional networks.209 These demographic differences increase the costs for investors to collect the soft information needed to identify, assess, and monitor minority-owned businesses, leaving them in a position where implicit biases may influence their decision-making.210 In sum, while investing in minority-owned businesses can be lucrative, success here requires specialized knowledge and unconventional research, placing most private capital funds at a competitive disadvantage because of their location, industry focus, and demographic makeup.211

Small businesses that struggle to access outside equity are invariably placed in a situation where they either do not have enough external financing or must rely on excessive and expensive leverage that can put the operational and financial health of the business at risk.212 In recent

208. See Thorne, supra note 29 (noting lack of diversity in the venture capital industry). A survey of venture capital investors found that “87 percent were Caucasian, nine percent were Asian, two percent were African American or Latino, and two percent were of mixed race.” See NVCA Forms Diversity Task Force to Foster Greater Inclusion Across the Innovation Ecosystem, NAT’L VENTURE CAP. ASS’N BLOG, https://nvca.org/pressreleases/nvca-forms-diversity-task-force-foster-greater-inclusion-across-innovation-ecosystem/ [https://perma.cc/R3PS-U9DT] (last visited Feb. 20, 2021). The low rate of minority-owned business making their pitch to angel investors also reflects the low proportion of minority individuals among angel investors. See JEFFREY SOHL, CTR. FOR VENTURE RSCH., THE ANGEL INVESTOR MARKET IN 2008: A DOWN YEAR IN INVESTMENT DOLLARS BUT NOT IN DEALS, https://scholars.unh.edu/cgi/viewcontent.cgi?article=1006&context=cvr [https://perma.cc/JYH7-7F6B] (noting that 3.6% of angel investors were minorities and that 3.7% of businesses pitching their business ideas to angel investors were minority-owned); Stricherz, supra note 201.

209. See supra notes 99–102 and accompanying text.

210. See Barr, supra note 206, at 15–16 (“One likely reason that minorities are disproportionately underserved by institutional sources of venture capital may be an information failure that results from a lack of common networks.”); Rubin, supra note 100, at 824–25 (“Leaving aside possible discrimination, the most likely reason that minority and female entrepreneurs are disproportionately underserved by the venture capital industry is the information failure that results from a lack of common networks . . . .”). See also supra notes 103–104 and accompanying text. Notably, a piece of advice often given to black entrepreneurs, hiring a white wing-man, is a strategy that addresses this informational problem. See Anand & McBride, supra note 205.

211. See FAIRLIE & ROBB, supra note 11, at 6, 19–20, 22. Anecdotal evidence indicates that funds focused on minority-owned businesses use unconventional, relationship-based networks to identify investment opportunities. See Timothy Bates & William Bradford, Traits and Performance of the Minority Venture Capital Industry, 613 ANNALS AM. ACAD. POL. & SOC. SCI. 95, 106 (2007); Rubin, supra note 100, at 825.

212. Susan Coleman & Richard Cohn, Small Firms’ Use of Financial Leverage: Evidence from the 1993 National Survey of Small Business Finances, 12 J. BUS. & ENTREPRENEURSHIP 81, 83–84 (2000) (noting that small firms generally cannot access equity capital and thus may overrely on debt which, can make them “susceptible to the problems of financial distress and failure”).
years, technological and regulatory developments have spurred new financing channels that seek to remedy some of the difficulties faced by small businesses in raising equity capital and less-expensive debt capital.\textsuperscript{213} A common strategy is to minimize frictions by reducing the role of financial intermediaries that stand between the ultimate suppliers of capital and issuers.\textsuperscript{214} The rise of the internet has led to the development of online platforms that allow entrepreneurs to connect directly with both debt and equity investors, bypassing these financial intermediaries.\textsuperscript{215} For many, this made crowdfunding and other financial technology (FinTech) developments, such as online lending platforms, promising game-changers.\textsuperscript{216}

\textsuperscript{213} See Joern H. Block, Massimo G. Colombo, Douglas J. Cumming & Silvio Vismara, \textit{New Players in Entrepreneurial Finance and Why They Are There}, 50 SMALL BUS. ECON. 239, 240 (2018) (“These new players and instruments have emerged, among others, because of the difficulties faced by entrepreneurs and early-stage new ventures in raising funds . . . .”).

\textsuperscript{214} See id. at 247 (“[T]he value of intermediation is now questioned as innovations allow to by-pass intermediaries so that the participants at the end of the supply and demand chain (i.e., savers/investors and borrowers/fund raisers) meet directly.”).

\textsuperscript{215} See id. (“[T]he development of online platforms has created new opportunities for entrepreneurs to raise seed capital and for non-professional investors to disintermediate their investments. By easing the manner in which demand for capital meets supply, recent financial innovations are expected to improve the efficiency of financial markets.”).

\textsuperscript{216} Online lending platforms have recently become a source of debt financing for small business, particularly minority-owned, that have been underserved by traditional banking. See Usman Ahmed, Thorsten Beck, Christine McDaniel & Simon Schropp, \textit{Filling the Gap: How Technology Enables Access to Finance for Small- and Medium-Sized Enterprises}, 10 INNOVATIONS 34, 35–36 (2016). A number of reasons may be driving this trend. Online platforms might use decision-making algorithms that consider hard, verifiable information in a more objective manner than a loan officer does (though attenuated biases do still remain). See Robert Bartlett, Adair Morse, Richard Stanton & Nancy Wallace, \textit{Consumer-Lending Discrimination in the FinTech Era} at 6–7 (Nov. 2019), https://faculty.haas.berkeley.edu/morse/research/papers/discrim.pdf [https://perma.cc/3A9C-62BN]. Various online lending platforms are marketed towards underserved populations. See Mark Schweitzer & Brett Barkley, \textit{Is “Fintech” Good for Small Business Borrowers? Impacts on Firm Growth and Customer Satisfaction} 11 (Fed. Resr. Bank of Cleveland, Working Paper No. 17-01, 2017). Though promising, the effectiveness of such platforms in bridging disparities is an open question. First, these platforms focus only on debt (not on equity or hybrid instruments) and are not tailored to gather and assess soft information problems and provide advice to the business they invest in. See Block, Colombo, Cumming & Vismara, supra note 213, at 241–42, 246–47. The terms of these loans are also far from ideal. See Brett Barkley & Mark E. Schweitzer, \textit{The Rise of FinTech Lending to Small Businesses: Businesses’ Perspectives on Borrowing} 18 (Fed. Resr. Bank of Cleveland, Working Paper No. 20-11, 2020). The size of loans disbursed by online lenders are smaller than those of traditional lenders. \textit{Id.} at 18. Moreover, the unregulated nature of these markets subjects borrowers to potential abuses, including worse terms and higher interest rates than traditional banking. See Lenore Palladino, \textit{Another Risk for Small Business: Lightly Regulated Fintech Loans}, BARRONS (April 21, 2020), https://www.barrons.com/articles/small-businesses-risk-predatory-loans-to-survive-51587492858 [https://perma.cc/R4F2-HRZJ]; Lenore Palladino, \textit{Small
2. CROWDFUNDING

Crowdfunding initially developed to support ventures by facilitating donations or product repurchases.\textsuperscript{217} The revolutionary feature of crowdfunding was empowering individuals to “directly” interact with members of the public via online platforms in order to raise funds, cutting out middlemen.\textsuperscript{218} Early funding platforms followed the reward and prepurchase models, where “investors” willing to fund a particular project would receive a copy of the product being created or a “reward” related to the funded project.\textsuperscript{219} Crowdfunding soon emerged as an alternative vehicle to raise relatively small amounts of capital from retail investors.\textsuperscript{220} Early microfinance portals allowed investors to lend money to microentrepreneurs for return of principal and nominal interest.\textsuperscript{221} The application of federal securities laws, however, limited the development of crowdfunding as a vehicle for more sophisticated debt instruments and equity investments.\textsuperscript{222}

\textit{a. The Evolution of Crowdfunding}

A business offering or selling securities must prepare a set of disclosure documents, including a registration statement (filed with the Securities and Exchange Commission, or SEC) and a prospectus to be distributed to investors.\textsuperscript{223} In addition, a set of “gun jumping” rules regulate the timing, manner, and form of communications made during the

\begin{thebibliography}{99}
\bibitem{219} See Bradford, supra note 217, at 16–17.
\bibitem{221} See id. at 25–26.
\bibitem{222} See Bradford, supra note 217, at 29–31.
\end{thebibliography}
offering process. Preparing the required disclosure documents and complying with the gun jumping rules is time consuming and costly. The significant fixed component of these compliance costs disproportionately affects smaller businesses.

To avoid these costs, issuers conduct exempt offerings. One of the most commonly used exemptions is Rule 506, under which an issuer may offer and sell, without registration, an unlimited aggregate principal amount of securities to any number of “accredited investors” so long as certain other conditions are met. However, the numerous conditions of Rule 506 limit the usefulness of this exemption for small businesses, especially those owned by minorities.

Exempt offerings generally involve accredited investors exclusively, and an entrepreneur who does not know or have ready access to these accredited investors will have a difficult time conducting a successful exempt offering.

The costs and difficulties faced by small businesses and minority-owned businesses in tapping accredited investors, who generally belong to a different social and professional network, made crowdfunding a

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224. See Carlos Berdejó, Going Public After the JOBS Act, 76 OHIO ST. L.J. 1, 9–10 (2016). Non-compliance with any of the requirements contained in the rules can result in substantial liability for the issuer. Id. at 10.

225. Id. at 10.


227. See Berdejó, supra note 224, at 20. The primary statutory exemption for private placements is Section 4(a)(2) of the Securities Act, which exempts “transactions by an issuer not involving any public offering.” 15 U.S.C. § 77d(a)(2). Since the statute does not define “public offering,” see 15 U.S.C. § 77b, the SEC promulgated Regulation D to provide clarity and predictability in the use of this exemption. See Heminway & Hoffman, supra note 223, at 915–18 (highlighting clarifying purpose of Regulation D).

228. See Berdejó, supra note 224, at 28.

229. 17 C.F.R. § 230.506(b)(2)(ii) (2020). The term “accredited investor” includes institutional investors such as banks, insurance companies, registered investment companies, and SBICs, as well as individuals with a net worth over $1 million or annual income over $200,000. §§ 230.501(a)(1)–(6).

230. See § 230.506(b) (requiring businesses to meet all terms and conditions of §§ 230.501–502, not exceed the purchaser limit, and ensure purchasers have the requisite level of sophistication).

231. Reaching out to investors to attract their attention is not easy given that issuers cannot use “any form of general solicitation or general advertising” as part of an offering involving any non-accredited investors. § 230.502(c). This prohibits the use of advertising, newspaper or magazine articles, Internet websites, media broadcasts, email campaigns, and public meetings to promote an offering. See Berdejó, supra note 224, at 28–29.
revolutionary and exciting financing vehicle.\textsuperscript{232} As part of its efforts to facilitate capital raising by small issuers, the JOBS Act of 2012 created a new exemption under the Securities Act for capital raised through “crowdfunding,” enabling the use of the internet to pool small individual investments.\textsuperscript{233} These offerings are open to a wide variety of investors, not just accredited ones.\textsuperscript{234} The exemption’s set of relaxed requirements not only expands the pool of investors that small businesses can tap but also reduces the costs of raising capital by providing for scaled disclosure requirements, which vary according to the aggregate offering amount.\textsuperscript{235}

\textit{b. The Promise and Shortcomings of Crowdfunding}

The Obama Administration promoted the JOBS Act as a tool to improve access to capital for minority- and women-owned businesses,\textsuperscript{236} touting the important role of crowdfunding in “empower[ing] diverse entrepreneurs to launch successful businesses after traditional sources of

\begin{footnotesize}
\begin{enumerate}
\item Sherwood Fouse, supra note 220, at 32. The Act limits the amount individuals may invest in crowdfunded offerings. These yearly limits are based on an investor’s income or net worth and range from $2,000 to $100,000. 15 U.S.C. § 77d(a)(6).
\end{enumerate}
\end{footnotesize}
capital turned them down.”237 The Administration’s optimism reflected the idea that crowdfunding could provide an avenue for the democratization of capital markets for small businesses, particularly minority-owned ones.238 Many hoped that providing minority-owned businesses with direct access to individuals eager to invest in them would level the playing field.239

A recent SEC report found that the number of crowdfunding offerings and the total amount of funding has been “relatively modest.”240 Market participants have made a number of proposals to revitalize crowdfunding, including increasing the amount a company can raise during a 12-month

237. See Thomas Kalil & Doug Rand, The Promise of Crowdfunding and American Innovation (June 8, 2016), https://obamawhitehouse.archives.gov/blog/2016/06/08/promise-crowdfunding-and-american-innovation [https://perma.cc/2NDY-LST9]; Stricherz, supra note 201 (analyzing blog posts by the Obama Administration suggesting that crowdfunding under the JOBS Act was intended to help minority businesses).


period,241 increasing individual investors’ investment limits,242 and reducing the reporting and disclosure obligations that, as is, are too burdensome and costly for many of the small issuers that rely on the rule.243 The SEC has recently proposed a series of revisions to the existing rules to address many of these concerns.244 Participation rates among traditionally underrepresented businesses have been discouragingly low during the early years of equity crowdfunding.245 Although some minority entrepreneurs have successfully employed crowdfunding to raise capital for their businesses,246 the existing evidence suggests that crowdfunding has not

241. See LINDSAY M. ABATE, U.S. SMALL BUS. ADMIN., OFF. OF ADVOCACY, ONE YEAR OF EQUITY CROWDFUNDING: INITIAL MARKET DEVELOPMENTS AND TRENDS 8, 13 (2018), https://www.sba.gov/sites/default/files/advocacy/Crowdfunding_Issue_Brief_2018.pdf [https://perma.cc/3SA7-Y95K] [hereinafter SBA Study]; Policy Position Paper, ASS’N OF ONLINE INV. PLATFORMS (June 18, 2019), https://www.aoiplatforms.org/official-positions [https://perma.cc/R9MX-7NW6], [hereinafter AOIP Paper] (“The current $1.07 million cap is arbitrary and creates a negative selection bias for companies— as quality companies requiring larger amounts of capital are discouraged from utilizing Reg CF.”); SEC CF Report, supra note 240, at 37 (citing one platform as stating that “while few offerings reach the current limit, many issuers choose not to rely on the crowdfunding exemption because the limit is too low”). Proposals recommend limits ranging from $5 to $20 million, more in line with average early-stage funding of start-ups. Id. (citing recommended limits ranging from $5 million to $20 million); AOIP Paper, supra, at 1 (recommending limit be increased to $10 million while noting that the “average early-stage funding round is . . . $7 million”).


243. See id. at 3; SEC CF Report, supra note 240, at 24 (noting that the most costly portion of a crowdfunding campaign relates to disclosure). Other costs include the creation of a campaign page and other marketing expenses. See id. at 23 (“[T]he total cost of creating a campaign page, issuer disclosures, film, and video, and hiring a marketing firm, a lawyer, and an accountant amounts to approximately 5.3% of the amount raised.”).

244. See SEC Proposed CF Amendments, supra note 233, at 17,994 (proposing to increase the crowdfunding ceiling from $1.07 to $5 million and placing no limits on how much accredited investors invest in crowdfunding offerings).

245. See SBA Study, supra note 241, at 13 (noting that businesses in areas not already considered technology and finance hubs have struggled).

246. See, e.g., Brandon Andrews, The Best New Way for African Americans to Invest In or Start a Business: Equity Crowdfunding, BLACK ENTER. (Feb. 8, 2018), https://www.blackenterprise.com/equity-crowdfunding-black-investors-entrepreneurs/ [https://perma.cc/YIQ3-UVYG] (providing examples of minority founders who have been successful in equity crowdfunding). Some of these success stories were publicized by the Obama administration as it promoted the JOBS Act. For example, the White House honored a minority female who was able to open a bookstore with the help of crowdfunding after banks had declined her loan applications. See Aurora Anaya Cerda, More than a Bookstore (June 6, 2013, 4:22 PM), https://obamawhitehouse.archives.gov/blog/2013/06/06/more-bookstore [https://perma.cc/539B-QS4Q]. For other similar examples, see Emily Nunez, Taking ‘Made in the USA’ to the Next Level (June 6, 2013, 4:36 PM), https://obamawhitehouse.archives.gov/blog/2013/06/06/taking-made-usa-next-level [https://perma.cc/K8MG-7Y9K]; Kalil & Rand, supra note 237.
been effective in reducing disparities in access to capital between minority and non-minority entrepreneurs.\textsuperscript{247} The prevalence of racial disparities in the crowdfunding space is consistent with discrimination in other FinTech markets, like online lending platforms, that have otherwise facilitated borrowings by small businesses.\textsuperscript{248} What can explain the underwhelming performance of these promising game-changers? A recent study of crowdfunded equity offerings found that, even when minority entrepreneurs attract a higher number of investors, they are no more likely to secure their target funding.\textsuperscript{249} That is, minority entrepreneurs tend to attract “small investors” (who follow a “community logic”) rather than “professional investors” (who follow a “market logic”) and, as a result, raise less capital than their non-minority counterparts.\textsuperscript{250} Why are “professional investors” who follow a “market logic” hesitant to invest in minority businesses?\textsuperscript{251} One leading theory is that implicit biases drive investors in the crowdfunding markets away from minority-owned businesses.\textsuperscript{252} This should not be surprising. Investing in small, minority-owned businesses requires the collection and analysis of soft information, and the collecting and analyzing of such information is not cost-effective for individual retail investors involved in crowdfunding. These unresolved informational asymmetries place these investors in a position where they can ultimately


\textsuperscript{250} See Cumming, Meoli & Wismara, supra note 249, at 16.

\textsuperscript{251} See generally Rhue, supra note 248, at 198–99.

\textsuperscript{252} See Rhue & Clark, supra note 247, at 2, 7, 11, 23 (finding that Black founders who conceal their race in their fundraiser photos perform better than campaigns where Black founders have Black fundraiser pictures); Younkin & Kuppuswamy, supra note 247, at 3274 (noting that in a setting where entrepreneurs can provide a picture, “projects from black founders continue to underperform projects from non-black founders and those without a founder picture”).
be influenced by their implicit biases, very much like banks and private equity investors so often are.253

Some have argued that concealing the race of the entrepreneur is the most effective way to address investor biases and even the playing field.254 Other arguments acknowledge the role of implicit biases but suggest that alternative strategies, such as project promotion, are just as effective in addressing informational issues.255 Allowing promising projects to differentiate themselves from the “crowd” (i.e., allowing them to credibly signal their quality) could help minority entrepreneurs with good ideas raise capital and grow, which in turn may enhance the social perception of minority business.256 Differentiation can be a particularly powerful tool if minority businesses are (or are perceived to be) on average less profitable or present less opportunity for growth than non-minority businesses.257

III. DESIGNING AN ALTERNATIVE APPROACH

A program that seeks to facilitate minority entrepreneurs’ access to capital must address the shortcomings of the initiatives discussed in Part II. First, it must enable the use of equity and hybrid securities to accommodate the operational needs of small businesses while alleviating informational asymmetry issues.258 Second, it must facilitate the production and analysis of soft information in a cost-effective manner by minimizing the level of hierarchies in decision-making.259 Third, it must present this soft information to potential investors in a credible manner to allow for differentiation.260 Fourth, it must provide an active role for

253. See supra notes 103–105 and accompanying text.
254. See Youkin & Kuppuswamy, supra note 247, at 3286. The nature of crowdfunding platforms makes it possible to conceal an entrepreneur’s race by not showing a picture of the entrepreneur or disclosing his or her race. See id. at 3283, 3286 (concluding that Black founders may improve their chances of success in raising money through crowdfunding by choosing a profile picture with race obscured or with a company logo). Similar concealment tactics are employed by female entrepreneurs to overcome gender biases. See Edwards & McGinley, supra note 104, at 1877, 1879 (describing techniques used by women in technology “to pass for an idealized masculine identity or to cover their otherwise stigmatized identities . . . for the purpose of accessing social and economic resources”).
255. Youkin & Kuppuswamy, supra note 247, at 3270. Project promotion may be more effective because it can be extremely difficult, if not almost impossible, to effectively conceal race since campaigns contain multiple racial signals, ranging from the entrepreneur’s name to project description. See Rhue & Clark, supra note 247, at 8, 13. Moreover, in a space where “authenticity leads to success,” anonymous campaigns could still face an uphill battle to be successful in attracting support. See id. at 2, 11.
256. See Youkin & Kuppuswamy, supra note 247, at 3270, 3285–86.
257. See id. at 3270–71, 3285–86.
258. See supra notes 188–212 and accompanying text.
259. See supra notes 93–100 and accompanying text.
260. See supra notes 255–257 and accompanying text.
investors in advising and counseling entrepreneurs on an ongoing basis.\textsuperscript{261} Fifth, it must be inclusive, enabling the participation of retail investors to further democratize the capital markets and provide a channel for grassroots efforts to address economic racial disparities.\textsuperscript{262}

Existing government programs have failed because of their reliance on debt as a financing mechanism and on large, hierarchical institutions that are ill-suited to navigate a niche imbued with soft information to act as gatekeepers.\textsuperscript{263} Crowdfunding’s disintermediation strategy has failed because well-intentioned investors seeking a financial return are unable to overcome informational asymmetries on an individual basis and fall prey to their own implicit biases.\textsuperscript{264} Although private equity’s organizational structure and investment strategy appear to be ideally suited for this task, the lack of diversity in its management ranks has rendered these tools ineffective in addressing the financing needs of minority-owned businesses.\textsuperscript{265} As leaders in the industry come to recognize the racial disparities in their portfolio companies and the need for change, we must figure out how to increase private equity participation in minority-owned businesses.\textsuperscript{266}

One possibility is to mandate such investments via regulatory mechanisms such as the Community Reinvestment Act.\textsuperscript{267} A similar possibility is to require that private equity funds increase the racial, industrial, and geographical diversity of their management ranks so that they are better positioned to successfully invest in minority-owned businesses.\textsuperscript{268} Coercive solutions like these, however, are unlikely to address the underlying structural problems and be sustainable in the long run. A wiser approach is to recruit private equity, not just as part of the solution, but as a partner in developing it alongside the government and members of the community. This can be achieved by channeling government and community efforts to provide actors in the private equity space the incentives to start investing in minority-owned businesses and retaining managers that are members of minority groups who can more

\textsuperscript{261} See supra note 199 and accompanying text.

\textsuperscript{262} See supra notes 236–239 and accompanying text.

\textsuperscript{263} See supra notes 127–133, 172–184 and accompanying text.

\textsuperscript{264} See supra notes 251–257 and accompanying text.

\textsuperscript{265} See supra notes 103–104, 208–211 and accompanying text.

\textsuperscript{266} See James Thorne, Funds, Recruiting and Support: VCs Address Diversity and Inequality, PITCHBOOK (June 8, 2020), https://pitchbook.com/news/articles/vcs-address-diversity-institutional-bias?sourceType=NEWSLETTER [https://perma.cc/6797-XF9L] (“Against a backdrop of widespread protests over the killings of black Americans, the venture capital industry has been forced to reckon with its own staggering lack of diversity.”).

\textsuperscript{267} See Rubin, supra note 100, at 829 (“The federal government also can increase private sources of subsidy by strengthening the [Community Reinvestment Act] and expanding its reach to more types of financial institutions.”).

\textsuperscript{268} See supra notes 208–211 and accompanying text.
effectively screen and monitor these investment opportunities. This sort of organic solution is more likely to motivate a positive feedback process, promote diversity within private equity ranks, and lead to the development of a self-sustaining industry, in a way much like how the early SBIC program gave birth to the venture capital industry.\(^{269}\)

The first section of this Part outlines the basic structure for such a program using existing and past government initiatives as building blocks. The second discusses how to overcome some of the legal and policy hurdles that might hinder its successful implementation. The last discusses fiscal strategies to help capitalize the program and spread the risks involved to facilitate private equity’s entry into this market.

A. Local Impact Small Business Investment Companies

The existing regulatory and market framework governing SBICs can provide the building blocks from which to design a new program. To facilitate our discussion, let us label a new type of SBIC, the “Local Impact Small Investment Company” (LISBIC). LISBICs will match investors (institutional and retail) seeking to finance minority-owned businesses with those businesses by raising capital from those investors through the issuance of LISBIC equity securities and then pool that capital to invest in minority-owned businesses.\(^{270}\) Properly vested with decision-making authority in a flat hierarchical structure, the LISBIC manager would be in a good position to collect soft information about potential investment opportunities and credibly signal this information to investors by its willingness to absorb some of the risks involved.\(^{271}\) The LISBIC manager would be able to negotiate terms with the issuer on behalf of all investors and structure these transactions by employing equity or hybrid securities.\(^{272}\) Post investment, the LISBIC can mentor the company on an ongoing basis and periodically decide whether additional amounts should be invested, subject to any regulatory ceilings.\(^{273}\)

The underwhelming history of Minority Enterprise SBICs (MESBICs) (and their successors, SSBICs) provide a cautionary tale of what happens when funds are unable to raise enough capital to cover operating costs and achieve a minimum size to diversify their portfolio and

\(^{269}\) See supra notes 167–168 and accompanying text.

\(^{270}\) See supra note 262 and accompanying text.

\(^{271}\) See supra notes 259–260 and accompanying text. Requiring that LISBICs invest in local companies (i.e., located near the manager and investors) could facilitate achieving these objectives.

\(^{272}\) See supra note 258 and accompanying text; SEC CF Report, supra note 240, at 58.

\(^{273}\) See supra note 261 and accompanying text; SEC CF Report, supra note 240, at 58.
engage professional managers with the requisite expertise. Minority-business focused venture capital funds provide us a sense of the required scale: their median capitalization is about $30 million, and their preferred investment begins at the $1 million range. LISBICs could initially tap three sources to obtain this level of required capital.

The first group would be institutional investors like pension funds, banks, and insurance companies that already provide the largest contributions to venture capital funds targeting minority-owned businesses. Recruiting pension funds should not be complicated, as investing in minority-owned businesses fits their political strategy. For banks, investing in a fund licensed as an SBIC is even more attractive as it provides a number of regulatory advantages over other investments. To maintain the right perspective among the LISBIC investor base, LISBICs should raise a share of their capital from non-institutional investors in crowdfunding-style offerings. Including retail investors would help deliver crowdfunding’s promise of democratizing capital; provide an additional avenue for investors following a “community logic” to effectively support businesses they care about; and help ensure that

274. See Bates, supra note 61, at 354.
275. See Bates & Bradford, supra note 199, at 490 (“The minority-oriented funds are typically small relative to the VC industry mainstream, starting out with a median capitalization of under $30 million.”). See also Bates, supra note 61, at 354 (“Small-business investment companies typically benefit from operational scale economies if they have at least $20 million in assets.”).
276. See Bates & Bradford, supra note 199, at 499 (“Managers of the minority-oriented VC funds indicate that their preferred investment size is the $1 million to $2 million range, considerably more than the $747,517 mean . . . .”). See id. at 492 (“The funds responding to our survey raised over $2.1 billion from institutional investors, the largest of which were public pension funds, commercial banks, and insurance companies.”).
277. See id. (“State pension funds that invest in minority VCs have high proportions of minority residents in their respective states: MBE-targeted in vesting is politically popular.”).
278. See id. (“State pension funds that invest in minority VCs have high proportions of minority residents in their respective states: MBE-targeted in vesting is politically popular.”).
279. For example, through their SBIC investments, banks may own indirectly more than 5% of the voting stock of a small business and bypass general prohibitions from owning interest in or sponsoring a private equity fund. Compare 12 C.F.R. § 225.22(d)(5) (2020) (stating that acquisitions of less than 5% do not require Board approval), and 12 U.S.C. § 1843(c)(6) (stating that an ownership share of less than 5% is exempt from the prohibition on owning or controlling an entity that is not a bank), with 12 C.F.R § 225.11(b) (2020) (stating that a bank may acquire ownership or control of an SBIC subject to some limits). Additionally, banks receive Community Reinvestment Act credit for SBIC investments since these are presumed by regulatory agencies to be a “qualified investment” for such purposes. See OCC SBIC Report, supra note 135, at 4–5; SBIC Overview, supra 135, at 2. Participating in a LISBIC would also give banks the opportunity to establish relationships with companies that are not ready for “big bank debt” but that may be so in the future. See Stephen Newton, Demystifying SBICs for Community Banks, ABA BANKING J. (Oct. 9, 2017), https://bankingjournal.aba.com/2017/10/demystifying-sbics-for-community-banks/ [https://perma.cc/W9C8-6LZK]; Rubin, supra note 100, at 829.
LISBICs are managed in a manner that promotes social change. The presence of a manager screening and monitoring portfolio companies would attract those retail investors who follow a “market logic” and who have so far been hesitant to support minority-owned businesses in crowdfunding offerings. Finally, the government could provide financial support to LISBICs directly via leverage (as it does with SBICs) or indirectly via tax exemptions.

B. Implementation of the LISBIC program

Organizing and operating a LISBIC in the manner envisioned above raises a number of legal questions. Facilitating access to capital is key, but the application of the Securities Act might increase the costs LISBICs face in raising capital. Registration and reporting obligations under the Investment Company Act of 1940 (ICA) could also increase the costs of organizing and operating a LISBIC. Protecting small, retail investors who are entrusting the LISBIC manager with their money and ensuring that the LIBIC manager adheres to the investment objectives of the LISBIC is another consideration. This section addresses these issues.

1. SECURITIES ACT CONSIDERATIONS

Relying on an intermediary introduces an additional securities transaction. First, the LISBIC must raise funds from the investors by issuing and selling security interests in the LISBIC. Once it has pooled such funds, the LISBIC would then invest in small businesses by purchasing securities issued by the latter. As those two sets of transactions are subject to the Securities Act, we need to find an exemption from registration that works for each. Obtaining an exemption for the second transaction is straightforward. The availability of Regulation D to exempt the sale of securities by a small business to the LISBIC hinges on the LISBIC’s status as an accredited investor, a term that explicitly includes licensed SBICs. Raising money from investors poses a less trivial question. Looking at the exemptions relied upon by SBICs is not very helpful, as these entities raise money via Rule 506 of Regulation D, which would be unavailable for LISBICs raising money from non-accredited

280. See supra notes 236–238, 245–246 and accompanying text.
281. See supra notes 249–250 and accompanying text.
282. See infra Part III.C.
285. See supra notes 223–231 and accompanying text.
retail investors. Two alternatives designed to accommodate financing small, retail investors are considered below.

\textit{a. Crowdfunding}

Existing crowdfunding regulations prohibit entities that qualify as investment companies from relying on the crowdfunding exception. As a result, a LISBIC would not be able to raise funds from non-accredited investors under the crowdfunding exemption if they qualified as investment companies. There are two ways of addressing this problem. First, LISBICs could be exempted from the definition of investment companies. Another option is to amend the crowdfunding rules to allow certain entities that would qualify as investment companies to instead rely on the crowdfunding exemption. In fact, various market participants and the SEC have already considered the possibility of amending the crowdfunding laws to allow certain special purpose vehicles organized to invest in a single company (which fall under the investment company exclusion) to be able to raise money using the crowdfunding exemption. Those modifications to the crowdfunding rules, which the SEC has now proposed, provide a springboard to the requisite exemptive language for LISBICs.

\footnote{See Investment Company Registration and Regulation Package, U.S. SEC. & EXCH. COMM’N (Dec. 21, 2014), https://www.sec.gov/investment/fast-answers/divisions/investmentinvcoreg121504htm.html [https://perma.cc/CDV3-GSFQ] [hereinafter SEC ICA FAQs]. The author also conducted his own analysis of SEC filings by SBICs listed in the SBA official directory.}


\footnote{See infra Section III.B.2.}

\footnote{See SEC CF Report, supra note 240, at 57–58 (noting proposals that “recommended allowing the use of SPVs to promote simplification of the capitalization table by aggregating investors”); U.S. DEP’T. OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES CAPITAL MARKETS 41 (2017) (recommending “allowing single-purpose crowdfunding vehicles advised by a registered investment adviser”); U.S. SEC. & EXCH. COMM’N., 2015 SEC GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION FINAL REPORT 26–27 (2016) (recommending that the SEC permit investments by SPVs, including those that share an adviser, and determine that such SPVs are not “investment companies”). These proposals recommend the use of an SPV to address concerns that the large number of crowdfunding investors can become unmanageable and raise corporate governance and finance complications. See SEC CF Report, supra note 240, at 58; Nicholas Tommarello, Until Congress Acts, Don’t Invest in Startups to Make Money, FORBES (July 22, 2016), https://fortune.com/2016/07/22/equity-crowdfunding/ [https://perma.cc/A4NN-P5JK].}

\footnote{See SEC Proposed CF Amendments, supra note 229, at 17,997 (proposing “a new exclusion under the Investment Company Act for limited-purpose vehicles (‘crowdfunding vehicles’) that function solely as conduits to invest in businesses raising capital through the vehicle under Regulation Crowdfunding”).}
Additional changes to the rules would also be necessary. The aggregate amount that an entity can raise over the course of 12 months (currently $1.07 million) needs to be revised.\textsuperscript{292} Raising this ceiling for individual issuers has been the subject of several proposals, and the SEC is considering raising it to $5 million.\textsuperscript{293} Even then, a fund that intends to invest in several businesses would likely need a more generous limit. Strict disclosure requirements for small businesses would not be necessary as the LISBIC could negotiate what the reporting obligations are, allowing requirements to vary from company to company. A more challenging question relates to the disclosure requirements that should be imposed on the LISBICs to protect its investors. Disclosure requirements under securities laws would depend on the exemption that the LISBIC (as the issuer) and LISBIC investors rely upon.\textsuperscript{294} Setting that consideration aside, SBIC rules provide for certain reporting obligations that are applicable to licensed SBICs, as discussed below.\textsuperscript{295}

\textit{b. Intra-State Crowdfunding}

Localized investing—where a LISBIC raises funds from investors located in the same region the LISBIC is headquartered and then also invests in businesses located in that region—would help achieve several of the LISBIC objectives outlined earlier.\textsuperscript{296} A LISBIC following this strategy could use the Rule 147A safe harbor, an issuing exemption that is loosely based on the intra-state exemption of Section 3(a)(11).\textsuperscript{297} Under that rule, a LISBIC would be deemed a resident of the state where its principal place of business is located.\textsuperscript{298} And as long as the issuer’s employees are based in that state or territory, it would also be deemed to be doing business in that state.\textsuperscript{299} Relying on that exemption, the LISBIC would then be able to sell securities without registration to investors whose principal residence is located in that same state.\textsuperscript{300} However, since Rule 147A is not available to an investment company registered or required to be registered under the ICA,\textsuperscript{301} the availability of this exemption would

\begin{itemize}
\item \textsuperscript{292} See id. at 17,992.
\item \textsuperscript{293} See supra note 241–244 and accompanying text.
\item \textsuperscript{294} Thomas Lee Hazen, \textit{Crowdfunding or Fraudfunding? Social Networks and the Securities Laws—Why the Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure}, 90 N.C.L. Rev. 1735, 1767–78 (2011).
\item \textsuperscript{295} See infra notes 320–328 and accompanying text.
\item \textsuperscript{296} See supra notes 258–261 and accompanying text.
\item \textsuperscript{298} § 230.147A(c)(1).
\item \textsuperscript{299} § 230.147A(c)(2)(iv).
\item \textsuperscript{300} § 230.147A(d)(2).
\item \textsuperscript{301} § 230.147A(a).
\end{itemize}
hinge on the treatment of the LISBIC under the ICA or an enabling modification to Rule 147A.  

2. INVESTMENT COMPANY ACT CONSIDERATIONS

The use of LISBICs would raise issues under the Investment Company Act of 1940 (ICA) and the Investment Advisors Act of 1940. Investment companies are subject to a number of registration and periodic disclosure requirements under the ICA. Under the ICA, an investment company is “any issuer which is . . . engage[d] primarily . . . in the business of investing, reinvesting, or trading in securities,” the latter term being broadly construed. LISBICs would certainly appear to fall under this definition. Therefore, an exemption from registration under the ICA might be necessary for LISBICs to qualify for some of the Securities Act exemptions.

There are a number of exemptions available under the ICA, the most common being the “private investment company” exemptions under Section 3(c)(1) and Section 3(c)(7). These exemptions, relied upon by entities like SBICs and hedge funds, would not be of use to the LISBICs because of their limits on the number of investors and requirements.

302. See infra Section III.B.2. Integration of a Rule 147A offering with a Rule 506 offering (targeted at institutional investors) that takes place more than six months after completion of the Rule 147A offering could raise additional issues. § 230.147A(g).
304. Investment Advisors Act of 1940, 15 U.S.C. §§ 80b-1–80b-2. Under the Advisors Act persons who manage the portfolios of registered investment companies must register with the SEC. Section 202(a)(11) of the Advisers Act generally defines an “investment adviser” as any person or firm that for compensation is engaged in the business of providing advice or making recommendations on securities, among other activities. § 80b–2(a)(11). Investment advisors must register with the SEC unless they are exempt from registration. § 80b–3(b). These exemptions cover investment advisors providing advise to private funds (such as hedge funds) or to SBICs. §§ 80b–3(b)(1), (7)(a).
305. See SEC ICA FAQs, supra note 287.
306. 15 U.S.C. § 80a–3(a)(1)(A). Investment securities are broadly defined to include “all securities” except a narrow set of securities that is not applicable. § 80a–3(a)(2).
307. See supra notes 288, 301 and accompanying text.
308. See SEC ICA FAQs, supra note 287.
309. Section 3(c)(1) covers issuers whose outstanding securities are beneficially owned by not more than one hundred persons and that is not making or planning to make a public offering of its securities. § 80a–3(c)(1). This is the most commonly used exemption by SBICs. See James D. Miller, Small Business Investment Companies: Licensing, Tax and Securities Considerations, 36 BUS. LAW. 1679, 1689–90 (1981).
310. Section 3(c)(7) covers issuers whose outstanding securities are owned exclusively by qualified purchasers and that is not making or planning to make a public offering of its securities. § 80a–3(c)(1). The term “qualified purchaser” is defined in Section 2(a)(51) of the ICA. § 80a–2(a)(51).
relating to their wealth. However, the SEC does have broad statutory authority to promulgate additional exemptions as long as “such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the ICA].”

3. PROTECTING RETAIL INVESTORS

Unlike existing SBICs that raise funds exclusively from institutional and accredited investors, LISBICs contemplate the inclusion of small, retail investors. Due to their backgrounds and limited size of their individual investments, these investors might lack the knowledge, experience, and financial incentives to monitor LISBIC managers in order to ensure that these are not engaging in self-dealing transactions and are staying true to the fund’s purpose.

There are two possible solutions to the first agency problem. The larger institutional investors will have the ability and incentive to monitor the LISBIC manager’s financial performance. LISBIC’s managers will also have the incentive to protect their reputational capital with these institutional actors with whom they repeatedly interact. In addition, state law might impose additional disclosure and fiduciary requirements on the LISBICs and those managing them. LISBICs will need to be organized under state law as corporations, limited liability companies, or limited partnerships. This organizational choice will determine the default legal rights of investors and define the obligations and duties of the LISBIC manager. As many of these provisions are default rules that can be contracted around in a LISBIC’s organizational documents, regulatory provisions could mandate that LISBICs provide for a menu of statutorily-

311. § 80a–3(c)(1), 3(c)(7).
312. § 80a–6(c)(1).
313. See Marco Becht, Patrick Bolton & Ailsa Röell, Corporate Governance and Control, in HANDBOOKS IN ECONOMICS 1, 17 (Kenneth J. Arrow, Michael D. Intriligator eds. 2003) (explaining how dispersed shareholders with small equity interest have little incentive to incur management monitoring costs).
316. See supra note 297–302 and accompanying text.
317. See supra note 137.
mandated rights in these organizational documents to facilitate investor protection.\textsuperscript{319}

A second set of agency problems revolves around LISBIC’s goal of investing in minority-owned businesses and providing them with active advice. Intermediary institutions, such as pension and mutual funds, have limited incentives to actively exercise governance rights in order to improve the performance of their portfolio companies, preferring instead to exit questionable investments.\textsuperscript{320} This can be true even when the investors funding the intermediary would be better off with the intermediary exercising its governance rights.\textsuperscript{321} This dynamic is unlikely to characterize a LISBIC’s management of its portfolio companies, however. Unlike traditional intermediaries, a LISBIC would not be competing against other funds invested in the same businesses and would therefore not be worried about others freeriding on its mentoring and assistance of a portfolio company. Another set of concerns relates to the selection process of LISBIC portfolio companies: will managers select investments that are consistent with a LISBIC’s non-monetary goals? The fact that for-profit organizations are often not in the best position to effectively pursue social goals heightens this concern.\textsuperscript{322}

SBA regulations provide a framework that we can employ to promote transparency and monitor the performance of LISBICs and their pursuit of non-monetary goals. SBICs must prepare an annual financial report for each fiscal year, audited by an independent certified public accountant.\textsuperscript{323} This report includes an assessment of the social-economic impact of each financing made by the SBIC, specifying its impact on job creation or retention, the revenues, and profits of the business, and taxes paid by the business and its employees.\textsuperscript{324} For each reporting period, SBICs must also prepare a valuation report that provides an estimate of the value of their loans and investments.\textsuperscript{325} Periodically, for each small business financing, SBICs submit a portfolio financing report.\textsuperscript{326} The SBA’s Office of Examinations annually reviews SBICs’ financial health and regulatory compliance and monitors the performance of SBICs through key

\textsuperscript{319} See id.
\textsuperscript{321} See id.
\textsuperscript{322} See Ofer Eldar, Designing Business Forms to Pursue Social Goals, 106 Va. L. Rev. 937, 942–44 (2020) (explaining challenges faced by for-profit entities in pursuing social goals and proposing new legal forms that, with key structural elements, give managers the incentives and competence to accomplish such goals).
\textsuperscript{323} 13 C.F.R. § 107.630(a) (2020).
\textsuperscript{324} § 107.630(d).
\textsuperscript{325} § 107.650.
\textsuperscript{326} § 107.640.
metrics. These reports would also facilitate the involvement of LISBIC’s retail investors, who are more likely to care about a LISBIC’s social goals and so have the incentive to verify that the LISBIC is fulfilling such goals.

C. Fiscal Incentives to Capitalize LISBICs

Government involvement would be critical in the development of LISBICs. In addition to leading coordination efforts across government agencies and market actors, public financial support would spread the risks inherent in developing a new market and incentivize private equity funds to incur the initial expenses necessary to successfully enter this niche. The current socioeconomic climate and will to address racial economic disparities make outlays of this type more politically feasible than in the past. This section describes two possible forms of public financial support.

1. GOVERNMENT LEVERAGE

A new SBIC program could revitalize the diminishing role of the federal government in promoting and providing financial support to minority-owned businesses, but past mistakes should not be repeated. LISBICs should be afforded the regulatory flexibility and predictability that SSBICs never had. More importantly, debt should not be the primary leveraging mechanism. Since LISBICs would also be investing in the equity of young, risky firms, having a debt obligation might be


328 Another strategy to address this issue could involve a certification process that verifies a LISBIC’s investment strategy and social impact. See Eldar supra note 322, at 978–80 (describing the certification process for community development financial institutions).


330 See Bates & Bradford, supra note 199, at 492 (“The federal government as a VC funder is fading into insignificance, as neither the newer funds nor the older SSBICs are currently raising capital from this source.”).

331 See id. at 499–500 (“Fund status as an SSBIC requires adherence to restrictive and changing SBA regulations, which is costly to SSBICs . . . .”). For example, rules governing the information that SBICs must obtain from portfolio companies might need to be relaxed for LISBICs to reduce the burdens on minority-owned businesses. See 13 C.F.R. § 107.620 (2020).

332 See supra notes 188–212 and accompanying text.
unduly burdensome and undesirably restrict a LISBIC’s investing options.  

In providing leverage to LISBICs, the SBA should pursue the policy goals of the now-defunct Specialized SBICs and Impact Investments SBICs but employ a funding mechanism more akin to the now-defunct SBA Participating Securities Program or the Startup America Initiative. Though these programs entail greater risk for the SBA, the amount could be capped and managed. Pursuing this alternative takes us closer to an initiative that is merely a pure hybrid of the SSBIC and Participating Securities programs. Though this is certainly an attractive and expedient approach to promote minority entrepreneurship, there is value to having small investors participate and set the tone as to the social and financial expectations of LISBICs’ investments, something that would be missing from a pure hybrid SBA program.

2. PREFERENTIAL TAX TREATMENT

Providing either tax deductions based on amounts invested in LISBICs or a lower tax rate for income and capital gains derived from LISBIC investments would help LISBICs attract capital and provide incentives to private equity funds to establish these in the first place. Using the tax code to encourage investment in young and small businesses is not a novel idea. A number of programs in the U.K. offer favorable tax treatment to investors participating in crowdfunding issuances by small companies. These tax advantages have been identified as one of the

333. See supra note 150 and accompanying text.
334. See supra notes 146–161 and accompanying text.
335. This author also supports this hybrid approach and proposes it as an alternative to the LISBICs contemplated in this Article.
336. A similar tax preferential treatment strategy is employed by the New Market Tax Credit Program (NMTC Program), which provides investors a tax credit in exchange for making equity investments in Community Development Entities, specialized intermediaries that finance projects, such as the construction or rehabilitation of real estate, in low-income communities. See Eldar, supra note 322, at 978–80; Anna Kovner & Josh Lerner, Doing Well by Doing Good? Community Development Venture Capital, 24 J. ECON. & MGMT. STRATEGY 643, 645–47 (2015). For an overview and assessment of the NMTC Program, see Martin D. Abravanel, Nancy M. Pindus, Brett Theodos, Kassie Bertumen, Rachel Brash & Zach McDade, U.S. DEP’T OF THE TREASURY, NEW MARKETS TAX CREDIT (NMTC) PROGRAM EVALUATION (2013).
337. The U.K. has two programs designed to boost innovation and entrepreneurship. The Seed Enterprise Investment Scheme (SEIS) and the Enterprise Investment Scheme (EIS) provide immediate tax deductions and no capital gain taxes to investors participating in qualifying offerings. See HM Revenue & Customs, Tax Relief for Investors Using Venture Capital Scheme, GOV.UK (Jan. 25, 2019), https://www.gov.uk/guidance/venture-capital-schemes-tax-relief-for-investors [https://perma.cc/2VV4-TC4H]. For more information on the SEIS and EIS programs, see HM Revenue & Customs, Use the Enterprise Investment Scheme (EIS) to Raise Money for
reasons why the U.K. crowdfunding market has performed better than the U.S. market. An association of online platforms has recently proposed similar tax exemptions for investors participating in crowdfunding investments as a way to maximize the potential of crowdfunding to fuel business and economic growth. Some groups have proposed a more general tax credit specifically targeted to promote venture capital investments in minority businesses.

3. CONSTITUTIONAL CONSIDERATIONS

Any government program that seeks to specifically target minority-owned businesses for preferential treatment could be challenged under the Equal Protection Clause. Under Supreme Court precedent, strict scrutiny review applies to all preference programs based on racial classifications, thus requiring that such classifications be narrowly tailored to further compelling governmental interests. This section outlines two strategies to address these potential legal challenges.

One approach is to use the SBA’s 8(a) Business Development program’s definition of “socially and economically disadvantaged individuals,” which includes “those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities.” This statutory definition of “socially disadvantaged individuals” in the SBA Act has survived constitutional challenges.

339. See AOIP Paper, supra note 241, at 1, 3 (proposing reasonable tax credits or deductions to encourage private investments in small businesses).
343. See supra notes 111–115 and accompanying text.
The SSBIC Program, which was designed for small business entrepreneurs “whose participation in the free enterprise system is hampered because of social or economic disadvantage,” followed a similar strategy in targeting minority-owned small businesses.\footnote{See supra note 154 and accompanying text; CRS SBIC Report, supra note 136, at 3, 23–24.}

Another possibility is to focus on the geographical region where the business receiving the financing is located by designating certain zip-codes or census tracts. These types of “place-based incentive programs” are used by local governments to revitalize economically depressed communities by providing investors preferential tax treatment or financial assistance through low-interest rate loans.\footnote{See David Neumark & Helen Simpson, Do Place-Based Policies Matter?, FRBSF ECON. LETTER 2015-7 at 1–2 (Mar. 2, 2015); Scott Eastman & Nicole Kaeding, TAX FOUND., OPPORTUNITY ZONES: WHAT WE KNOW AND WHAT WE DON’T (2019); David Neumark & Helen Simpson, Place-Based Policies, in 5 HANDBOOK OF REGIONAL & URBAN ECONOMICS 1197, 1198–99 (2015).} Such designations have also been employed under the Community Reinvestment Act and the Impact Investment SBIC program.\footnote{See supra note 155 and accompanying text.} A recent program enacted as part of the Tax Cuts and Jobs Act of 2017 provides investors temporary preferential tax treatment if they invest in real estate or equity located in an area designated as an opportunity zone, a community designated by the Internal Revenue Service as being “economically distressed.”\footnote{See supra note 160–162 and accompanying text.} Though the program’s implementation has been criticized,\footnote{See Opportunity Zones Frequently Asked Questions, IRS (Oct. 22, 2019), https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions [https://perma.cc/AE9H-ZDYZ] [hereinafter IRS OZ FAQs]; Morgan Simon, What You Need to Know About Opportunity Zones, FORBES (Mar. 30, 2019, 4:03 PM), https://www.forbes.com/sites/morgansimon/2019/03/30/what-you-need-to-know-about-opportunity-zones [https://perma.cc/PS4Q-XY9K]. These low-income areas are generally defined as census tracts with a poverty rate of 20% and median family income of 80% of the surrounding metropolitan area. See Matthew Blake, Opportunity Zones Program Finally Kicks off in Los Angeles, THE REAL DEAL L.A. (Jan. 20, 2020, 4:28 PM), https://therealdeal.com/la/2020/01/20/opportunity-zones-program-finally-kicks-off-in-los-angeles/ [https://perma.cc/8KEZ-YGA].} it provides an example of a Constitutional, But Its Reasoning Raises Questions, HOLLAND & KNIGHT (Sept. 26, 2016), https://www.hklaw.com/en/insights/publications/2016/09/dc-circuit-rules-that-the-8a-program-is-constitutional [https://perma.cc/B66T-XX8X].

See supra note 345. See supra note 348 (discussing “impact washing” and the low multiplier effects of investments in low income communities); Alan Sage, Mike Langen & Alex Van de Minne, Where Is the Opportunity in Opportunity Zones? Early Indicators of the Opportunity Zone Program’s Impact on Commercial Property Prices (May 1, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3385502 (finding that opportunity zone designation did not impact all properties prices, but resulted in a 13.5% price increase for “redevelopment” properties and a 9.6% price increase for vacant development sites, which suggests that the program has primarily passed through the tax benefits to existing land owners, with limited evidence of additional value creation); Lisa Christensen Gee & Lorena Roque, Opportunity Zones Bolster Investors’ Bottom Lines Rather than Economic
politically viable “place-based incentive program” at the federal level used to target investors to help the development of minority communities.\footnote{350}

**CONCLUSION**

In light of recent political and economic events, removing the financial barriers faced by minority entrepreneurs is more crucial now than ever. Promoting the growth of minority-owned businesses is also sound policy, as it would have a considerable impact both at the local and national levels. Locally, it would help the economic development of minority communities in need of new jobs and better infrastructure. Diverting efforts and resources from redistributive transfer and relief to an initiative that mobilizes grassroots and private capital to help minority-owned businesses will strengthen a second front in the war against poverty by providing a market-based channel to remedy long-standing racial inequities.\footnote{351} The aggregate economic effect of these efforts would also be felt nationally: due to discriminatory financing practices, our nation is losing over “1.1 million minority-owned businesses, and as a result, foregoing over 9 million potential jobs and $300 billion” in national income.\footnote{352}

The problem examined in this Article has been widely acknowledged; the body politic and market participants are more willing than ever to act.\footnote{353} That past programs have been relatively unsuccessful should not be discouraging. Understanding why past programs have come up short helps us design ones better suited to solve the problem at hand. Finding the right approach, however, requires identifying specific processes that drive disparities. This Article starts that conversation by highlighting the importance of soft information for minority-owned businesses and explaining how related informational issues have kept mainstream investors away. Most of the ingredients for a successful program, such as the one proposed in the Article, are already in place. The key lies in

\begin{itemize}
\item \footnote{350}{See Eastman & Kaeding, supra note 346, at 2.}
\item \footnote{352}{See Applewhite, supra note 104; \textit{Austin, supra} note 340, at 3.}
\item \footnote{353}{See \textit{supra} notes 329, 340 and accompanying text.}
\end{itemize}
coordinating different regulatory frameworks and administrative bodies and involving private equity investors and members of the community. The costs and risks involved are great, but the benefits are immeasurable.
Inequality in Business Ownership, Business Performance and Financial Capital

Perspectives on Minority Business Development
Penn State University
April 20, 2021

Robert W. Fairlie
University of California, Santa Cruz and NBER
Earnings Inequality – Bureau of Labor Statistics

<table>
<thead>
<tr>
<th>Weekly Earnings</th>
<th>White</th>
<th>Black</th>
<th>Latino</th>
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<tbody>
<tr>
<td>77%</td>
<td>72%</td>
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Business Ownership Inequality

<table>
<thead>
<tr>
<th>Race</th>
<th>Percentage</th>
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<tr>
<td>White</td>
<td>78%</td>
</tr>
<tr>
<td>Black</td>
<td>40%</td>
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<tr>
<td>Latino</td>
<td></td>
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</table>
Business Sales Inequality

Average Sales

- White: 11%
- Black: 26%
- Latino: 26%
Job Creation Inequality

Average Employment

- White: 16%
- Black: 28%
- Latino: 2%
Wealth Inequality

Net Worth

White 6% 7%
Black 2-132
Latino 2-132
Number of Active Business Owners in the United States (January 2005 - April 2020)

April 2020
Number of Active Business Owners before and after COVID-19 (Racial Minority Groups)

- African-American: -41%
- Latinx: -32%
- Asian: -26%
Figure 1
## Change in Number of Active Business Owners in the United States

<table>
<thead>
<tr>
<th></th>
<th>Black Relative to:</th>
<th>Latinx Relative to:</th>
<th>Asian Relative to:</th>
<th>White Relative to:</th>
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<tbody>
<tr>
<td>Feb. 2020</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Mar. 2020</td>
<td>0%</td>
<td>-6%</td>
<td>5%</td>
<td>-4%</td>
</tr>
<tr>
<td>Apr. 2020</td>
<td>-41%</td>
<td>-52%</td>
<td>-6%</td>
<td>-17%</td>
</tr>
<tr>
<td>May 2020</td>
<td>-26%</td>
<td>-35%</td>
<td>-19%</td>
<td>-26%</td>
</tr>
<tr>
<td>June 2020</td>
<td>-10%</td>
<td>-18%</td>
<td>-11%</td>
<td>-3%</td>
</tr>
<tr>
<td>July 2020</td>
<td>-11%</td>
<td>-18%</td>
<td>-10%</td>
<td>-10%</td>
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<tr>
<td>Aug. 2020</td>
<td>1%</td>
<td>-5%</td>
<td>-9%</td>
<td>-11%</td>
</tr>
<tr>
<td>Sept. 2020</td>
<td>2%</td>
<td>-6%</td>
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</tr>
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<td>Oct. 2020</td>
<td>7%</td>
<td>-4%</td>
<td>-1%</td>
<td>-15%</td>
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<tr>
<td>Nov. 2020</td>
<td>3%</td>
<td>-5%</td>
<td>5%</td>
<td>-22%</td>
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<td>Dec. 2020</td>
<td>-3%</td>
<td>-12%</td>
<td>-3%</td>
<td>-20%</td>
</tr>
<tr>
<td>Jan. 2021</td>
<td>2%</td>
<td>0%</td>
<td>-10%</td>
<td>-18%</td>
</tr>
<tr>
<td>Feb. 2021</td>
<td>0%</td>
<td>-10%</td>
<td>-12%</td>
<td>-8%</td>
</tr>
</tbody>
</table>
More Information

Research on business inequality:
https://people.ucsc.edu/~rfairlie/papers/

Ongoing Small Business Activity Tracking:
https://people.ucsc.edu/~rfairlie/recent/
Robert W. Fairlie, Professor of Economics, University of California, Santa Cruz

Robert W. Fairlie

I am a Professor of Economics at the University of California, Santa Cruz and a member of the National Bureau of Economic Research (NBER). My research interests include entrepreneurship, education, information technology, racial and gender inequality, labor economics, and immigration. Publications from my research have appeared in journals such as the American Economic Review, Economic Journal, AEJ: Applied, AEJ: Policy, ReSTAT, JOLE, JAMA: Surgery, Nature: SoE, Management Science, JPAM and MIT Press (book). I received a Ph.D. and M.A. from Northwestern University and B.A. with honors from Stanford University. I have held visiting positions at Stanford University, Yale University, UC Berkeley, and Australian National University. I have received funding for my research from the National Science Foundation as well as numerous government agencies and foundations, and have testified to the U.S. Senate, U.S. House of Representatives, U.S. Department of Treasury, and the California State Assembly, and received a joint resolution from the California State Assembly. I am regularly interviewed by the media (e.g. NY Times, WSJ, Washington Post, NPR, PBS, CNN, CBS, NBC) to comment on economic, small business, inequality and policy issues.

Barry W. Ickes, Professor of Economics and Head, Department of Economics, Penn State

Barry W. Ickes

I am Head of the Department of Economics at the Pennsylvania State University. I am also Professor of Economics and Director of the Center for Research on International Financial and Energy Security, and a Founder of The New Economic School in Moscow. Formerly, I was a Non-Resident Senior Fellow at the Brookings Institution. I am the past Chair of the Board of Directors of the National Council for Eurasian and East European Research. I was the President of the Association for Comparative Economic Studies during 2004.
Session 3: Perspectives of Bankers and an SBA Expert
5:15 - 5:45 p.m. EDT

Discussion Leader: Kay Gordon, partner at Nelson Mullins, New York City

Presenters: Dana Peterson, Chief Economist at The Conference Board and former Citi Banker; Gina D. Nisbeth, Director of Structured Lending and Investments, Citi Community Capital; and Ethan Smith, Co-founder and Managing Partner of Starfield & Smith and expert in SBA lending

Event Co-Chairs:

Samuel C. Thompson Jr.
Professor and Arthur Weiss Distinguished Faculty Scholar at Penn State Law

Sabrina Conyers
Partner at Nelson Mullins Riley & Scarborough

pennstatelaw.psu.edu/events/mbd-perspectives
PENN STATE LAW, MINORITY BUSINESS DEVELOPMENT COURSE

PERSPECTIVES ON MINORITY BUSINESS DEVELOPMENT, APRIL 20, 2021

MATERIALS FOR: SESSION 3: PERSPECTIVES OF BANKERS AND AN SBA EXPERT

DISCUSSION LEADER: KAY GORDON, PARTNER AT NELSON MULLINS, NEW YORK CITY
PRESENTERS: DANA PETERSON, CHIEF ECONOMIST AT THE CONFERENCE BOARD AND FORMER CITI BANKER; GINA D. NISBETH, DIRECTOR OF STRUCTURED LENDING AND INVESTMENTS, CITI COMMUNITY CAPITAL; AND ETHAN SMITH, CO-FOUNDER AND MANAGING PARTNER OF STARFIELD & SMITH AND EXPERT IN SBA LENDING

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SESSION 3: BIOGRAPHIES

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CLOSING THE RACIAL INEQUALITY GAPS

The Economic Cost of Black Inequality in the U.S.

Citi GPS: Global Perspectives & Solutions
September 2020

Citi is one of the world’s largest financial institutions, operating in all major established and emerging markets. Across these world markets, our employees conduct an ongoing multi-disciplinary conversation – accessing information, analyzing data, developing insights, and formulating advice. As our premier thought leadership product, Citi GPS is designed to help our readers navigate the global economy’s most demanding challenges and to anticipate future themes and trends in a fast-changing and interconnected world. Citi GPS accesses the best elements of our global conversation and harvests the thought leadership of a wide range of senior professionals across our firm. This is not a research report and does not constitute advice on investments or a solicitations to buy or sell any financial instruments.

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Dana M Peterson Director, is a Global Economist with Citi Research. Her goal is to provide high value, accurate and timely analysis that informs Citi’s top tier clients in their investment, risk, and business planning decisions. Dana has specific responsibility for identifying, analyzing, and publishing research papers on important global economic themes having direct financial market implications. Such global economic themes include, monetary policy, fiscal and trade policy, debt, taxation; ESG; and demographics. Dana also examines U.S. themes using granular data. Dana and her research have been featured by U.S. and international news outlets in print and on television, including the CNBC, Bloomberg, Thomson-Reuters, WSJ, the Financial Times (FT), Fox Business News Network, BNN-Bloomberg, Globe and Mail, CBC, and National Post.

Please note: This is the last report written by Dana Peterson in her role as Global Economist at Citi. We thank Dana for her insights and dedication to global thematics and in particular her work on this important Citi GPS report. We wish her all the best in her new role as Chief Economist at The Conference Board.

Catherine L Mann is the Global Chief Economist at Citigroup where she is responsible for thought leadership, research guidance of a global team of economists, and cross-fertilization of research across macroeconomics, fixed-income, and equities. Prior to this position, she was Chief Economist at the OECD, where she also was Director of the Economics Department and was Finance Deputy to the G20 (2014-2017). Prior to the OECD, she held the Barbara ’54 and Richard M. Rosenberg Professor of Global Finance at the International Business School, Brandeis University, where she also directed the Rosenberg Institute of Global Finance (2006-2014). She spent 20-plus years in Washington, DC (1984-2006) where her positions included Senior Fellow at the Peter G. Peterson Institute for International Economics; Economist, Senior Economist, and Assistant Director in the International Finance Division at the Federal Reserve Board of Governors; Senior International Economist on the President’s Council of Economic Advisers; and Adviser to the Chief Economist at the World Bank. Dr. Mann received her PhD in Economics from the Massachusetts Institute of Technology and her undergraduate degree is from Harvard University.

+1-212-816-6498 | catherine.mann@citi.com

Contributors

Lara Ouvaroff
Global Thematics Team

Aaron Liu
Global Economics Team
CLOSING THE RACIAL INEQUALITY GAPS

The Economic Cost of Black Inequality in the U.S.

In his Letter from a Birmingham Jail, Dr. Martin Luther King Jr. wrote, "We are caught in an inescapable network of mutuality, tied in a single garment of destiny. Whatever affects one directly, affects all indirectly."

Today, more than at any time since Dr. King’s assassination, we are bearing witness to the grave injustices affecting our fellow citizens. Black, Latinx, and Native Americans have been hospitalized for COVID-19 at a disproportionately high rate, a direct result of what the Centers for Disease Control and Prevention has identified as “long-standing systemic health and social inequities.” Blacks and People of Color are also bearing a disproportionate share of the pandemic’s economic devastation. And the killings of Ahmaud Arbery, Breonna Taylor, and George Floyd have finally shaken the U.S. and the world awake to the egregious racial inequities in our criminal justice system.

As Dr. King noted, these injustices affect all of us. Higher rates of infection among some affect the health of all, and the loss of health, life, and livelihood among communities of color diminish everyone’s economic security. No one should want to live in a society that incarcerates or kills so many of its citizens just because they are black or brown.

The privileges we enjoy by working for Citi come with responsibilities. While elected officials and community activists must do their part, so must we. One important thing we can do is to show the costs of racial inequality through objective analysis which is what the authors of this report have sought so effectively to demonstrate. Our overarching goal for the Citi GPS series is not only to tackle the key opportunities and challenges of the 21st century, but also to address complex societal questions and to not shy away from difficult subjects. As such, we believe we have a responsibility to address current events and to frame them with an economic lens in order to highlight the real costs of longstanding discrimination against minority groups, especially against Black people and particularly in the U.S.

The analysis in the report that follows shows that if four key racial gaps for Blacks — wages, education, housing, and investment — were closed 20 years ago, $16 trillion could have been added to the U.S. economy. And if the gaps are closed today, $5 trillion can be added to U.S. GDP over the next five years.

I write this forward as Citi’s Vice Chairman and Chairman of our Global Banking, Capital Markets and Advisory business, but my journey began at the bottom. My two brothers and I were raised in Dayton, Ohio by our single mom and her parents, who had migrated from Georgia to escape the injustice and terror of Jim Crow. They worked tirelessly as janitors, social workers, and leaders at our local church to give us every opportunity. At any given time, we shared our home with five to eight foster siblings.

Yet even today, with all those credentials and as one of the leading executives on Wall Street, I am still seen first as a six-foot-four, two-hundred-pound Black man wherever I go — even in my own neighborhood. I could have been George Floyd. And my wife and I are constantly aware that our children could have their innocence snatched away from them at any given moment, simply for the perceived threat of their skin color. I hope that the analysis in this report brings sober perspective as well as hope to our readers as we collectively find substantive and sustainable opportunities to address the gaps we identify.
A Path Towards Equality

NOT ADDRESSING RACIAL GAPS BETWEEN BLACKS AND WHITES HAS COST THE U.S. ECONOMY UP TO $16 TRILLION OVER THE PAST 20 YEARS

WHAT CAN INDIVIDUALS DO?

WHAT CAN THE GOVERNMENT DO TO CLOSE THE GAPS BETWEEN BLACKS AND WHITES?

Closing the Black Wage Gap could have added $2.7 trillion in income or +0.2% to GDP per year.

Facilitating easy access to higher education for Black students could have increased lifetime incomes $90-$113 billion.

Improving access to housing credit might have added an additional 770,000 Black homeowners, adding $218 billion in sales and expenditures.

Providing fair and equitable lending to Black entrepreneurs might have resulted in the creation of an additional $13 trillion in business revenue and potentially created 6.1 million jobs per year.

If these racial gaps were closed today, we could see $5 trillion of additional GDP over the next 5 years, or an average add of 0.35 percentage point to U.S. GDP growth per year and 0.09 percentage point to global growth per year.

ADVOCATE FOR ONE’S CAREER

USE EDUCATION AS A PATHWAY FOR SUCCESS

UTILIZE POLITICAL POWER

EMBRACE DELAYED GRATIFICATION AND RISK TO GENERATE WEALTH

PROVIDE GUARANTEED WAGES, INCOMES AND JOBS

IMPLEMENT TAX REFORM

PROMOTE FINANCIAL INCLUSION

DECouple HEALTHCARE

ENCOURAGE WORK

IMPLEMENT HOUSING INCENTIVES

INVEST IN WEALTH BUILDING

INVEST IN PROTECTIONS AGAINST DISCRIMINATION

IMPLEMENT SALARY HISTORY BANS

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ATTITUDES AND POLICIES THAT UNDERMINE EQUAL ACCESS ARE AT THE ROOT OF THE RACIAL GAPS PLAGUING U.S. SOCIETY

**Housing**
The gap between white and Black home ownership remains wide with discriminatory practices still an issue.

**Policing**
Blacks are 5x as likely to be incarcerated vs. whites and make up an oversized percent of the U.S. prison population – 33% vs. 12% of total U.S. population.

**Income**
Peak income occurs sooner and is lower for Black males (age 45-49, $43,859) vs. white males (age 50-54, $66,250).

White families have 8x as much wealth as Black families and lower debt-to-asset ratios (~10% vs. ~30%).

**Voting**
Over past 10 years, 25 of 50 States have implemented voting restrictions which disproportionately affect Black voters.

Of the 3.1 million American adults estimated as banned from voting, 2.2 million are Black Americans.

Source: Census Bureau, FRED

Source: NAACP

Source: The Sentencing Project

Source: Census Bureau, Federal Reserve

WHAT CAN CORPORATES DO?

- **Support Diversity and Inclusion Initiatives from the Top**
- **Address Racial Gaps in Hiring, Retention, and Firing**
- **Engage in Corporate Social Responsibility**
- **Develop Metrics to Analyze, Report, and React**
- **Recruit More Black Board Members**
- **Dismantle Structural Barriers to Hiring Black Talent**
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The Economic Costs of U.S. Racial Inequality

A useful definition of racial equity hails from the San Francisco Fed: “racial equity means just and fair inclusion in an economy in which all can participate, prosper, and reach their full potential. We will know we have achieved racial equity when race no longer predicts life outcomes.”

A plethora of data, studies, and societal ills indicate the U.S. has yet to achieve the point of racial equity, given the prevalence of major gaps in economic opportunity, education, income, housing, and wealth that run along racial fault lines.

The COVID-19 pandemic and the deaths of several Black people while in police custody in rapid succession have laid bare the United States’ longstanding problem of discrimination against minority groups, especially against Black people. Moreover, it has laid bare how inequality has produced real economic costs and social losses.

These costs are most evident in racial gaps: wide numerical differences in key social and economic indicators between Black and white Americans. These gaps are apparent in unemployment, net worth, debt levels, wages, peak income, financing for businesses, spending on education, and rates of imprisonment and sentencing levels. The gaps in many cases remain wide 60 years after the Civil Rights Movement. In some cases, including in homeownership rates and college degree attainment, the gaps are wider now than in the 1950s and 1960s.

This report (1) identifies the underlying causes of the racial and economic gaps exacerbated by the COVID-19 pandemic; (2) discusses the value of closing gaps; and (3) outlines how governments, corporations, and individuals can work together to eliminate gaps for good.

We discover that closing racial gaps is a pareto improvement to both the U.S. economy and society. If racial gaps for Blacks had been closed 20 years ago, U.S. GDP could have benefitted by an estimated $16 trillion. If we close gaps today, the equivalent add to the U.S. economy over the next five years could be $5 trillion of additional GDP, or an average add of 0.35 percentage points to U.S. GDP growth per year and 0.09 percentage points to global GDP growth per year.

- Closing the Black racial wage gap 20 years ago might have provided an additional $2.7 trillion in income available for consumption and investment.
- Improving access to housing credit might have added an additional 770,000 Black homeowners over the last 20 years, with combined sales and expenditures adding another $218 billion to GDP over that time.
- Facilitating increased access to higher education (college, graduate, and vocational schools) for Black students might have bolstered lifetime incomes that in aggregate sums to $90 to $113 billion.
- Providing fair and equitable lending to Black entrepreneurs might have resulted in the creation of an additional $13 trillion in business revenue over the last 20 years. This could have been used for investments in labor, technology, capital equipment, and structures and 6.1 million jobs might have been created per year.

Closing the wage, housing, education, and business investment racial gaps can help narrow the wealth gap, which is significant for facilitating homeownership, business, and job creation, plus establishing a pipeline for intergenerational wealth accumulation.

Figure 1. Racial Gaps Cause Economic Harm

Figure 2. The Economic Case for Closing Racial Gaps is Highly Compelling
COVID-19 Shines Light on Racial Disparities

Figure 3. COVID-19 Uncovers Long-Standing Biases and Inequities in the U.S.

The dual health and economic crises resulting from the coronavirus lays bare long simmering racial tensions and inequities that have plagued the U.S for centuries. The overlay of deep job cuts, threat of eviction, hunger, business closures among minority groups, and uneven fiscal supports, with high rates of infections and deaths, plus repeated incidences of police brutality involving Black Americans has proven too great to ignore. The result not only has precipitated protests in the streets, but also a general reassessment of the very soul of the nation. Specifically, how past and current biases have embedded themselves into the economy and society, and what should be done to rectify them.

While all racial and ethnic groups are suffering from the fall-out of the pandemic, data reveal the burden is falling more heavily on certain demographics. Black persons, in particular, appear to have suffered greater job losses amid government-ordered shutdowns; found themselves in industries that are essential but low paying; possessed more pre-existing factors leading to COVID-19 mortality; owned businesses that closed permanently or were unable to access Paycheck Protection Program (PPP) loans; and reported elevated rates of food, income, and housing insecurity amid the crisis. The tangible and emotional hardships of the virus impact spilled over into national outrage about the deaths of several Black people during altercations with the police. Most notably, the video-taped death of George Floyd.

The combination of the pandemic and deadly community policing tactics leads us to revisit the problem of racial gaps in the U.S., and the case for closing them. First we review the disproportionate impact of the virus on minority groups, and Black persons in particular, plus the linkages to preexisting racial gaps.
Health Divide

Ethnic minorities were more likely to contract and perish from COVID-19. Death rates tallied by the U.S. Center for Disease Control (CDC) for New York City — a particularly hard hit region — showed mortality figures for Black/African American persons (92.3 deaths per 100,000 population) and Hispanic/Latino persons (74.3) were substantially higher than that of white (45.2) or Asian (34.5) persons. A Federal Reserve Bank of New York study reveals there is a high significance of death from COVID-19 and the existence of various conditions, including belonging to a low income group, living in a densely populated urban area, and/or being a member of a major minority group (Figure 4). Indeed, an overlay of COVID-19 deaths and U.S. counties having large minority populations indicates a higher prevalence of perishing from COVID-19 if one belongs to a racial minority: Black, Hispanic, and Native American plus select Asian and Pacific Islander population groups (Figure 5).

Figure 4. Being a Minority with Low Income, and/or Residing in Densely Populated Urban Areas Raised the Likelihood of Death from COVID-19

Regressions of Cases and Deaths on Demographics

<table>
<thead>
<tr>
<th></th>
<th>Cases/ 1,000 population (1)</th>
<th>Cases/ 1,000 population (2)</th>
<th>Cases/ 1,000 population (3)</th>
<th>Cases/ 1,000 population (4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low Income</td>
<td>.5843**</td>
<td>1.183***</td>
<td>.8616***</td>
<td>.1192***</td>
</tr>
<tr>
<td></td>
<td>(2.46)</td>
<td>(5.18)</td>
<td>(3.37)</td>
<td>(9.09)</td>
</tr>
<tr>
<td>Majority Minority</td>
<td>3.838***</td>
<td>2.887***</td>
<td>2.453***</td>
<td>.0951***</td>
</tr>
<tr>
<td></td>
<td>(14.91)</td>
<td>(11.58)</td>
<td>(8.34)</td>
<td>(6.64)</td>
</tr>
<tr>
<td>In Metropolitan Statistical Area</td>
<td>1.837***</td>
<td>-1.381***</td>
<td>-1.465***</td>
<td>-.1096***</td>
</tr>
<tr>
<td></td>
<td>(6.68)</td>
<td>(-4.51)</td>
<td>(-4.77)</td>
<td>(-6.23)</td>
</tr>
<tr>
<td>Log Population Density</td>
<td>1.41***</td>
<td>1.404***</td>
<td>.1177***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(20.35)</td>
<td>(20.26)</td>
<td>(29.57)</td>
<td></td>
</tr>
<tr>
<td>Low Income x Majority</td>
<td>1.335***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(2.77)</td>
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</tr>
<tr>
<td>Observations</td>
<td>3216</td>
<td>3136</td>
<td>3135</td>
<td>3136</td>
</tr>
</tbody>
</table>

Note: t statistics in parenthesis; Significance: * 10% level, ** 5% level, *** 1% level
Source: Federal Reserve Bank of NY

Federal data corroborate the racial disparity of COVID-19 death. The Centers for Disease Control (CDC) stated that contributing factors included living conditions (densely populated, residential segregation, multi-generational households, incarceration), work circumstances (critical workers, lack of paid sick leave), and underlying health conditions (lack of access to health insurance, serious underlying medical conditions, stigma, and systemic inequalities). Regarding health conditions, the SHADAC analysis of the American Community Survey (ACS) Public Use Microdata Sample (PUMS) files reveals that although the number of uninsured persons has fallen since passage of the Affordable Care Act in 2012, ethnic minorities are still less likely to have health insurance (Figure 7).

Figure 5. U.S. Counties with Large Number of COVID-19 Deaths Tend to Overlap with Counties Having Large Minority Populations

Source: CDC, Census Bureau, Citi Research

Figure 6. Persons Belonging to Minority Groups, Especially Black Persons, Suffered More Deaths Per Capita than White Persons

Source: CDC, Census Bureau and Citi Research

Figure 7. Insurance Coverage has Improved Since Obamacare Passage, But Minorities Are Still More Likely to be Uninsured

Source: SHADAC analysis of the American Community Survey, Citi Research

Wealth and income gaps between Black families and Hispanic, Asian, and white families have remained wide for last 40 years.

The eroded sentiment among minorities amid the pandemic, and Black Americans in particular, reflects not only policing and health care inequities, but also long simmering economic disparities. Both the wealth and income gaps between Black and Hispanic families and white and Asian families have remained wide over the last 40 years for which the U.S. Census Bureau has collected data. The real median income (Figure 8) and wealth (Figure 9) disparities continue to be stark for Black Americans. These gaps have been exacerbated by business shutdowns amid the coronavirus pandemic. In the latest Bureau of Labor Statistics (BLS) employment report, the civilian unemployment rate in the U.S. continues to edge lower.

Nonetheless, jobless rates are falling for white persons faster than for other minorities, and the unemployment rate for Black workers at 13.0 percent is the highest (Figure 10). Moreover, the NBER reported there was greater business destruction over the February-April 2020 span for Black-owned firms, in terms of percentage decline, than for businesses owned by other ethnicities (Figure 11).
Black households have had more difficulty managing the basics of daily living amid the COVID-19 pandemic.

Managing the basics of daily living have been more difficult for Black households amid the COVID-19 pandemic. Food sufficiency has been a greater challenge for select households of color, and Black households in particular, during the COVID-19 pandemic. The Census Bureau’s *Household Pulse Survey* revealed that in June 2020, it was more likely the case for Black, Hispanic, and Other Racial category households to have inadequate access to food during the pandemic than was the case for white and Asian households. Black households were more likely to say that they sometimes or often did not have enough to eat (Figure 12). Meanwhile, it was more likely the case that Black, households fell behind on rent or mortgage payments amid the coronavirus pandemic than white households (Figure 13). Black households were also less confident they could make future housing payments than were white households.
The unequal nature of job losses, which heavily affected low-skilled and discretionary sectors that largely employ minorities, was directly linked to food and housing insecurity levels. Food and housing insecurity during the pandemic were directly linked to the unequal nature of job losses that heavily affected low-skilled and discretionary sectors employing large shares of minorities. The U.S. Private Sector Job Quality Index® (JQI) listed jobs in the food and beverage services, retail, travel and attractions, and the auto sector among the most vulnerable amid COVID-19 disruptions (Figure 14). Many of these jobs rank low in the quality index. The JQI interprets “job quality” as meaning the weekly dollar income a job generates for an employee. Hence, it is also likely many of these jobs have low skills requirements given the relatively low quality of pay. U.S. job cuts among these sectors were disproportionately skewed toward women and minorities due to labor market segmentation into areas that were discretionary in nature and/or impossible to execute in a work-from-home scheme. Indeed, a staggering 14 million white workers were laid off, but this is compared to 8 million minorities, which comprise 23 percent of the working age population. In the second quarter of 2020, Black persons working in coronavirus disruption-sensitive sectors experienced an employment loss of 2.7 million. However, as a share of the number of employed Black persons one year prior, the loss was 14 percent compared to 12 percent for white persons (Figure 15). For Hispanic and Asian people the loss was 15 percent, each.
For Black persons who maintained their jobs, the split between essential and non-essential work highlighted that the most hazardous jobs were also among those with the lowest pay. According to the U.S. Bureau of Labor Statistics (BLS), only 30 percent of U.S. workers are able to telework (work-from-home or WFH). Hispanic and Black workers were the least able to WFH (16 percent and 20 percent, respectively). (Figure 16). The BLS also reported laborers who are below the 50th percentile in terms of wage level were the least likely to WFH: <25th percentile (9 percent) and 25th to 50th percentile (20 percent) (Figure 17). Moreover, many of the jobs deemed essential by governments were the least amenable to WFH (Figure 18). Of essential jobs with high exposure to infection, many of them are low wage jobs in which Black workers are clustered (Figure 19). Healthcare, food service, and child care stand out as low-wage, essential occupations employing large numbers of Black employees.
Figure 16. Only 20% of Black Workers Can Work from Home

Figure 17. Low Income Workers Less Likely to Work from Home

Figure 18. Low Wage Industries Less Amenable to Work from Home

Figure 19. Black Workers Are Overrepresented in Many of the Lowest Wage Jobs Considered High-Contact, Essential Services

Note: Dotted line denotes Black workers as a percent of the civilian non-institutional population 20 and over or 12.6 percent. Source: McKinsey Global Institute analysis, U.S. Bureau of Labor Statistics, Citi Research estimates
Uneven Relief

The CARES Act of 2020 legislated the Paycheck Protection Program (PPP), which provided loans to businesses suffering coronavirus disruptions. The potentially forgivable loans were designed to encourage firms to invest and retain workers until domestic demand improved. A Bloomberg News analysis of Small Businesses Association (SBA) data revealed that in the initial wave of the program, minority-owned firms received fewer loans as a share of the total number of minority-owned businesses (17 percent) than did white-owned firms (27 percent). The percentages improved and largely evened out in the second tranche of PPP loans at 75 and 72 percent, respectively (Figure 20). Nonetheless, minority firms found themselves shut-out of the initial rounds of relief and struggled to receive funding from large financial institutions at the outset of the pandemic disruptions, as the availability of community banks expedited lending (Figure 21).

Figure 20. Minority-Owned Firms Received COVID-19 Relief Later than White-Owned Firms

<table>
<thead>
<tr>
<th>First Round: Percentage of small businesses receiving PPP loans in majority white &amp; predominantly minority Congressional districts (April 3-16)</th>
</tr>
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<table>
<thead>
<tr>
<th>Second Round: Percentage of small businesses receiving PPP loans in majority white &amp; predominantly minority Congressional districts (through June 30)</th>
</tr>
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</table>

Source: Bloomberg News

Figure 21. Minority-Owned Firms Received COVID-19 Relief Later

Percent of SBA Loans Going to Minority-Owned Businesses

Source: Bloomberg News
Simmering Tensions

In addition to the disruption from COVID-19, the U.S. has also been gripped by protests fueled by a conflagration of inequality, racism, and police brutality. The civil unrest comes against a backdrop of disproportionately higher numbers of deaths for minorities, especially Black persons from COVID-19, and elevated unemployment figures for Black Americans amid the pandemic-induced U.S. recession. Roughly 1,000 people per year die during altercations with the police (Figure 22). Nearly half of them are racial minorities, and Black persons have a higher share of fatalities per capita (Figure 23). A number of these deaths have come on account of mishandling by police forces, which have been linked at times to long-standing social and racial issues. In general, the U.S. has lost ground relative to other advanced economies, and even the world, in terms of discrimination and violence against minority groups (Figure 24).

Figure 22. Roughly 1,000 People/Yr Die in Altercations with the Police

![Graph showing number of people in fatal police shootings by race from 2017 to 2020.](Source: Statista.com, Citi Research)

Figure 23. Police-Related Deaths Per Capita is Highest for Black People

![Graph showing police-related deaths per capita from 2017 to 2020.](Source: Statista.com, Citi Research)

Figure 24. The U.S. Has Lost Ground Relative to Other Advanced Economies and the World Regarding Discrimination and Violence Against Minority Groups

![Graph showing discrimination and violence against minorities from 2013 to 2018.](Source: The Social Progress Imperative, Citi Research)
Why Gaps Exist: Racism and Inequality Are Little Improved

The 400 years of enslavement of Black populations in the Americas has residual effects that persist to this day despite tomes of legislation providing equal access to various aspects of American life under the law. Attitudes and policies undermining equal access are at the root of the racial gaps plaguing U.S. society.

Moreover, societal inequities have manifested themselves into economic costs, which have harmed individuals, families, communities, and ultimately the growth and well-being of the U.S. economy. If the racial gaps in wages in the U.S. had been closed two decades ago, there might have been an additional 0.2 percentage point to real GDP growth per year. Adequate access to housing credit might have produced 770,000 new Black homeowners. More Black students with university and advanced degrees might have generated an additional $90 to $113 billion in income that could have contributed to consumption. More than 6 million jobs per year might have been added and $13 trillion in cumulative revenue gained if Black-owned firms had equitable access to credit. The global implications are also apparent given the U.S. contributes a one-third share of growth to the world economy.

Figure 25. What the United States Could Have Gained by Closing Racial Gaps 20 Years Ago

Source: Citi Research
Bias

The persistence of racially-biased attitudes, coupled with the implementation and maintenance of policies enshrining these attitudes, constitute what is often termed as systemic racism. Biases may be conscious or unconscious. Nonetheless, the result of policies creating and perpetuating bias produce inequality. Even when the biases fade, the policies may linger, rendering the inequality multi-generational as it becomes interwoven with the way things are done: in broader society, government, corporations, and/or institutions.

The continuation of racial bias and systemically-entrenched inequality born from past and present biases are evident across multiple facets of U.S. society. The Civil Rights Movement of the 1950s launched 20 years of major legislative achievements for Black persons in America that also spurred other movements for equality. However, 70 years later, improvements appear to be few and far between for many Black Americans. The U.S. is light-years more equal than it was in the 1950s, but systems perpetuating inequalities among different racial groups either still remain or are being reinvented, either consciously or unconsciously.

Bias, whether conscious or unconscious, plays a central role in economic and social outcomes for Black Americans. Building upon the bias seen in businesses financing, there are numerous cases of bias within the hiring spectrum and moreover from a consumption prospective. As discussed by Greenwald and Krieger, 78 percent of those who took the Harvard Implicit Association Test (IAT) displayed implicit bias, with 85 percent of whites showing bias against Blacks. The overarching message in the study was that most people possess bias, and due to its infinitely engrained status, people are generally unaware of their own bias despite its profound impact upon behavior and attitude. One study, which sent out resumes with traditionally white-sounding names like Emily and Greg and also resumes with Black-sounding names like Lakisha and Jamal, found a white applicant was 49 percent more likely than their Black counterpart to receive a call back in Chicago and 50 percent more likely in Boston. This kind of systematic discrimination is inherently exclusionary of Black people from the workforce, demonstrating the significant impact of bias, be it unconscious or not. A 2015 experiment involving baseball card auctions on eBay again highlighted the significant difference racial bias can have on economic outcomes. Baseball cards held by dark-skinned/African American hands sold for approximately 20 percent less than cards held by light-skinned/Caucasian hands, despite the cards held by the African American hand being more valuable on average. Without addressing bias directly, the challenge of equality will remain profound.

The U.S. Civil Rights Movement: A Synopsis

The Civil Rights Movement that began in the late 1950s won African Americans basic rights long denied to them, inspired other discriminated groups to fight for their own rights, and had a deep effect on American society.

After the Civil War, the 13th, 14th, and 15th amendments to the Constitution were supposed to guarantee equal rights for African Americans. But in the South, segregation of the races, the denial of opportunities to African Americans, and their disenfranchisement continued in a system known as "Jim Crow laws." In 1896, in a controversial decision, the United States Supreme Court, in the case *Plessy v. Ferguson*, upheld the "separate, but equal" facilities for the races.

During World War II, some progress on equality was made as President Roosevelt outlawed discrimination in the defense industry. Moreover, as the country fought for freedom around the world, many African-Americans began to wonder why they did not enjoy those freedoms at home. In 1954, a series of landmark cases testing segregation pressed by the National Association for the Advancement of Colored People (NAACP) culminated in the Supreme Court's ruling in the *Brown v. Board of Education* case, which unanimously outlawed segregation of public schools.

On December 1, 1955, the modern civil rights movement began when Rosa Parks, an African-American woman, was arrested in Montgomery, Alabama for refusing to move to the back of the bus. A new minister in town, Martin Luther King, Jr., organized a community bus boycott, which eventually led to the desegregation of the bus line and launched protests across the South. In 1960, spontaneous sit-ins by students began at lunch counters throughout the South, and in 1961, "Freedom Riders" boarded inter-state buses to test and break down segregated accommodations. These protests were peaceful, but they were met with violent, and often, brutal force — televised images helped win support from sympathetic whites in the North. In 1963, TV viewers saw hundreds of thousands of African Americans and whites march on Washington, DC to end racial discrimination. It was there that Martin Luther King, Jr. delivered his famous "I Have a Dream" speech.

After the assassination of President Kennedy and the landslide election of Lyndon Johnson, Congress passed the landmark *Civil Rights Act of 1964* and the *Voting Rights Act of 1965*, which outlawed racial discrimination in public accommodations and schools and removed obstacles to voting. As part of the Civil Rights Act, the Federal government would withhold funds from any state that did not desegregate, and as Health, Education & Welfare Secretary, John Gardner was the man holding the purse strings. In 1967, he threatened to cut off $95.8 million in Federal welfare funds to the state of Alabama unless it complied with desegregation guidelines. As Gardner remembers, "Civil rights was real hardball."

The passage of the Voting Rights Act, in particular, prompted a massive effort to register African Americans throughout the South to vote. Again, this was often met with violent resistance. After 1966, the Civil Rights Movement began to fracture between those who favored non-violent means to achieve integration and younger, more radical leaders who wanted to fight for "Black power." This split alienated some white allies, a process that was accelerated by a wave of rioting in Black neighborhoods in Northern cities throughout 1965 and 1967.

After Dr. King was assassinated 1968 and more rioting ensued, the Civil Rights Movement as a cohesive effort disintegrated. Yet the push for civil rights continued, with African Americans making gains economically, politically, and socially. Moreover, other discriminated groups were inspired by the Civil Rights Movement and borrowed its tactics. Over the 1960s and 1970s, gays and lesbians, women, Native Americans, and people with disabilities pushed for their own inclusion in American society. Source: PBS.org.
Housing & Education

Intricate linkages between racial bias in housing and education dating back over a century are major factors in economic gaps that persist today.

Housing Segregation

Past discriminatory housing practices have contributed to economic inequality for Black Americans in the present. According to the Economic Policy Institute (EPI), systemic and legalized housing discrimination over the 1940 to 1960 period prevented Black families from achieving homeownership, a critical staple for building intergenerational wealth. Moreover, the disparity in homeownership was perpetuated by continued discrimination in housing, through government, private sector, individual, and even technological choices and actions, keeping the racial gap wide (Figure 26). As recently as 2019, a popular Internet platform was cited for discriminatory practices by its search engines according to the Fair Housing Act.

Figure 26. The Gap Between Black and White Homeownership Rates Remains Wide

In an effort to combat a housing shortage in the mid 1930s the Federal Housing Administration (FHA) refused to insure mortgages in and near Black neighborhoods, a practice known as redlining. The most desirable neighborhoods for mortgages were designated green, and the least, typically predominantly Black neighborhoods, were designated red.

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One study revealed that between 1934 and 1968, 98 percent of home loans approved by the Federal government were given to white applicants. The FHA also subsidized builders creating large tracts of housing in suburban areas as long as those projects excluded Black homebuyers. Meanwhile, minorities were directed to urban housing projects. These urban neighborhoods, where Black family housing was permitted, were often cut off from resources and subject to underinvestment.

Individual and private sector choices also perpetuated housing segregation. Prior to the Fair Housing Act of 1968, residents of neighborhoods were allowed to create contracts called restrictive covenants to establish and maintain a particular racial makeup. Minorities, particularly Black persons, were prevented from moving into the suburbs or predominantly white sections of metropolitan areas either legally or through intimidation. Maps of Black neighborhoods were redlined and/or persons wishing to leave these neighborhoods for majority-white neighborhoods were threatened with violence. Realtors were threatened with the loss of their licenses if they showed homes to Black families outside of prescribed areas. These activities not only upheld segregation, but also concentrated poverty and underdevelopment in geographic locations.

Housing discrimination did not end with the Fair Housing Act. Tactics used to reinforce segregated neighborhood boundaries and majority-white suburbs became less overt. Real estate agents would show potential Black home purchasers houses in predominantly Black neighborhoods and decline to show many, if any, in other neighborhoods. Banks would continue to decline to provide financing for mortgages to Black homeowners, and insurance companies would refuse to insure mortgages assumed by Black owners. “Gentrification” in urban areas contributed to the decrease in affordability of housing for Black households. Realtors, renovators, and builders played a role as neighborhoods formerly populated by a certain racial or ethnic group were renamed, homes were upgraded to “luxury” status raising the price point, or upscale homes were built in low-income neighborhoods, inviting other such projects. These developments can lead to the displacement of current residents resulting in a change in demographics.

Housing discrimination became less overt after the Fair Housing Act including practices like gentrification, which decreased the affordability of homeownership for Blacks. Barriers to homeownership have resulted in Black families holding the least amount of housing wealth.

Fifty years of barriers to Black home ownership means that Black families have missed out on the benefits of home price appreciation — a key ingredient to wealth accumulation. The Federal Reserve’s Survey of Consumer Finances reported that as of 2016, Black homeowners continued to hold the least amount of housing wealth compared to other racial groups (Figure 27). The median amount of housing wealth for a Black family was $124,000, while the median amount for white families was $200,000, Hispanic households $158,000, and other households $240,000.

8 Fulwood Ill, S., “The United States’ History of Segregated Housing Continues to Limit Affordable Housing,” Center for American Progress, December 15, 2016.
11 National Low Income Housing Coalition. “Gentrification and Neighborhood Revitalization: WHAT’S THE DIFFERENCE?"
A Princeton University study notes that even among Black families owning homes, properties do not appreciate at the same rate as properties held by other ethnic groups. This is a reflection of the location of Black-owned homes in areas with generally lower home values and/or bias in the way others view Black homeowners. Even though the Great Recession’s housing crisis featured a wave of foreclosures, in the subsequent ten years, white homeowners were more likely to see some home price appreciation (+3 percent on average) versus Black families who didn’t see a recovery (-6 percent on average) (Figure 28). Indeed, past housing policies have concentrated Black families into higher-poverty neighborhoods with fewer of the amenities that help raise home values. Moreover, even higher-income Black families are still more likely to own homes in impoverished, predominately Black neighborhoods (Figure 29). Black families have also not benefited from tax incentives related to homeownership, including mortgage interest deductions (Figure 30).

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12 “The sordid history of housing discrimination in America,” Vox, December 5, 2019.
Segregated housing has led to segregated schooling by virtue of how schools are generally funded in the U.S.

Separate & Unequal Education

Segregated housing has facilitated and perpetuated unequal access to quality education for Black Americans, which is pivotal to erasing income and wealth gaps. *Brown vs. the Board of Education* was designed to end separate and categorically unequal public schooling. However, housing segregation and the method used to fund schools have helped to perpetuate separate and unequal access to education for many Black students (Figure 31). A significant degree of evidence suggests a strong correlation between high-value housing and the quality of schooling. Seventy-five percent of children attend public schools in the U.S., which means they are assigned to a school nearest to where they live. If neighborhoods are segregated, then so are the schools. Moreover, if schools are largely funded via property taxes, then schools in wealthy neighborhoods will invariably receive greater resources, while schools in poorer areas will receive fewer resources (Figure 32). State governments attempt to make up the differences, but often fall short.14 Resources affect both the quality of the school and the education students are given. Hence, racially segregated schools in areas of concentrated poverty have fewer resources, higher teacher turnover, and a lower quality of education.15 School choice in the form of vouchers and charter schools have in various instances improved the quality of education, but have been unable to address the underlying problem of segregation.

Figure 31. Greater Racial Housing Segregation Often Means Less Public School Funding

School Funding Per Student ($) vs. Degree of Racial Housing Segregation (0=No Segregation)


Figure 32. More Than One-Third of States Rely on Property Taxes as a Major Source of Public School Funding

Revenues for Public Elementary & Secondary Schools
(by Source of Funds & State or Jurisdiction, 2016-17)

Policing & Voting

Policies relating to community policing and mass-incarceration have contributed to a deleterious cycle that has led to underrepresentation in government and the labor market.

Community Policing

Extraordinary levels of incarceration as a consequence of bias within the criminal justice system are evident from movements such as the War on Drugs. Following the Rockefeller drug laws of the 1970s and born from the Reagan era, the War on Drugs has become interchangeable with the enhanced prosecution of Blacks. The perceived injustice is only amplified when considering the disparate application of punishment when associated with crimes committed predominantly by Blacks, such as the abuse of crack-cocaine, with 88 percent of Federal crack defendants Black by 2012, in comparison to crimes committed predominantly by whites (powdered cocaine) (Figure 33).\(^{16}\) Though the original 1986 100-1 ratio (500 grams of powdered cocaine and just 5 grams of crack cocaine incurred the same five-year sentence) has been reduced by the 2010 Fair Sentencing Act, a significant disparity remains with the current ratio standing at 18-1.\(^{17}\) According to recent Bureau of Justice Statistics, there has been material improvement in incarceration rates in the U.S., with the rate for Black Americans declining the most; down 34 percent since 2006.\(^{18}\) Nonetheless, the share relative to the entire Black population remains stubbornly high (Figure 34).

Figure 33. Drug Offences for Black Prisoners Are Overwhelmingly for Crack Cocaine

<table>
<thead>
<tr>
<th></th>
<th>Powder Cocaine</th>
<th>Crack Cocaine</th>
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<th>Marijuana</th>
<th>Methamphetamine</th>
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<td>45.6</td>
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<tr>
<td>Asian/Pacific Islander</td>
<td>0.5</td>
<td>0.3</td>
<td>0.7</td>
<td>1.7</td>
<td>3.1</td>
<td>10.8</td>
</tr>
<tr>
<td>American Indian/Alaska Native</td>
<td>0.4</td>
<td>0.3</td>
<td>0.1</td>
<td>1.5</td>
<td>1.2</td>
<td>0.8</td>
</tr>
</tbody>
</table>

Source: Bureau of Justice Statistics, Citi Research

Unequal application of drug-related sentencing has led to mass-incarceration leading to a much higher likelihood of Black incarceration.

Reductions in incarceration rates notwithstanding, Black Americans remain far more likely to be imprisoned than their other racial counterparts — almost twice as likely as Hispanic Americans and five times more likely than white Americans. As a result, the United States prison population is disproportionally Black dominated (33 percent) relative to their presence in the U.S. total population (12 percent). A similar trend can be seen with the Hispanic population (23 percent of prison population vs 16 percent of U.S. population), in contrast to white Americans who make up just 30 percent of the prison population despite being 63 percent of total U.S. population. Startlingly, one in every three Black boys born can expect to be sentenced within

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their lifetime, versus one in every six Latino boys and one in every seventeen white boys.

This disparity is even more apparent when reviewing individual age ranges, with 1 in 20 Black Americans between the ages of 35 and 39 in either State or Federal Prison. Moreover, several studies have shown the percentage difference in sentence length for Black versus white prisoners can be from 5 to 20 percentage points (Figure 35). Though only accounting for 5 percent of the global population, the U.S. is home to 25 percent of the world’s prison population, recording the highest incarceration rate globally. Aside from the racial inequality, the cost of maintaining this system is outsized, costing $81 billion in 2012 alone (with the rate of spending three times that on Pre K-12 education over the last 30 years).19

Incarceration also limits the ability of Black ex-offenders to obtain employment, earn income, and build wealth. The Brookings Institute highlights several key facts linking low job prospects to incarceration and vice-versa. Former prisoners fare poorly in the labor market, with only 55 percent earning any income in the first year of release and median earnings of only $10,090. Prisoners generally had poor labor market prospects before becoming incarcerated. An estimated 51 percent of prime-age men were employed two full years prior to imprisonment, with median earnings of only $6,250. Growing up in poverty dramatically increased the likelihood of incarceration. Boys raised in families in the bottom decile of the income distribution were 20 times more likely to be in prison in their early 30s than those born in the top decile. Notably, boys from the poorest families were 40 times more likely to be imprisoned than boys from the wealthiest families. Brookings finds that an astounding one-third of men age 30 without any annual earnings are either incarcerated or ex-prisoners. Moreover, where one grows up is highly correlated with the likelihood of incarceration. Imprisonment rates can vary by a factor of 30 between zip codes in the same city.20

19 NAACP. “Criminal Justice Fact Sheet.”
Bias against ex-prisoners leads to a poor earnings trajectory post-imprisonment

A poor earnings trajectory post-imprisonment is linked to bias. Unemployment following incarceration is often a consequence of the “prison penalty,” where employers discriminate against persons with criminal records. Evidence of a criminal record reduces employer call-back rates by 50 percent.

Studies suggest that formerly incarcerated persons do desire to work: among 25-44 year olds, 93.3 percent were active in the labor market compared to 83.8 percent of the general population of the same age. However, unemployment rates for formerly incarcerated persons can be five times that of persons who were never imprisoned. Unemployment rates for Black female former inmates were 44 percent before COVID-19, and the rate for Black males was 35 percent. Black women are also more likely to work part-time jobs after imprisonment than other racial groups.

Voting Power

This cycle of mass incarceration becomes increasingly problematic when considering the impact of felony disenfranchisement and its disproportionate impact on people of color. As of 2016, one in every thirteen Black American adults could not vote due to felony convictions, with more than 20 percent of Black adults in four states (Florida, Kentucky, Tennessee and Virginia) disenfranchised.21 There is a sense of cyclicality within disenfranchisement as 27 percent of non-voters were rearrested versus only 12 percent of voters. It has been argued that political elections would have seen differing outcomes should disenfranchisement not have been established, including seven Senate races between 1970 and 1998, as well as the infamously tight Gore-Bush Presidential election of 2000.22 Though there has been significant progress, with 25 States modifying their felony disenfranchisement provisions since 1997 (10 repealing or amending lifetime disenfranchisement laws), it still stands that of the total 3.1 million American adults estimated as banned from voting, 2.2 million are Black Americans.23

The forced reduction in political clout is only compounded by already lower voter turnout rates for Black and minority voters versus their white counterparts. Excluding record turnout in 2008 (69.1 percent) during the Obama election cycle, Black voters have underperformed white voters with regards to turnout; 51.4 percent vs. 54.2 percent on average from 2000-2018.\(^{24}\)

Figure 38. Felony Disenfranchisement Restrictions by State, 2019

The Black and minority vote is set to become increasingly significant as the U.S. is forecast to become minority white by 2045.\(^ {25}\) With white voters at less than 50 percent for the first time, the influence of minority voters will be enhanced with the Black vote making up 13.1 percent of the vote, Hispanic 24 percent and Asian 7.9 percent. This trend is compounded by the emergence of Gen Z as part of the electorate. As a group, ‘minority majority’ is set to potentially be reached in Gen Z as early as this year (2020), with the 18-29 age range achieving this by 2027.\(^ {26}\) Perhaps unsurprisingly Gen Z voters are set to be some of the most ‘liberal’ yet, essentially reflecting Millennial positioning on key issues.

What is apparent is that Gen Z voters from both sides of the aisle are more consolidated around core social issues than their older counterparts. Significantly, over 60 percent of both Gen Z and Millennial voters view increasing racial and ethnic diversity as a good thing for society, versus only 48 percent of Boomers.

With the U.S. set to become minority white by 2045 based on demographic trends, the Black and minority vote will become increasingly significant.

Younger voters (Gen Z) are more ethnically diverse and are more consolidated around core social issues than older voters.

---

\(^{24}\) United States Elections Project. “Voter Turnout Demographics”.


\(^{26}\) Ibid.
More importantly, even amongst Republican Gen Z voters, a majority still agree with that statement, versus only 30 percent of Republican Boomers.\textsuperscript{27}

This disparity between younger and older Republicans can be found elsewhere, with a majority of Republican Gen Z also in favor of the government having a larger role in society. Sixty-six percent of American Gen Z and Millennials also hold the opinion that the Black population in the U.S. is treated less fairly than the white population vs. only 50 percent of Gen X. As the younger generations gain prominence amongst the voting population, first as a support to the already established Millennial voting trends and then in their own right, they will demand more political attention. With Gen Z voters composing 9 percent of the 2020 electorate (up from 4 percent in 2016), versus the declining share of Baby Boomers (from 68 percent in 2016 to only 4/10 in 2020), policymakers may need to be more conscientious of this new group of voters.\textsuperscript{28}

Recent events have rallied and inspired the political activism of many young and Black voters — traditionally two groups with lower-than-average voter turnout. Given the demographic makeup of Gen Z is increasingly diverse (minority majority by 2020 with Blacks (14 percent) and Hispanics (25 percent) the largest minority groups), its unsurprising that movements such as ‘#BlackLivesMatter’ had the support of over 60 percent of Millennials and Gen Z, versus only 37 percent of Boomers.\textsuperscript{29} Should young minority voters translate this intensified interest in addressing the issues most prominent to themselves into presence at the polls, then there is a real argument to stress the significance and impact this group can have.

Voter suppression remains a persistent threat to full participation of Black voters in the U.S. democratic process. The connection between voter suppression and race did not end in the 1960s. Tactics that disenfranchise voters of color, and particularly Black voters, are still in existence today, although they are less blatant than those deployed during the Jim Crow era. The Voting Rights Act of 1965 significantly curtailed voter suppression. In 1966, the Supreme Court invalidated poll taxes. However, a 2013 Supreme Court decision *Shelby County v. Holder* vacated key provisions of the Voting Rights Act opening the door for state and local governments to erect barriers to voting for racial minorities. The main element in the 2013 decision ended the requirement of state and local governments to obtain preclearance from the Federal government before changing voting rules. Over the last 10 years, 25 of 50 states have implemented new voting restrictions. Ten of those states have sizable Black populations: Mississippi, Alabama, Florida, Georgia, North Carolina, South Carolina, Virginia, Illinois, Michigan, and Tennessee according to the Brennan Center.

New restrictive voting rules include requiring voters to present government-issued photo IDs, which disproportionately affects the youngest and oldest voters, as they are less likely to have a driver’s license or permit (Figure 41). There is even disparity among types of IDs. In Texas for example, handgun licenses, which are predominantly held by white persons (82 percent), are permissible (Figure 44). But student IDs are disallowed, despite more than half of the students of the University of Texas system being racial or ethnic minorities (51 percent). While the stated aim of voter rules is to combat voter impersonation fraud research by the Brennan Center for Justice has found *scant evidence of such types of behavior*. Other barriers to voting include restrictions on early voting, which is largely used by minority voters; third party voter registration drives that often target Black voters; voter list purges, which have eliminated 33 million voters from the rolls over the 2014-2018 period (Figure 43); and exact matches of voter registration form data and IDs. Other tactics include not upgrading technology; moving or closing polling stations without notifying voters; shortening voting hours; restricting early voting on weekends when Black voters are likely to vote; shutting Departments of Motor Vehicles (DMVs) in minority communities where heavy voter registration takes place; and/or not properly training poll workers. Federal courts have ruled that many voting restrictions have been implemented with the aim to racially discriminate.

**Figure 41. Black Voters Are More Likely to Not Have Government Issued Photo IDs**

<table>
<thead>
<tr>
<th>Voting-Age Citizens in U.S. Without Current Government-Issued Photo ID</th>
</tr>
</thead>
<tbody>
<tr>
<td>White</td>
</tr>
<tr>
<td>Black</td>
</tr>
</tbody>
</table>

Source: Brennan Center. Citi Research

**Figure 42. In Some States, Like North Carolina, Black Voters Are More Likely to Vote Early**

<table>
<thead>
<tr>
<th>Percentage of Early Voters in 2012 North Carolina Elections</th>
</tr>
</thead>
<tbody>
<tr>
<td>White</td>
</tr>
<tr>
<td>Black</td>
</tr>
</tbody>
</table>

Source: Brakebill vs Jaeger, Citi Research

**Figure 43. Several States with Notable Minority Populations Are Engaged in Heavy Voter Registration Purges: Percent of Lists Purged**

Source: Brennan Center. Citi Research
Figure 44. Handgun Licenses Are Acceptable Forms of ID for Voting in Texas, but Student IDs Are Not

Texas: Number of Handgun Licenses Issued (2018)

<table>
<thead>
<tr>
<th>Ethnicity</th>
<th>Licenses Issued</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Native American</td>
<td>282,076</td>
<td>82%</td>
</tr>
<tr>
<td>Black</td>
<td>17,137</td>
<td>1%</td>
</tr>
<tr>
<td>Asian or Pacific Islander</td>
<td>8,406</td>
<td>2%</td>
</tr>
<tr>
<td>Multi-Racial</td>
<td>22,359</td>
<td>8%</td>
</tr>
<tr>
<td>Other/Unknown</td>
<td>6,033</td>
<td>2%</td>
</tr>
<tr>
<td>White</td>
<td>15,496</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: Texas Department of Public Safety, Citi Research

Figure 45. Many States with Large Minority Populations in the South and West have Closed Polling Stations

Number of Polling Places Closed (2012-2018)

<table>
<thead>
<tr>
<th>State</th>
<th>Number of Polling Places Closed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alaska</td>
<td>6</td>
</tr>
<tr>
<td>Arizona</td>
<td>320</td>
</tr>
<tr>
<td>Texas</td>
<td>15,496</td>
</tr>
<tr>
<td>Louisiana</td>
<td>750</td>
</tr>
<tr>
<td>Mississippi</td>
<td>72</td>
</tr>
<tr>
<td>South Carolina</td>
<td>96</td>
</tr>
<tr>
<td>Georgia</td>
<td>126</td>
</tr>
<tr>
<td>North Carolina</td>
<td>18</td>
</tr>
<tr>
<td>Alabama</td>
<td>18</td>
</tr>
<tr>
<td>North Carolina</td>
<td>29</td>
</tr>
</tbody>
</table>

Source: The Leadership Conference Education Fund, Citi Research

Income and Wealth

Disparities in housing, education, policing, and voting rights plus conscious and unconscious bias have limited access to employment for many Black Americans, and consequently social mobility and wealth accumulation.

Peak Income

An extended history of job discrimination, plus unequal access to quality education in the U.S., have capped lifetime income prospects for many Black Americans. Census Bureau data reveal that as of 2018, it was still the case that male Black and Hispanic workers would see peak income earlier in their careers (age 40s), and at a far lower level (~$40,000) than their white male peers (early 50s and ~$65,000) (Figure 46). The gap between peak income between Black and Hispanic workers is even greater relative to Asian male workers (~$80,000), even though Asian males experience peak income around the same age. For women the peak age is about the same as males, and the gaps in income between races is smaller. Moreover, peak earnings for Black women are about $5,000 higher than for Black men. Nonetheless, women in general earn notably less over a lifetime than do men (Figure 47), having significant negative implications for retirement income which must typically be stretched over a longer period for women than for men.

Peak earnings are lower for Black and Hispanic males than white males and occur at a younger age.
Income is key to accumulating liquid assets, which are important for smoothing consumption. Lower lifetime income prospects not only cap retirement funds, but also limit spending options over the course of a lifetime, and especially during economic downturns. The Bureau of Labor Statistics’ Consumer Expenditure Survey shows that Black families spend slightly more of their incomes than other ethnic and racial groups on budgetary staples, including on housing (20 percent) and utilities (8 percent) (Figure 48). Black families (69 percent) are highly likely to be faced with unaffordable child care options, as are Hispanic families (72 percent), which can often consume as much as 11 percent of a family’s monthly income (Figure 49).\textsuperscript{30} Importantly, the level of family income is important for creating liquid assets (i.e., savings in the form of cash or easily convertible instruments like certificates of deposit (CDs)).

Savings are paramount for helping families to smooth their consumption over a lifetime, particularly during recessions, and shocks including job loss and illness. According to the Federal Reserve Board’s Survey of Consumer Finances, the median amount of liquid assets held by Black families in 2016 (the most recent reading), was $11,400 (Figure 50). This is roughly one-third of what white families held ($29,200), suggesting that Black families are potentially more vulnerable to hardship during tough economic times. Hispanic families were worse off, with just $6,500 in liquid assets.

Historical gaps in intergenerational wealth accumulation have led to challenges in social mobility for Black Americans.

### Wealth and Debt Gaps

The Federal Reserve Board’s Survey of Consumer Finances reveals that the wealth gap between Black families and white families has remained persistently wide. Among Black families, household net worth, which is defined as total assets less all liabilities, has hovered in the $15,000 to $25,000 range over the last thirty years (Figure 51). Net worth for white families has been in the range of $115,000 and $200,000. The gap between white and Black familial income is a multiple of eight. Meanwhile, the leverage ratio — debt divided by assets — for Black families has remained stubbornly elevated above 25 percent over much of the last 30 years, while the leverage ratio for white families has held between 10 and 15 percent (Figure 52). These metrics matter as the body of literature suggests that wealth and debt play meaningful roles in social mobility, especially from one generation to the next.
Building wealth is not just a function of higher income, but the ability to save out of income once basic needs are met. The outsized debt-to-asset ratio for Black families indicates that a number of families have insufficient income to meet needs and are financing expenditures with credit. This indicates a lack of disposable income available for saving and investing. Other factors contributing to wealth accumulation include (1) intergenerational transfers of wealth within families; (2) conditions where one lives, such as poverty rates, home values and housing segregation;(3) geographic and financial barriers to human capital formation (e.g., elevated costs for education; limited job prospects in region); (4) discrimination in labor markets and/or racially motivated segmentation; and (5) racial biases in policies and practices of government, institutions, and the private sector. Without amelioration, each of these factors discussed above will perpetuate racial wealth gaps.

Figure 51. White Families Have 8x More Wealth than Black Families

Figure 52. Leverage Ratios for Black Families Have Remained Elevated

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31 (i) (e.g., Meschede et al. 2017; Chiteji and Hamilton 2002; McKernan et al. 2014b); (ii) (e.g., Chetty et al. 2019; Perry et al. 2018); (iii) (e.g., Dobbie and Fryer 2011; Jackson and Reynolds 2013; Addo et al. 2016); (iv) (e.g., Grodsky and Pager 2001; Bertrand & Mullainathan 2004); (v) (e.g., Oliver and Shapiro 2013; Katznelson 2005; Robles et al. 2006; Bayer et al. 2014; Asante-Muhammad).
Closing Gaps Generates Growth

Figure 53. The Economic Case for Closing Racial Gaps in the United States

Amid a once-in-a-century global pandemic that has resulted in staggering economic and job losses, investors should welcome ideas and actions that can add value. Closing racial gaps is one.

The business case for eliminating racial gaps is well established. Some firms believe continuing to focus on Diversity & Inclusion (D&I) as part of their COVID-19 recovery strategy is a luxury. However evidence shows firms who do not abandon D&I protocols may fare better. Companies in the top quartile for both gender and ethnic diversity are 12 percent more likely to outperform companies in lower quartiles. Top quartile companies outperformed those in the fourth by 36 percent in terms of profitability (up from 33 percent in 2017, 35 percent in 2014). The economic case for closing racial gaps is equally compelling. Present racial gaps in income, housing, education, business ownership and financing, and wealth are derived from centuries of bias and institutionalized segregation, producing not only societal, but also real economic losses. However, future gains from eliminating these gaps are enormous: benefiting not only individuals, but also the broader U.S. economy with positive spillover effects into the global economy. If four key racial gaps had been closed 20 years ago, then the additional GDP that could have been added to the U.S. economy might have summed to as much as $16 trillion. Casting this amount forward into the future, a global economic model suggests roughly $5 trillion could be added to U.S. GDP through 2025 from closing the gaps. The consequent additions to U.S. and global GDP growth averages roughly 0.4 percentage point and 0.1 percentage point per year, respectively. These gains do not reflect the potential narrowing of the wealth gap experienced by Black persons in the U.S., which would inevitably also lead to additional economic gains.

Racial and gender wage gaps remain wide in the U.S., signaling lost opportunity for income, consumption, investment, and real GDP growth. Typically, wage gaps are measured by comparing the median wage of female and/or non-white workers to that of white males. Over the last 20 years, wages for Asian males have broken significantly above those of white males, and in the most recent two years, wages for Asian women exceed those of white males. However, for white women in general and Black and Hispanic workers in particular, the gaps between white male wages persist. The gap for Black male wages compared to white male wages was 80 cents on the dollar, as of 2020. The gap for Black female wages to white male wages was just below 70 cents on the dollar in 2020. The gaps for male and female Hispanic workers relative to white male wages is even starker at about 70 cents and 60 cents, respectively (Figure 54).

Individual wage losses due to gaps over the last 20 years have been substantial. The gap in terms of aggregate income for white female wages (i.e., all white women nationwide) compared to white male wages has been narrowing as a share of U.S. GDP over the last 20 years (Figure 55). Some of this reflects slower GDP growth in general, but also a slight increase in white female wages. However, for Black and Hispanic male and female workers, their gaps as shares of GDP have not improved. The presence of gaps denote significant opportunity loss in terms of wages that could have been used for personal consumption, home buying, or investment in small businesses. As the wage gap with white males was not collapsed for white females 20 years ago, the typical individual white female worker missed out on roughly $175,000 in additional income. For Black males, the loss was approximately $225,000, for Black females and Hispanic males about $300,000, and for Hispanic females roughly $360,000 (Figure 56).
Closing the minority wage gap 20 years ago could have generated $12 trillion in income; $2.7 trillion for Blacks

Closing the Gap

The wage gaps between minoritities and white males, if closed 20 years ago might have generated $12 trillion in additional income, and indeed for Black workers an additional $2.7 trillion. Since the Great Financial Crisis, income inequality expressed in one fashion by wage gaps has worsened in most years. The aggregate amount of income lost due to wage gaps each year is equivalent to a roughly 0.15 percentage point contribution to U.S. GDP growth per year (Figure 57). While that appears to be a nominal amount in comparison to the losses experienced amid the COVID-19 global recession, in "normal" years a nearly 0.2 percentage point add to annual U.S. GDP growth is actually quite substantial. This is especially true as the pre-pandemic economy was on course to slow to a new equilibrium rate of 1.7 to 1.9 percent a year. The total amount of income that could have been generated since 2000 if all income gaps were closed sums to an astounding $12 trillion, with $5 trillion from closing the white male-white female gap, and another $7 trillion from closing the gaps between white males and Black and Hispanic workers. The contribution of closing the Black worker gaps with white male wages is an outsized $2.7 trillion (Figure 58 and Figure 59).
Figure 57. Closing Wage Gaps for White Women and Minorities Could Have Contributed to GDP Growth in Most Years Post-Great Financial Crisis (GFC)

Figure 58. Gaps with White Male Salaries Remain Wide in 2020

Figure 59. Lost Wages Add Up to Trillions of Dollars in Foregone GDP
Racial Labor Segmentation Gap

Location, Location, Location

Where a person works determines their wage potential. In general, Black workers are underrepresented in management, business, financial, professional and related occupations that pay the highest salaries. The share of Black managers is roughly 10 percent compared to almost 20 percent among white workers (Figure 60). The share of Black professionals is about 20 percent compared to nearly 35 percent among Asian. On balance, Black workers represent 10 percent or less of many of the occupations that pay the top wages, including STEM, finance, legal, medicine, and management jobs (Figure 61). Black workers are, however, overrepresented in sales and services occupations, office and administrative, as well as in transport and material moving occupations (Figure 62).

Black workers are more likely to be situated in jobs requiring lower skills and/or are more susceptible to automation. Skill requirements and the risk of automation appear to be drivers of wage differences between more technical and less technical occupations. A study by Carl Benedikt Frey and Michael Osborne highlighted in the Citi GPS report Technology at Work noted that 47% of U.S. jobs were at risk due to automation. Among Black workers, close to half (46 percent) work in jobs that are subject to potential automation compared to those that are not (54 percent), and only 3 percent of Black workers are in technical jobs, leaving the other 97 percent in non-technical jobs that could be automated to some degree (Figure 63).

Figure 60. Black Workers Are Underrepresented in Management, Business, financial, Professional and Related Occupations

Figure 61. Black Workers Comprise Small Shares of Occupations that Typically Pay Higher Wages Compared to White and Asian Workers
Figure 62. Black Workers Are More Concentrated in Jobs that Pay Less than $25/hour and May Also Require Fewer Skills

Source: Bureau of Labor Statistics, Citi Research

Figure 63. Black People are More Likely to Work in Jobs That Are Susceptible to Automation

Source: U.S. Government Accountability Office, BLS and Citi Research
Pursuing education and training for more technical and skills-based careers can help close the racial labor segmentation gap.

**Closing the Gap**

Encouraging Black students and workers to pursue education and training suitable to more technological and skills-based careers can help close the racial labor segmentation gap. The BLS cites literature in labor economics positing that technology has increased the productivity of workers with college educations more than workers with less education. The increase in productivity helps explain the rise of earnings for college-educated workers relative to the earnings of non-college-educated workers, despite the increase in the labor supply of college-educated workers. The BLS notes that since 1980, the relative incomes of college-educated workers have risen compared to high school-educated workers, after adjusting for other observable factors. The phenomenon is called the college earnings premium, which has increased from 34 percent in 1980 to 68 percent by 2018 (Figure 65). One aspect of the widening premium is the share of hours worked by college-educated workers has nearly doubled from 20 percent in 1979 to 39 percent by 2018. In a simple supply-demand framework, this suggests demand for college-educated workers has outpaced the steady increase in supply. Hence, there is plenty of room for more Black college graduates to be absorbed into the U.S. labor market.

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**Figure 64. Select Occupations Are More Susceptible to Automation**

**Occupations Projected to Experience Declines in Share of Industry Employment Due to Automation (2016-2026E)**

- Other
- Farming, Fishing, & Forestry
- Business & Financial
- Transport & Material Moving
- Office & Admin Support
- Production

Source: US Government Accountability Office, BLS, Citi Research

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**Figure 65. College Degrees Produce Notable Wage Benefits**

**College Wage Premium, Experience Premium, & Share of Labor Supplied by College-Educated Workers (1964–2018)**

Source: BLS, Citi Research
Racial Education Gap

Higher Education

Encouraging Black students to pursue higher education is a manner in which racial wage and income gaps can be closed, but there are challenges. Plenty of literature and simple calculations affirm that persons with a degree beyond a high school diploma earn more over a lifetime than persons with a high school degree or less. The difference over a 40-year career is upwards of $1.3 million for a person with a bachelor’s (or equivalent) degree and $2.0 million for a person with an advanced degree (Figure 66). However, the path towards college and advanced degrees for Black students is challenged by lack of access to a quality pre-school education and underfunding of public schools from grades K-12. For Black students who do attend college, which since 1980 has consistently been 10 percentage points below the national average, the occupation chosen after graduating from college or with an advanced degree also determines lifetime income.

Figure 66. Students Earning Bachelor or Advanced Degrees Earn More Lifetime Income

Estimated Earnings Over 40-Year Career
(2010 to 2050E)

<table>
<thead>
<tr>
<th>Attainment of higher education can be challenged by lack of access to quality pre-school education and underfunded public schooling in K-12</th>
</tr>
</thead>
</table>

Black children are more likely to attend full-time pre-school than other children

1. Education literature suggests that children who receive a pre-school education perform better once in grades K-12. Pre-school programs also serve as an important form of childcare for working parents. A [Brookings Institute](https://www.brookings.edu) report summarizing early education studies found that high-quality programs produced short-term gains in cognitive functioning and longer-term gains in school achievement and social adjustment. Moreover, pre-school education yields higher school achievement, fewer children being ‘left-back’ in a grade, reduced need for special education, and a reduction in neighborhood crime. Early childhood education can also save governments between $13,000 and $19,000 per child over and above the cost of the pre-school program. The [National Center for Education Statistics](https://nces.ed.gov) reported that in 2018, 26 percent of Black children aged 3-5 years old attended full-time pre-school, exceeding every other racial group (Figure 67). Slightly more white children overall (43 percent) attended either full- or part-time pre-school, compared to 38 percent of Black children. Nonetheless, a sizable number of Black children overall attend pre-school.
However, access to high quality, adequately-funded pre-school remains challenged in terms of availability, quality, funding, and training of teachers. State-funded (as opposed to private) pre-school programs serve just 22 percent of 4-year-olds and 3 percent of 5-year-olds. Only three states — Florida, Georgia, and Oklahoma — make pre-school available to all 4-year-olds. Twelve states with state-funded pre-school do not offer programs to 3-year-olds, and 12 states have no state-funded pre-school at all (Figure 68). Overall state spending on pre-school is disparate, ranging from $1,600 per child to $10,000, and the average amount of spending ($3,600 per child) is roughly one-third of the average spend on public school students in K-12. Quality of education also varies. The National Institute for Early Education Research (NIEER) reports only 17 states meet eight or more of the ten quality-checklist criteria. Poor funding is directly linked to quality according to NIEER, and programs serving primarily poor students tend to receive less funding than those who serve more middle-class students. Relatedly, while 76 percent of pre-school teachers have a Bachelor’s degree, only roughly 56 percent have a teaching certificate to teach young children. Moreover, pre-school teachers earn less than half of that earned by elementary school teachers, and 70 percent report earnings below 200 percent of the Federal poverty guidelines.

These figures are important, as state programs comprise 70 percent of all early childhood education centers, and the states with the least funding and poorest quality tend to host large Black populations.

The funding gap between white and minority school districts in the U.S. sums to $23 billion, despite serving the same number of children. However, access to high-quality, adequately-funded pre-school varies by state... and poor funding is directly linked to quality of education.

### Figure 67. Black Children More Likely to Attend Full-Day Pre-School

<table>
<thead>
<tr>
<th>Race/Ethnicity &amp; Attendance Status</th>
<th>Percentage of 3- to 5-yr Olds Enrolled in Pre-School Programs</th>
</tr>
</thead>
<tbody>
<tr>
<td>White Full-Day</td>
<td>21%</td>
</tr>
<tr>
<td>Black Full-Day</td>
<td>26%</td>
</tr>
<tr>
<td>Hispanic Full-Day</td>
<td>21%</td>
</tr>
<tr>
<td>Asian Full-Day</td>
<td>20%</td>
</tr>
<tr>
<td>Two or more races Full-Day</td>
<td>19%</td>
</tr>
<tr>
<td>White Part-day</td>
<td>22%</td>
</tr>
<tr>
<td>Black Part-day</td>
<td>12%</td>
</tr>
<tr>
<td>Hispanic Part-day</td>
<td>13%</td>
</tr>
<tr>
<td>Asian Part-day</td>
<td>16%</td>
</tr>
<tr>
<td>Two or more races Part-day</td>
<td>16%</td>
</tr>
</tbody>
</table>

Source: Census Bureau, Citi Research

### Figure 68. Few States Have High Quality Pre-School Programs

Note: Idaho, Montana, New Hampshire, North Dakota, South Dakota, Utah and Wyoming have no state pre-school program. These multi-program states have programs with different quality standards. Data in map is for largest state program. Source: National Institute for Early Education, NPR, Citi Research

### Funding K-12 Schools

The racial education gap begins with widespread underfunding of schools with high concentrations of children of color. The average difference in funding of predominately white school districts and predominately minority school districts sums to $23 billion, despite serving roughly the same number of children, according to a study by nonprofit think tank EdBuild. In the U.S., 27 percent of students live in non-white districts, while 26 percent live in white districts. In white districts, 5 percent of students live in high-poverty areas, while in non-white districts 20 percent of student live in high-poverty areas (Figure 69). Even relative to high-poverty white districts, well-off non-white districts receive less money.
The difference between the revenue received for funding low-poverty white districts ($14,121 per student) and all non-white districts ($11,853) is more than $2,200 per student (Figure 70). EdBuild estimates the national average difference in revenue per student between non-white and white districts is $2,226. This difference this difference sums to $22.5 billion ($2,226 times 10,126,150 affected students). States that stand out in terms of the severity of the funding gap between non-white and white school districts include California, Texas, New Jersey, and Arizona (Figure 71).

Reliance on property taxes for school funding means wealthier municipalities will have potentially greater resources to finance their school districts.

Where a student resides can determine whether they will face a funding disadvantage. The Federal government spends roughly $23 billion a year on K-12 education. While a sizable figure, it only constitutes 10 percent of total funding for public schools. The remaining $660 billion is raised at the state and local government level. The gap in school funding reflects a combination of past housing segregation policies and a patchwork of current district financing schemes that value local control.
According to EdBuild, nearly all states rely upon property taxes to fund schools. Hence wealthier municipalities will have potentially greater resources to finance their school districts. Fifteen states also generate funds through locally-raised sales taxes, six permit locally-governed income taxes and many states use revenues from lottery gaming programs. Just over half of all states employ a student-based formula, while the remainder fund schools based upon a variety of formulas.

**STEM and High-Demand Careers**

In addition to funding, school curricula and whether students are directed towards high-wage and/or in-demand occupations matters for closing the education gap that can help solve the income gap. Department of Education data from 2013 indicated that U.S. high school students were on average taking fewer course credits in STEM (Science, Technology, Engineering, and Mathematics) disciplines than in humanities and arts. Even among those taking STEM coursework, Black students took slightly fewer credits than their white and Asian counterparts (Figure 72). More recent data from 2015-16 show that among students receiving university degrees few — 20 percent or less — earn degrees in STEM-related fields, which typically have elevated wages and lifetime earnings potential. Asian students were the exception, with 30 percent of all degrees from STEM programs. Among all other students, Black students produced the least STEM graduates at 12 percent (Figure 73).

---

**Figure 72. U.S. Students in General Are Taking Fewer Credits in STEM Courses than Non-STEM Courses**

![Diagram showing average high school credits earned by subject areas (by race/ethnicity, number of credits, 2013)](image)

*Source: National Center for Educational Statistics, Citi Research*

---

STEM jobs generally pay more than many ‘middle-class’ non-STEM jobs. Even within the STEM fields, jobs requiring greater skills pay notably more than the U.S. national median annual salary of $38,640 (Figure 74). It’s logical for young students, to not only pursue more difficult jobs in the STEM, finance, and legal fields, but to also aim for those requiring greater mental and/or technical acuity within these fields given the enhanced potential for increased lifetime earnings. Access to high quality education and opportunities throughout one’s academic career, as well as guidance by mentors and exposure to higher paying occupations early in one’s working career are key to closing the gap.
Closing the Gap

Closing the gap in advanced degrees between Blacks and the national average 20 years ago would have produced an additional 1.7 million Black university graduates.

Closing the college/advanced degree racial gap 20 years ago might have generated up to $113 billion in additional income for saving, investing and consumption. Since the early 1980s, the proportion of Black people aged 25+ who obtain a bachelor’s degree has persistently been about 10 percentage points below the U.S. national rate (Figure 75). If this gap was closed back in 2000, then over the last 20 years there might have been an additional 1.7 million Black university graduates. If these graduates earned the median income that bachelor degree holders made, as described above, the equivalent additional income generated might be roughly $90 billion. If all of those graduates obtained advanced degrees, the figure might increase to $113 billion (Figure 76). This is not a recommendation for students to only pursue college or graduate school. It is saying that any degree — college, graduate, associate, technical — in excess of a high school degree typically signals greater lifetime income.

Figure 73. Black People Have the Smallest Share of STEM Graduates

STEM Bachelor’s Degrees as % of Total Bachelor’s Degrees Conferred by Post-Secondary Institutions, (by Race/Ethnicity, Academic Year, 2015–16)

Figure 74. STEM Jobs Pay More than Many Middle-Class Jobs

Annual Median Salary ($/Year)

Source: National Center for Education al Statistics, Citi Research

Source: National Center for Educational Statistics, Citi Research

Rates of Bachelor’s Degree Attainment Among Persons Age 25 and Over (1940 - 2018)

Closing the Black Post-Secondary Degree Gap Additional Income for Consumption ($bn)

Source: National Center for Educational Statistics, Citi Research

Source: National Center for Educational Statistics, Citi Research

Figure 75. The Gap Between Black and National Degree Attainment Has Been Fairly Steady at Around 10 Percentage Points

Figure 76. Closing the 10 Percentage Point Gap 20 Years Ago Might Have Generated an Additional $90 to $113 Billion in Black Income
Racial Wealth Gap

Black and Hispanic families continue to trail white and Asian families in accumulating wealth. Issues like lack of inheritances and barriers to entry, including to income and access to credit, appear to be working against the ability of Black and Hispanic families to amass wealth required for acquiring assets for personal financial security and community investment. Data from the Federal Reserve’s 2010 and 2013 Surveys of Consumer Finances, while dated, reveal that inherited wealth significantly bolsters familial wealth, particularly for white families (Figure 77). Black families are less likely to receive (10.6 percent) or expect an inheritance (5.9 percent) relative to white families (22.9 percent and 18.8 percent). Meanwhile, easier avenues toward the accumulation of generational wealth, like home ownership and retirement benefits, are littered with obstacles for minorities, especially Black and Hispanic families.

Figure 77. Inheritance Can Meaningfully Bolster Familial Wealth

<table>
<thead>
<tr>
<th></th>
<th>Including Households With Inheritances</th>
<th>Only Households Without Inheritance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean Wealth</td>
<td>Median Wealth</td>
</tr>
<tr>
<td>White</td>
<td>$1,152,818.00</td>
<td>$287,457.00</td>
</tr>
<tr>
<td>Black</td>
<td>$168,238.00</td>
<td>$38,174.00</td>
</tr>
<tr>
<td>Hispanic</td>
<td>$399,498.00</td>
<td>$65,960.00</td>
</tr>
</tbody>
</table>

Source: Federal Reserve Board, Citi Research

Financial Assets

Black families have one-third, and Hispanic families one-fourth the financial assets of white families. Financial assets are dependent on income, job benefits, the ability to accumulate savings, and generational (inherited) wealth. The ability to invest depends on initial conditions including inherited wealth, the ability to work in a high wage job that facilitates savings needed for investment, a higher tolerance for risk, and financial savvy. The sections above explain the challenges for Black and Hispanic families regarding inheritances and high wage employment. Linked to high wage employment are benefits including retirement benefits and pooled investment funds like 401K plans, which are an easy way to accumulate financial wealth. Black and Hispanic workers are almost equally likely to participate in traditional pension plans, but less likely to participate in 401K plans relative to their white counterparts (Figure 78). Jobs that have unions which bargain for pensions may explain some of the similarity in rates of participation among racial groups. Greater labor force participation in jobs that are non-unionized, part-time and/or lacking in benefits among Black and Hispanic workers may explain the disparity for 401K plans (Figure 79).
**Figure 78. Black and Hispanic Workers Are Less Likely to Participate in 401(k) Plans**

<table>
<thead>
<tr>
<th>Race</th>
<th>Retirement Plan Participation of Families (Age 32-61, 2016)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hispanic</td>
<td>13% (401(k)-Style Defined Contribution) 28% (Defined Benefit Pension)</td>
</tr>
<tr>
<td>Black</td>
<td>17% (401(k)-Style Defined Contribution) 33% (Defined Benefit Pension)</td>
</tr>
<tr>
<td>White</td>
<td>21% (401(k)-Style Defined Contribution) 51% (Defined Benefit Pension)</td>
</tr>
</tbody>
</table>

Source: Federal Reserve Survey of Consumer Finances, Citi Research

**Figure 79. Black Men are Slightly More Likely to Work Part-Time than White Men; Black Women More Likely to Work Part-Time than Men**

<table>
<thead>
<tr>
<th>Race</th>
<th>Percent of Employed Persons Working Part-Time (Percent of Total Workers by Gender &amp; Race)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hispanic</td>
<td>14% Women 5% Men</td>
</tr>
<tr>
<td>Asian</td>
<td>11% Women 4% Men</td>
</tr>
<tr>
<td>Black</td>
<td>18% Women 6% Men</td>
</tr>
<tr>
<td>White</td>
<td>22% Women 7% Men</td>
</tr>
</tbody>
</table>

Source: Bureau of Labor Statistics, Citi Research

**Nonfinancial Assets**

Black families have fewer assets in every category of nonfinancial wealth compared to other races. Nonfinancial assets depend upon income and wealth (Figure 80), but also equal access to credit. The largest contributors of nonfinancial wealth are related to real estate (primary residence, other residential property and nonresidential property). Property is typically acquired through inheritance, or a combination of savings (from earned income and financial assets) and access to credit, which is often dependent upon one’s savings, proof of a perpetual source of income (wages), and credit history. Black families are trailing other races on nearly all of these fronts, rendering the path towards building wealth through nonfinancial assets difficult to attain (Figure 81).

**Figure 80. Black Families Have One-Third of the Financial Assets of White Families**

<table>
<thead>
<tr>
<th>Race</th>
<th>Financial Wealth by Race (Median Values in $, 2016)</th>
</tr>
</thead>
<tbody>
<tr>
<td>White</td>
<td>$400,000 - $500,000</td>
</tr>
<tr>
<td>Black</td>
<td>$100,000 - $200,000</td>
</tr>
<tr>
<td>Hispanic</td>
<td>$100,000 - $200,000</td>
</tr>
<tr>
<td>Other/ Multiple</td>
<td>$0 - $100,000</td>
</tr>
</tbody>
</table>

Source: Federal Reserve Board, Citi Research

**Figure 81. Black Families Have Fewer Assets in Every Category of Nonfinancial Wealth Relative to Other Races**

<table>
<thead>
<tr>
<th>Race</th>
<th>Nonfinancial Wealth by Race (Median Values in $, 2016)</th>
</tr>
</thead>
<tbody>
<tr>
<td>White</td>
<td>$400,000 - $500,000</td>
</tr>
<tr>
<td>Black</td>
<td>$100,000 - $200,000</td>
</tr>
<tr>
<td>Hispanic</td>
<td>$100,000 - $200,000</td>
</tr>
<tr>
<td>Other/Multiple</td>
<td>$0 - $100,000</td>
</tr>
</tbody>
</table>

Source: Federal Research Board, Citi Research
Hard and Soft Barriers

The Federal Reserve found the primary driver behind the wealth gap is the income gap. Moreover the income gap is large enough to explain the persistent difference in wealth accumulation between different racial groups in the United States. The key policy implication of this finding is that policies designed to speed the closing of the racial wealth gap should focus upon closing the racial income gap. Looking at the Federal Reserve’s Survey of Consumer Finances dating back nearly 40 years reveals that while wealth and incomes have fallen, the ratio of both wealth and income of Black and white families remained persistently wide (Figure 82). Looking ahead, the Federal Reserve estimates the wealth gap can be eliminated if the racial income gap is closed (Figure 83). This effect would eventually negate the influences of unequal bequests, initial conditions, and unequal returns. The downside is that this might take roughly 200 years to achieve.

Intangibles also matter significantly for wealth accumulation. Black and Hispanic families are less likely to have exposure to financial markets and peer groups of successful investors, which help provide the financial literacy required to make informed decisions. Black and Hispanic people are few and far between in finance jobs, which would facilitate education and access to peer groups (Figure 84). Moreover, financial literacy coursework is still far from fully included in academic curriculums, which is problematic for all students, not just for students of color. According to the Council for Economic Education, only 21 states require high school students to take a course in personal finances, and only a handful of states require standardized testing around financial literacy (Figure 85). Compounding these barriers are the lower levels of tolerance for risk among Black and Hispanic families which is strongly associated with the level of net worth (i.e., higher net worth allows for a higher risk tolerance) (Figure 86 and Figure 87).
Figure 84. Black People Represent Small Share of Financial Workers

<table>
<thead>
<tr>
<th>Persons Employed in Financial Services (2019)</th>
<th>Black</th>
<th>Asian</th>
<th>Hispanic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance Carriers &amp; Related Activities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities, Commodities, Funds, Trusts, &amp; Other FIls</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nondepository Credit &amp; Related Activities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Savings Institutions (incl Credit Unions)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banking &amp; Related Activities</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Bureau of Labor Statistics, Citi Research

Figure 85. Few States Mandate Financial Literacy Coursework

Source: Council for Economic Education

Figure 86. Average 2013 Family Wealth by Attitudes Toward Saving and Investing (Family Head Ages 35 to 59)

<table>
<thead>
<tr>
<th>Net Worth</th>
<th>Tolerant of risk</th>
<th>Not tolerant</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ 1,079,478.00</td>
<td>$ 375,608.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Net Worth</th>
<th>Long time horizon for saving and investing</th>
<th>Short or medium time horizon</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ 748,093.00</td>
<td>$ 183,354.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Net Worth</th>
<th>Approve of borrowing for vacations or luxuries</th>
<th>Do not approve</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ 435,134.00</td>
<td>$ 532,150.00</td>
</tr>
</tbody>
</table>

Source: Federal Reserve Board: Exploring the Racial Wealth Gap Using the Survey of Consumer Finances

Figure 87. Wealth, Race, and Attitudes Toward Saving and Investing: Distribution of Attitudes by Race

<table>
<thead>
<tr>
<th>Risk Tolerant</th>
<th>Long Horizon</th>
<th>Luxury Borrower</th>
</tr>
</thead>
<tbody>
<tr>
<td>White</td>
<td>23%</td>
<td>71%</td>
</tr>
<tr>
<td>Black</td>
<td>15%</td>
<td>53%</td>
</tr>
<tr>
<td>Hispanic</td>
<td>15%</td>
<td>52%</td>
</tr>
<tr>
<td>Total</td>
<td>21%</td>
<td>67%</td>
</tr>
</tbody>
</table>

Source: Federal Reserve Board: Exploring the Racial Wealth Gap Using the Survey of Consumer Finances
Racial Housing Gap

Housing is the largest stock of wealth most families hold, with Black families facing the greatest obstacles to home ownership. At 47 percent as of the first quarter of 2020, Black families have the lowest rate of home ownership among different racial groups (Figure 88). Income and wealth gaps contribute to lower levels of homeownership, but so do other factors, including access to credit, outstanding debt, and a short supply of affordable housing options.

Figure 88. Black Homeownership Rates Are Below That of All Other Racial Groups

Access to Credit

The path towards Black family home ownership is limited by reduced access to credit. The Consumer Financial Protection Bureau (CFPB) reported in 2019, Black families continued to be the most likely racial group to be denied a conventional or nonconventional mortgage for home purchase or refinance (Figure 89). The denial rate for Black families remained above 15 percent for home purchase and was roughly 35 percent for refinance, compared to just above 5 percent and 15 percent, respectively, for white families. The higher denial rate for Black families largely reflected elevated debt-to-income ratios, poor credit histories, and incomplete applications (Figure 90).
Figure 89. Black People Continue to Experience the Highest Level of Mortgage Loan Denials

*Consists of applications by American Indians or Alaska Natives, Native Hawaiians or other Pacific Islanders, and borrowers reporting two or more minority races.

Source: Consumer Financial Protection Bureau, Citi Research

Figure 90. Elevated Debt-to-Income Ratios, Poor Credit Histories, and Incomplete Applications Are the Main Drivers of Loan Application Denials for Black Homebuyers and Mortgage Loan Refinancers

*Consists of applications by American Indians or Alaska Natives, Native Hawaiians or other Pacific Islanders, and borrowers reporting two or more minority races.

Source: Consumer Financial Protection Bureau, Citi Research
Access to Financial Services

Lower credit scores among Black families can be partially explained by the forces of structural racism in the financial system. Research shows the legacies of redlining, community segregation, and few traditional financial institutions in predominately Black neighborhoods have limited access to traditional credit for Black borrowers’ and exposed them disproportionately to predatory lending sources. A study by think-tank New America reveals that alternative financial institutions predominate in states where more Black people tend to reside. An overlay of the 16 states (IL, MI, AR, LA, MS, AL, TN, GA, FL, SC, NC, VA, MD, DE, NJ, NY) where Black people represent a greater percent of the population than the national average, maps nearly one-to-one with the elevated number of alternative banking institutions (Figure 91). Moreover, traditional banks in predominately Black neighborhoods, tend to require higher initial opening deposits, higher minimum balances. This translates into Black account holders needing to deposit a higher percentage of their paychecks into accounts to avoid fees or closure (Figure 92). Higher costs contribute to the elevated number of unbanked individuals who are forced to turn to alternative financial institutions like check cashing outfits and payday lenders, which carry higher interest rates and fees (Figure 93). McKinsey estimates the average person could save as much as $40,000 over a career by switching from check cashing places to a traditional bank account. Fines, fees, and subprime borrowing erode credit scores and consequently reduce access to credit for home ownership (Figure 94).

Figure 91. Traditional and Nontraditional Banking Services by Concentration of Minority Populations

Source: New America
Figure 92. Even Traditional Banking Can Cost More for Minority Communities

Figure 93. Black Consumers Are More Likely to be Unbanked or Underbanked

Figure 94. There is a Notable Relationship Between Alternative Financial Services Use and Low Credit Scores

Student Loan Debt

Elevated student loan debt and high debt-to-income levels inhibit Black homeownership.
In many metropolitan areas with large Black populations, geographic segregation is compounded by lack of available affordable housing.

**Affordable Housing**

Even when income and credit conditions are met, lack of affordable housing remains a major constraint to homeownership for many Black families. Data from the Census Bureau and real estate agency Zillow reveal that in many metropolitan areas with large Black populations, geographic segregation is compounded by lack of available affordable housing. The dissimilarity score is a metric that measures the extent to which racial groups are clustered in geographic areas. Again, many of these clusters are a result of past policies including housing discrimination and redlining. Cities with sizable Black populations including New York, Los Angeles, Washington DC, Boston, Miami, Philadelphia, Atlanta, Houston, and Detroit are not only quite segregated (dissimilarity scores closer to 1 than 0.5) but also have wide gaps between the least and most expensive homes (Figure 97). A Trulia real estate agency study also revealed the widening gap between the median home valuation and most homes in large metro areas appeared to be occurring at the lower end of the market. In other words in most markets affordable housing is disappearing.
If the Black home ownership rate were returned to the 2000 level, there would be an estimated 770,000 additional Black homeowners.

Closing the Gap

Closing the Black family housing gap 20 years ago might have generated $218 billion in additional U.S. consumption. According to the Urban Institute, the current 30 basis point gap between Black and white family home ownership is greater now than before 1968 when housing discrimination was legal. The ownership spread is directly related to the racial wealth gap and the increase in inequality in general post the Great Financial Crisis. If the Black home ownership rate were returned to the 2000 level, there would be an estimated 770,000 additional Black homeowners. Multiplying the National Association of Realtor’s median existing home price by this figure equates to $154 billion in additional home sales over the 2000 to 2019 period (Figure 98). A simple calculation of spending on maintenance, cars, and furniture, which often accompany home buying using the Bureau of Labor Statistics’ Consumer Expenditure Survey suggests that there might have been another $65 billion in consumption over the last two decades (Figure 99).
Figure 98. 770,000 Additional Black Homeowners Might Have Added Another $154 Billion in Spending on Housing Since 2000

Figure 99. Black Homeowners Might Have Generated an Additional $65 billion in Consumption on Housing-Related Expenditures

Source: National Association of Realtors, Citi Research

Source: Bureau of Labor Statistics, Citi Research

Figure 100. Seventeen Percent of the Black-White Homeownership Gap Remains Unexplained

Oaxaca Decomposition: Estimated Explanatory Power For Black-White Home Ownership Gap at the MSA Level

Source: Urban Institute, Citi Research
Racial Investment Gap

Capital Deficit

Black entrepreneurs suffer not from a lack of vision, but a lack of funding along every point in the investment cycle. Funding is a challenge over the phases of start-up and as the business matures (Figure 101). Indeed, Black business owners are more likely to cease the operations of their business due to insufficient sales and/or lack of financing than other racial group (Figure 102). During the early stages of funding for a new business, Black founders are more likely to source funds from family, friends, and employees than are white founders. However, funding from friends and family tends to yield $25,000 or less in capital for Black-owned firms, and even less for white-owned firms (Figure 103). Black founders are more likely to bring their own resources to the table than are white founders, with Black founders more apt to use personal and business credit cards that may have higher interest rates and fees (Figure 104). Black founders are also less likely to receive other forms of financing, including business loans from banks, financial institutions, and friends, grants, and professional investors (e.g., angel and venture capital investors). For Black founders who do gain access to these other types of investment, the percentage receiving loans of $100,000 or more is somewhat smaller than the size of loans for white founders (Figure 106).
Figure 103. Black Entrepreneurs Are More Dependent Upon Sources of Capital from Friends, Family, and Own Resources for Capital

Sources of Start-up Financing: White Entrepreneurs

<table>
<thead>
<tr>
<th>Source of Capital</th>
<th>White Entrepreneurs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal/family savings of owners</td>
<td>65.4</td>
</tr>
<tr>
<td>Personal/family home equity loan</td>
<td>10.3</td>
</tr>
<tr>
<td>Personal credit cards</td>
<td>9.9</td>
</tr>
<tr>
<td>Business credit cards</td>
<td>5.4</td>
</tr>
<tr>
<td>Business loan from a government</td>
<td>1.9</td>
</tr>
<tr>
<td>Business loan from a bank/financial institution</td>
<td>3.3</td>
</tr>
<tr>
<td>Investment by venture capitalists</td>
<td>5.1</td>
</tr>
<tr>
<td>Grants</td>
<td>9.4</td>
</tr>
<tr>
<td>Other sources of capital</td>
<td>8.9</td>
</tr>
</tbody>
</table>

Source: SBA, Census Bureau Annual Survey of Entrepreneurs, Citi Research

Sources of Start-up Financing: Black Entrepreneurs

<table>
<thead>
<tr>
<th>Source of Capital</th>
<th>Black Entrepreneurs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal/family savings of owners</td>
<td>70.6</td>
</tr>
<tr>
<td>Personal/family home equity loan</td>
<td>17.6</td>
</tr>
<tr>
<td>Personal credit cards</td>
<td>11.3</td>
</tr>
<tr>
<td>Business credit cards</td>
<td>7.8</td>
</tr>
<tr>
<td>Business loan from a government</td>
<td>8.1</td>
</tr>
<tr>
<td>Business loan from a bank/financial institution</td>
<td>2.8</td>
</tr>
<tr>
<td>Business loan from a bank or financial institution</td>
<td>15.2</td>
</tr>
<tr>
<td>Investment by venture capitalists</td>
<td>3.5</td>
</tr>
<tr>
<td>Grants</td>
<td>8.1</td>
</tr>
<tr>
<td>Other sources of capital</td>
<td>0.5</td>
</tr>
<tr>
<td>Don’t know</td>
<td>0.2</td>
</tr>
<tr>
<td>None needed</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Source: SBA, Census Bureau Annual Survey of Entrepreneurs, Citi Research

Figure 104. Black Founders Are More Likely to Produce their Own Resources for Start-ups

Distribution of Firms (by Owner Financing Amounts)

- White: $250,000 or more
- Black: $100,000 to $249,999
- Asian: $25,000 to $49,999
- Hispanic: $10,000 to 24,999

Figure 105. Friends and Family Yield Limited Resources for Both Black and White Founders

Distribution of Firms (by Family, Friends & Employees Financing Amts)

- White: $250,000 or more
- Black: $100,000 to $249,999
- Asian: $25,000 to $49,999
- Hispanic: $10,000 to 24,999

Figure 106. Black Founders Receive Less Funding for Projects Above $100,000

Distribution of Firms (by Banks & Financial Institutions Financing Amts)

- White: $250,000 or more
- Black: $100,000 to $249,999
- Asian: $25,000 to $49,999
- Hispanic: $10,000 to 24,999

Source: SBA, Census Bureau Annual Survey of Entrepreneurs, Citi Research
Bank Loans and Denials

Black entrepreneurs appear shut-out of traditional forms of financing. The reliance of Black founders on less lucrative forms of financing may reflect the difficulty in financing along the investment channel. According to the Fed, creditworthy Black-owned firms experience greater challenges raising capital than creditworthy white-owned firms. Even after controlling for firm characteristics and performance, the Fed finds that approval rates for Black-owned firms still remain lower. Fed data indicate all entrepreneurs are more likely to apply to large banks versus other institutions for financing. However, Black-owned businesses are the least likely to receive approval for loans from large banks (Figure 107). Despite Black-owned firms being less likely to apply for financing at small banks, they are similarly less likely to be approved for loans than white-owned firms at these small banks. Black founders are the least likely to apply to online lending sources, like most other racial groups, but are about equally likely to be approved as white founders at these alternative financial institutions. This suggests there may be critical factors differentiating Black founders in traditional bank lending standards than among alternative financial institutions. If Black-owned firms are passing the gauntlet along myriad metrics, but still not receiving funding, then the epsilon may be bias.

![Figure 107](image)

The Fed also found that underfunding is affecting financing. While Black-owned firms are roughly equivalent with white-owned firms in the percentage who decline to apply for loans due to discouragement, Black founders are still less likely to say that they had sufficient funding in place (Figure 108). The Fed reports that even for those Black-owned firms who are approved for financing, they typically receive less than half of what was requested. According to the Fed, minority-owned businesses in recent times are still facing potentially large unmet financing needs. Census Bureau data confirm this. When complaints of underfunding are tabulated across different types of financing, Black founders routinely state that they received fewer dollars than requested.
Asymmetric Information and Narrow Pipelines

Black investors are missing out on an important stage in capital raising. Angel and venture capital (VC) investment are important phases in the private business capitalization pathway, but Black investors represent small shares of these types of investors. Just over 1 percent of all angel investors are Black (Figure 109), while 4 percent of the VC workforce is Black, with just 3 percent in the senior ranks of leadership (Figure 110). The number of Black persons in finance provision positions is important because they can play a pivotal role in directing capital to Black-owned businesses. In the VC space, this is extremely important as the majority of products purchased by consumers received VC funding at some point and these financiers decide which businesses receive funding and ultimately what products go to market.

Studies suggest that the sparse amount of investments by Black angel and VC investors reflect a combination of asymmetric information — in that Black entrepreneurs are not aware of these sources of funding — and/or a narrow pipeline of incoming investors. With respect to information, SEC regulation prohibits business founders from publicly advertising fundraising. Communication of these opportunities are limited to a network of accredited investors. Accredited investors must have $1 million in net worth, not including a home, or income exceeding $300,000, which can be prohibitive for many would be angel investors. Hence, a lack of information and wealth-limits create barriers for entrepreneurs and potential investors. Regarding the pipeline, many VCs have backgrounds in investment banking, which have struggled with diversity given in part to recruiting from elite schools that are also lacking in diversity. Indeed, 40 percent of venture capitalists attended either Harvard or Stanford University. Over the last 30 years Harvard Business School had a Black population averaging about 5 percent. The high cost of a business school education is one prohibition for Black students.
Unconscious bias may also be at the root of the dearth of investment in Black-owned businesses.

Investor Bias

Venture capital is a relationship-based business, so the leaders decide which other investors are invited into the fold, and which firms receive capital. This proves problematic if the perception of Black founders and their business ventures are tinged by unconscious bias. Anecdotal assertions of bias include investors not trusting that Black entrepreneurs have viable and sustainable businesses, and/or lack an understanding of the product or customer Black founders are serving. Even for professional investors choosing to invest in VC funds, data-based evidence of bias is revealed in a Stanford University study which determined when venture capital funds are managed by a person of color with strong credentials, professional investors judge them more harshly than their white counterparts with identical credentials (Figure 111). The study found investors were able to easily distinguish between stronger and weaker white-led teams, where the stronger team received the higher ratings and the weaker team lower ratings. However, investors were unable to distinguish between stronger and weaker Black-led teams. Strong white-led teams were expected to raise more funds than strong Black-led teams, suggesting lower funding prospects for Black-led fund teams, and consequently financing for Black-owned businesses (Figure 112).
Increased access to funding and information, alternative measures of credit, and financial education can all help close the financing gap.

Closing the Gap

Increased access to financing and information are tactics that may help close the financing gap for Black-owned businesses. As Black-owned firms appear to invest greater sums of owner-generated financing for start-up projects, this greater level of personal sacrifice should factor more favorably into lending decisions from financial institutions. Experts have also advocated for alternative measures of credit to factor more materially in underwriting decisions, not just FICO scores. Black entrepreneurs are on balance more highly educated than the average small business owner, and are more likely to be Gen X’ers (45 percent) and Baby Boomers (31 percent) than Millennials (22 percent). However, there still appear to be gaps in experience running a firm and/or knowledge about financing options, including angel and venture capital investment. Governments (including the SBA) can make it easier for firms to learn about funding options and/or lowering the barrier for interested investors to become engaged, particularly for angel investors. There is also a market for private firms to educate and counsel Black business owners regarding applying for and obtaining financing via traditional and non-traditional financing channels.

Eliminating bias will be more difficult. However, if lenders and professional investors changed their views towards minority-owned firms, there might be greater access to capital. More capital helps ensure the survival of Black-owned firms, and greater revenue, which currently trails that of white-owned firms in every industry except manufacturing (Figure 113). More revenue leads to greater job creation, and more income which facilitates consumption and real GDP growth. A Fed survey found that 60 percent of Black-owned firms declined to apply for financing, even when needed, due to concern that they would be denied. Increasing applications as well as improving approval rates would be highly favorable for Black-owned firms.

Closing the share of Black-owned firms-gap 20 years ago might have generated $13 trillion of revenues for investment, 6.1 million jobs per year, and a cumulative $182 billion in income for consumption.

Closing the share of Black-owned firms-gap 20 years ago might have generated $13 trillion of revenues for investment, 6.1 million jobs per year, and a cumulative $182 billion in income for consumption. In 2017, there were more than 114,400 small Black-owned firms, employing 1.2 million persons, generating $121 billion in revenue and $35 billion in annual payroll. However, the number of Black-owned small businesses represents just 0.6 percent of the Black civilian population age 20 and over (20 million people). This is compared to a 3.6 percent share of white-owned small firms to the white civilian population (122 million).
If the share of Black-owned firms was raised to 3.6 percent of the U.S. Black population, the number of businesses would rise to more than 720,000, or a 6-fold increase. Per year, revenue might increase to $761 billion, the number of employees to 7.3 million, and payrolls to $10.8 billion. If this gap were closed two decades ago, then the additional amount of consumption from workers’ incomes might have summed to near $182 billion. Some share of the extra $13 trillion in revenues over the last 20 years might have also contributed to GDP-enhancing capital expenditure on equipment, intellectual property, and structures (Figure 114).

Figure 113. With the Exception of Manufacturing, White-Owned Firms Generate More Revenues per Business than Black-Owned Firms

<table>
<thead>
<tr>
<th>Revenues Per Type of Business ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>White</td>
</tr>
<tr>
<td>Black</td>
</tr>
<tr>
<td>Wholesale Trade</td>
</tr>
<tr>
<td>Utilities</td>
</tr>
<tr>
<td>Transportation &amp; Warehousing</td>
</tr>
<tr>
<td>Retail Trade</td>
</tr>
<tr>
<td>Real estate &amp; Rental &amp; Leasing</td>
</tr>
<tr>
<td>Professional, Scientific, &amp; Technical Svcs</td>
</tr>
<tr>
<td>Other Services (except Public Admin)</td>
</tr>
<tr>
<td>Mining, Quarrying, &amp; Oil &amp; Gas Extraction</td>
</tr>
<tr>
<td>Manufacturing</td>
</tr>
<tr>
<td>Mgmt of Companies &amp; Enterprises</td>
</tr>
<tr>
<td>Information</td>
</tr>
<tr>
<td>Health care &amp; Social Assistance</td>
</tr>
<tr>
<td>Finance &amp; Insurance</td>
</tr>
<tr>
<td>Educational Services</td>
</tr>
<tr>
<td>Construction</td>
</tr>
<tr>
<td>Arts, Entertainment, &amp; Recreation</td>
</tr>
<tr>
<td>Agriculture, Forestry, Fishing, &amp; Hunting</td>
</tr>
<tr>
<td>Admin &amp; Support and Waste Mgmt &amp; Remediation Svcs</td>
</tr>
<tr>
<td>Accommodation &amp; Food Services</td>
</tr>
</tbody>
</table>

Source: Census Bureau Survey of Business Owners, Citi Research

Figure 114. Small Firms, Revenues, Employment and Payrolls: 2017 Actual and Gap Closure Estimates

<table>
<thead>
<tr>
<th>Black Small Businesses</th>
<th>Per Year</th>
<th>20 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2017 Share of Black population (0.6 percent)</td>
<td>3.6 Percent Share of Black Population</td>
</tr>
<tr>
<td>Firms (Number)</td>
<td>114,400</td>
<td>720,069</td>
</tr>
<tr>
<td>Revenues (Billions of US$)</td>
<td>$121</td>
<td>$761</td>
</tr>
<tr>
<td>Employees (Number)</td>
<td>1,155,344</td>
<td>7,272,095</td>
</tr>
<tr>
<td>Payrolls/Year (Billions of US$)</td>
<td>$1.7</td>
<td>$10.8</td>
</tr>
</tbody>
</table>

Source: Citi Research
How Do We Close the Gaps: Future Policy

Figure 115. Governments, Corporations, and Individuals Can All Work Together to Close Gaps

To emerge from a history of entrenched segregation and active discriminatory policy into an era of genuine equity will require conscientious reform at individualistic, corporate, and governmental levels. Although there is much to celebrate regarding renewed interest in closing gaps, there is still considerable work that must be done. Moreover, given the exacerbation of inequality amid the COVID-19 pandemic, now is an important time to focus on eliminating racial gaps. In the U.S., the sum total of wealth held by U.S. billionaires is equal to three-quarters of all Black wealth ($3.5 trillion vs $4.6 trillion). Hence, it is crucial to address severe income inequality as part of the overall economic resolution and to avoid the perpetuation of disparity as seen after the Global Financial Crisis (GFC) of 2008. As of 2016, only 20 percent of Americans are said to have recovered to pre-GFC wealth levels, with Black Americans having suffered a 33 percent decline in wealth between 2007 and 2010. The GFC wealth loss further compounded how the median Black family witnessed their wealth almost halve, once adjusted for inflation, from 1983 to 2016; in comparison to an increase of almost one-third for white households.\(^3\)

Governments can help reduce racial gaps by eliminating discriminatory barriers and implementing policies that support work, homeownership, entrepreneurship, and well-being. Basic actions, borrowed in part from the literature on gender equity, include (1) adequate race-specific data collection, necessary for identifying, tracking, and ameliorating race-based gaps; (2) prohibiting discrimination in wages, housing, labor, financial services, lending etc. based upon race; (3) facilitating work, including affordable childcare options, quality K-12 education, access to higher education, and paid family leave; and (4) supporting innovation, including enabling access to financing for Black-owned firms and start-ups. Additionally, governments can act to promote access to affordable healthcare and housing, which are paramount for supporting work and innovation. In this paper, we also highlight more unconventional ideas for how governments can contribute to closing racial gaps, from the Fed and Congress, to the state and local level.

Monetary Policy Focus

More voices are calling for the U.S. central bank to enhance its focus upon racial economic gaps. Economic gaps produced as a consequence of decades of racial discrimination have been highlighted by Democratic politicians in the U.S. in their proposal for the Fed to integrate racial considerations in its policymaking. Under ‘The Federal Reserve Racial and Economic Equity Act’, the reduction of racial inequality in the U.S. economy would become an official part of the Fed’s mission. Former Vice President, Joe Biden called on the Fed to ‘aggressively enhance’ its highlighting of ‘persistent racial gaps in jobs, wages and wealth.’ It is worth highlighting that before the pandemic, the Black unemployment rate, concurrent will all other jobless rates, was falling and reached an all-time low of 5.4 percent in August 2019. However, it remained higher than overall unemployment, which troughed at 3.5 percent in February 2020 and the white unemployment rate, which fell to 3.1 percent in January 2020 (Figure 117).

Amid the pandemic, jobless rates across every racial group swelled to nearly four times their pre-COVID levels, but the racial gaps persisted.\textsuperscript{35}

Even in the absence of new legislation, the Fed has signaled a willingness to enhance its focus upon inequality. At the 2020 Jackson Hole Economic Summit, the Fed indicated its policies will focus on “broad-based and inclusive” job gains, language suggesting the central bank’s policies may help disadvantaged Americans in particular, rather than as a consequence of focusing upon maximum employment in general. Practically, the Fed will now allow inflation to exceed the 2-percent target for a period of time before raising interest rates, allowing unemployment rates to fall further. Still Chairman Powell stated that ending racial inequality “is more of an all-government, society project that we need to take on forcefully…It can’t just be the way the Fed manages interest rates.”\textsuperscript{36} In other words, there is a role for fiscal policies at every level of government. Moreover, a counter argument to the Fed allowing rates to remain lower for longer, is that low rates inflate the prices of assets that do not benefit low income persons on the upswing, but do negatively affect them on the downswing when the owners of capital (employers) respond to financial market crises by cutting labor.

Figure 117. Black Unemployment Rate is Consistently Higher than Other Races

\textsuperscript{35} Zeitli, M., “Federal Reserve policy has failed Black Americans for decades. Now is the time to fix that,” Business Insider, July 18, 2020.

Encourage Work

Reforming tax benefits and the application of specialized tax reforms can encourage work among lower income families and help reduce racial gaps. One recent study highlighted that of the nearly $275 billion within the 2018 Tax Cuts and Jobs Act, 80 percent benefited white households; receiving $2,020 on average in cuts, versus $970 received by Latino households and just $840 by Black Households. Moreover, households in the highest 1 percentile received 23.7 percent of the law’s total tax cuts, in comparison to just 13.8 percent received by the bottom 60 percent. Given that white households are three times as likely as Black or Latino households to be in the top 1%, these racial gaps are further exacerbated. Some effective and racially-inclusive tax provisions linked to work such as the Earned Income Tax Credit (EITC), and Child Tax Credit (CTC), have proven to reduce poverty while serving a larger proportion of minority groups, especially Black and Latina Women. Some policymakers would make CTC fully refundable so the benefits reach the poorest children. Indeed, an estimated 17 million Black households would benefit from a fully-refundable CTC. Under current law, the Congressional Budget Office (CBO) estimates the share of Federal government spending on these credits is set to tumble over the next decade without Congressional intervention (Figure 118).

How do the EITC and the Child Tax Credit Encourage Work?

- **EITC**: The Earned Income Tax Credit, EITC or EIC, is a benefit for working people with low to moderate income. To qualify for EITC, tax filers must have earned income from either working for someone or from running or owning a business or farm, in addition to meeting some basic rules. Filers must also either meet additional rules for workers without a qualifying child or have a child that meets all the qualifying child rules. (Source: IRS.gov).

- **CTC**: The Child Tax Credit (CTC) is designed to give an income boost to the parents or guardians of children and other dependents. It only applies to dependents who are younger than 17 as of the last day of the tax year. The credit is worth up to $2,000 per dependent, but income level determines the exact amount of the credit. Tax filers need to have earned at least $2,500 to qualify for the CTC. Then it phases out for income above $200,000 for single filers and $400,000 for joint filers. If earned income is above the applicable threshold, filers will receive a partial credit. (Source: Smartasset).

Provide Guaranteed Wages, Income, and Jobs

A policy with dramatic implication would be a “living wage.” Currently, the Federal minimum wage for tip earning employees is just $2.13 an hour and $7.25 for others. Although Black workers make up only 11 percent of the workforce, 38 percent of Black workers currently work for minimum wage and would receive a pay increase under such legislation, helping to address the wage gap (Figure 119). Another policy gaining traction in U.S. policy circles, which has also been implemented in other nations (e.g., Canada), is that of guaranteed income supports.
Means-tested, direct government transfers to families, with the potential to expand guaranteed income above the poverty line might help assist families with expenses such as childcare, which is a key enabler of work. A successful basic income program in practice is the Alaska Permanent Fund. The Fund has paid residents a dividend of $1,600 on average in recent years, with one study showing the program reduced poverty by 20 percent in the state. In a similar fashion, a Federal Job Guarantee has also been advocated as an effective way to decrease the racial income gap. While potentially an expensive proposition, with estimated ranging from $378 billion to $543 billion per year, there is some potential to mitigate poverty through work.

Implement Tax Reform

Changes to current tax provisions, including a more progressive tax code, might also have a material impact on efforts to close gaps. Some policymakers and experts suggest taxing wealth rather than income, and increasing taxes on inherited wealth — both of which are traditionally areas where Black Americans fall behind their white counterparts. Much of the Federal tax code is designed to offset less progressive state tax codes, which rely heavily on sales and excise taxes; meaning that on average, the lowest-income households pay a higher share of their income than the highest-income households. Indeed, 25 of the 50 states in the U.S. plus Washington DC, have combined state and local sales taxes in excess of the national median of 6.98 percent (Figure 120).

Ten of the 50 states (Illinois, Indiana, Kentucky, Massachusetts, Michigan, New Hampshire, North Carolina, Pennsylvania, Tennessee, and Utah) have one income

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tax rate for all individual tax payers, making them the least progressive (Figure 121). A clear approach the U.S. could take in order to reduce racial inequality would be to raise more revenue overall in a progressive manner, with the revenues then directed to investments which advance racial equity. Indeed, the U.S. system of taxes currently underperforms 27 other high-income countries in regards to reducing post-tax inequality.44

44 Based on reductions in the Gini measure of inequality among 33 countries for which OECD data for 2016 or the latest available year are available (see OECD Income Distribution Database, 2019). The United States ranks above only New Zealand, Israel, Switzerland, Korea, and Chile on this measure. (Data for Mexico, Hungary, and Turkey are unavailable.)

Increasing access to financial services is key to increasing the amount of Blacks in the financial system

Promote Financial Inclusion

To address racial wealth inequality, the exceptionally high number of unbanked or underbanked Black households (estimated to be 47 percent) also needs to be combatted with Federal banking services. In order to avoid the usual obstacles of traditional for-profit banking of minimum account balances and transaction costs, one study advocates the Congressional strengthening of the U.S. Postal Service (USPS) as an avenue for financial services. At its peak in 1947, the Postal Savings systems held $3.4 billion in reserves. Enabling the USPS to provide financial services would provide an alternative means of banking for many families, and in tandem allow for more money to circulate within the economies of low-income communities. The immediate need for cash availability, which a Postal Service/FedAccounts proposal would mobilize, has been incredibly apparent during the COVID-19 pandemic. These FedAccounts would enable free and digitized payments, withdrawals, and provide the ability to receive payments such as jobless benefits or stimulus checks without minimum balance requirements or fees.
Fintech can also play a critical role in reducing the number of unbanked persons. Ex-JP Morgan Managing Director and founder of Mobility Capital Finance, Wole Coaxum, estimates that “Black and Hispanic people spend 50 to 100 percent more per month for basic banking services, which, over a lifetime, can cost $40,000 in fees.”4546 His company, along with a number of others, seeks to tackle this in providing financial services to those on low to moderate incomes. Similarly FS Card provides credit cards with $500 spending limits as an alternative to payday loan services. In providing these alternative services without the high fees, these fintech firms have the ability to drastically improve access to basic financial services. Moreover, in August 2020, leaders of the fintech industry, including Credit Karma, Monzo, and Stash, announced the creation of the Fintech Equality Coalition. The Coalition will focus on enhancing access to financial services and committing to providing opportunities in recruitment outreach within the Black community.47

Decouple Health Care

Access to affordable healthcare is a key component of enabling work and wealth creation. Indeed, a Gallup poll found that 9 percent of American adults and 14 percent of non-white American adults would avoid treatment for the coronavirus over concerns over medical expense.48 An idea gained greater traction in the U.S. is to decouple healthcare from employment. Most people who have health insurance in the U.S. receive it via their employers (Figure 122). Expansion of Medicaid — public healthcare for persons under 65 years of age — has increased since being implemented under Obamacare (ACA) in 2012, but the private-direct purchase option under the ACA has fallen during the Trump Administration. Given the three groups who saw their unemployment markers spike to elevated peaks in April 2020 were women (15.5 percent), Black Americans (16.7 percent), and Latinos (18.9 percent), there is a clear connection between race/gender and those most at risk from losing their healthcare coverage.49 In providing minimum government-supported healthcare, as an additional option to private job-linked health care, those in more economically-challenged industries would have an increased level of health security, with potentially significant benefits to minority groups.

46 FDIC National Survey of Unbanked and Underbanked Households, 2017.
Figure 122. The Majority of U.S. Persons Are Covered by Private-Employed Based Insurance; The Number of Persons in the Private-Direct Purchase Option Has Declined in Recent Years

<table>
<thead>
<tr>
<th>Year</th>
<th>Private: Direct Purchase</th>
<th>Public: Medicaid</th>
<th>Public: Medicare</th>
<th>Public: Military</th>
<th>Not Covered</th>
</tr>
</thead>
<tbody>
<tr>
<td>94</td>
<td>145,000</td>
<td>155,000</td>
<td>165,000</td>
<td>175,000</td>
<td>185,000</td>
</tr>
<tr>
<td>96</td>
<td>155,000</td>
<td>165,000</td>
<td>175,000</td>
<td>185,000</td>
<td>195,000</td>
</tr>
<tr>
<td>98</td>
<td>165,000</td>
<td>175,000</td>
<td>185,000</td>
<td>195,000</td>
<td>205,000</td>
</tr>
</tbody>
</table>

Note: Some persons may have more than one type of insurance. Source: Census Bureau, Citi Research

Implement Housing Incentives

Public policy should focus upon housing as a pathway to wealth

Encouraging homeownership is a potential path to intergenerational wealth

Two suggestions proposed for providing affordable housing include: (1) expansion of tax incentives encouraging low-income housing in affluent areas; and (2) low-income community revitalization policies encouraging residential and commercial development in poor and primarily communities of color. A third avenue for facilitating the path to homeownership for Black families is to close gaps enabling higher earnings and wealth accumulation necessary for home ownership.

Policy reform of established programs to benefit minority groups, might be instrumental in closing equity gaps. One candidate for reform is the Mortgage Interest Deduction program which currently only benefits 6% of Black families. Enhancing the benefit to Black households requires increased homeownership, but the gap in homeownership rates between white and Black families is significant: the Black homeownership rate is at 44 percent vs. white at 70 percent. Affordable also housing remains a challenge in many local regions with large Black populations (Figure 123). Increasing incentives and access to affordable housing is an avenue towards greater homeownership. With a stark deficiency in affordable housing — in no state can a full time employee on $7.25 afford a two bedroom apartment — progress in this area is of desperate necessity. The American Housing and Economic Mobility Act provides an initial framework with provisions for down payment assistance for first time buyers living in formerly redlined or officially segregated areas.

Many Highly Populated Regions of the U.S. Are Unaffordable Even For Median-Income Households

Figure 123.

Notes: Median incomes are estimated at the core-based statistical area (CBSA) level. Recently sold homes are defined as homes with owners that moved within the 12 months prior to the survey date. Monthly payments assume a 3.5% down payment and property taxes of 1.15%, property insurance of 0.35%, and mortgage insurance of 0.85%. Affordable payments are defined as requiring less than 31% of monthly household income. Only CBSAs with at least 30 home sales in the past year are shown.

Source: JCHS tabulations of US Census Bureau, 2017 American Community Survey 1-Year Estimates, and Freddie Mac, PMMS

The Urban Institute found intangible factors are contributing to the widening racial housing gap, highlighting the need for targeted policy solutions. According to the Urban Institute, even after accounting for individual factors including marital status, income distribution, FICO scores, age, median household income, and city segregation, approximately 17 percent of the Black-white family home ownership gap remains unexplained (Figure 100). These intangible factors suggest a combination of policies are necessary to narrow the gap, built on a foundation of fair housing and lending, plus new technologies.

- **Advance policy solutions at the local level:** Expand small-dollar mortgages; remove discriminatory terms in home- and condo-association deeds on single family units; property tax relief for low- and moderate-income taxpayers; strengthen lender networks.

- **Tackle housing supply constraints and affordability:** Reform local land-use, building codes and zoning laws; Federal investments in affordable housing; Government-sponsored enterprise (GSE) and Housing & Urban Development (HUD) collaboration with organizations working to make housing affordable.

- **Promote an equitable and accessible housing finance system:** Increase visibility, access, and types of down payment assistance programs; alternative data for credit histories and diverse sources of income for down payments.

- **Further outreach and counseling for renters and mortgage-ready millennials:** Improve and expand financial education and homeownership preparation; expand programs that automate saving for down payments.

- **Focus on sustainable homeownership and preservation:** Strengthen post-purchase counseling; early-warning displacement metrics; mitigation strategies and interventions for homeowners at high risk for flood and disaster events.
Government investment in training programs can help narrow income and wealth gaps

Public-private partnerships can help narrow training gaps

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**Invest in Training**

Government focus on specific skills training with respect to identified occupational availability through either community college courses or named industry training has proven instrumental in combating economic inequality. With over 12 million students enrolling in community colleges each year, and a majority of those enrolled as undergraduates in 2-year public colleges identifying as non-white, funding for these programs is vital in delivering a more equitable workforce. However, without a permanent funding stream, sustainability can be a challenge. Though community colleges have been the benefactors of a number of grants, including the Community Based Job Training Grant (CBJTG), which provided $600 million in three years from 2005-2010, and two Federal grant programs under President Obama — Health Profession Opportunity Grant and Trade Adjustment Assistance Community College and Career Training (TAACCT) — there have been calls to reform the workforce system to move away from presumptions based upon skills narratives. Skills narratives place an emphasis on skills, which for many workers “fail[s] to recognize the historical and inter-generational way in which multiple systems, including not only workforce, but also education, housing, criminal justice and others, have created an inherent set of disadvantages for people of color.” Without proper recognition of individual circumstance, and an understanding that a multidimensional, rather than a ‘one-size-fits-all’ approach is far more likely to deliver meaningful results, there is a natural restriction to equity progress.

Public-private partnerships can help narrow training gaps. Notably, white high school dropouts have the same chance of obtaining a job as Black workers who have completed some college or earned an associate degree. In order to address such discrepancies, The Center for American Progress has highlighted four policy features that are essential for developing an equitable design and process for training and job access: (1) expand the share of economic risk by requiring employers of a certain size to pay into the WETF (Workforce Equity Trust Fund); (2) make a suite of wrap-around services (e.g., childcare) and employment benefits standard; (3) improve workforce analytics by creating an accountability dashboard for multiple measures of job quality; and (4) govern the WETF by a multi-stakeholder partnership comprising of business, labor and the public. There are a number of programs along such guidelines emerging with community-based organizations designing programs to directly train and connect workers to local opportunities.

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54 Kilpatrick, S., “A Quick Rundown of Community College Diversity Statistics,”, EVERFI
For example, in Detroit, HOPE has incorporated robotics training into its technical training; and in San Diego, the International Rescue Committee has included solar panel installation into training options; connecting a high-growth local industry currently facing a skilled labor shortage with job-seekers.\(^6\)

**Invest in Wealth Building**

Government investment in building wealth is a radical approach to closing the racial wealth gap. One approach is “Baby Bonds”.\(^6\) Championed by New Jersey Senator Cory Booker, the bonds would provide every child born with $1,000 in an interest-bearing savings account that would be added to annually (maximum of $2,000 based upon family income) up to the age of 18. Upon reaching adulthood, the funds accrued can be accessed for wealth building activities such as down payments on homes, college tuition, or start-up funding.\(^6\) A study by Columbia University on the effect of instruments such as ‘Baby Bonds’ estimated that though the racial disparity would persist, it would be substantially narrowed: from a factor of 15.9 to 1.4 at the median, with the median Caucasian adult holding approximately $79,000 versus $58,890 for the median Black adult.\(^6\) The program is expected to cost $60 billion per year, and to be funded by modifying the estate tax and closing the tax break for inherited capital gains.\(^6\) There have also been some successes at the state and local level. In Oklahoma, the Ford Foundation provided over a thousand babies with $1,000 in state-owned 529 college savings account in 2007. There is evidence to suggest these kinds of programs could have significant impact with young people who, with a college fund, are three times as likely to go to college, and four times as likely to graduate, helping to address future racial earnings gaps.\(^6\)

**Invest in Protections**

Established in 1965, the U.S. Equal Employment Opportunity Commission (EEOC) is tasked with enforcing Federal laws preventing discrimination against job applicants and employees based upon race, color, religion, sex, national origin, age, disability, or genetic information. However, as the U.S. population has grown by 44 percent in 40 years to roughly 330 million persons, and become even more diverse, Federal funding for the EEOC has not kept pace. Indeed, funding for the EEOC has shrunk by 8 percent over the same period, and the number of employees at the EEOC fielding discrimination complaints has decreased by 42 percent since 1980. Meanwhile, at the state level, funds for employment anti-discrimination programs are modest and in some cases non-existent. A 2015 census of ten states with the largest Black populations revealed that none of them spent more than 70 cents per resident on employment anti-discrimination programs. Indeed, three states — Mississippi, Alabama, and North Carolina — spent zero dollars on such programs.

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\(^{61}\) Zwede, N., “Universal Baby Bonds Reduce Black-White Wealth Inequality, Progressively Raise Net Worth of All Young Adults.”


\(^{63}\) Zwede, N. “Universal Baby Bonds Reduce Black-White Wealth Inequality, Progressively Raise Net Worth of All Young Adults.”


Implement Salary History Bans

Salary history bans are a method to stop the perpetuation of racial wage gaps. With the wage gap between white and Black workers having grown at the median between 2000 and 2019, increasing the discrepancy from 20.8 percent to 24.4 percent, addressing this disparity is particularly important. One approach that has proven particularly effective is banning employers from inquiring about historical salaries. A study by Boston University found that, following bans, pay for job switchers increased by 13 percent for Black workers and 8 percent for women workers, respectively. By removing the knowledge of prior salaries, employers are no longer influenced by potential discrimination of previous employers, and hence are less likely to perpetuate the wage gap between white and Black employees by continuing to maintain the difference. Massachusetts, as the first state to impose a ban preventing employers asking candidates their previous salaries in 2016, has been followed by 18 other states, with individual cities nationwide, including Washington DC, also following suit (Figure 126).

Figure 125. Anti-Discrimination Agency Spending at the State Level is Significantly Underfunded in States with Large Black Populations

Per-Capita Funding of EEOC and Anti-Discrimination Agencies in States with the Largest Black Populations (FY 2018)

<table>
<thead>
<tr>
<th>State</th>
<th>Per-Capita Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>EEOC</td>
<td>$1.19</td>
</tr>
<tr>
<td>South Carolina</td>
<td>$0.69</td>
</tr>
<tr>
<td>Maryland</td>
<td>$0.55</td>
</tr>
<tr>
<td>Tennessee</td>
<td>$0.39</td>
</tr>
<tr>
<td>Delaware</td>
<td>$0.38</td>
</tr>
<tr>
<td>Georgia</td>
<td>$0.06</td>
</tr>
<tr>
<td>Louisiana</td>
<td>$0.02</td>
</tr>
<tr>
<td>North Carolina</td>
<td>$0.00</td>
</tr>
<tr>
<td>Alabama</td>
<td>$0.00</td>
</tr>
<tr>
<td>Mississippi</td>
<td>$0.00</td>
</tr>
</tbody>
</table>

Source: EEOC, Henry J. Kaiser Family Foundation, Citigroup Research

Figure 126. Only 19 of 50 States Plus Washington, DC, and 20 of Thousands of Municipalities, Have Salary History Bans

Source: AccuSource, HRDrive, Citigroup Research
What Can Companies Do?

The Business Case

While imperfect, there is a business case for diversity that should help motivate firms to act upon closing racial gaps. The body of literature suggests that when executed well, diversity and inclusion in the workplace may lead to increased revenue, reduced costs, greater innovation, and increased employee engagement, productivity, and commitment. The business case is multifaceted:

- **Changing demographics**: Businesses may desire their workforces to reflect current and future population trends. According to the U.S. Census Bureau, by 2060, the percentage of non-Hispanic white persons will decline to 44 percent from roughly 60 percent currently and there will be a major increase in the number of persons of color. If this is the case, firms should adjust their employee composition to match their future customer base. Even today, when persons of color are still in the minority, many firms still do not reflect the demographics of the nation at every rung on the jobs ladder.

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Diversity of Perspectives: Persons from diverse backgrounds and experiences will have a multiplicity of ideas and perspectives. Diversity of perspectives may produce better outcomes as diversity can help avoid “group-think.” A diversity of opinions can create friction. However, if diverse employees are made to feel included, then outcomes can potentially be positive. A Boston Consulting Group (BCG) international survey, including the U.S., revealed a strong and statistically significant correlation between the diversity of management teams and overall innovation. “Firms reporting above-average diversity on their management teams also reported innovation revenue that was 19 percentage points higher than that of companies with below-average leadership diversity — 45% of total revenue versus just 26%.”

Bolstering the Bottom Line: Studies suggest that diverse firms may have stronger financial results more generally. A separate McKinsey & Company international survey found that “companies in the top quartile for racial and ethnic diversity were 35 percent more likely to have financial returns above their respective national industry medians.” In the United States, McKinsey found “there is a linear relationship between racial and ethnic diversity and better financial performance: for every 10 percent increase in racial and ethnic diversity on the senior-executive team, earnings before interest and taxes (EBIT) rise 0.8 percent.”

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Moreover, that “racial and ethnic diversity has a stronger impact on financial performance in the United States than gender diversity, perhaps because earlier efforts to increase women’s representation in the top levels of business have already yielded positive results.”

![Figure 129: Businesses with Diverse Leadership Teams May Generate More Revenue](image1)

![Figure 130: Diverse Firms May Perform Better](image2)

- **A Matter of Talent - Recruiting and Retaining the Best Talent Is Paramount:** By hiring a limited group of people based upon a specific mold (i.e. white and/or male), companies are foregoing significant segments of talent. Hence, firms should consider directing resources and energy towards recruiting and retaining diverse employees, and creating inclusive workplace cultures where everyone has an equal opportunity to contribute and succeed. McKinsey & Company posits that more diverse companies, “are better able to win top talent and improve their customer orientation, employee satisfaction, and decision making, and all that leads to a virtuous cycle of increasing returns.”

- **Moral Imperative - It’s the Right Thing to Do:** The Society for Human Resource Management defines inclusion as, “the achievement of a work environment in which all individuals are treated fairly and respectfully, have equal access to opportunities and resources, and can contribute fully to the organization’s success.” Employees who are made to feel like they belong are potentially better performers and happier people.

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Support Initiatives from the Top

Support of Diversity and Inclusion (D&I) initiatives must come from the top. As of 2020, only four CEOs at Fortune 500 companies are Black. This statistic highlights concerns about equity, as management diversity is often reflected at all levels of a company. Literature suggests that corporations must actively engage in D&I initiatives in order to change the composition and complexion of their firms, but focus must start at the top of the corporate ladder. Indeed, the Edelman Trust Barometer indicates that in the U.S., 63 percent of consumer respondents to their poll believed corporations that make statements in support of racial equality must follow it up with concrete actions in order not to be seen as exploitative or opportunistic (Figure 130).

A number of high profile CEOs support D&I initiatives, including former Xerox CEO Ursula Burns (the first Black female CEO of a Fortune 500 company) who stated “Business leaders have to start to lead, what has happened in the past, they’ve trailed.” Similarly a number of CEOs have pledged hard dollars to address racial gaps. For example, Comcast pledged $100 million over three years to accelerate efforts on diversity and inclusion, and Walmart also pledged $100 million over five years to create a new center on racial equity that would concentrate in four areas: financial, health care, criminal justice and education.

Citi’s Response

In direct response to the messages from the #BLM Protests, Citi itself has committed to $10.7 million in donations: $1 million each to two organizations working to close the Black achievement gap in education in the United States: UNCF and Management Leadership of Tomorrow (MLT). This is in addition to the $8 million Citi committed to four leading Black-led organizations addressing voting rights, income and wealth gaps, and housing discrimination (the NAACP Legal Defense Fund, the Lawyers’ Committee for Civil Rights, the National Urban League and the National Fair Housing Alliance), for a total of $10,684,000 in charitable contributions, inclusive of employee contributions.

Figure 131. Consumers Expect Firms to Follow up Talk with Action

<table>
<thead>
<tr>
<th>Country</th>
<th>Percent Agreeing</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>65%</td>
</tr>
<tr>
<td>Canada</td>
<td>63%</td>
</tr>
<tr>
<td>U.S.</td>
<td>63%</td>
</tr>
<tr>
<td>U.K.</td>
<td>57%</td>
</tr>
<tr>
<td>France</td>
<td>54%</td>
</tr>
<tr>
<td>Germany</td>
<td>53%</td>
</tr>
</tbody>
</table>

Source: Edelman Brand Trust Barometer 2020, Citi Research

81 Stankiewicz, K., “CEOs are offering plans and investments to address racial inequality after George Floyd death”. CNBC. June 11, 2020.
Address Racial Gaps in Hiring, Retention, and Firing

Corporations can implement policies that are more conscious of addressing racial gaps in matters of hiring, retention, and firing. There are several recommendations for the corporate setting:

- **Recruitment and Hiring:** Establishing diverse slates and limiting selection bias is paramount at the recruitment and hiring stage. Analysis by NatCen suggests that there is discrimination and 'ethnic filtering' in the recruitment process. Indeed, National Academy of Sciences data reveal the rate of callbacks for Black candidates is generally lower than that of white candidates, and this rate has been little changed over since the 1970s.\(^{82}\) Moreover, businesses may be inadvertently perpetuating wage inequality by asking for salary histories. To enhance motivation for greater minority employment, companies could be subject to mandatory, randomized public diversity monitoring with the intention that in facing potential obligation to publish minority employment statistics this would translate into material change and diversification of the recruitment process. Additionally, a government supported and fiscally incentivized enhancement of online recruitment as a method to further anonymize the hiring process likely would prove instrumental in improving racial equality in hiring practices.\(^{83}\)

- **Retention:** With research showing that a professional leaving an organization can cost as much as twice the average associate’s salary there is clear economic incentive to improve retention rates, especially among minority employees who are more likely to leave a firm due to mistreatment.\(^{84}\) Active consideration of minority interests and implementation of specific programs to address minority representation within a firm are proven avenues to greater retention levels. These include mentoring schemes, with defined commitment from employers to provide clear evaluation tools to deliver tangible advancement of their minority employees; active inclusion in high visibility assignments; and proactive endeavors to provide influential sponsors to minority employees within the firm to support the navigation of corporate ascent.\(^{85}\) Firms should ensure that pay and promotion of Black employees is commensurate with other workers.\(^{86}\)

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\(^{84}\) Kapor Center. 2017 Tech Leavers Study.


Figure 132. Callbacks of White Applicants Relative to Black Applicants

Source: Meta-analysis of field experiments shows no change in racial discrimination in hiring over time. Lincoln Quilliana, Devah Pager, Ole Hexela, and Arnfinn H. Midtbøen, Proceedings of the National Academy of Sciences (PNAS), 2017

- **Layoffs**: Black and Hispanic workers are more likely to be subject to reductions in force (RIF) actions amid economic downturns due to higher labor market segmentation in lower-level or more discretionary jobs. The Harvard Business Review (HBR) suggests employers can consider performance more than position, and cross-training and upskilling workers to help narrow the numbers of minorities reduced. Companies factoring performance into their decision-making, often are able to retain their best performers, regardless of gender and race. Businesses can redeploy workers with transferable skills to other parts of the firm, and/or cross-train employees for other tasks to avoid major labor cuts. Employers can also cut pay and hours, but continue to retain workers.  

- **Lists**: HBR recommends that firms, when releasing employees, maintain lists of persons being let go to note major disparities and to share those lists with other firms that may have job openings. Businesses can draw from these lists of recently unemployed persons to find a diverse set of talent.

**Engage in Corporate Social Responsibility**

Bolstering external communities and supporting minority-owned firms can help close gaps at the societal level. Businesses can engage in corporate social responsibility (CSR). CSR is considered a strategic differentiator for firms, which can aid in brand reputation externally and support employee morale and sense of purpose internally. Moreover, corporations can provide direct investments in minority-owned small businesses.

Firms can also consider public actions to accelerate policies and legal measures to protect and support vulnerable populations. This can include public condemnation of events or legislation that target groups of people based upon race.  

Studies have shown CSR is not only for attracting and retaining customers, but also for retaining talent. For example, Millennials are willing to forego an average of 14.4 percent of their expected compensation to work at socially responsible companies. Also 88 percent of Millennials believe a business should be proactively participating in the community. A reported 92 percent of employees involved in CSR programs cite higher rates of emotional and physical health. Moreover, 66 percent of employees report a greater sense of loyalty to their employers as a consequence of participating in CSR programs.  

**Dismantle Structural Barriers to Hiring Black Talent**

Other structural barriers inhibiting corporations from hiring Black talent must also be dismantled. In a Time Magazine article written by Darren Walker, the President of the Ford Foundation, Walker advocated enforcement of racially diverse candidate pools while also stressing the material impact of engaging fully with Fair Chance Hiring (FCH). FCH is where companies are encouraged to employ qualified job applicants with criminal histories — a group in which Black Americans are overrepresented, as African American men are 11.8 times more likely to be incarcerated than white men of the same age. Policies that might help reduce joblessness among ex-inmates include: (1) temporary basic income; (2) occupational licensing reform; (3) bond insurance and tax incentives for employers who hire ex-offenders; (4) automatic record expungement; and (5) banning employment discrimination subject to Title VII of the Civil Rights Act of 1964. Moreover, removing blanket bans on occupational licensing, and following a more bespoke approach. For example, in New Jersey and Oklahoma, a conviction must have a ‘direct, rational, or reasonable relationship’ to the duties of the occupation to be defined for licensing.

**Develop Metrics to Analyze, Report, and React**

In order for firms to begin and/or continue the process of facilitating racial gap closures in the workplace, metrics must be used to analyze, report, and react. The steps towards eliminating wage gaps include: (1) collecting data; (2) analyzing and publicizing the data; and then (3) acting on the results of the data if they reveal that inequity in pay exists for jobs requiring the same qualifications. First, firms can assess current workforce demographics: do the present number of Black employees match national and local population ratios? Second, firms may set recruitment targets to address discrepancies for Black employees. In areas where Black employees are underrepresented, firms can establish recruitment targets with accountability mechanisms like tying executive compensation to meeting targets or holding leaders accountable in performance reviews.

89 IBID.  
91 Walker, D., “If Corporations Really Want to Address Racial Inequality, Here are 9 Things That Actually Make a Difference.” Time, August 4, 2020.  
Targets are useful for opening up opportunity for highly qualified underrepresented persons while potentially limiting space for less qualified persons among overrepresented groups.\textsuperscript{94} Third, investigate whether Black employees are compensated for equal work and promoted as regularly as other employees. Following the pay equity study (analyze), firms should be transparent about the results (report), and then create a plan to rectify discrepancies (react).\textsuperscript{95} Business can also hire specialized recruitment and employment firms (e.g., Jopwell) to assist with diversification initiatives.

**Recruit More Black Board Members**

To assist with accountability, companies can add more Black executives to their boards. According to Deloitte LLP “a critical need for inclusive leadership, the shifting U.S. demographics, and investor pressure in the United States have increased the focus on diversity in the C-suite and on public company boards.”\textsuperscript{96} A 2018 Deloitte study found that 34 percent of Fortune 500 seats were held by women and minorities, and 38.6 percent of Fortune 100 board seats were held by women and minorities. This share might increase to 40 percent by 2024 if the rate of increase identified over the 2016 to 2018 period of the study were kept. Notably, Black women gained 32 Fortune 500 seats in 2018, and Black men acquired 26 seats, rates of increase of 26.2 percent and 8.5 percent respectively.\textsuperscript{97} Nonetheless, the study confirmed that many of the Black board members were “recycled,” meaning they had already been board members elsewhere or are currently serving on another board. Hence, while board diversity is increasing, the absolute number and share of Black men and women on boards (9 percent) is lagging relative to the U.S. population (13 percent).

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\textsuperscript{97} Ibid.
Challenges to adding more Black board directors must be overcome. According to the Harvard Business Review, challenges to adding Black board members include: (1) few existing minority directors to recruit and attract Black board members; (2) a lack of Black persons in the executive pipeline, who are often persons tapped for board seats; (3) an insufficient number of minorities on recruitment slates; (4) homogenous social networks that may have few or no Black persons who might be tapped for board directorships; (5) inadequate director onboarding required for directors to get to know each other and work more effectively; (6) lack of leadership roles on boards for Black directors, making them less effective; and (7) bias, where Black directors, especially women, feel that their ideas are devalued or ignored.98 Many of these challenges can be overcome by (1) broadening the search criteria for board members; (2) better leveraging search firms for finding board members; (3) improving on-boarding training; (4) ensuring more leadership roles for Black directors; (5) building up the pipeline of potential directors by addressing problems with retention of Black employees; and (6) valuing the expertise, contributions, and opinions of Black board directors. Diverse boards provide a diversity of perspectives, create a virtuous cycle of greater diversity, and help with recruitment and retention of diverse talent throughout the company.

Figure 134. Social Networking is a Major Factor In Selecting Black Board Members

How Black Directors Were Initially Introduced to the Board (% of Black or White Directors)

- Known to the board or one of the other directors: 35% Black, 54% White
- Recruited by an executive search firm: 25% Black, 33% White
- Known to the CEO: 31% Black, 33% White
- Known to a member of executive management: 13% Black, 21% White
- Appointed by a major shareholder: 15% Black, 13% White
- Am a current or former executive of the company: 0% Black, 12% White
- Other: 13% Black, 13% White

Source: Harvard Business Review, Citi Research

Figure 135. Racially Diverse Boards Tend to Prioritize Racial Diversity Within the Company

Percent of Directors Who Agree or Strongly Agree

- Diversity in this company is a high priority: 56% Black, 69% White
- This board has an ideal mix of members with diverse perspectives and experiences: 66% Black, 77% White

Source: Harvard Business Review, Citi Research
What Can Individuals Do?

While we argue that structural factors have and continue to play significant roles in perpetuating racial gaps, individuals are far from powerless. Black persons in the U.S. can continue to advocate for themselves in the realms of finances, education, business, and politics. Meanwhile, persons of other races can continue to educate themselves about historical disparities and work towards fixing them.

Use Education as a Pathway for Advancement

Parents can advocate for greater accountability from and funding for schools. Although Black parents are less likely to volunteer at school events, often due to work commitments, it does not mean that they are not involved in their children’s education. Parents show their activism in their choices for education for their children including charter schools, private schools, and magnet public schools. (Figure 137). On a small scale, one study revealed that 83 percent of Black students had their homework checked by a parent, compared to 57 percent of white students and 59 percent of Asian students. ⁹⁹ In terms of more dramatic action, parents have reported willingness to move in order to provide their students with access to a better school district. Parents can continue to take action against unequal disciplinary measures against their children that can disrupt learning and future prospects. Black youth comprise roughly 16 percent of public school students and about 9 percent of private school students. Yet, they account for 35 percent of in- and out-of-school suspensions, and 39 percent of expulsions. ¹⁰⁰ Parents can ensure that their children are considered for gifted and talented education (GATE) programs and apply to magnet schools, which have become more racially segregated. ¹⁰¹ Finally, parents can use their political power (Decennial Census, voting) to ensure that adequate funding is directed towards their school districts.

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¹⁰⁰ Ibid.
As mentioned above, students can take more courses relevant to STEM fields, and take Advanced Placement courses in high school. Students should seek education beyond a high school degree: college, trade school. Students should also consider advanced and professional degrees even after earning a college degree. Throughout the school career, students can take advantage of organizations that promote academic achievement and stepping stones into business. Notable organizations include Girls Who Code, My Brother’s Keeper Alliance, Jack and Jill of America Incorporated, United Negro College Fund (UNCF), Management Leadership for Tomorrow (MLT), INROADS, Toigo, Sponsors for Educational Opportunity (SEO), A Better Chance, the Jackie Robinson Foundation, and the Urban League. Funding for education can be tackled in part via familial investments in college savings plans and student applications to scholarships. As discussed above, training and higher education are highly correlated with higher incomes over a lifetime.
Have Non-Profit Organizations Built the Middle Class? Spotlight on MLT and INROADS

Non-profit organizations have existed for more than 100 years to help advance the financial and social wellbeing of Black Americans. Two organizations have quantified how their efforts have bolstered the expansion of the Black middle-class.

- **MLT** – Statistics from the MLT website indicate the average starting salary for their Career Prep Fellows is $75,000, with half of these students coming from homes with annual household incomes of less than $50,000. Moreover, of their 1,600 scholars per year, 90 percent of their undergraduates receive an offer for a high trajectory job, 90 percent of its MBA Prep students matriculate at top 10 business schools, and 90 percent of its first-generation college students are on track to graduate within 4-6 years, compared to the national average of 11 percent.

- **INROADS** – INROADS in partnership with Australian-based non-profit Career Trackers surveyed 1000 INROADS alumni to determine how the organization has helped to narrow racial gaps. Among respondents, 57 percent have incomes in the range of $50,000 to $100,000 and 34 percent with incomes exceeding $100,000. Forty-seven percent have net worth in the range of $100,000 to $500,000, and 40 percent in the $500,000 to $5 million range. Plus, 76 percent own a home. Regarding real estate, 49 percent own at least one property and 56 percent own more than one property (Figure 138).

**Source:** Adam Davids, Fulbright Scholar hosted by INROADS and Director of Learning and Innovation, CareerTrackers Australia, Citi Research
What Is Citi Doing to Help Minority Women Advance in Technology?

Citi Foundation Supports NPower and their report Breaking Through, Rising Up; Strategies for Propelling Women of Color in Technology

In May 2018, the Citi Foundation awarded a $1.64 million grant to NPower to increase the enrollment of young women in its program from 25% to 40% by 2022 — now two years into this mission, enrollment rates are at 31%. In September 2020, Citi Foundation announced it was expanding its partnership with NPower, including an additional $4 million investment, to help advance the careers of young Black and Latinx women in the technology field across six U.S. cities.

To date, the intersection of gender, race, and class in technology has received little attention. NPower seeks to address this discrepancy and highlight the core elements crucial to establishing a more equitable industry; with a particular focus on women of color. Undeniably, achieving this goal will require intention, investment and innovation as well as cross-sector awareness and action by practitioners and executives. With women making up just 26% of the technology workforce and with Black and Latinx women making up just 3% and 1% of the computing workforce, respectively, there is significant progress to be made.

NPower seeks to address inequality in providing free training in technology. Its aim is to correct diminished access to early computing as a result of inequitable funding streams in high-poverty areas disproportionally affecting minority groups. There are four key aspects to the program: (1) focusing on recruitment; (2) support services; (3) instruction; and (4) job placement services. In combining the practical with the personable, the program is able to best approach training for women of color. In using community-based organizations to expand applicant pools whilst providing wraparound support services, the impact of the training and economic mobility provided to alumni can be material. Moreover, in endeavoring to target classroom bias by providing female instructors, the program is also able to provide applicable role models; challenging what is often seen as a barrier to motivation to join an industry. With Citi’s support, the instructional staff at NPower has gone from one female instructor in 2018 to recruiting and onboarding six additional female instructors two years later. This trend of inclusion is further emphasized within the job placement aspect of the program, primarily in their drive to create strong partnerships with employers that demonstrate successful and integrated diversity practices.

NPower supports utilization of a number of strategies that practitioners, employers, and funders can apply in order to deliver a successful and minority favorable outcome. Particularly impactful is the suggestion for the provision of flexible training provisions, such as online or at the weekend, whilst considering skill based hiring and embracing non-traditional educational backgrounds. Moreover from a funding prospective, investing in wraparound services such as childcare — with 19% of female and 10% of male students citing managing childcare responsibilities as a significant challenge during the program — and transportation, deliver meaningful differences for participants.

NPower believes a number of policy levers for increasing opportunities for Women of Color in Technology can also be widely applied to the minority population as a whole. Fundamentally, an expansion of funding for apprenticeship programs as well as the expansion of Pell Grants to shorter term training programs would have a positive impact, alongside the increased funding for childcare subsidies, especially during non-traditional hours. To provide sustainability, expanding family leave laws and strengthening pay parity laws would prove instrumental in progressing towards a more equitable workplace, not just in technology, but in every industry.

Don’t Ask, Don’t Get: Advocate for One’s Career

Black workers can enhance their wage and income prospects by advocating for their careers.

Black workers should seek greater opportunities, including stretch assignments and leadership roles. Ask for and accept constructive feedback during reviews in order to identify areas of strength and weakness. Request clear goals that constitute success and review them with managers on a frequent basis. When it comes to compensation ask for the raise, but also arm oneself with a list of accomplishments warranting an increase. Ask employers where your salary lies within the range for your duties. If outside of that range, ask for it to be rectified. Unfortunately, a study by PayScale indicates that “People of color were significantly less likely than white men to have received a raise when they asked for one.
Women of color were 19 percent less likely to have received a raise than a white man and men of color were 25 percent less likely. Nonetheless, if workers do not ask for a raise, then they lower the likelihood of receiving one. Network and remain visible, highlighting your successes with key stakeholders. Workers should seek mentors, advocates, and sponsors to help navigate their careers within a corporate setting. Join trade unions or professional clubs within your industry. Join or create support groups with colleagues outside of your business to glean knowledge and to build morale. Remain curious and retool one’s skillset in order to be prepared for larger roles, greater responsibilities, and new opportunities.

- **Consider starting a business:** The U.S. Chamber of Congress and the SBA are resources for Black-owned businesses to find sources for grants, financing, and advice on how to run effective firms.

- **Move:** While a difficult decision, relocation may be the answer to improved jobs prospects. Sixty five percent of the Black population resides in 16 states in the U.S. However, according to a survey by McKinsey and Company, on average these states rank below national averages in metrics that can lead to an improved quality of life and wealth generation. Black workers, especially younger workers can opt to move to states that are generating the most jobs in high paying industries.

Figure 139. Black Workers Are Concentrated in States with Poor Economic Prospects Relative to National Average

[Bar chart showing McKinsey Leading State Index Scores: 2017]

Source: McKinsey & Company, Citi Research

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Embrace Delayed Gratification and Risk

Financial literacy and engaging with more traditional forms of financial services are ways that Black families can learn to budget and adjust spending in order to generate savings. Savings are critical for generating wealth via investments in homes, retirement and college savings vehicles, businesses, and financial assets. Indeed, a 2017 Gallup poll revealed that only 36 percent of Black respondents compared to 60 percent of white respondents cited investments in the stock market (Figure 141). 103 This is despite one fifth to one quarter of people in the US believing that stocks are a good long-term investment in recent years (Figure 142). 104 Actions that generate wealth require delayed gratification and a measure of risk, but can often lead to positive returns over the longer run.

Operation Hope and Dfree are notable organizations that advocate financial literacy as an avenue for achieving financial independence, often known as “silver rights.” Online brokerage firms that require smaller initial investments and reduced fees, as well as investment clubs are ways that families with modest incomes can begin to invest in their futures. Families with greater means can seek professional advice from brokers and financial advisors. All persons working at jobs with pension funds and/or retirement savings vehicles (IRAs, 401Ks) should take advantage of them, especially early in one’s career.

Figure 141. Black People Less Likely to Own Stocks than White People

Figure 142. A Significant Share of Americans Favor Stock Holdings

Black persons can use the power of the purse and political activism to advance closure of racial gaps

Utilize Political Power

Many people are utilizing the #BlackLivesMatter movement as an opportunity to speak out against and address racial disparities of all stripes in the United States. Even ordinary persons can use their wallets to challenge firms to change practices that perpetuate inequality. Meanwhile, shareholders can use their influence over corporate executives to advance change. Every citizen having the right to vote should exercise it. Those willing to have a more direct hand in effecting change at the institutional level can engage in political activism by running for office or supporting elected officials with finances and time. While the number of Black politicians, particularly at the Federal level, remains few, the numbers have been on the rise, and likely will continue to do so (Figure 144).
Figure 143. Number of Blacks in Congress is Small but Steadily Climbing

Figure 144. Blacks in Federal Positions Have Increased

Source: Pew Research Center, Citi Research
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NOW / NEXT
Key Insights regarding the future of Racial Equality

EDUCATION
Closing the college/advanced degree racial gap 20 years ago might have generated up to $113 billion in additional income for saving, investing and consumption. Removing funding gaps from K-12 education funding, focusing on school curricula (including STEM) and directing Black students toward higher wage and in-demand occupations can help close the education gap and solve the income gap.

LABOR MARKET
In general Black workers are underrepresented in management, business, financial, professional and related occupations that pay the highest salaries. They are also more likely to be situated in jobs that require lower skills and/or are more susceptible to automation. Encouraging Black students and workers to pursue education and training suitable to more technological and skills-based careers can help close the racial labor segmentation gap.

POLICY
The current 30 basis point gap between Black and white family home ownership is greater now than before 1968 when housing discrimination was legal. Public policy should focus upon housing as a pathway to wealth and encourage home ownership as a path to intergenerational wealth.
Citi Launches More Than $1 Billion in Strategic Initiatives to Help Close the Racial Wealth Gap

**HIGHLIGHTS**

“Action for Racial Equity” represents unprecedented effort to leverage Citi’s core business capabilities and Citi Foundation philanthropy to help address racial equity and justice in the U.S.

Visit Citi’s Action for Racial Equity site.

New York – Citi and the Citi Foundation today announced more than $1 billion in strategic initiatives to help close the racial wealth gap and increase economic mobility in the United States. Citi’s Action for Racial Equity is a comprehensive approach to 1) providing greater access to banking and credit in communities of color, 2) increasing investment in Black-owned businesses, 3) expanding homeownership among Black Americans, and 4) advancing anti-racist practices in the financial services industry.

To support these goals, Citi core businesses as well as the Citi Foundation are committing the following resources over the next three years:

- $550 million to support homeownership for people of color and affordable housing by minority developers
- $350 million in procurement opportunities for Black-owned business suppliers
- $50 million in additional impact investing capital for Black entrepreneurs
- $100 million to support Minority Depository Institutions’ growth and revenue generation
- $100 million in Citi Foundation grants to support community change agents addressing racial equity

“Addressing racism and closing the racial wealth gap is the most critical challenge we face in creating a fair and inclusive society and we know that more of the same won’t
do,” said Citi CEO Michael Corbat. “We are bringing together all the capabilities of our institution—our people, our lines of business, our balance sheet, and our philanthropy—like never before to combat the impact of racism in our economy. This is a moment to stand up and be counted, and Citi is committed to leading the way and investing in communities of color to build wealth and strong financial futures.”

According to the recently published Citi GPS report “Closing the Racial Inequality Gaps,” if the U.S. had closed key racial gaps for Black Americans in wages, housing, education and investment 20 years ago, $16 trillion could have been added to the U.S. economy. If these gaps are closed today, $5 trillion could be added to U.S. GDP over the next five years.

“We are in the midst of a national reckoning on race, and words are not enough. We need awareness, education and action that drive results,” said Mark Mason, Citi’s CFO and one of the industry’s most senior Black executives. “The commitments we are announcing today are just the starting point. By harnessing the central role Citi plays in local economies and the financial lives of Americans, we are determined to help close the racial wealth gap and help build an anti-racist economy and society.”

As part of Action for Racial Equity, Citi’s businesses are focused on four key outcomes:

**GOAL #1: EXPAND BANKING AND ACCESS TO CREDIT IN COMMUNITIES OF COLOR**

*Why it matters:* Many communities of color lack access to traditional banking services that are the foundation of financial stability and thriving communities. Economic security is also hampered by insufficient access to credit, which makes it hard to qualify for affordable mortgages and small business loans.

*What Citi will do:*

- Provide **Minority Depository Institutions (MDIs)** with up to $50 million in **growth capital to strengthen their ability** to serve racially diverse households and entrepreneurs.
- **Generate revenue for MDIs** by inviting them into up to $50 million in **loan participation opportunities** between the Citi Community Capital division in the Institutional Clients Group and its clients to finance affordable multi-family rental housing.
- **Provide pro-bono technical assistance and training to MDIs**—through a collaboration with Deloitte and others—to help MDIs navigate the changing economy, improve operational efficiencies and support talent development.
- Partner with community organizations serving racially diverse households through Citi’s U.S. Consumer Bank to **expand access to the Citi® Access Account Package, which includes low-cost checking and savings products** and new digital financial education.
- **Alleviate one of the biggest barriers to banking** by expanding the Citi ATM Community Network program that **removes out-of-network fees at Citibank ATMs for customers of participating minority-owned banks and community**
development credit unions. Since 2016, Citi’s U.S. Consumer Bank has removed these fees for 440,000 customers of 28 institutions.

• Put 1 million youth on the path to higher education by expanding the Citi Start Saving® platform—which initially was developed to power the City and County of San Francisco’s children’s savings program.

GOAL #2: INVEST IN BLACK ENTREPRENEURSHIP

Why it matters:
Black-owned businesses have long faced obstacles in obtaining loans. They are the most likely to apply for bank financing, but get turned down at twice the rate as white business owners. This financing gap is especially pronounced in the startup world, where studies show that Black entrepreneurs receive only 1% of venture capital funding.

What Citi will do:

• Allocate an additional $50 million to the Citi Impact Fund exclusively to support businesses owned by Black entrepreneurs. Citi kicked off the fund in January with $150 million in capital for businesses that are developing solutions to social and environmental challenges.
• Increase Citi business procurement spend with certified diverse suppliers from $700 million to $1 billion annually, including $250 million with Black-owned firms.
• Launch a new program called Citi Start CreditSM, which will work with Community Development Financial Institutions (CDFIs) to help underserved entrepreneurs increase their credit scores and access more affordable credit.

GOAL #3: INVEST IN AFFORDABLE HOUSING AND PROMOTE THE GROWTH OF BLACK HOMEOWNERSHIP

Why it matters:
Homeownership is a key way to build wealth and equity, and safe, affordable housing is an important platform for financial stability. However, Black homeownership is at its lowest level since the 1960s. In addition, rental housing in many urban areas across the country is scarce and too expensive. Compounding this crisis is the near-absence of minority-owned real estate developers in the affordable housing industry.

What Citi will do:

• Expand the U.S. Consumer Bank’s community lending team and its network of correspondent lenders to increase access to Citi’s mortgage products and services among minority borrowers in low- and moderate-income neighborhoods.
• Provide $200 million of equity and preferential financing through Citi Community Capital to affordable and workforce housing projects by minority developers who either are the sole equity owners or are in a joint venture with meaningful equity participation. Some of this funding also will be invested in
minority developers to build their capacity and allow them to compete for larger affordable housing projects.

GOAL #4: STRENGTHEN CITI’S POLICIES AND PRACTICES IN ORDER TO BECOME AN ANTI-RACIST INSTITUTION

Why it matters:
Advancing racial equity requires a more intentional focus on the challenges faced by communities of color and a commitment to becoming an anti-racist institution. Citi is taking a hard look at its own policies and practices to actively identify potential bias to help level the playing field for communities of color.

What Citi will do:

- Strengthen due diligence processes for project-related financing to **address environmental justice and social impacts on communities of color**.
- Develop standards for **inclusive software design that eliminate bias** and help deliver equitable outcomes to the communities Citi serves.
- **Expand Citi’s capital market activities with minority-owned broker dealers**, assisting with their business and franchise development.
- Work with **marketing, communications and legal partners to establish guidelines that increase representation of people of color** on Citi accounts and within their leadership teams.
- Establish a council of senior leaders from across the company to **develop additional product innovations, assess performance gaps and hold businesses accountable** for **Action for Racial Equity commitments**.

In addition to Citi’s business commitments, the Citi Foundation is making a new $5 million grant to Living Cities to provide U.S. mayors with access to technical expertise, training, and seed capital for pilot initiatives that address racial wealth and income gaps. The Citi Foundation also is expanding employability and entrepreneurship efforts serving Black youth as part of a new **three-year $100 million** investment in its successful Pathways to Progress initiative.

“Citi is going beyond talking about discrimination by implementing concrete strategies to address longstanding inequities in communities of color,” said Kristen Clarke, President & Executive Director of the Lawyers’ Committee for Civil Rights Under Law. “Citi is charting a course that we hope will be replicated throughout the sector. We look forward to continuing our partnership.”

Over the past decade, Citi and the Citi Foundation have invested nearly $100 million in programs and partnerships aimed at closing the racial wealth gap. In 2020, with renewed attention on racial equity in the U.S. and around the globe, Citi donated an additional $10 million to Black-led organizations fighting for racial justice. Citi is also working to increase representation of Black employees in the U.S., especially in senior roles, and encourage a stronger awareness of the legacy of racism and discrimination in the workforce and the industry.
Certain *Action for Racial Equity* commitments, including portions of Citi's investments in minority developers and in Minority Depository Institutions, will require approval from the Office of the Comptroller of the Currency.

For more information on *Action for Racial Equity*, visit citigroup.com/racialequity.

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Citi

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Contacts

Media: Brendan McManus, (212) 793-7064
Investors: Elizabeth Lynn, (212) 559-2718
Fixed Income Investors: Thomas Rogers, (212) 559-5091
In aftermath of protests, new doors are opening. But they say more is needed.

Buwa Binitie looks out at the city skyline from the top floor of Capitol Vista in Mount Vernon Triangle in D.C. (Bill O'Leary/The Washington Post)
By Amanda Abrams
April 1, 2021
Despite more than 15 years as a residential real estate developer, Buwa Binitie says he has grown accustomed to regularly fielding queries about his expertise.

“Those questions come when a lender might be underwriting you, or maybe there are brokers who are marketing the deal and don’t know you. Questions like ‘Where’s your capital coming from, who’s behind you, who owns your company?’ ” says Binitie, who is Black and is the managing principal of Dantes Partners, a real estate development firm in D.C. “Me and my peers call them ‘unnecessary questions.’ We feel our White peers don’t get them at all.”

Binitie — whose company built the Hodge in D.C.’s Shaw neighborhood and Delta Towers in the H Street corridor, both affordable senior housing developments — is far from alone in his experiences. In the Washington area and around the country, the development community is almost exclusively White. In an industry characterized by huge sums of money, Black developers say they face major hurdles in accessing capital, connecting with influential networks and expanding their businesses.

But in the wake of George Floyd’s killing in Minneapolis last May and the subsequent Black Lives Matter protests, developers of color say the industry seems to be experiencing a shift: Some lenders, investors, municipalities, development partners and others in the commercial real estate world are recognizing how homogenous the field has been and are taking steps to address it.

“I’m feeling a little bit of a difference,” says Binitie. He is echoed by other Black developers, who say they have been fielding some new business opportunities and offers of collaboration from lenders and White-led development companies over the past nine months. “[Lenders and investors are] making a significant effort to produce capital specifically for Black and Brown real estate developers,” Binitie says.
But whether this is a permanent change remains to be seen, he cautions. “Is this going to be continuous? Or is it a one-time thing so they can say, ‘We provided the capital, and are now going back to our normal course of business?’ ”

A woman walks down a pedestrian area of CityCenterDC, a high-end office, retail and residential development on the site of the city's old convention center. (Michael Robinson Chavez/The Washington Post)
The Southwest Waterfront seen across Washington Channel from Ohio Drive in 2017. (Benjamin C Tankersley for The Washington Post)
Access to capital

Over the past decade, D.C. neighborhoods have experienced astounding growth. Some, like the Wharf, 14th Street and CityCenter, have been dramatically transformed. Developers have played a key role in that growth, determining what the new buildings would look like, how upscale the condos and apartments would be, and whether existing residents and businesses would be accommodated.

But the lack of diversity among developers has often translated into a lack of diversity in the product, observers say, with real estate projects overwhelmingly targeted to middle- and upper-income groups.
Statistics for developers are difficult to come by, but Urban Land Institute (ULI), a national real estate and land use industry association, says 5 percent of its members identify as Black or African American.

The Washington Post spoke with more than 15 Black people working in real estate development about their experiences. The developers, many of whom have been in the industry for years and hold degrees from Ivy League universities, agreed that their opportunities have been limited by racism, institutional bias and a lack of connection to powerful networks.

“It’s a fraternity environment in this niche filled with so much wealth,” says Anthea Martin, a senior vice president at Bellwether Enterprise, a mission-driven mortgage bank that aims to increase the supply of affordable housing. “This limits the money that minorities can tap into.”

“It’s multiples more difficult to get loans,” says Diarra McKinney, a D.C. native who runs Rosewood Strategies, a company that has constructed multifamily buildings in the D.C. neighborhoods of Takoma and Ivy City. Before starting his business, McKinney says he worked for White-led companies. “Banks would say, ‘Oh, we love you guys!’ and they’ll have a term sheet in a day. For [me and other Black developers], we might have significantly more experience than many of those companies, but we still get all kinds of questions.”

As McKinney points out, the loans do usually come through. “It’s not the 1950s,” he says. “I can go through the process and get a loan offer. But the terms are not the same; the interest rate will be much higher. And you don’t know why that is. It’s all behind the scenes.”

Developers also need equity, in the form of investments from friends, family or private firms, to close their deals. And that can be even harder for Black developers to procure than bank credit. The asset management industry, which includes institutional investors and private equity groups, is
overwhelmingly White. And family and friends, even well-off ones, simply may not have the extra funds to invest in a real estate project.

“I think more than anything, it’s a function of the wealth disparities in this country,” says Curtis Doucette, a managing partner of Iris Development, which has renovated several apartment complexes in and near New Orleans, and is building a $19 million mixed-use, multifamily development there. “We have far less net worth in the Black community. We’re less likely to have it ourselves, our families are less likely to have it, our networks are less likely to have it.”

Doucette, who has been in the real estate business for 18 years, has partnered with White developers and says the contrast was like night and day. “It was a different socioeconomic environment. It was amazing to me to see how willing people were to put hundreds of thousands of dollars into a project.”

There is one area where Black developers are better represented: affordable housing. Most affordable housing is built with some amount of government subsidy; although it can be difficult and time-consuming to procure, it lowers the barrier to entry by reducing a developer’s dependence on private financing.

“The African American developers that I know, they’re in that niche,” says Martin at Bellwether Enterprise. “Most multifamily developers don’t want to play in that space where the deals are perceived as more of a hassle to finance and manage” and where the returns tend to be significantly lower.
Bo Menkiti, left, of Menkiti Group, and Buwa Binitie, of Dantes Partners, in front of Capitol Vista in Mount Vernon Triangle. (Bill O'Leary/The Washington Post)
The developers, along with two other Black-led companies, built Capitol Vista, an affordable-housing development. (Bill O'Leary/The Washington Post)
LEFT: Bo Menkiti, left, of Menkiti Group, and Buwa Binitie, of Dantes Partners, in front of Capitol Vista in Mount Vernon Triangle. (Bill O'Leary/The Washington Post) RIGHT: The developers, along with two other Black-led companies, built Capitol Vista, an affordable-housing development. (Bill O'Leary/The Washington Post)

But others say Black developers are not in the sector just out of necessity. “Minority developers are doing affordable housing because they grew up in those communities. They see that the need is there,” says Adeola Adejobi, a New York lawyer who runs the Diversity in Commercial Real Estate Conference. “When you’re looking at a deal from that lens, you’re bringing a different perspective.”

It is a perspective that is arguably a little more people-centered. Many African American developers find ways to benefit Black communities with their projects, for example. Cecily King, who runs Kipling Development in Detroit, is developing a mixed-income condo building in an upscale community; it will
allow low-income residents to own property in an area with good schools and rising home values. And that, King says, could be life-changing for a family.

“It’s still a business at the end of the day,” she says. “But the perspective you bring to the table [as a Black person] opens your eyes to what the opportunities can be.”

Bree Jones, who runs Parity Homes in Baltimore, says she has experienced the microaggressions familiar to African Americans in the development field and has struggled to find financing for her project. She has a plan to redevelop 96 abandoned rowhouses in west Baltimore and sell them at affordable rates to local residents. (Open Society Institute Baltimore)

**New initiatives on the horizon**

Bree Jones is another developer who is hoping to do good while doing well. Her company, Parity Homes, has a plan to redevelop 96 abandoned rowhouses in west Baltimore and sell them at affordable rates to local residents. “Development without displacement,” she says.
Jones says she has experienced the microaggressions familiar to African Americans in the field and has struggled to find financing for her project. But a year ago, after months of networking and conference-hopping, she met an investor whose company had a social impact wing. The investor, she says, immediately understood the value of her plan.

“They wanted it to work — they believed in me inherently,” Jones says. The subsequent funding, $1.5 million in equity, is one of the last pieces she needed to begin the project.

Black real estate developers have long collaborated to build networks and pull each other up, and that is continuing. But today, a growing number of initiatives are helping to bring in new capital and new connections — and much of that seems to be the result of the country’s intensified focus on racial equity since last summer.

For example, Enterprise Community Partners, a national nonprofit lender, has recently launched a $3.5 billion program to support developers of color who are creating and preserving affordable homes. Capital Impact, another nonprofit financial institution, started a program in D.C. and Detroit to give a select cohort of minority developers access to mentors, training and, in some cases, funding. And a few big banks have recently earmarked funds for minority developers.

D.C.’s Office of the Deputy Mayor for Planning and Economic Development established an initiative that gives minority-run companies priority access to city-led redevelopment projects. “We’ve had a conversation since the beginning of 2019 about how we can make housing in the city more equitable,” says John Falcicchio, who leads the department. “This is a giant leap forward.”

New York City recently announced a similar initiative.
But to really address the discrepancy, developers say a multifaceted approach is needed — one that nurtures the talent pipeline at all levels. After all, at this point, “There are not that many [Black-led] development firms that have the capacity to meaningfully participate,” says Bo Menkiti, founder and CEO of the Menkiti Group in D.C. Together with Dantes Partners and two other Black-led companies, Menkiti’s firm also built Capitol Vista, an affordable-housing development in Mount Vernon Triangle.

More coverage about race and housing
One home, a lifetime of impact
The ‘heartbreaking’ decrease in black homeownership
Home buying while black
Bank programs seek to widen the path to Black homeownership

Helping smaller minority companies grow so they can eventually take on major projects themselves might require an uptick in partnerships with established firms, or the creation of mentorship initiatives.

Some new programs are focusing on young people. “A lot of Black kids don’t know what development is,” says Mark Marshall, director of real estate at the Denver-based Urban Land Conservancy. Marshall partners with Urban Land Institute’s Colorado group to mentor and train young adults who might be interested in the field, a program that ULI is replicating in chapters around the country.

ULI’s leaders say they are taking the industry’s racial discrepancies seriously. “Since the murder of George Floyd, [racial equity] has become a top priority for everyone at ULI,” says Gwyneth Jones Cote, the president of ULI Americas.

This year, the organization’s annual Emerging Trends survey showed that 70 percent of members who responded believe the real estate industry can help address systemic racism.

That’s why this shift is so significant, industry insiders say.
“I’ve had conversations that I definitely didn’t have more than six months ago with people in the industry who want to know what they’re missing,” says King, the Detroit developer.

“Outside of the industry, I’ve seen people have interest in investing in communities of color to right the wrongs they’re now aware of,” she adds. But “how long will it last? That’s the challenge right now.”

realestate@washpost.com
Markets

Citi Looks Beyond Checks to Make Good On Promise to Black Banks

By Jennifer Surane and Lananh Nguyen

December 10, 2020, 12:00 AM EST

The largest U.S. lenders have spent years overlooking Black-owned banks. Now, as the smaller firms face extinction, Citigroup Inc. is hoping to bring them into the fold.

This week, the lender offered one such firm, Houston-based Unity National Bank, the chance to put up $1.65 million for a $13.95 million loan for 93 affordable housing units. Citigroup is following up on a September promise to help these minority depository institutions, or MDIs, finance as much as $50 million in affordable multifamily rental housing.

“We never would have been considered because our lending limit would have never been large enough to come to the table,” Unity National Bank Chief Executive Officer Laurie Vignaud said in an interview. “But Citi made sure there was a piece that we could participate in.”

The number of Black-owned banks in the U.S. has dwindled from 48 to 18 over the last two decades, and their combined assets have declined since the 2008 crisis. While one loan deal can’t solve a crisis decades in the making, it’s another sign that the biggest lenders have begun taking steps to help.

The approach compares to the direct equity investments Bank of America Corp. made in 10 MDIs in recent months, and the $24.6 million that Morgan Stanley pledged to three lenders. Even corporate clients are throwing their weight behind MDIs. Netflix Inc. will shift $100 million of its cash to banks that serve the African-American community.

While Citigroup has pledged as much as $50 million in growth capital to MDIs, its work with Unity National Bank shows the firm is also seeking to take a different path. Citigroup has recruited more than a half dozen lenders to be part of a mentoring program to help them learn the ropes of underwriting bigger loans.

“This is how we change the narrative: long-term sustainable opportunities,” Harold Butler, a managing director in Citigroup’s public-sector group inside its investment bank, said in an interview. “We’re not viewing these relationships as something we can get from them.”

Citigroup is committed to expanding the mentorship program after its latest construction-loan partnership with Unity National Bank, said Gina Nisbeth, a director of structured lending and investments at Citi Community Capital, the firm’s community-development arm. And the lender hopes other major banks will join it.

“The leadership has clearly said this isn’t a coin-operated endeavor,” Butler said. “If your expectation is that there’s a wallet opportunity here, I’m just going to say ‘Next.’”

UP NEXT

Microsoft (MSFT) Is in Talks to Buy Nuance (NUAN)
Real estate diversity program, Project REAP, has named the first fellows to take part in a new initiative to drive money and know-how into building new communities.

The pilot Open Access Fellowship Program in Community Development Finance will provide a pathway for black, Indigenous and people of color (BIPOC) to work in a sector of real estate finance that can help build new communities and improve the health, education and access to wealth of economically disadvantaged populations.

“REAP is proud to help launch the rollout of Open Access, a program that will increase the representation of persons of color in community development finance,” said REAP chief program officer Osayamen Asemota-Bartholomew.

“REAP is proud to help launch the rollout of Open Access, a program that will increase the representation of persons of color in community development finance,” said REAP chief program officer Osayamen Asemota-Bartholomew.

“The current disproportionately low number of BIPOC professionals in the field both deprives neighborhoods of the cultural affinities offered by persons who reflect the ethnicity of the communities served and leaves large groups of talent unaware of and lacking access to career opportunities. We are glad to welcome the first round of Open Access fellows, a stellar and dedicated group.”

The community development finance industry, bolstered by the recent reauthorization of the New Markets Tax Credit Program, offers economic support to low-income areas in the form of lower than market rate interest loans and other economic incentives to help support small businesses, housing organizations and other areas requiring assistance.

The industry is urgently needed as the nation strains to recover from a pandemic that disproportionately affected communities of color in terms of health crises and the ensuing economic devastation that has witnessed unparalleled unemployment rates, evictions realized and threatened, food deprivation, and small businesses forced to close or struggle to stay viable.
Yet, while community development often serves communities of color, it is currently grossly under-represented by Black and Latinx individuals.

Open Access is a newly organized group of executive-level individuals led by co-founders Gina Nisbeth, a director at Citi, and Jeff Monge, managing partner of Monge Capital.

Open Access provides paid virtual fellowships as well as online experience, training, mentorships, and networking sessions to talented professionals of color seeking careers in community development finance.

The program is presented in collaboration with Project REAP (Real Estate Associate Program), the nation’s most successful diversity initiative connecting professionals to commercial real estate (CRE) for over two decades.

The group chose MLK Day, January 18, 2021, to announce the selection of 23 professionals for the pilot Open Access Fellowship Program in community development finance that will run through Friday, April 16, 2021.

The fellows were chosen from a wide pool of candidates spanning the nation from LA and Denver to Chicago, New Orleans, Newark, New York City and many other major cities.

The Inaugural Open Access Fellows are:

<table>
<thead>
<tr>
<th>Fellow</th>
<th>Fellowship</th>
<th>Headquarters</th>
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<tbody>
<tr>
<td>Trevor Nelson</td>
<td>Advantage Capital</td>
<td>New Orleans, LA</td>
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<tr>
<td>Anika Wright</td>
<td>Advantage Capital</td>
<td>New Orleans, LA</td>
</tr>
<tr>
<td>Jaquis McCullough</td>
<td>Baker Tilly US, LLP</td>
<td>Chicago, IL</td>
</tr>
<tr>
<td>Melanie McNeely</td>
<td>Chicago Community Loan Fund</td>
<td>Chicago, IL</td>
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<tr>
<td>Ja’Shar Hartley</td>
<td>Cinnaire</td>
<td>Lansing, MI</td>
</tr>
<tr>
<td>Name</td>
<td>Company</td>
<td>Location</td>
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</tr>
<tr>
<td>John Moore</td>
<td>Classic Lake Consulting</td>
<td>Los Angeles, CA</td>
</tr>
<tr>
<td>Ed Chatmon</td>
<td>Cleveland Development Advisors</td>
<td>Cleveland, OH</td>
</tr>
<tr>
<td>Christen Richardson</td>
<td>Greenline Ventures</td>
<td>Denver, CO</td>
</tr>
<tr>
<td>Isaiah Williams</td>
<td>Greenline Ventures</td>
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</tr>
<tr>
<td>Chabelli Caceres</td>
<td>Monge Capital</td>
<td>Newark, NJ</td>
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<tr>
<td>Chima Joseph</td>
<td>Monge Capital</td>
<td>Newark, NJ</td>
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<tr>
<td>Brianne Andrea Lund</td>
<td>Monge Capital</td>
<td>Newark, NJ</td>
</tr>
<tr>
<td>Giovanni Araujo</td>
<td>National Trust Community Investment Corporation</td>
<td>Washington, DC</td>
</tr>
<tr>
<td>Danielle Salters</td>
<td>New Jersey Community Capital</td>
<td>New Brunswick, NJ</td>
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<tr>
<td>Jocelyn Moore</td>
<td>New Markets Support Company</td>
<td>Chicago, IL</td>
</tr>
<tr>
<td>Rob Ebanks</td>
<td>New Markets Support Company</td>
<td>Chicago, IL</td>
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<tr>
<td>Allison Bernstein</td>
<td>Novogradac &amp; Company LLP</td>
<td>San Francisco, CA</td>
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<tr>
<td>Name</td>
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<tr>
<td>Ashley McMichael</td>
<td>Novogradac &amp; Company LLP</td>
<td>San Francisco, CA</td>
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<tr>
<td>Jessica Washington</td>
<td>Novogradac &amp; Company LLP</td>
<td>San Francisco, CA</td>
</tr>
<tr>
<td>Nicole Dillard</td>
<td>Stonehenge Capital</td>
<td>Columbus, OH</td>
</tr>
<tr>
<td>Marcus Jones</td>
<td>TELACU</td>
<td>Los Angeles, CA</td>
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<tr>
<td>Steven McClendon</td>
<td>Reinvestment Fund</td>
<td>Philadelphia, PA</td>
</tr>
<tr>
<td>Desiree Thomas</td>
<td>TruFund Financial Services</td>
<td>New York, NY</td>
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In addition to paid fellowship sponsorships, other programmatic financial sponsors include JPM Chase, U.S. Bank, Citi, PNC Bank, Novogradac, Dudley Ventures, Advantage Capital, NTCIC, and Monge Capital. For more information see www.projectreap.org
Is your business ready to expand to the next level? If so, when considering options for financing your organization’s growth, don’t overlook the Small Business Administration (SBA) — they aren’t just for starting new businesses.

When more established businesses are ready to expand to the next level, the Small Business Administration (SBA) offers programs to help qualified businesses. Some of those businesses grew so much they became household names, like these seven big brands that may surprise you.

#1. Under Armour®

If you or your family members participate in any sports or physical activity, you know the name Under Armour. This $3.96 billion workout-wear company used SBA assistance to expand in it’s early years.

#2. Chobani® Yogurt

When Hamdi Ulukaya wanted to switch his business from making feta cheese to making yogurt, he needed larger premises. He used an SBA 504 loan to purchase an
80,000 square foot Kraft factory in New Berlin, NY, and today this $3 billion company employs 2000 workers.

#3. Chipotle®

Love Mexican food? The next time you visit a Chipotle Restaurant, keep in mind that when founder Steve Ells was ready to open his third restaurant, he did so with SBA assistance.

#4. Apple®

The SBA’s Small Business Investment Company (SBIC) Program has a long history of directing capital to innovative technological organizations. One of the most iconic tech companies to benefit? You guessed it - Apple. And the SBA’s Small Business Innovative Research (SBIR) Program funded the research for that handy fingerprint scanning technology on your iPhone.

#5. Nike®

Iconic brand Nike also has the SBIC Program to thank. The well-known footwear and apparel company used the program, which helps small businesses access private debt and equity financing, to grow beyond its small business beginnings.

#6. Ben & Jerry’s®

If you love ice cream (even if you just like it a little), chances are you’ve tasted at least one of Ben & Jerry’s wonderful flavors. It was SBA assistance that helped the Vermont-based ice cream company get going in its early days.

#7. Federal Express®

It may seem hard to believe that this behemoth of a delivery company (currently serving 220 countries, with 400,000 employees and projected 2017 revenues of $60.3 billion) was once a small business. Yet back in the early 70’s it was just getting started, and a SBIC program provided the extra capital boost required to expand it to the next level.
If you don’t qualify for an SBA loan right now, don’t despair — you do have other small business expansion financing options. Alternative funding companies offer solutions, usually through online applications and interactions, that you may not have known about. Another possibility is peer-to-peer funding, where private funders offer unsecured financing to qualified small business borrowers.

When you’re considering growing your business, research your financing options. And get inspired by this list of other small businesses that borrowed to expand, and never looked back.
Small Business Administration
SBA

Cassandra Havard, Esq.
Ethan Smith, Esq.
Britani Peterson
Education:
B. A., with highest honors, Bennett College
J.D., University of Pennsylvania

Expert in:
- Corporate Governance and Compliance
- Financial Institutions’ Regulation
- Financial Access and Inclusion
- Subprime and Predatory Lending
- Venture Capital Financing
Ethan Smith, Esq.

**Education:**
B. A., The Johns Hopkins University
J.D., College of William and Mary

**Specialties:**
- Commercial Lending
- Government Guaranteed Lending
- Mergers and Acquisitions
- Real Estate
- Corporate Governance
- Regulatory Compliance
THE SBA: HISTORY & BACKGROUND

Great Depression
President Herbert Hoover, 1932
Reconstruction Finance Corporation (RFC)

World War II
Franklin D. Roosevelt, 1942
Smaller War Plants Corporation (SWPC)

Post-WWII
Office of Small Business (OSB) in the Department of Commerce

Small Business Act of July 30, 1953
Created the Small Business Administration
Function: to aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns
THE SBA: AUTHORITY
Laws, policy, and regulations

- Small Business Act (1953)
- Small Business Investment Act (1958)
- Code of Federal Regulations
- Standard Operating Procedures: SOPs

Mission: The U.S. Small Business Administration helps Americans start, build, and grow businesses.
The SBA provides an array of financing for small businesses from the smallest needs in microlending to substantial debt and equity investment capital.

The SBA provides free counseling and low-cost training to new entrepreneurs and established small businesses in over 1,800 locations.

The SBA sets goals with other federal departments and agencies to award 23 percent in prime contract dollars to small businesses.

The SBA reviews Congressional legislation, testifies on behalf of small businesses, and assesses the impact of regulatory burden on small businesses.
Three primary loan programs:

**7(a) loans**
A group of SBA loans which guarantee portions of the total amount, cap interest rates, and limit fees

**504 loans**
Long-term, fixed-rate financing to purchase or repair real estate, equipment, machinery, or other assets

**Microloans**
The SBA’s smallest loan program, providing $50,000 or less to help businesses start up and expand
## Standard 7(a) Loan

<p>| | |</p>
<table>
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<tr>
<td><strong>Maximum Loan Amount</strong></td>
<td>$5 million</td>
</tr>
<tr>
<td><strong>Maximum SBA guarantee %</strong></td>
<td>85% for loans up to $150,000 and 75% for loans greater than $150,000</td>
</tr>
<tr>
<td><strong>Interest Rate</strong></td>
<td>Lenders and borrowers can negotiate the interest rate, but it may not exceed the SBA maximum</td>
</tr>
<tr>
<td><strong>Collateral</strong></td>
<td>Lenders are not required to take collateral for loans up to $25,000. For loans in excess of $350,000, the SBA requires that the lender collateralize the loan to the maximum extent possible up to the loan amount.</td>
</tr>
</tbody>
</table>
Operate for profit

Be considered a small business, as defined by the SBA

Be engaged in, or propose to do business in, the United States or its possessions

Have reasonable invested equity

Use alternative financial resources, including personal assets, before seeking financial assistance

Be able to demonstrate a need for a loan

Use the funds for a sound business purpose

Not be delinquent on any existing debt obligations to the U.S. government
- Long- and short-term working capital
- Revolving funds based on the value of existing inventory and receivables
- The purchase of equipment, machinery, furniture, fixtures, supplies, or materials
- The purchase of real estate, including land and buildings
- The construction a new building or renovation an existing building
- Establishing a new business or assisting in the acquisition, operation or expansion of an existing business
- Refinancing existing business debt, under certain conditions
CDC/504 Loans

| Maximum Loan Amount | Generally capped at $5 million  
|                    | Certain energy-efficient projects may be up to $5.5 M |
| Interest Rate      | Fixed rates                                                 |
| Collateral         | Typically a 10% down payment required                        |

Small business owner
Certified Development Company (submits loan package to SBA)
Bank or credit union

10% owner contribution
40% financing
50% financing
The purchase or construction of:

- Existing buildings or land
- New facilities
- Long-term machinery and equipment

Or the improvement or modernization of:

- Land, streets, utilities, parking lots and landscaping
- Existing facilities
Microloans

- Maximum amount: $50,000
- Eligibility Requirements: depends on intermediary lender

Microloans can be used for:

- Working capital
- Inventory or supplies
- Furniture or fixtures
- Machinery or equipment
An SBIC is a privately owned company that’s licensed and regulated by the SBA.

SBICs invest in small businesses in the form of debt and equity. The SBA doesn’t invest directly into small businesses, but it does provide funding to qualified SBICs with expertise in certain sectors or industries. Those SBICs then use their private funds, along with SBA-guaranteed funding, to invest in small businesses.
Contracting Assistance Programs

Women-Owned Small Business Federal Contracting Program
- Goal: at least five percent to women-owned small businesses

Service-Disabled Veteran-Owned Small Businesses program
- Goal: at least three percent to service-disabled veteran-owned small businesses

8(a) Business Development program
- Goal: at least 5 percent to small disadvantaged businesses
Questions?
The following slides were received from Professor Cassandra Jones Havard, Esq.
BRANCH NUMBERS

NCRC
OPENING DOORS TO ECONOMIC OPPORTUNITY

2008: 95,018
2009: 95,379
2010: 94,394
2011: 93,979
2012: 93,179
2013: 92,109
2014: 90,662
2015: 89,364
2016: 87,484
2017: 85,713
Businesses who have had SBA assistance:
Kay Gordon, partner at Nelson Mullins, New York City

Kay Gordon counsels clients on hedge fund, funds-of-fund, private equity fund, real estate fund, venture funds, and compliance-related matters involving registered advisers and broker-dealers. She also advises clients on a broad range of securities and regulatory matters as well as a variety of financial instruments and transactions, including managed accounts, credit facilities, joint ventures, and derivative instruments. She works closely with strategic, institutional, and seed investors and also represents clients in investigations by the SEC and other regulators. Ms. Gordon is a frequent speaker and author. She is a chartered financial analyst (CFA) and currently serves on an advisory board of a large hedge fund.

Gina D. Nisbeth, Director of Structured Lending and Investments, Citi Community Capital

Gina D. Nisbeth is a Director in the Structured Lending and Investments Group. She began her career with Citi 16 years ago on the Short Term sales and trading desk. Gina traded the municipal Tender Option Bond portfolio to money market funds for 10 years, growing that program to the largest in the industry. She transitioned into Citi Community Capital, Citi’s community development lending and investing group, in 2009 and she is now responsible for the management of Citi’s New Markets Tax Credit program including transaction origination and structuring as well as portfolio management. Ms. Nisbeth also serves as the President of the firm’s Community Development Entity, named the Citi NMTC Corporation. Gina graduated from Rutgers College with a B.A. in Political Science and as an Eagleton Institute of Politics Undergraduate Fellow. She later received an MBA from The Fox School of Business at Temple University with a concentration in Finance. Gina holds a Series 7 and 63 licenses from FINRA.
Dana Peterson is the Chief Economist & Center Leader of Economy, Strategy & Finance at The Conference Board. Peterson joins The Conference Board from Citi, where for many years she served as a North America Economist and later as a Global Economist. Her wealth of experience extends to the public sector, having also worked at the Federal Reserve Board in Washington, D.C. Dana’s wide-ranging economics portfolio includes analyzing global economic themes having direct financial market implications, including monetary policy; fiscal and trade policy; debt; taxation; ESG; and demographics. Her work also examined myriad US themes leveraging granular data. In addition, Dana conducted multi-asset research and wrote publications with other Citi research teams – both US and global – including strategists covering rates, equities, credit, foreign exchange, commodities, political analysis, and asset allocation. Peterson’s research has been featured by US and international news outlets, both in print and broadcast. Publications and networks include CNBC, FOX Business, Bloomberg, Thomson-Reuters, the Financial Times, and the Wall Street Journal. She is the 1st Vice Chair of the New York Association for Business Economics (NYABE), and a member of NABE, and NBEIC. She received an undergraduate degree in Economics from Wesleyan University and a Master of Science degree in Economics from the University of Wisconsin-Madison.

Ethan Smith is a co-founder and Managing Partner of Starfield & Smith. He focuses his practice in commercial law, with an emphasis on government guaranteed lending, conventional commercial lending and real estate law. Designated closing counsel for several Certified Development Companies. Represents lenders in SBA licensing, compliance, regulatory enforcement, and guaranty purchase matters. Represents lenders before the US Small Business Administration. Active writer and speaker on government guaranteed lending issues nationwide. Ethan has prepared loan documents and performs compliance reviews for loan files for hundreds of SBA 7(a), 504, conventional, and USDA B&I commercial loans. He has also closed numerous other conventional commercial financing transactions and complex commercial transactions.
Perspectives on Minority Business Development
Tuesday, April 20, 4:00-8:45 p.m. EDT

Session 4: Perspectives of Business School Deans
5:55 - 6:25 p.m. EDT

Discussion Leader: Tom Sharbaugh, Professor of Practice and Director, Entrepreneur Assistance Clinic, Penn State Law in University Park

Presenters: Glenn Carrington, Dean, Norfolk State Business School; and Charles Whiteman, Dean, Smeal College of Business, Penn State

Event Co-Chairs:

Samuel C. Thompson Jr.
Professor and Arthur Weiss Distinguished Faculty Scholar at Penn State Law

Sabrina Conyers
Partner at Nelson Mullins Riley & Scarborough

pennstatelaw.psu.edu/events/mbd-perspectives
MATERIALS FOR: SESSION 4: PERSPECTIVES OF BUSINESS SCHOOL DEANS

DISCUSSION LEADER: TOM SHARBAUGH, PROFESSOR OF PRACTICE AND DIRECTOR, ENTREPRENEUR ASSISTANCE CLINIC, PENN STATE LAW IN UNIVERSITY PARK

PRESENTERS: GLENN CARRINGTON, DEAN, NORFOLK STATE BUSINESS SCHOOL; AND CHARLES WHITEMAN, DEAN, SMEAL COLLEGE OF BUSINESS, PENN STATE

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<td>4-1 through 4-62</td>
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<td>FAIRLIE, ALICIA ROBB, AND DAVID T. ROBINSON, WORKING PAPER 28154,</td>
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<td>NBER WORKING PAPER SERIES</td>
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<td>DOC. 04B, 757 RECOVERY AND RESILIENCE ACTION FRAMEWORK EXECUTIVE</td>
<td>4-63 through 4-75</td>
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<td>SESSION 4: BIOGRAPHIES</td>
<td>4-i through 4-ii</td>
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We are grateful for comments and suggestions from Pat Bayer, Elijah Brewer, Scott Frame, John Graham, Melinda Petre, Amit Seru, Per Stromberg, participants at the AEA meetings, the Society for Government Economists meetings, the CESifo Conference on Entrepreneurship and Economics, the Federal Deposit Insurance Corporation, Federal Reserve Bank of Cleveland and Kauffman Foundation Conference on Entrepreneurial Finance, the International Conference on Panel Data, the APPAM meetings, as well as seminar participants at Illinois, IFN Stockholm, McGill University, Stockholm University, Stockholm School of Economics, University of British Columbia, University of Melbourne, University of Southern California, and Vanderbilt University. The views expressed herein are those of the authors and do not necessarily reflect the views of the National Bureau of Economic Research.

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Black and White: Access to Capital among Minority-Owned Startups
Robert W. Fairlie, Alicia Robb, and David T. Robinson
NBER Working Paper No. 28154
November 2020
JEL No. J15,J71,L26

ABSTRACT

We use confidential and restricted-access data from the Kauffman Firm Survey and matched administrative data on credit scores to explore racial disparities in access to capital for new business ventures. The novel results on racial inequality in startup financing indicate that black-owned startups start smaller and stay smaller over the entire first eight years of their existence. Black startups face more difficulty in raising external capital, especially external debt. We find that disparities in credit-worthiness constrain black entrepreneurs, but perceptions of treatment by banks also hold them back. Black entrepreneurs apply for loans less often than white entrepreneurs largely because they expect to be denied credit, even when they have a good credit history and in settings where strong local banks favor new business development.

Robert W. Fairlie
Department of Economics
Engineering 2 Building
University of California at Santa Cruz
Santa Cruz, CA 95064
and NBER
rfairlie@ucsc.edu

Alicia Robb
333 18th Street
Boulder, CO 80302
alicia@nextwaveimpact.com

David T. Robinson
Fuqua School of Business
Duke University
100 Fuqua Drive
Durham, NC 27708
and NBER
davidr@duke.edu
1 Introduction

More than half a century after the passage of the Civil Rights Act, economic differences between whites and African-Americans continue to be a source of social and political tension in the United States. Median black and white households live under substantially different economic circumstances. For example, the median household income for black families is $37,000; for white families the number is $63,000. One out of four black families live in poverty; the poverty rate for white families is 9 percent (U.S. Census Bureau 2016). Inequality is even higher for wealth and financial assets. For example, the ratio of median household net worth for black families to that of white families is 11 to 1, and only 7 percent of black families own stocks or mutual funds compared with 23 percent of white families (U.S. Census Bureau 2019).

Entrepreneurship is often viewed as a mechanism for promoting economic mobility, wealth accumulation and job creation in minority communities, representing a potential tool for alleviating these racial disparities (Bradford and Osborne 1976; Borjas 1999; Boston, 1999, 2006; Bradford 2003). Yet, access to financial capital is a critical element of new business formation (Kerr and Nanda 2011; Simoes et al. 2016). This paper explores racial differences in capital market outcomes associated with launching a new businesses. Although previous research provides evidence that established minority-owned firms experience higher loan denial probabilities, we know little about the racial differences in financing that occur when firms are initially started.1 To our knowledge, our analysis is the first to provide a detailed analysis of race, financing, and creditworthiness at the time a business is first launched.

To explore these racial differences, we use the confidential, restricted-access version of the Kauffman Firm Survey (KFS) with matched administrative data on credit scores. The KFS is the only dataset that provides panel data on startups with detailed information on financing outcomes, credit worthiness and credit expectations. The panel structure of

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the KFS allows us to focus on both the initial capital that firms receive in their founding year, as well as later capital injections secured over the firm’s next seven years of operations. Ultimately this allows us not only to measure initial differences, but also study whether any differences diminish or persist over time as a startup builds an observable track record of performance.

The panel structure of our data offers two key advantages relative to previous work on racial differences in funding, which has focused on cross-sectional differences in firms that are already operating. First, it allows us to avoid problems with retrospective question recall bias and survival bias found with cross-sectional data. Second, if we restrict our analysis to the sample of firms that survive eight years, the initial racial differences in startup capital are considerably smaller than if we look at the full sample, which includes firms that do not survive. This suggests that conditioning on survival understates the degree of racial differences in access to capital. Previous research has highlighted the differences in rates of job creation, responsiveness, and growth between young firms and small firms (Hurst and Pugsley, 2011; Haltiwanger, Jarmin and Miranda, 2013; Adelino, Ma and Robinson, 2016). Previous research showing racial differences in capital access in a cross-section of established businesses could be attributed to racial differences in human capital that have played out over time, inducing sorting of minority-owned businesses into low-growth industries where small firms are the dominant mode of organization. Our work instead demonstrates that there are within-industry, within-geography differences in access to capital at firm inception, which may have important implications for understanding racial differences in regional economic growth and employment.

Our analysis proceeds in three steps. In the first step we demonstrate large racial differences in the sources and amounts of financial capital that are used to launch businesses. Black-owned startups start smaller in terms of overall financial capital and invest less on average as they mature. Racial differences in outside debt account for more than half of the difference in total financial capital. Indeed, the ratio of debt to total capital (i.e., the leverage ratio) for black-owned startups is persistently below that observed for white-
owned startups. But, the disparities do not end here: alternative sources of capital such as loans from friends and family, personal equity and credit cards do little to attenuate these differences. Black-owned startups also have lower levels of all other major sources of funding than do white-owned startups.

The second step is to explore the underlying causes of these financing patterns. Throughout the paper, we use the term *access to capital* to capture the amount of capital obtained by a particular business, understanding that this quantity is an equilibrium capital market outcome affected by both supply-side and demand-side factors. Large racial disparities in access to capital could reflect racial differences in either demand for capital, in the underlying quality of the business opportunity, or in attitudes towards credit markets. Under these demand-side explanations, black borrowers obtain less capital because they need or want less, because they are more risk averse (perhaps the stigma of bankruptcy affects them more greatly) or because they anticipate rejection when they apply for credit. There are also supply-side channels, through which race matters to lenders. A long literature in economics going back to Becker (1971) and Phelps (1972) debates whether this ultimately traces back to taste-based discrimination rooted in racial animus or instead statistical discrimination based on differences in endowments and incomplete information. Under both sets of explanations the race of the borrower affects the level of capital they receive.

Although we cannot definitively rule out any particular explanation, our data allow us to paint a rich descriptive picture of racial differences in access to capital by exploring these potential explanations in considerable detail. First, because we have new confidential administrative data on credit ratings from Dun & Bradstreet that have been matched to all businesses in the restricted-access version of the KFS, as well as information on founder net worth, we can condition on an extensive set of founder and business characteristics that are correlated with race, and likely affect lending decisions. Thus, we can identify key traits contributing to inequality and can examine whether correlated traits are the primary source of racial disparities. After we control for industry, business credit
scores, founder net worth, education and experience, as well as many business characteristics that may ultimately be endogenous to the amount of funding received, we can explain about one-third of the initial funding gap between black-owned and white-owned startups. Lower credit scores among black startups contribute the most among correlated traits.

Nevertheless, as is common with much work that attempts to explain firm-level differences in capital structure, our analysis cannot fully account for the unobserved differences in opportunity sets that might drive firm-level differences in borrowing. Including fixed effects for business location dramatically increases the explanatory power of our regressions, but does little to alter the estimated differences between black- and white-owned businesses in initial size. That is, including a fixed effect for the core-based statistical area (CBSA) of the business raises the regression $R^2$ from around 15% to around 30%, and specifications including zipcode fixed effects produce $R^2$ values over 60%. In short, racial differences across neighborhoods within the same city are as large as racial differences across cities.

Moreover, the initial differences in funding are not erased by later injections of capital. In order for black- and white-owned businesses to converge in size, black-owned businesses would need substantially larger capital injections in the years after inception to make up for differences at founding. Racial differences in the size of later injections of new funding are smaller than the initial differences, but they remain significantly smaller in later years. Thus, on average, businesses started by black founders do not converge to the size of white-owned businesses as they age.

This persistent difference in funding is driven primarily by differences in the amount of bank loans and other bank credit products, which in turn are not substituted by other sources of capital. Lower amounts of banking services could reflect worse treatment by banks, less demand for banking services, or could reflect differences in borrower attitudes.

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2Core-based statistical areas include metropolitan statistical areas (MSAs) but also include “micropolitan” statistical areas, defined by the US Census as “areas that have at least one urban cluster of at least 10,000 but less than 50,000 population, plus adjacent territory that has a high degree of social and economic integration with the core as measured by commuting ties.”
and expectations, and ultimately less willingness to approach banks. One important advantage of our data is that they include measures of loan application expectations, even among those who did not seek funding. Typically, differential average participation rates confound the measurement of discrimination; here, detailed questions in the KFS measuring the demand for loans, the rate of loan rejections, and the expected fear of denial among borrowers who chose not to attempt to borrow allow us to explore how expectations of discrimination may impact participation in financial markets.

Black entrepreneurs apply for bank loans less frequently than white entrepreneurs. This stems largely from differences in the fear of rejection. Overall, black entrepreneurs are about three times more likely to state that they did not apply for credit when needed for fear of having their loan application denied. Similarly, black-owned startups are about three times less likely than white-owned startups to report that their loan requests are always approved. These differences persist even after controlling for credit scores and net worth: indeed, even black founders in the top quartile of the credit score distribution are more than twice as likely to report a fear of denial than white founders with below median credit scores. These effects are stronger in areas where historical and current racial tension is higher, and weaker in areas where racial tensions are less severe, which suggests that actual or perceived statistical or taste-based discrimination could be a factor in these results.

Banks use both hard information (objective, easily codified and transmitted information like credit scores) and soft information (potentially more precise, but subjective and difficult to verify information) in their lending decisions, and to varying degrees based on bank characteristics. Because black-owned startups tend to be at a hard-information disadvantage relative to white-owned startups, we next explore whether they face fewer constraints in settings where soft information is potentially more actionable. Given that large national banks tend to rely more on hard information when making lending decisions, while local banks tend to rely more on soft information (Berger, Miller, Petersen, Rajan, and Stein, 2005; Petersen and Rajan, 2002), we exploit regional variation in the
strength of local banks to ask whether these attitudes and outcomes are different in regions where soft information could play a bigger role in the lending decision. Areas with stronger local banks are indeed areas where the average founder is less afraid of loan denial, and where average business loan amounts to startups in our sample is higher. But these effects are exclusive to white-owned startups. Black founders are not less afraid of loan denial in these markets; if anything, they are somewhat more likely to report that they did not apply for fear of denial in regions with stronger local banks. In these areas, white-owned startups receive larger amounts of bank debt on average but black-owned startups do not.

The third step and final piece of our analysis attempts to assess the importance of these differences to cumulative capital disparities. For this, we use decomposition techniques developed by Blinder (1973) and Oaxaca (1973) to assess how much of the size difference between black-owned and white-owned businesses is attributable to the characteristics we observe. We can explain around one-half of the total difference in firm size with observables. Of these, business credit scores and founder net worth (which presumably measures collateral) account for about two-thirds of the difference. Differences in education and experience account for only a modest portion of the difference. If the average black-owned business had the observable characteristics of the average white-owned business, it would be about 75% larger.

This paper adds to the literature on racial differences in financial market outcomes. Chatterji and Seamans (2012) find that the expansion of credit card availability stimulated entry into entrepreneurship especially for black entrepreneurs, and find that the strongest results in areas with high rates of historical racial discrimination. Dougal, Gao, Mayew and Parsons (2017) find that historically black colleges pay higher issuing costs for bonds than other higher-education bond issuers, and attribute these higher spreads to racial animus among wealthy white bond purchasers. Earlier studies provide cross-sectional evidence from the SSSBF of racial differences in lending markets for established businesses (Bostic and Lampani 1999; Cole 1999; Cavalluzzo, Cavaluzzo and Wolken 2002;
Blanchflower, Levine and Zimmerman 2003; Blanchard et al. 2008; Mitchell and Pearce 2011). Apart from our study being the first to focus on new business ventures, rather than more-established, existing businesses, our work departs from earlier work in the breadth and depth of our empirical measures of overall capital sources, creditworthiness and loan expectations, and use of longitudinal data on a cohort of firms.

The balance of the paper is organized as follows. In Section 2, we describe the restricted-access KFS panel that follows startups from their founding through seven years of operations after their startup year and the matched Dun and Bradstreet (D&B) administrative data on credit scores. In Section 3, we examine whether there are differences in the use of financial capital (levels and detailed sources) between black and white firms at startup and in the years following startup. Section 4 explores potential causes of racial differences in financial capital. In Section 5, we explore racial differences in credit market explanations. Section 6 explores the potential role of racial bias in capital markets, and Section 7 explores the question of how much of the racial gap in funding disappears after controlling for startup characteristics. Section 8 concludes. An online appendix provides additional details regarding racial differences in survival, profitability, and funding sources.

2 The Kauffman Firm Survey

We use the confidential, restricted access version of the Kauffman Firm Survey (KFS) to study how startups access capital markets. The KFS is a longitudinal survey of new businesses in the United States, collecting annual information for a sample of 4,928 firms that began operations in 2004. The underlying sample frame for the KFS is Dun and Bradstreet (D&B) data.

The KFS data contain unprecedented detail on the financing patterns of startups, as well as detailed information on both the firm itself and up to ten business owners of the firm. In addition to the 2004 baseline year data, we also use the seven years of follow up data covering calendar years 2005 through 2011. Detailed information on the owners
includes race, gender, age, education, previous startup experience, and previous work experience. Detailed information on the firm includes industry, physical location, employment, sales, intellectual property, and financial capital used at start-up and over time. The detailed financing information in the KFS allows us to examine the relative importance of each source of financing at start up and over time. The confidential, restricted-access version of the KFS includes credit scores, continuous measures of key variables, such as financing, and more detail on industries and geographic locations than the publicly-available KFS. The KFS was also designed using sample weights to be representative of all new businesses in the U.S. economy and not restricted to a narrow set of industries or business types.

Our administrative data on credit scores from D&B for all firms in the KFS allows for a novel analysis of racial differences among startups. Credit scores are not available on most surveys, perhaps because most entrepreneurs do not know readily know what their scores are. To be sure, the Survey of Small Business Finances (SSBF) includes information on credit scores, but only for larger, more established, and older businesses (Cavalluzo and Wolken 2005). While the KFS contains unprecedented detail on the business formation process, the availability of business credit scores allows us to control for many differences in firm characteristics that would be observable by bank lending personnel but typically unobservable to the econometrician.

The KFS is the only large, nationally representative, longitudinal dataset providing detailed information on new firms and their financing activities. Most previous research on the use of financial capital among small businesses has relied on cross-sectional data on existing businesses. For example, the Survey of Business Owner (SBO) data provide information on the amount of startup capital, but provide only retrospective information for surviving businesses and do not provide information on the relative importance of the different sources of financing. Another commonly-used dataset, the Federal Reserve Board’s Survey of Small Business Finances (SSBF), provides information on recent financing, but does not provide information on financing at startup or the early stages of firm
growth (and was discontinued after 2003). Furthermore, both the SBO and the SSBF are cross sectional surveys that do not provide information on firm financing over time for the same sets of firms. Finally, fundraising levels in the KFS are measured annually, and are thus less prone to recall bias as is the case with both the SBO and the SSBF.

We restrict our attention to the set of firms that either survived over the sample period or that have been verified as going out of business over the sample period. In most analyses, we condition on survival in that year, but we also conduct robustness checks taking alternative approaches to addressing survival. Our main results are not sensitive to the approach, and we discuss the robustness check results below. We also specifically focus on firms that have a white or black primary owner. These restrictions result in a sample of 3,551 startups out of the total sample of 4,124 startups with owners of any race that began operations in 2004 and either continued through the final year in the sample period (2011) or can be verified to have exited sometime over the period.

We assign owner demographics at the firm level based on the primary owner. For firms with multiple owners (35 percent of the sample), the primary owner is designated by having the largest equity share in the business. In cases where two or more owners owned equal shares, hours worked and a series of other variables are used to create a rank ordering of owners in order to define a primary owner following the algorithm proposed in Ballou et al (2008). We include businesses with owners of all races in the regression analysis, but focus our comparisons on black- and white-owned businesses. Following standard conventions in the literature, the white category includes only non-Hispanic whites. Using these definitions, we find that 9.1 percent of the KFS sample of startups is black-owned. The percentage of black-owned startups does not notably change over time indicating similar survival rates. In the seventh year after startup we find that 8.4 percent of the KFS sample is black-owned.

Because so much of our analysis centers around founder net worth and creditworthiness, we also compare the distribution of net worth among startup owners in our data with that of the broader U.S. population as a whole. The most recent government source
for data on U.S. net worth is from the 2013 Survey of Income and Program Participation (SIPP). Figure 1 compares the KFS and SIPP net worth distributions. Solid bars represent the U.S. population and dotted bars represent startup owners. The bottom two quartile categories are collapsed because of reporting restrictions. Additionally, the quartiles are inexact due to data availability in the published net worth statistics from SIPP.

Insert Figure 1 here

There are two key findings here. First, both black and white owners have net worth distributions to the right of their respective population net worth distributions. Thus, both black and white startup owners are less likely to be from the lower tail of the wealth distribution than the population as a whole. Second, the wealth disparity between whites and blacks found in the overall U.S. population also holds among startup owners. Black startup owners have a wealth distribution to the left of the white startup owners distribution, and the same holds for the U.S. population.

3 Are There Racial Differences in Access To Startup Capital?

Table I reports average amounts of capital by type of capital for startups (and Figures 1 and 2). The KFS contains finely detailed sources of funding for startups, which are reported along with summary statistics in Appendix Table I. To facilitate an analysis of broad patterns in the data, in most of our analysis we follow Robb and Robinson (2014) and group the detailed categories into six broad buckets based on the source of capital and the structure of the capital (reported in Table I). The three alternative sources of capital are owners, insiders, and outsiders; the two alternative types of capital are debt and equity. The distinction between sources captures whether the funding source is the founder, informal channels such as friends or close associates of the founder who are not direct owners of the business, or formal channels such as banks, venture capital firms, and angel investors. Robb and Robinson (2014) make distinctions along these lines because the personal balance sheets of business owners and the balance sheets of the firms
themselves are often deeply intertwined at the time the business is founded, and therefore there is little practical distinction between, for instance, a business credit card and a personal credit card, or a personal bank loan and a business bank loan.

Insert Table I Here

In the initial year of the KFS, black-owned startups are started with substantially less capital than white entrepreneurs. The average level of startup capital among black entrepreneurs is $35,205 compared with $106,720 for white entrepreneurs. Racial differences in the sources of capital are also pronounced. In the year the business is founded, black owners contribute around $19,500 of personal equity, compared with around $34,500 for white business owners. Inside equity—equity stakes taken by family members or other business insiders—are relatively modest for both groups, but are about five times larger for white-owned than black-owned startups.

Differences in outside equity—venture capital, angel financing, and the like are even more stark. The average black-owned startup has around $500 of outside equity, whereas the average white-owned business has more than $18,500 from outside equity at founding. These numbers are a reflection of the fact that while outside equity is relatively uncommon for white-owned businesses, it is exceedingly rare for black-owned startups.

Owner debt includes personal loans extended to the business by the founder. These are small on average for both black-owned and white-owned firms, but white-owned businesses have higher average amounts here as well, by a factor of five in the initial year. Inside debt—money lent to the firm by family members or business insiders—is about the same order of magnitude as owner debt, although there is no statistically significant difference across racial groups.

The largest quantitative difference between white- and black-owned startups is in the amount of outside debt associated with their businesses. Outside debt includes personal loans, business loans, personal and business credit cards, as well as other types of loans made by banks either directly to business owners for the purpose starting their business or else to the business itself. Robb and Robinson (2014) show that on average, this is
the largest source of financing for firms in the KFS. Here, we see that this is only true of white-owned firms. At startup, black-owned firms borrow about one-half as much as they put in of their own capital, whereas white-owned firms borrow about 1.7 times what they put in of their own capital. In the year of founding, white-owned firms on average borrow nearly six times as much black-owned firms. Although the amount of outside debt accessed by black-owned startups grows steadily over time, average outside debt for black-owned startups is substantially lower than that seen among white-owned firms.

Insert Figure 2 here

In the later years of the survey, there is significant convergence in the average amounts of personal equity injected into the business, but this largely reflects the fact that personal equity injections from white startup owners dramatically decline in the years after founding: the average amount drops to around $11,000 in years 1-3 after startup and to around $4,000 by years 4-7 after startup on average for white-owned businesses. On average, insider equity (that is, equity injections from friends, family or other non-business owner acquaintances) is a negligible source of financing for most firms after founding, and the differences between white- and black-owned startups is not statistically significant. Indeed, across most of the individual categories, differences in new capital cease to be statistically different after the initial founding year. Because these numbers track new dollars coming into the firm, however, this means that the accumulated difference in size grows over time.

Insert Figure 3 here

In the appendix, we dig deeper into the differences in access to debt for minority and white-owned startups by looking at the specific sources of debt financing. This is presented in Table A.4. In the founding year, there are differences between black and white owned businesses across a wide array of debt sources. Only one percent of black owners obtain business loans, compared with 7% for white-owned firms. While 30% of
white-owned businesses use business credit cards in their founding year, only 15% of black owned businesses do. Similarly, 18% of white business owners rely on personal loans for their business in the founding year, while only 14% of black-owned startups do. All these differences are statistically significant.

What sources offset these differences? As we show in the Appendix, it is not the case that black-owned startups rely more on personal credit cards. In fact, the opposite is true. Instead, black-owned startups appear to rely more on informal borrowing from family members: 14% of black-owned startups relied on family loans in their founding year, while only 9% of white-owned businesses do. Interestingly, the average amounts borrowed from family and other sources are not statistically different between minority and non-minority businesses. This could be a reflection of liquidity constraints in the network of family members that are stronger for black-owned startups than for white-owned firms (Fairlie and Robb 2008). Average amounts of capital from personal bank loans and business bank loans are statistically smaller for black-owned startups. Black-owned startups continue to rely on family loans to a greater degree than white-owned firms in the three years following the firm’s founding. This suggests that access to formal debt channels remains limited for minorities.

All told, the descriptive evidence thus far indicates that black-owned startups access less formal credit. It suggests that they partially substitute for this with a heavier reliance on informal channels and personal equity, but this substitution is an imperfect one (perhaps due to lower levels of personal and family wealth). This results in businesses that start with smaller amounts of financial capital and that do not converge over time. To illustrate this, Figure 4 reports average firm size, for all firms as well as white- and black-owned firms, over time from startup to seven years after startup.

4 What Explains Racial Differences in Access to Capital?

In this section, we investigate the causes of racial inequality in financial capital reported in the previous section. We focus on the question of whether credit scores, and other founder
and business characteristics limit the ability of black startups to obtain comparable levels of financial capital as white startups. We first examine differences in access to capital in the firm’s initial year, then examine differences as the startup ages.

4.1 Differences in Initial Capital

We begin by examining the difference in total capital raised across all sources. Given its importance, we then turn to examining differences in the amount of outside debt. The final step is to examine differences in business bank loans.

4.1.1 Total Financial Capital

Table II models variation in the natural log of the total amount of capital (from all sources) in the startup year based on race, owner characteristics and business characteristics. Industry fixed effects at the two-digit NAICS level are included in all specifications to capture general differences in capital levels based on types of businesses started. The inclusion of industry fixed effects partly addresses the concern that black and white businesses differ in their need for capital because they cluster in industries with different capital requirements.

In column (1) we report the baseline specification, which includes only a dummy for the race of the founder and industry fixed effects with no additional controls. The loading on the black-owned startup dummy variable illustrates that black-owned startups have total capital investments that are roughly 0.73 log points lower in terms of initial total capital than white-owned businesses.

Insert Table II Here

The remaining columns of the table in some sense seek to explain away this difference with a variety of control variables. Including the credit score lowers the loading on the black-owned startup dummy variable from -0.73 to -0.60. Credit scores are much lower among black startups than white startups, and the loading on the credit score indicates that credit
scores have a large positive effect on the amount of capital raised.\footnote{In unreported regressions, we tested whether credit scores had a different effect for white and black owned startups and found no statistically significant difference.} We find that moving up 10 percentile points in the credit score distribution is associated with an increase in financial capital by roughly 20 percent. These results are consistent with previous research focusing on larger, established businesses, which finds that credit scores have a negative effect on loan denial rates (Cavalluzzo and Wolken 2005). But, even after controlling for credit scores, the black indicator estimate remains large and statistically significant.

In Column (3) we introduce founder net worth. Although founder net worth is not available in the survey until the fourth followup year, we rely on the high persistence in net worth, especially as measured categorically in the KFS. We treat this as a proxy of owner’s net worth in the startup year and note some caution in interpreting the estimates. The net worth categories included in Column (3) indicate that high net worth individuals launch businesses at a much larger scale than others. Controlling for net worth attenuates the loading on the black-owned startup indicator variable but does not diminish its statistical significance.

Next we include measures of formal education (in the form of dummy variables for levels), prior work experience to starting the business (both industry specific and non-industry specific), and previous entrepreneurial experience. These are included in Column (4), and capture the human capital of the entrepreneur. Education and prior work experience in the same industry have been found to be important determinants of business success in previous research (Van Praag et al. 2005; Parker 2009). We find some evidence that education is important, but no evidence of important effects for prior work experience. Previous entrepreneurial experience is positively associated with capital investments, perhaps due to prior knowledge of finding capital. Rather than further erase the difference between white-owned and black-owned startups, controlling for human capital widens the racial difference slightly. The loading on the black-owned startup dummy remains statistically significant in these specifications.

Columns (5) and (6) introduce a range of detailed additional controls for business
type, growth goals and performance. These variables may be endogenous to the amount of capital the firm was able to raise, but including them does not diminish the racial difference in total capital. In column (5) we add controls for firm characteristics to condition on the fact that black and white founders may open different types of businesses with different capital needs. We include dummies for whether the firm sells a product or service, whether it is based out of the founder’s home, and whether it has patents or other intellectual property. In column (6) we include a dummy for whether the business is full-time or part-time, its incorporation status, and employment level (i.e. employees). Interestingly, when we control for the type of business started (i.e., whether it sells a product or service, whether it has intellectual property, and whether it is incorporated) the effect of prior startup experience drops in half and becomes statistically insignificant: serial entrepreneurs, on average, start observationally different types of businesses than first-time entrepreneurs.

The inclusion of controls for business characteristics in Columns (5) and (6) has little affect on the measured racial difference in startup capital, but the controls themselves indicate that home-based businesses invest less capital, and product-centered businesses and businesses with intellectual property invest more capital, as would be expected. When we further add additional controls for firm performance and growth goals, such as whether the business is full-time or part-time, its incorporation status, and employment level, the black-founder loading does not change. Although many of these controls may well be endogenous, the stability of the black-owner loading across different specifications suggests that remaining black/white differences in capital use are not primarily driven by easily observable differences in firm characteristics. Moreover, the addition of these variables does not substantially change the coefficient estimates on credit scores and human capital measures, which suggests that credit scores are not simply proxying for the type of business.

In the remaining two columns we attempt to control for the effect that business location may have on demand conditions, unobservable business quality, and hence demand
for capital. In Column (7) we introduce Core-Based Statistical Area (CBSA) fixed effects. CBSAs include the standard MSAs but add to them ‘micropolitan’ statistical areas, which the Census describes as 1a new set of statistical areas that have at least one urban cluster of at least 10,000 but less than 50,000 population, plus adjacent territory that has a high degree of social and economic integration with the core as measured by commuting ties.’ As column (7) shows, including a CBSA fixed effect does little to change the point estimates on the main initial lending outcomes. This suggests that unobserved differences in business quality captured by coarse location measures—the difference between being located in Duluth, Minnesota instead of Mobile, Alabama, for example—does little to explain away the observed racial difference in startup capital.

In Column (8) we include zipcode-level fixed effects. Because this results in an extremely large number of model parameters, we cannot use the sampling weights included in Columns (1)-(7), thus we urge caution in comparing the point estimate on the Black-owned Startup indicator with the preceding estimates. In addition, this parameter is only identified using survey zipcodes which contain both black and white survey respondents, limiting the sample size. Nevertheless, there remains a statistically significant racial difference in total capital. Thus, black-owned startups access less capital than their white-owned neighbors in the same zip code.

4.1.2 Outside Debt

Given the importance of outside debt as illustrated in Section 3, we now turn to exploring the potential causes of racial differences in access to outside debt. Exploring potential explanations for differences in outside debt may also be useful for shedding further light on the importance of credit scores and provide a useful consistency check on this variable. Credit ratings are undoubtedly one of the most important pieces of information used by banks and other financial institutions in loan determination. Table III reports regression results, which follow the same format as Table II, except that the dependent variable is the log of total outside debt instead of the log of total financial capital.

Insert Table III Here

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The results for the determinants and patterns across the regression specifications for outside debt are similar to those for total financial capital. Credit scores exert a strong influence on the ability of businesses to find outside debt. Even controlling for an extensive list of business characteristics proxying for need and ability to raise capital (i.e. make products, intellectual property, home-based, part-time, incorporated, and employment) the coefficient on credit scores is large, positive and statistically significant. The results for human capital measures are also similar, with previous startup experience demonstrating the strongest association with outside debt capital, but also some evidence of the influence of education and work experience. Wealth is a stronger predictor of outside debt, which may be due to the importance of personal wealth as collateral in obtaining loans. Racial differences persist even after controlling for business location using either coarser CBSA fixed effects or narrower zipcode fixed effects.

4.1.3 Business Bank Loans

To zero in on borrower/lender effects, we refine our analysis one step further by examining only business bank loans. Whereas total capital includes all sources of debt and equity financing, and total outside debt includes many forms of debt (e.g. credit cards) that do not require any interaction between a borrower and a loan officer, by studying business bank loans separately we are honing in on the empirical setting in which there is the greatest scope for personal interactions between the borrower and lender to influence outcomes.

Table IV reports regressions of the log of business bank loans on the same set of observables that were used to explain total capital and total outside debt. The results are largely consistent with the previous analysis, in that about 1/3 of the initial industry-adjusted racial difference is attenuated with controls for credit score, net worth, and business characteristics. The raw magnitude of the racial difference is smaller for business bank loans than for total debt, which reflects the fact that differences in access to business bank loans
are not attenuated by access to other forms of outside debt. These results remain statistically significant in the presence of location fixed effects.

4.2 Differences in Capital at Later Stages

The previous tables examine racial differences in the year of founding and demonstrate that controlling for a rich set of observable characteristics only partially removes the large difference in funding between white-owned and black-owned startups. In Table V we ask whether these racial differences abate over time, as startups build track records that might help them overcome information asymmetries with lenders. We repeat the same basic specification from Column (6) of the previous three tables, but form two groups, one for years 1-3 and one for years 4-7 after startup. We include followup year fixed effects in each model to absorb variation over time in access to capital.4

In Columns (1) and (2), the dependent variable is the log of business bank debt that the business received; this is the narrowest of the three sources of capital investigated in the preceding tables, the source of capital with the greatest scope to be influenced by direct, personal borrower/lender interactions. In both the years 1-3 period and the years 4-7 period, there continues to be a statistically significant difference between black-owned and white-owned businesses in the amount of business bank debt they receive. In terms of magnitudes, the years 4-7 point estimate is about 1/3 the size of the point estimate in the initial survey year, meaning that the black-white funding gap persists but is considerably smaller.

Columns (3) and (4) focus on total outside debt from all sources. In the years 1-3 sample, the point estimate is about half as large as the comparable point estimate in the initial year, meaning that about half the black-white difference is erased over the next

[4]These followup year fixed effects also capture differences in survival rates between black and white startups. The results are not sensitive to their inclusion. We also examine the sensitivity of the results to survival bias by conditioning the sample on including only firms surviving through the last year in the survey (year 7 after startup). Taking this approach, we also find similar results. To push the analysis further, we also take an approach that is in the spirit of a bounds analysis (e.g. Fairlie, Karlan and Zinman 2015). We estimate the regressions assuming as a lower bound that all non-surviving businesses would have used zero financial capital in that year. And, as a potential upper bound we alternatively impute all non-surviving firm observations as equal to the median level of financial capital among surviving firms. The regression results are not sensitive to this imputation.
three years of the firm’s life. In the years 4-7 period, the difference between black-owned and white-owned businesses is no longer statistically significant. The final two columns broaden the scope further to include all forms of financial capital. Here the differences between black-owned and white-owned businesses ceases to be statistically significant, even in the years 1-3 sample.

Taken together, these point estimates illustrate that differences in bank lending to black-owned and white-owned businesses persist over time, but that over time black borrowers are able to substitute into other forms of capital. The fact that we are able to condition on a rich set of observables means that the remaining differences are unlikely to be explained by creditworthiness, collateral, aspects of the business operating strategy, or the industry in which operates. It is important to recognize that the dependent variable here is measured in terms of new dollars flowing in during a given survey year: it is a measure of the flow of new capital, not the outstanding stock of capital. This in turn means that the initial differences in funding do not dissipate; they do not converge in the level of cumulative total capital over time. In the Appendix we provide estimations that include zipcode-level fixed effects. These specifications produce results that are quality similar to those presented here.

5 Do Black Borrowers Expect To Be Treated Differently

The previous section asks whether observable differences in borrower characteristics that might be important for lenders can explain the large unconditional differences in the levels of capital that white-owned and black-owned businesses receive. In this section, we ask whether differences in attitudes and expectations about the bank borrowing experience are important for understanding differences in access to capital. To explore this question, we use survey information in the KFS that gauges demand and unmet need for credit among entrepreneurs.

Access to measures of attitudes towards borrowing among entrepreneurs is rare in survey data sets, but beginning in the third followup year, the KFS included a series
of questions gauging borrowing intentions. The new questions ask whether the startup business applied for a loan that year, and whether it did not apply for a loan that year because of a fear of rejection. Among those startups that did apply, a follow-up question asks whether they were always approved, always denied, or sometimes approved and sometimes denied.

Racial differences in responses to these questions are analyzed in Table VI. We report survey-weighted averages by minority ownership status, both for the sample as a whole, as well as splits based on notable points in the distribution of credit scores. White entrepreneurs are more likely to apply for loans than black entrepreneurs, which potentially reflects different capital needs, but could also reflect different attitudes and expectations of the loan application process. When we focus on borrowers with below-median credit scores, there is no statistical difference in the rates of loan application, but among above-median borrowers, loan application rates are lower for blacks than for whites.

Turning to those who did not apply for loans that year, we also study racial differences in whether they did not apply for fear of rejection in Table VI. There are massive differences in fear of rejection between white and black business owners. Overall, black business owners are about three times more likely to not apply for loans because of fear of rejection than white business owners. This difference is highly statistically significant. Although it is even more pronounced among below-median credit borrowers, even among credit worthy borrowers we find that blacks are more than twice as likely than whites to fear rejection. Black business owners whose credit scores are above the 75th percentile for the entire sample are still more than twice as likely as white business owners of similar creditworthiness to not apply for a loan for fear of having their loan application denied.

Another measure of unmet financing needs is whether loans are always approved, always denied, or sometimes approved and sometimes denied. Here, the results mirror those from the discussion above. Black business owners are significantly less likely to

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5Although the question, did not apply for fear of rejection, is asked of all respondents, some owners who applied for loans might have wanted to apply for additional loans. We do not include these owners and focus on only those firms who did not apply for a new loan for clarity. The results are unchanged if we examine all responses to this question.
report that they are always approved for loans. This holds throughout the distribution of credit scores.

A useful summary measure of whether a startup experiences unmet capital need combines responses to being denied a loan application and not applying for a loan because of fear of rejection. Affirmative answers to these two questions imply that the startup did not obtain all of the capital it needed. Using this measure, black startups are much more likely to face unmet need for capital than are white startups.

Taken together, these results provide further evidence that the lower levels of borrowing among black-owned businesses are a reflection of unmet need, stemming at least in part from different attitudes and perceptions of the banking process, and not simply because black-owned startups need or want less capital. But they are still unconditional in nature; to address this, Table VII examines these findings in a multivariate setting.

Even controlling for a detailed set of firm and founder characteristics, we still observe pronounced differences in the fear of denial and loan denial rates based on the race of the firm founder. These findings are consistent with previous findings for larger, more established and older businesses (i.e. SSBF data) that minority-owned firms experience higher loan denial probabilities than white-owned businesses even after controlling for differences in credit-worthiness and other factors (Bostic and Lampani 1999; Cole 1999; Cavalluzzo, Cavaluzzo and Wolken 2002; Blanchflower, Levine and Zimmerman 2003; Blanchard et al. 2008; Bates and Robb, 2014). Finally, these findings also provide evidence that racial differences in financing patterns are not simply due to lower levels of financing needs among black startups.

Of course, one reason why a borrower might fear denial is because they had already received a lot of debt in prior years, so that they were near their maximum debt capacity for the business. Thus, one reason why black founders might be fearful of borrowing is that they had already borrowed. To explore this possibility we split the sample into black-owned businesses and all other businesses and regressed a dummy variable for fear of denial or denied credit on the amount of prior accumulated debt as well as the
same set of controls we have used throughout the preceding analysis.

The results are presented in Table VIII. Columns (1) and (2) focus on the fear of denial. Among white-owned businesses, high levels of past borrowing are a strong predictor of failing to apply for a loan for fear of denial. The opposite is true for black borrowers; those with more past borrowing are less likely to indicate that they are afraid to apply. Similarly, in Columns (3) and (4) we find that among white-owned businesses, high past borrowing is associated with a greater likelihood of being denied credit. Among black borrowers, there is no statistically significant relationship, and the sign of the relation is the opposite of what we find in the white-owned sample.

These results suggest that not only are there pronounced racial differences in the fear of loan denial, but the determinants of having this fear are a function of race. Among white borrowers, fear of denial is correlated with remaining debt capacity: white borrowers are more likely to fear denial when they have borrowed heavily in the past and perhaps worry about perceived debt levels being too high. Among black borrowers, fear of denial is correlated with past borrowing experience: those who have borrowed in the past are less afraid of denial than those who have not perhaps because they perceive discrimination to have declined.

6 Do Banks Treat Black Borrowers Differently

The previous sections demonstrate pronounced differences in capital access based on the race of the business founder. This section attempts to discern whether discrimination is the root cause of the differences we find. We do this in three steps. First, we make use of the fact that small, local banks rely more on soft information, while larger, national banks rely more heavily on credit scores and other types of quantifiable borrower characteristics to examine whether differences in local banking conditions exacerbate or alleviate racial differences. Next, we develop two measures of regional variation in the degree of racial bias and ask how perceptions about access to capital by black borrowers vary according to these measures. One is based on a historical measure of racial inequality, the other a
contemporaneous measure. Both measures provide evidence that areas where racial bias is stronger are areas where black business founders are more likely to anticipate being denied credit.

6.1 Do Stronger Local Banks Help?

A large literature in banking draws a distinction between soft information and hard information. Hard information—like that contained in credit scores—is quantitative and impersonal, and can be easily transmitted, while soft information is qualitative, and while it may be very precise, it is difficult to communicate credibly (see Petersen and Rajan, 2002). While large, national banks have been shown to have an advantage in obtaining hard information, small banks tend to have a comparative advantage in lending to small businesses, which are traditionally more informationally opaque, since small banks tend to rely more on soft information than do large banks (Berger, Cerquiero and Penas, 2014; Berger, Miller, Petersen, Rajan, and Stein, 2005; Brickley, Link, and Smith, 2003).

In this section we ask whether racial differences in startup funding vary with the strength of local banks. On the one hand, minority-owned businesses should face fewer financing hurdles in areas with stronger local banks if the main source of their disadvantage is that they have good ideas but little ability to signal their quality objectively. In this case, the funding gap between black- and white-owned startups would be smaller in areas with stronger local banks, because local banks, with their increased reliance on soft information, would award capital to minority borrowers with good ideas but potentially weaker verifiable credit history. On the other hand, a greater reliance on soft information might create greater scope for lenders to cater to racial preferences or biases, which could mean that black-owned businesses face greater funding challenges in environments where more objective creditworthiness criteria might receive less weight in lending decisions.

Table IX explores these issues. In Panel A, we estimate models for did not apply for fear of denial. Column (1) verifies the previous finding that black startups have higher rates of fear of denial than white startups. In column (2) we add the share of county bank
deposits held by local banks and find that areas with higher local bank concentration are areas in which new businesses are much less likely to report that they do not apply for fear of denial. 6 This comports with a wide body of evidence suggesting that small, informationally opaque businesses have an easier time securing bank loans in areas where local bank concentrations are higher. Column (2) suggests that startups recognize that they will face an easier time in markets where local banks are stronger.

Column (3) introduces an interaction term to explore whether black and white-owned businesses experience different outcomes in high local bank concentration areas. If black-owned startups found it easier to borrow in these markets, presumably because they expected lenders acting on soft information to be easier to work with, then we would expect the interaction term to be negative—their reluctance to apply for loans for fear of denial would be attenuated in these markets.

Instead, we do not find evidence that black-owned startups receive more financing in these markets. The interaction term is statistically significant, but has the wrong sign. Of course, we cannot rule out the possibility that borrower perceptions of their own creditworthiness differ according to bank market structure, nevertheless, the results do not provide evidence that minority business owners expect it to be easier to obtain bank loans in markets where local banks are stronger.

To guard against the possibility that black borrowers fear rejection due to concerns about underlying credit quality, in Columns (4)-(6) repeats the analysis of columns (1)-(3) but includes the borrowers credit score and net worth as controls. This effectively holds constant the hard information available to lenders. This has no qualitative impact on the findings. Black founders continue to be more afraid of denial, not less afraid of denial, in higher soft information environments when we condition on available hard information.

To examine how these perceptions are correlated with financing, in Panel B of Table IX, we report regressions of log business bank debt on race and interactions with the local banking variables. In keeping with prior research, areas with higher local bank

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6We follow Cortes (2015) and Adelino, Ma and Robinson (2017) and define a local bank as one with at least 75% of its deposits coming from that MSA. Deposit data are taken from the FDIC Summary of Deposits. See https://www5.fdic.gov/sod/.
concentration are areas with higher bank lending to startups. But while entrepreneurs in areas with stronger local banks receive larger amounts of bank loans, this is an effect that is confined almost entirely to white borrowers. Comparing the main effect of local bank share with the interaction term between race and local bank share suggests that the effect of stronger local banks is almost zero for black-owned businesses.

As a further check, we also examine whether the competitiveness of the local banking market affects our results. A more competitive local banking market could make it more likely that black borrowers obtained loans in those markets by increasing a borrower’s ability to shop for a loan. These results are presented in the Appendix. Here, we also find no impact on the black dummy variable after including a Herfindahl index of local banking competition.

In sum, areas with stronger local banks are areas where banks are perceived, and indeed act, more favorably towards startups. But there is no evidence that areas with stronger local banks are areas where black-owned businesses have an easier time raising capital. Black founders are not less afraid of loan denial in these markets, nor do they receive larger amounts of capital in these markets. The pro-startup effects of a strong local banking community do not appear to accrue to minority business founders.

6.2 Historical Inequality and Racial Bias

Because contemporaneous measures of inequality are likely to be correlated with contemporaneous business conditions, we use a measure of historical inequality obtained from Braggion, Dwarkasing, and Ongena (2015). They instrument current measures of income inequality at the MSA level with data on the historical distribution of farm plot-sizes in 1890. Braggion, Dwarkasing and Ongena (2015) show that this historical distribution of plot sizes in 1890 is highly correlated with current measures of inequality and use this measure to show that more historically unequal regions have lower rates of self-employment. Based on the fact that areas with high degree of skewness in the historical size distribution of landholdings are areas in which slavery was common, we build on their insight and ask whether racial differences in borrowing attitudes and outcomes are
more pronounced in these areas by exploring interactions of the Gini coefficient with the business owner’s race.

The main idea is to ask whether perceptions of lending outcomes are different in areas with high historical inequality. The first three columns of Table X indicate that they are. In Panel A, we report regression results for the fear of denial on race, the historical Gini coefficient, and the race/gini interaction, along with all the variables listed in Table IV. Local areas with high levels of historical inequality have much higher levels of the fear of denial among black entrepreneurs relative to white entrepreneurs than areas with low levels of inequality. In columns (4) through (6), we repeat the analysis in the first three columns but include the business credit score as an independent variable. The results are qualitatively identical.

In Panel B of Table X, we report a probit analysis for unmet capital need on race, the historical Gini coefficient, and the race/gini interaction. Regions with high levels of historical inequality have higher average levels of respondents reporting that they have unmet capital need, and these effects are more pronounced among black borrowers in areas with high inequality. As in Panel (A), this conclusion holds even when we include the business credit score as a control variable in Columns (4) through (6).

6.3 Contemporary Inequality and Racial Bias

Next we turn to a contemporaneous measure of potential discrimination that varies regionally and is likely to be correlated with racial bias, but not necessarily with contemporaneous business conditions. Views about interracial marriage and resulting actual rates of interracial marriage are likely to be associated with racial prejudice. Racial prejudice measured along other dimensions and wage disparities are higher and when views against interracial marriage are more negative (Charles and Guryan 2008). Thus, a finding of lower levels of fear of denial and unmet capital needs in geographical areas with high interracial marriage rates provides evidence that is at least consistent with black entrepreneurs perceiving and facing racial bias in lending markets.

To create regional interracial marriage rates we use Census 2000 5 Percent PUMS mi-
crodata. We condition the sample on married couples that involve at least one black or white partner. At the state level, we calculate the percentage of blacks who have white marital partners. We then normalize the interracial marriage rate by the probability of marriage to a white partner that would occur if this were random. For example, if 10 percent of blacks are married to white partners and the population is 90 percent white then the normalized interracial marriage rate is \( \frac{0.10}{0.90} = 0.11 \), whereas the normalized interracial marriage rate for an area with 10 percent of blacks married to whites and a population that is 70 percent white would have a higher normalized rate (0.14) because the underlying probability of an interracial marriage for a black is lower.

Table XI reports the same set of specifications as Table X. In Panel A, we report regression results for the fear of denial on race, the interracial marriage rate coefficient, and the race/marriage interaction, along with all the variables listed in Table IV.

Local areas with high levels of interracial marriage have much lower levels of fear of denial among black entrepreneurs relative to white entrepreneurs than areas with low levels of interracial marriage. In Panel B of Table XI, we report a probit analysis for unmet capital need on race, the interracial marriage coefficient, and the race/marriage interaction. Regions with high levels of interracial marriage have lower average levels of unmet capital need among black borrowers relative to white borrowers. Overall, fear of denial and unmet capital are lower among black entrepreneurs relative to white entrepreneurs in areas where interracial marriage is higher, and thus potentially racial bias is lower.

7 What if Black-owned Startups Looked Like White-Owned Ones?

The final part of our analysis asks how much of the racial gap in funding documented above would disappear if black-owned startups had similar observable characteristics to white-owned startups. To explore this, we use a technique pioneered by Blinder (1973)

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7 We use the Census microdata to match heads of households to their spouses using household identifier codes.

8 The normalization also results in similar rates when the focus is shifted to the percentage of whites married to blacks. In these two examples, we would have 1.11 and 1.43 percent of whites married to blacks, with the same normalized interracial marriage rates of 0.11 and 0.14.
and Oaxaca (1973) that decomposes the inter-group differences in a dependent variable into those due to different observable characteristics across groups (sometime referred to as the endowment effect) and those due to different “prices” of characteristics of groups. Consider a regression $Y = X\beta + \epsilon$ with group means of the independent variables for the black and white subpopulations given by $\bar{X}^B$ and $\bar{X}^W$. To implement the standard Blinder-Oaxaca decomposition, we begin by writing the inter-group difference in the average value of a dependent variable, $Y$, as:

$$\bar{Y}^W - \bar{Y}^B = \left[ \bar{X}^W - \bar{X}^B \right] \hat{\beta}^W + \bar{X}^B \left[ \hat{\beta}^W - \hat{\beta}^B \right]$$  \hspace{1cm} (1)

The first term, $\left[ \bar{X}^W - \bar{X}^B \right] \hat{\beta}^W$, reflects the part of the inter-group difference that can be attributed to differences in the group averages of the independent variables $X$—differences in observables. The second term reflects the different “prices” or factor loadings of the characteristics across the two groups.

There are two issues associated with implementing Equation 1. The first concerns how to deal with the second term of the equation, $\bar{X}^B \left[ \hat{\beta}^W - \hat{\beta}^B \right]$. This “unexplained” component of the decomposition partly captures contributions from group differences in unobserved characteristics. This part is sensitive to the choice of omitted characteristics making the results difficult to interpret. Another issue that arises is the “index” problem is that the decomposition itself can either be written using coefficient weights $\beta^W$ or $\beta^B$.\(^9\)

To deal with this issue, we use an alternative method developed by Oaxaca and Ransom (2004), which is to weight the first term of the decomposition expression using coefficient estimates from a pooled sample of the two groups. Following this approach, we calculate the decompositions by using coefficient estimates from regressions that includes a sample of all racial groups. We thus calculate the first term in the decompositions as:

$$\left[ \bar{X}^W - \bar{X}^B \right] \hat{\beta}^*$$  \hspace{1cm} (2)

where $X^j$ are means of firm characteristics of race $j$, $\hat{\beta}^*$ is a vector of pooled coefficient

\(^9\)Note that an alternative formulation of Equation 1 is $\bar{Y}^W - \bar{Y}^B = \left[ \bar{X}^W - \bar{X}^B \right] \beta^B + \bar{X}^W \left[ \beta^W - \beta^B \right]$.  

29
estimates, and \( j = W \) or \( B \) for white or black, respectively.

We report estimates using pooled estimates from a regression that includes both white and black observations (Oaxaca and Ransom 1994). It is becoming increasingly popular when studying racial differences to use the full sample of all races to estimate the coefficients (Fairlie and Robb 2007). This version of the pooled sample is advantageous in that it incorporates the full market response and does not exclude other racial groups. The full set of racial and ethnic dummies in the regression specification are included to allow us to remove any influence on the coefficients from racial differences that are correlated with any of the explanatory variables.

Table XII reports Blinder/Oaxaca decompositions of the difference in business size in the seventh year after startup, which is the final year of the KFS.\(^\text{10}\) The top panel of Table XII shows that the accumulated difference in business size by the end of the survey is about $336,000. Around one-half of this difference can be explained with observable characteristics. The lower panel shows how much can be attributable to each set of observable characteristics.

Roughly speaking, the explanatory components of this difference can be grouped into three equally sized categories. About one-third of the difference is attributable to differences in business credit scores. Another one-third is attributable to differences in founder net worth. And the final one-third is attributable to all other observable characteristics: gender, founder education and work experience (collectively labeled human capital), as well as business characteristics such as incorporation status, whether it generates a product or service, whether it operates in or outside the home, and whether it owns intellectual property.

Given that the average black-owned business is around $200,000 in size in year 7, assigning average white characteristics to an average black-owned business would result in it being about seventy-five percent larger. Merely assigning white credit scores to a black-owned business would result in a business about 25% larger. On the one hand, to

\(^{10}\text{Similar decompositions for individual sources of capital and for individual years mirrors the results presented here and are available from the authors upon request.}\)
the extent that this score can be improved by better financial management, rather than simply being a manifestation of circumstances that are difficult to control, these results suggest that improving credit scores would have a non-trivial impact on the racial gap in funding. These results also illustrate that about half the difference in size cannot be explained by observables, which illustrates the importance of attitudes and perceptions by and about black borrowers in credit markets.

8 Conclusion

This paper uses confidential, restricted-access microdata from the KFS and matched administrative data on credit scores to explore racial inequality in access to capital among startups. Our analysis of detailed financial data available in the KFS and panel data following startups through the first seven years of existence provides several novel findings. Black entrepreneurs start businesses at a substantially smaller scale than white entrepreneurs, and while the disparity in later-stage capital injections narrows over time, they continue to take on less capital in the early years of the firm’s operation than white entrepreneurs. Thus, initial funding differences persist. We also find that black entrepreneurs access less outside debt in the founding year and in the years that follow, which is by the far the largest cause of disparities in total financial capital. Alternative sources of capital such as loans from friends and family, personal equity and credit cards also do little to attenuate these disparities. Black-owned startups have lower levels of all sources of funding than do white-owned startups.

These differences in financial capital use do not appear to be due to differences in the need for capital between black and white entrepreneurs. Black startups report substantially higher levels of loan denials and overall unmet need for capital than white startups, even after controlling for differences in credit scores and founder wealth. Moreover, industry differences, which should represent first-order differences in need for capital do not explain racial disparities. The inclusion of detailed, potentially endogenous business characteristics such as goals for growth and type of business also has little effect on the
racial differences we find providing further evidence against need differences.

Focusing on supply-side channels, we find that racial differences in financial capital cannot be attributed entirely to white lenders looking unfavorably upon black borrowers. There are large differences in credit worthiness between black and white entrepreneurs. Detailed administrative data on credit ratings linked to all KFS businesses provides the first evidence in the literature of extensive differences in creditworthiness between black and white startups and their effects on financing outcomes. Our analysis also reveals that the relatively low credit scores for black business owners explain a substantial amount of the gaps in both financing at startup and in the years after startup. These results imply that a great deal of the capital investment differences between black- and white-owned businesses is the result of persistent differences in the founder’s financial health that are present at the very inception of the firm. This connects our findings to an increasing concern over inequality in household finance and financial literacy and suggests interesting connections between household financial planning, behavioral finance, race and entrepreneurship.

At the same time, on the demand side our evidence clearly indicates an enduring belief among even the most credit-worthy black borrowers that they will be turned away by banks. The fact that many well-qualified black entrepreneurs do not apply for credit, even when they feel they need it, because they anticipate being denied credit suggests that overcoming differences between black and white borrowers is not simply a matter of expanding the supply of credit available to lower income borrowers. Interestingly, we also find that simply increasing the strength of local banks is unlikely to help – although white-owned startups receive large amounts of bank debt on average in areas with stronger local banks black-owned startups do not. 11 Getting to the root cause of racial differences in the way that new businesses are financed likely requires changes in perceptions and financial planning behaviors as much as it requires augmenting the supply of credit to traditionally underserved borrowers.

11Further increases in credit card access might help reduce disparities (Chatterji and Seamans 2012), but this source provides only high interest borrowing which might be prohibitive for larger borrowing needs.
References


Figure 1: Racial Differences in Wealth in the Kauffman Firm Survey
Figure 2: Racial Differences in Sources of Initial Capital for Startups
Figure 3: Racial Differences in Sources of New Capital for Startups, Years 1-3
Figure 4: Racial Differences in the Evolution of Total Assets over Time
Table I: Racial Differences in Sources of Funding

This table reports survey-weighted mean values by race for broad funding categories. The components of the classifications (Owner, Insider, Outsider/Debt, Equity) are described in detail in Appendix Table A.1. The final column reports p-values from the t-test of the difference between black- and white-owned businesses.

<table>
<thead>
<tr>
<th>KFS Initial Survey Year</th>
<th>Overall Mean</th>
<th>White Mean</th>
<th>Black Mean</th>
<th>p-value(diff)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner’s Equity</td>
<td>33,078</td>
<td>34,426</td>
<td>19,562</td>
<td>0.00</td>
</tr>
<tr>
<td>Inside Equity</td>
<td>2,117</td>
<td>2,139</td>
<td>440</td>
<td>0.14</td>
</tr>
<tr>
<td>Outside Equity</td>
<td>16,768</td>
<td>18,543</td>
<td>536</td>
<td>0.10</td>
</tr>
<tr>
<td>Owner Debt</td>
<td>4,890</td>
<td>5,228</td>
<td>1,010</td>
<td>0.05</td>
</tr>
<tr>
<td>Inside Debt</td>
<td>6,663</td>
<td>7,195</td>
<td>2,849</td>
<td>0.17</td>
</tr>
<tr>
<td>Outside Debt</td>
<td>51,680</td>
<td>56,663</td>
<td>10,809</td>
<td>0.01</td>
</tr>
<tr>
<td>Total Financial Capital</td>
<td>99,344</td>
<td>106,720</td>
<td>35,205</td>
<td>0.00</td>
</tr>
<tr>
<td>Leverage Ratio</td>
<td>0.19</td>
<td>0.19</td>
<td>0.12</td>
<td>0.00</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>KFS Survey Years 1-3</th>
<th>Overall Mean</th>
<th>White Mean</th>
<th>Black Mean</th>
<th>p-value(diff)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner’s Equity</td>
<td>13,047</td>
<td>13,308</td>
<td>8,555</td>
<td>0.13</td>
</tr>
<tr>
<td>Inside Equity</td>
<td>14,864</td>
<td>16,499</td>
<td>551</td>
<td>0.07</td>
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<tr>
<td>Outside Equity</td>
<td>1,206</td>
<td>1,284</td>
<td>664</td>
<td>0.48</td>
</tr>
<tr>
<td>Owner Debt</td>
<td>4,200</td>
<td>4,336</td>
<td>2,297</td>
<td>0.15</td>
</tr>
<tr>
<td>Inside Debt</td>
<td>5,385</td>
<td>5,713</td>
<td>2,491</td>
<td>0.49</td>
</tr>
<tr>
<td>Outside Debt</td>
<td>51,147</td>
<td>54,813</td>
<td>14,883</td>
<td>0.19</td>
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<tr>
<td>Total Financial Capital</td>
<td>69,256</td>
<td>72,958</td>
<td>29,107</td>
<td>0.00</td>
</tr>
<tr>
<td>Leverage Ratio</td>
<td>0.29</td>
<td>0.30</td>
<td>0.21</td>
<td>0.00</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>KFS Survey Years 4-7</th>
<th>Overall Mean</th>
<th>White Mean</th>
<th>Black Mean</th>
<th>p-value(diff)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner’s Equity</td>
<td>8,327</td>
<td>7,944</td>
<td>4,678</td>
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</tr>
<tr>
<td>Outside Equity</td>
<td>7,663</td>
<td>8,339</td>
<td>1,227</td>
<td>0.20</td>
</tr>
<tr>
<td>Inside Equity</td>
<td>1,037</td>
<td>1,047</td>
<td>254</td>
<td>0.63</td>
</tr>
<tr>
<td>Owner Debt</td>
<td>3,618</td>
<td>3,671</td>
<td>3,482</td>
<td>0.42</td>
</tr>
<tr>
<td>Inside Debt</td>
<td>4,898</td>
<td>5,176</td>
<td>979</td>
<td>0.21</td>
</tr>
<tr>
<td>Outside Debt</td>
<td>48,616</td>
<td>49,809</td>
<td>20,265</td>
<td>0.64</td>
</tr>
<tr>
<td>Total Financial Capital</td>
<td>58,684</td>
<td>59,825</td>
<td>27,348</td>
<td>0.54</td>
</tr>
<tr>
<td>Leverage Ratio</td>
<td>0.29</td>
<td>0.29</td>
<td>0.20</td>
<td>0.00</td>
</tr>
</tbody>
</table>
Table II: Initial Differences in Log Total Capital

This table models variation in the amount of total capital from all sources, include founder, insider and outside debt and equity. All columns include 2-digit NAICS industry fixed effects and controls for gender and other racial categories (Asian, Hispanic, and Other). Missing or negative net worth is the omitted category. Column (7) includes CBSA fixed effects, while Column (8) includes zipcode-level fixed effects. Survey weights are used in Columns (1)-(7), but not in Column (8). One, two and three asterisks denote statistical significance at the 10, 5 and 1% level, respectively.

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
<th>(7)</th>
<th>(8)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Black-owned Startup</td>
<td>-0.731***</td>
<td>-0.599***</td>
<td>-0.485***</td>
<td>-0.512***</td>
<td>-0.496***</td>
<td>-0.501***</td>
<td>-0.502***</td>
<td>-0.857***</td>
</tr>
<tr>
<td>Error</td>
<td>(0.113)</td>
<td>(0.111)</td>
<td>(0.110)</td>
<td>(0.111)</td>
<td>(0.102)</td>
<td>(0.114)</td>
<td>(0.330)</td>
<td></td>
</tr>
<tr>
<td>Credit Score</td>
<td>0.021***</td>
<td>0.020***</td>
<td>0.020***</td>
<td>0.020***</td>
<td>0.012***</td>
<td>0.012***</td>
<td>0.010***</td>
<td></td>
</tr>
<tr>
<td>Error</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.004)</td>
<td></td>
</tr>
<tr>
<td>Net Worth: Up to 50K</td>
<td>-0.517***</td>
<td>-0.498***</td>
<td>-0.504***</td>
<td>-0.313***</td>
<td>-0.288**</td>
<td>-0.465*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Error</td>
<td>(0.119)</td>
<td>(0.121)</td>
<td>(0.120)</td>
<td>(0.109)</td>
<td>(0.127)</td>
<td>(0.278)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Worth: 50-100K</td>
<td>-0.581***</td>
<td>-0.566***</td>
<td>-0.566***</td>
<td>-0.392***</td>
<td>-0.332**</td>
<td>-0.050</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Error</td>
<td>(0.130)</td>
<td>(0.130)</td>
<td>(0.129)</td>
<td>(0.116)</td>
<td>(0.131)</td>
<td>(0.283)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Worth: 100-250K</td>
<td>-0.167</td>
<td>-0.151</td>
<td>-0.153</td>
<td>-0.061</td>
<td>-0.035</td>
<td>-0.167</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Error</td>
<td>(0.108)</td>
<td>(0.108)</td>
<td>(0.108)</td>
<td>(0.103)</td>
<td>(0.114)</td>
<td>(0.241)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Worth: Over 250K</td>
<td>0.360***</td>
<td>0.332***</td>
<td>0.330***</td>
<td>0.277***</td>
<td>0.232**</td>
<td>0.099</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Error</td>
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Observations                   | 4,124 | 4,038 | 4,038 | 3,975 | 3,975 | 3,840 | 3,590 | 1,214 |
R-squared                       | 0.055 | 0.097 | 0.117 | 0.131 | 0.139 | 0.281 | 0.394 | 0.624 |
Table III: Initial Differences in Total Outside Debt

This table models variation in the log of the amount of total outside debt. All columns include 2-digit NAICS industry fixed effects and controls for gender and other racial categories (Asian, Hispanic, and Other). Missing or negative net worth is the omitted category. Column (7) includes CBSA fixed effects, while Column (8) includes zipcode-level fixed effects. Survey weights are used in Columns (1)-(7), but not in Column (8). One, two and three asterisks denote statistical significance at the 10, 5 and 1% level, respectively.

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Table IV: Initial Differences in Total Business Debt

This table models variation in the amount of total debt for the business. All columns include 2-digit NAICS industry fixed effects and controls for gender and other racial categories (Asian, Hispanic, and Other). Missing or negative net worth is the omitted category. Column (7) includes CBSA fixed effects, while Column (8) includes zipcode-level fixed effects. Survey weights are used in Columns (1)-(7), but not in Column (8). One, two and three asterisks denote statistical significance at the 10, 5 and 1% level, respectively.

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<td>-0.000</td>
<td>-0.001</td>
<td>-0.001</td>
<td>-0.001</td>
<td>-0.001</td>
<td>-0.001</td>
</tr>
<tr>
<td></td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.002)</td>
</tr>
<tr>
<td>Some College</td>
<td>-0.119</td>
<td>-0.115</td>
<td>-0.144*</td>
<td>0.009</td>
<td>-0.219</td>
<td>-0.219</td>
<td>-0.219</td>
<td>-0.219</td>
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<tr>
<td></td>
<td>(0.076)</td>
<td>(0.075)</td>
<td>(0.075)</td>
<td>(0.075)</td>
<td>(0.170)</td>
<td>(0.170)</td>
<td>(0.170)</td>
<td>(0.170)</td>
</tr>
<tr>
<td>College Deg.</td>
<td>-0.033</td>
<td>-0.032</td>
<td>-0.082</td>
<td>0.100</td>
<td>-0.071</td>
<td>-0.071</td>
<td>-0.071</td>
<td>-0.071</td>
</tr>
<tr>
<td></td>
<td>(0.087)</td>
<td>(0.087)</td>
<td>(0.086)</td>
<td>(0.086)</td>
<td>(0.182)</td>
<td>(0.182)</td>
<td>(0.182)</td>
<td>(0.182)</td>
</tr>
<tr>
<td>Grad. Deg.</td>
<td>0.092</td>
<td>0.112</td>
<td>0.038</td>
<td>0.149</td>
<td>-0.059</td>
<td>-0.059</td>
<td>-0.059</td>
<td>-0.059</td>
</tr>
<tr>
<td></td>
<td>(0.105)</td>
<td>(0.105)</td>
<td>(0.105)</td>
<td>(0.096)</td>
<td>(0.190)</td>
<td>(0.190)</td>
<td>(0.190)</td>
<td>(0.190)</td>
</tr>
<tr>
<td>Prev. Startup Exp.</td>
<td>0.084*</td>
<td>0.074</td>
<td>0.012</td>
<td>0.024</td>
<td>-0.288***</td>
<td>-0.288***</td>
<td>-0.288***</td>
<td>-0.288***</td>
</tr>
<tr>
<td></td>
<td>(0.051)</td>
<td>(0.050)</td>
<td>(0.050)</td>
<td>(0.051)</td>
<td>(0.097)</td>
<td>(0.097)</td>
<td>(0.097)</td>
<td>(0.097)</td>
</tr>
<tr>
<td>Makes Product</td>
<td>0.279***</td>
<td>0.243***</td>
<td>0.230***</td>
<td>0.217**</td>
<td>0.217**</td>
<td>0.217**</td>
<td>0.217**</td>
<td>0.217**</td>
</tr>
<tr>
<td></td>
<td>(0.059)</td>
<td>(0.060)</td>
<td>(0.060)</td>
<td>(0.107)</td>
<td>(0.107)</td>
<td>(0.107)</td>
<td>(0.107)</td>
<td>(0.107)</td>
</tr>
<tr>
<td>Intel. Property</td>
<td>-0.050</td>
<td>-0.102*</td>
<td>-0.052</td>
<td>-0.190*</td>
<td>-0.190*</td>
<td>-0.190*</td>
<td>-0.190*</td>
<td>-0.190*</td>
</tr>
<tr>
<td></td>
<td>(0.066)</td>
<td>(0.062)</td>
<td>(0.058)</td>
<td>(0.114)</td>
<td>(0.114)</td>
<td>(0.114)</td>
<td>(0.114)</td>
<td>(0.114)</td>
</tr>
<tr>
<td>Home-based</td>
<td>-0.190***</td>
<td>-0.127**</td>
<td>-0.117</td>
<td>-0.117</td>
<td>-0.117</td>
<td>-0.117</td>
<td>-0.117</td>
<td>-0.117</td>
</tr>
<tr>
<td></td>
<td>(0.048)</td>
<td>(0.051)</td>
<td>(0.110)</td>
<td>(0.110)</td>
<td>(0.110)</td>
<td>(0.110)</td>
<td>(0.110)</td>
<td>(0.110)</td>
</tr>
<tr>
<td>Part time Bus.</td>
<td>0.039</td>
<td>-0.013</td>
<td>-0.127</td>
<td>-0.127</td>
<td>-0.127</td>
<td>-0.127</td>
<td>-0.127</td>
<td>-0.127</td>
</tr>
<tr>
<td></td>
<td>(0.056)</td>
<td>(0.054)</td>
<td>(0.118)</td>
<td>(0.118)</td>
<td>(0.118)</td>
<td>(0.118)</td>
<td>(0.118)</td>
<td>(0.118)</td>
</tr>
<tr>
<td>Incorporated</td>
<td>0.144***</td>
<td>0.095*</td>
<td>-0.003</td>
<td>-0.003</td>
<td>-0.003</td>
<td>-0.003</td>
<td>-0.003</td>
<td>-0.003</td>
</tr>
<tr>
<td></td>
<td>(0.050)</td>
<td>(0.054)</td>
<td>(0.112)</td>
<td>(0.112)</td>
<td>(0.112)</td>
<td>(0.112)</td>
<td>(0.112)</td>
<td>(0.112)</td>
</tr>
<tr>
<td>Employment</td>
<td>0.056***</td>
<td>0.053**</td>
<td>0.069***</td>
<td>0.069***</td>
<td>0.069***</td>
<td>0.069***</td>
<td>0.069***</td>
<td>0.069***</td>
</tr>
<tr>
<td></td>
<td>(0.011)</td>
<td>(0.010)</td>
<td>(0.006)</td>
<td>(0.006)</td>
<td>(0.006)</td>
<td>(0.006)</td>
<td>(0.006)</td>
<td>(0.006)</td>
</tr>
<tr>
<td>Observations</td>
<td>4,124</td>
<td>4,038</td>
<td>4,038</td>
<td>3,975</td>
<td>3,975</td>
<td>3,840</td>
<td>3,590</td>
<td>1,214</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.022</td>
<td>0.032</td>
<td>0.039</td>
<td>0.044</td>
<td>0.052</td>
<td>0.110</td>
<td>0.346</td>
<td>0.590</td>
</tr>
</tbody>
</table>
Table V: Later-Stage Differences in Debt

This table models variation in the amount of total debt, outside debt, and business debt for the later survey years. The regression specifications mirror those in Column (6) of the previous three tables. All columns include industry fixed effects controls for gender and other racial categories and dummy variables for the survey years. Human capital controls include education, previous work experience and previous startup experience. Product characteristics control for whether the business sells a product or a service (or both), and whether it has intellectual property. Firm characteristics control for whether the business is fulltime or parttime, whether it is home-based, incorporated and has employees. Standard errors appear in parentheses below point estimates. One, two and three asterisks denote significance at the ten, five and one per cent level, respectively.

<table>
<thead>
<tr>
<th></th>
<th>Business Bank Debt</th>
<th>Total Outside Debt</th>
<th>Total Financial Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Years 1-3 (1)</td>
<td>Years 4-7 (2)</td>
<td>Years 1-3 (3)</td>
</tr>
<tr>
<td>Black-owned Startup</td>
<td>-0.163*** (0.031)</td>
<td>-0.084*** (0.032)</td>
<td>-0.260*** (0.084)</td>
</tr>
<tr>
<td>Controls:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit Score</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Net Worth</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Human Capital</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Product Characteristics</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Firm Characteristics</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Industry Dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Survey-Year Dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>9,482</td>
<td>8,979</td>
<td>9,608</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.157</td>
<td>0.124</td>
<td>0.135</td>
</tr>
</tbody>
</table>
**Table VI: Racial Differences in Attitudes Towards Formal Debt**

This table reports survey-weighted averages by racial group to questions in the KFS that capture attitudes and intentions with respect to borrowing. “Applied for a loan” is a dummy equaling one if the respondent applied for a loan, regardless of whether the loan was approved. “Did not apply for fear of rejection” is one for those borrowers who did not apply for a loan, but who did not only because they anticipated the loan being denied. “Loan Always Approved” is only available for those who applied for a loan: it is a dummy for whether the respondent received the full amount they were asking for, or whether sometimes their loans are denied or reduced in size. “Unmet Need” is 1 if the respondent either did not apply for fear of rejection, or else applied but did not always get the full amount. The column labeled Overall is for all respondents. The remaining columns split the sample on whether the respondent had below or above median credit score, or whether credit scores were above the 75th percentile of observed scores across the whole sample.

<table>
<thead>
<tr>
<th>Credit Score:</th>
<th>Overall</th>
<th>Below Median</th>
<th>Above Median</th>
<th>Above 75th</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Applied for a Loan</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>White</td>
<td>0.1200</td>
<td>0.0838</td>
<td>0.1414</td>
<td>0.1617</td>
</tr>
<tr>
<td>Black</td>
<td>0.0785</td>
<td>0.0752</td>
<td>0.0834</td>
<td>0.1125</td>
</tr>
<tr>
<td><strong>Loan Always Approved</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>White</td>
<td>0.6826</td>
<td>0.6201</td>
<td>0.7038</td>
<td>0.7225</td>
</tr>
<tr>
<td>Black</td>
<td>0.2240</td>
<td>0.1153</td>
<td>0.3862</td>
<td>0.2530</td>
</tr>
<tr>
<td><strong>Did Not Apply For Fear of Rejection</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>White</td>
<td>0.1617</td>
<td>0.1666</td>
<td>0.1590</td>
<td>0.1497</td>
</tr>
<tr>
<td>Black</td>
<td>0.4181</td>
<td>0.4746</td>
<td>0.3244</td>
<td>0.3228</td>
</tr>
<tr>
<td><strong>Unmet Need</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>White</td>
<td>0.1633</td>
<td>0.1671</td>
<td>0.1611</td>
<td>0.1525</td>
</tr>
<tr>
<td>Black</td>
<td>0.4295</td>
<td>0.4929</td>
<td>0.3246</td>
<td>0.3174</td>
</tr>
</tbody>
</table>
Table VII: Race and the Demand for Capital

This table provides a multivariate analysis of the relation between founder race and the demand for capital. In Panel A, the dependent variable is a dummy for whether the borrower did not apply for a loan for fear of denial. In Panel B, the dependent variable is a dummy for whether they applied but were denied credit or else received less than they asked for. Human capital controls include education, previous work experience and previous startup experience. Product characteristics control for whether the business sells a product or a service (or both), and whether it has intellectual property. Firm characteristics control for whether the business is fulltime or parttime, whether it is home-based, incorporated and has employees. Standard errors appear in parentheses below point estimates. One, two and three asterisks denote significance at the ten, five and one per cent level, respectively.

<table>
<thead>
<tr>
<th>Panel A: Did Not Apply for Fear of Denial</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Black-owned Startup</td>
<td>0.856***</td>
<td>0.798***</td>
<td>0.638***</td>
<td>0.621***</td>
<td>0.628***</td>
<td>0.617***</td>
</tr>
<tr>
<td></td>
<td>(0.058)</td>
<td>(0.059)</td>
<td>(0.070)</td>
<td>(0.070)</td>
<td>(0.070)</td>
<td>(0.074)</td>
</tr>
<tr>
<td>Controls:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit Score</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Net Worth</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Human Capital</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Product Characteristics</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Firm Characteristics</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Industry Dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Survey-Year Dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>11,380</td>
<td>11,337</td>
<td>8,982</td>
<td>8,878</td>
<td>8,878</td>
<td>8,620</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B: Denied Credit or Received Less than Requested</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Black-owned Startup</td>
<td>0.450***</td>
<td>0.432***</td>
<td>0.275**</td>
<td>0.288**</td>
<td>0.307**</td>
<td>0.292**</td>
</tr>
<tr>
<td></td>
<td>(0.101)</td>
<td>(0.102)</td>
<td>(0.124)</td>
<td>(0.122)</td>
<td>(0.122)</td>
<td>(0.128)</td>
</tr>
<tr>
<td>Controls:</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit Score</td>
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<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Net Worth</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Human Capital</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Product Characteristics</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Firm Characteristics</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Industry Dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Survey-Year Dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>9,954</td>
<td>9,915</td>
<td>7,829</td>
<td>7,736</td>
<td>7,736</td>
<td>7,515</td>
</tr>
</tbody>
</table>
Table VIII: Past Borrowing and Credit Beliefs

This table explores the relation between prior loan balances and lack of access to capital by race. The dependent variable in the first two columns is a dummy variable for whether the respondent was afraid to apply for a loan for fear of denial. Column (1) includes all businesses that are not black-owned, while Column (2) focuses only on black-owned startups. In columns (3) and (4), the dependent variable is a dummy for whether the respondent reported that they were either denied credit or they received less than they asked for: again, the columns split the samples according to the race of the founder. Prior Accumulated Debt is the sum of all outside debt up through the previous survey round, in hundreds of thousands of dollars. Human capital controls include education, previous work experience and previous startup experience. Product characteristics control for whether the business sells a product or a service (or both), and whether it has intellectual property. Firm characteristics control for whether the business is fulltime or parttime, whether it is home-based, incorporated and has employees. Standard errors appear in parentheses below point estimates. One, two and three asterisks denote significance at the ten, five and one per cent level, respectively.

<table>
<thead>
<tr>
<th></th>
<th>Fear of Denial</th>
<th></th>
<th>Denied Credit</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td>Prior Accumulated Debt</td>
<td>0.007***</td>
<td>-0.011*</td>
<td>0.007***</td>
<td>-0.005</td>
</tr>
<tr>
<td></td>
<td>(0.002)</td>
<td>(0.007)</td>
<td>(0.002)</td>
<td>(0.004)</td>
</tr>
<tr>
<td>Controls:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit Score</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Net Worth</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Human Capital</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Product Characteristics</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Firm Characteristics</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Industry Dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Survey-Year Dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Black-Owned Startup Sample</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>8,209</td>
<td>639</td>
<td>7,265</td>
<td>405</td>
</tr>
</tbody>
</table>
Table IX: Local Banking Conditions and Racial Differences in Access to Credit

Panel A reports Probit regressions in which the dependent variable is a dummy if the respondent answered yes to “Did Not Apply for Fear of Rejection” or if they reported that they did not always get the full amount they asked for. Panel B reports regressions (Pooled OLS with year dummies) in which the dependent variable is the natural log of total business debt. Local bank share is the share of total county-level deposits held by local banks. Standard errors in parentheses, with one, two and three asterisks denoting significance at the 10, 5 and 1 percent level. Controls from Table IV included but not shown.

### Panel A: Dependent variable is Did Not Apply for Fear of Denial

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Black-Owned Startup</td>
<td>0.820***</td>
<td>0.815***</td>
<td>0.794***</td>
<td>0.621***</td>
<td>0.618***</td>
<td>0.591***</td>
</tr>
<tr>
<td></td>
<td>(0.066)</td>
<td>(0.066)</td>
<td>(0.086)</td>
<td>(0.070)</td>
<td>(0.070)</td>
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<td>Local Bank Share</td>
<td>-0.306***</td>
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<td>-0.241**</td>
<td>-0.262**</td>
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<td></td>
<td>(0.116)</td>
<td>(0.121)</td>
<td>(0.120)</td>
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<td>Local Bank Share × Black</td>
<td>0.146</td>
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<td>Net Worth</td>
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<td>Industry Dummies</td>
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### Panel B: Dependent variable is log Business Bank Debt

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<td>Black-Owned Startup</td>
<td>-0.206***</td>
<td>-0.199***</td>
<td>-0.148***</td>
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<td>(0.019)</td>
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<td>(0.020)</td>
<td>(0.025)</td>
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<td>0.350***</td>
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<td></td>
<td>(0.059)</td>
<td>(0.063)</td>
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<td>(0.063)</td>
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<td>Local Bank Share × Black</td>
<td>-0.360***</td>
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<td></td>
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<td></td>
<td>(0.130)</td>
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<td>Human Capital</td>
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<td>Yes</td>
<td>Yes</td>
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<td>0.017</td>
<td>0.017</td>
<td>0.023</td>
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Table X: Historical Inequality and Racial Bias

Panel A reports regressions (Pooled OLS with year dummies) in which the dependent variable is a dummy equaling one if the respondent answered yes to “Did Not Apply for Fear of Rejection.” The dependent variable in Panel B is a dummy equaling one if they reported that they did not always get the full amount they asked for. Regional Historical Gini is the gini coefficient of the MSA in 1890; data from Braggion, Dwarkasing, and Ongena (2015). In each panel a constant is estimated but suppressed for brevity. Standard errors in parentheses, with one, two and three asterisks denoting significance at the 10, 5 and 1 percent level. Controls from Table IV included but not shown.

### Panel A: Dependent Variable is Did Not Apply For Fear of Denial

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<td>Black</td>
<td>0.8141***</td>
<td>0.7514***</td>
<td>0.2008</td>
<td>0.7605***</td>
<td>0.7022***</td>
<td>0.1819</td>
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<td>(0.276)</td>
<td>(0.059)</td>
<td>(0.061)</td>
<td>(0.274)</td>
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<td>Historical Inequality</td>
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<td>0.4507***</td>
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<td>0.6057***</td>
<td>0.5056***</td>
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<td>(0.166)</td>
<td>(0.159)</td>
<td>(0.166)</td>
<td>(0.166)</td>
<td></td>
</tr>
<tr>
<td>Gini \times Minority</td>
<td>1.1465**</td>
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<td></td>
<td></td>
<td></td>
<td>1.0848*</td>
</tr>
<tr>
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<td>(0.568)</td>
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<td>-0.0032***</td>
<td>-0.0032***</td>
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<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td></td>
</tr>
<tr>
<td>Constant</td>
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<td>-1.2252***</td>
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<td>(0.135)</td>
<td>(0.099)</td>
<td>(0.135)</td>
<td>(0.137)</td>
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<td>9,436</td>
<td>11,204</td>
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### Panel B: Dependent variable is Unmet Capital Need

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<th>(6)</th>
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<td>0.7622***</td>
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<td>(0.061)</td>
<td>(0.273)</td>
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<td>0.4609***</td>
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<td>0.6239***</td>
<td>0.5139***</td>
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</tr>
<tr>
<td></td>
<td>(0.157)</td>
<td>(0.164)</td>
<td>(0.157)</td>
<td>(0.157)</td>
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</tr>
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<td>Gini \times Minority</td>
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<td></td>
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<td>1.2012**</td>
</tr>
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<td></td>
<td></td>
<td>(0.560)</td>
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<td>-0.0030***</td>
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<tr>
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</tr>
<tr>
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<td>-1.3343***</td>
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<td>-1.1903***</td>
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<td>(0.136)</td>
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<td>9,437</td>
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Table XI: Attitudes towards Interracial Marriage and Access to Capital

Panel A reports regressions (Pooled OLS with year dummies) in which the dependent variable is a dummy equaling one if the respondent answered yes to “Did Not Apply for Fear of Rejection.” The dependent variable in Panel B is a dummy equaling one if they reported that they did not always get the full amount they asked for. “Interracial Marriage” is the state level percentage of black married persons who have white marital partners, scaled by the proportion of white married persons in the state. In each panel a constant is estimated but suppressed for brevity. Standard errors in parentheses, with one, two and three asterisks denoting significance at the 10, 5 and 1 percent level. Controls from Table IV included but not shown.

### Panel A: Dependent Variable is Did Not Apply For Fear of Denial

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<th>(6)</th>
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<tbody>
<tr>
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<td>0.8105***</td>
<td>1.0072***</td>
<td>0.7605***</td>
<td>0.7559***</td>
<td>0.9670***</td>
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<td>(0.059)</td>
<td>(0.101)</td>
<td>(0.059)</td>
<td>(0.060)</td>
<td>(0.102)</td>
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<tr>
<td>Interracial Marriage</td>
<td>0.2741</td>
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<td>0.210</td>
<td>0.2895</td>
<td>0.4099*</td>
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<td>(0.210)</td>
<td>(0.210)</td>
<td>(0.210)</td>
<td>(0.213)</td>
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<tr>
<td>Black × Interracial</td>
<td>-2.3124**</td>
<td>-2.3124**</td>
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<td></td>
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<td>-0.0036***</td>
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<tr>
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<td>-0.9596***</td>
<td>-0.9802***</td>
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<td>(0.101)</td>
<td>(0.102)</td>
<td>(0.099)</td>
<td>(0.103)</td>
<td>(0.104)</td>
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### Panel B: Dependent variable is Unmet Capital Need

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<tbody>
<tr>
<td>Black</td>
<td>0.8323***</td>
<td>0.8370***</td>
<td>1.0509***</td>
<td>0.7808***</td>
<td>0.7848***</td>
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<td>(0.101)</td>
<td>(0.059)</td>
<td>(0.060)</td>
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<td>Interracial Marriage</td>
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<td>0.6315***</td>
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<td>(0.210)</td>
<td>(0.210)</td>
<td>(0.213)</td>
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<td>Black × Interracial</td>
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<tr>
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<td>10,789</td>
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51
Table XII: Oaxaca-Blinder Decompositions of Business Size

This table presents Oaxaca-Blinder decompositions of size differences in businesses in the final survey year based on whether or not the founder is black. The upper panel reports differences in the mean values of black-owned and white-owned size, expressed both in dollars and in log size. The bottom panel decomposes the mean difference into amounts explained by each set of independent variables. Human capital controls include education, previous work experience and previous startup experience. Business characteristics control for whether the business sells a product or a service (or both), whether it has intellectual property, and whether the business is fulltime or parttime, whether it is home-based, incorporated and has employees.

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<td><strong>Average Business Size, 2011:</strong></td>
<td>Dollar Value</td>
<td>Log(Size)</td>
</tr>
<tr>
<td>White-Owned</td>
<td>$533,726.05</td>
<td>11.693</td>
</tr>
<tr>
<td>Black-Owned</td>
<td>$197,634.84</td>
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<tr>
<td>Difference</td>
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<td>0.848</td>
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<table>
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<th><strong>Explanatory Components:</strong></th>
<th>(1) Dollar Value</th>
<th>(2) Log(Size)</th>
</tr>
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<td>Race and Gender</td>
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<td>Human Capital</td>
<td>$40,695.11</td>
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<td>Business Characteristics</td>
<td>$4,966.81</td>
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</tr>
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<td>Business Credit Score</td>
<td>$51,105.07</td>
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<td>Founder Net Worth</td>
<td>$59,158.65</td>
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</tr>
<tr>
<td>Total Explained</td>
<td>$161,384.67</td>
<td>0.5510</td>
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A Appendix

This appendix presents information on financing, and racial differences in owner and business characteristics in the KFS.

Table A.1 describes the detailed financing choices in the founding year for the firms in our sample (2004). The detailed sources are grouped into six broad categories, based on the source of the capital and the type of capital following Robb and Robinson (2014). These are (owner, informal, formal) × (debt, equity). The first column, labelled “Full KFS”, includes all 4,928 firms in the Kauffman Firm Survey. For some of these firms, it cannot be verified that they either went out of business or remain in operations, therefore in the remaining columns we include 3,972 firms that either survived over the followup years 1-3 period or were verified as going out of business over the same period. This Column is labelled “Analysis Sample.” These two columns report means that include firms with $0 amounts of a particular source of capital. The third column, labelled “Mean if > 0” reports the mean, in dollars, for only firms with positive amounts of that source of funding. The number of respondents reporting a positive amount of each source of funding is reported in the final column.

Table A.2 provides summary statistics for key variables based on the race of the firm owner.
Table A.1: Detailed Sources of Financing for All Startups in the KFS

<table>
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<th>Category</th>
<th>Funding Source</th>
<th>Full KFS</th>
<th>Analysis Sample</th>
<th>Mean if &gt; 0</th>
<th>Count</th>
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<td>33,640</td>
<td>31,734</td>
<td>40,536</td>
<td>3,093</td>
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<tr>
<td>Total Owner Debt:</td>
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<td></td>
<td></td>
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<tr>
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<td>Personal Credit Card balance, owner</td>
<td>4,952</td>
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<td>15,765</td>
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<tr>
<td></td>
<td>Personal Credit Card balance, others</td>
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<td>2,811</td>
<td>9,375</td>
<td>1,158</td>
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### Table A.2: Summary Statistics by Race

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<th>p-value(diff)</th>
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Table A.3: Summary Statistics on Key Firm and Founder Characteristics

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## Racial Differences in Profitability and Survival

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<td>23,153</td>
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<td>Standard errors in parentheses</td>
</tr>
</tbody>
</table>

*** p<0.01, ** p<0.05, * p<0.1
Table A.4: A Closer Look at Sources of Debt

This table reports survey-weighted mean values by race for dummy variables that track the use of particular types of credit, as well as for mean values of these sources of credit. The final column reports p-values from the t-test of the difference between black- and white-owned businesses. The first block of numbers for each year range ("Uses") reports the proportion of the sample that indicates they use that form of debt. The lower block of numbers for each year range (indicated with $) reports the average dollar amounts for that funding category.

<table>
<thead>
<tr>
<th></th>
<th>Overall</th>
<th>White Mean</th>
<th>Black Mean</th>
<th>p-value(diff)</th>
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<tbody>
<tr>
<td>KFS Initial Survey Year</td>
<td></td>
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<td></td>
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<tr>
<td>Uses Personal Credit Cards</td>
<td>0.48</td>
<td>0.49</td>
<td>0.34</td>
<td>0.00</td>
</tr>
<tr>
<td>Uses Personal Bank Loan</td>
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<td>0.18</td>
<td>0.14</td>
<td>0.01</td>
</tr>
<tr>
<td>Uses Business Credit Cards</td>
<td>0.28</td>
<td>0.30</td>
<td>0.15</td>
<td>0.00</td>
</tr>
<tr>
<td>Uses Loans from Family Members</td>
<td>0.10</td>
<td>0.09</td>
<td>0.14</td>
<td>0.00</td>
</tr>
<tr>
<td>Uses Business Bank Loans</td>
<td>0.06</td>
<td>0.07</td>
<td>0.01</td>
<td>0.00</td>
</tr>
<tr>
<td>Personal Bank Loan ($)</td>
<td>13,660</td>
<td>14,497</td>
<td>6,971</td>
<td>0.04</td>
</tr>
<tr>
<td>Personal Loans from Fam. ($)</td>
<td>2,465</td>
<td>2,571</td>
<td>1,801</td>
<td>0.36</td>
</tr>
<tr>
<td>Personal Loans, Other Sources ($)</td>
<td>4,360</td>
<td>4,659</td>
<td>2,161</td>
<td>0.24</td>
</tr>
<tr>
<td>Business Bank Loan ($)</td>
<td>9,540</td>
<td>10,551</td>
<td>1,106</td>
<td>0.03</td>
</tr>
<tr>
<td>Business Non-bank Loans ($)</td>
<td>5,510</td>
<td>6,035</td>
<td>866</td>
<td>0.06</td>
</tr>
<tr>
<td>KFS Survey Years 1-3</td>
<td></td>
<td></td>
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<tr>
<td>Uses Personal Credit Cards</td>
<td>0.38</td>
<td>0.38</td>
<td>0.35</td>
<td>0.84</td>
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<tr>
<td>Uses Personal Bank Loan</td>
<td>0.13</td>
<td>0.13</td>
<td>0.08</td>
<td>0.01</td>
</tr>
<tr>
<td>Uses Business Credit Cards</td>
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<td>0.43</td>
<td>0.32</td>
<td>0.00</td>
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<tr>
<td>Uses Loans from Family Members</td>
<td>0.07</td>
<td>0.07</td>
<td>0.12</td>
<td>0.00</td>
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<tr>
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<td>0.06</td>
<td>0.06</td>
<td>0.03</td>
<td>0.02</td>
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<tr>
<td>Personal Bank Loan ($)</td>
<td>7,992</td>
<td>8,228</td>
<td>4,171</td>
<td>0.05</td>
</tr>
<tr>
<td>Personal Loans from Fam. ($)</td>
<td>1,454</td>
<td>1,491</td>
<td>1,323</td>
<td>0.17</td>
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<tr>
<td>Personal Loans, Other Sources ($)</td>
<td>1,999</td>
<td>2,070</td>
<td>1,451</td>
<td>0.60</td>
</tr>
<tr>
<td>Business Bank Loan ($)</td>
<td>5,039</td>
<td>5,589</td>
<td>625</td>
<td>0.01</td>
</tr>
<tr>
<td>Business Non-bank Loans ($)</td>
<td>2,933</td>
<td>3,085</td>
<td>742</td>
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<tr>
<td>KFS Survey Years 4-7</td>
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<td>0.33</td>
<td>0.30</td>
<td>0.23</td>
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<tr>
<td>Uses Personal Bank Loan</td>
<td>0.08</td>
<td>0.09</td>
<td>0.05</td>
<td>0.08</td>
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<tr>
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<td>0.43</td>
<td>0.27</td>
<td>0.00</td>
</tr>
<tr>
<td>Uses Loans from Family Members</td>
<td>0.06</td>
<td>0.06</td>
<td>0.08</td>
<td>0.00</td>
</tr>
<tr>
<td>Uses Business Bank Loans</td>
<td>0.05</td>
<td>0.05</td>
<td>0.02</td>
<td>0.08</td>
</tr>
<tr>
<td>Personal Bank Loan ($)</td>
<td>2,523</td>
<td>2,719</td>
<td>635</td>
<td>0.04</td>
</tr>
<tr>
<td>Personal Loans from Fam. ($)</td>
<td>677</td>
<td>702</td>
<td>298</td>
<td>0.34</td>
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<tr>
<td>Personal Loans, Other Sources ($)</td>
<td>944</td>
<td>973</td>
<td>343</td>
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<td>Business Bank Loan ($)</td>
<td>2,589</td>
<td>2,624</td>
<td>1,392</td>
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</tr>
<tr>
<td>Business Non-bank Loans ($)</td>
<td>1,484</td>
<td>1,507</td>
<td>521</td>
<td>0.43</td>
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### Table A.5: Later Stage Differences in Access to Capital with Zipcode Fixed Effects

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<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
</tr>
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<tbody>
<tr>
<td>Black</td>
<td>-0.317**</td>
<td>-0.265*</td>
<td>-0.462**</td>
<td>-0.511**</td>
<td>0.120</td>
<td>-0.473*</td>
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<td>(0.133)</td>
<td>(0.151)</td>
<td>(0.211)</td>
<td>(0.225)</td>
<td>(0.226)</td>
<td>(0.244)</td>
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<td>Asian</td>
<td>-0.121</td>
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<td>-0.302</td>
<td>-0.810***</td>
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<td></td>
<td>(0.160)</td>
<td>(0.174)</td>
<td>(0.255)</td>
<td>(0.260)</td>
<td>(0.269)</td>
<td>(0.279)</td>
</tr>
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<td></td>
<td>(0.140)</td>
<td>(0.167)</td>
<td>(0.223)</td>
<td>(0.249)</td>
<td>(0.238)</td>
<td>(0.267)</td>
</tr>
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<td>Other</td>
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<td>-1.276***</td>
<td>-0.773**</td>
<td>-0.707**</td>
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</tr>
<tr>
<td></td>
<td>(0.198)</td>
<td>(0.263)</td>
<td>(0.316)</td>
<td>(0.392)</td>
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<td>(0.431)</td>
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<td>Female</td>
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<td>-0.139</td>
<td>-0.127</td>
<td>-0.178</td>
<td>-0.265**</td>
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<tr>
<td></td>
<td>(0.073)</td>
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<td>(0.125)</td>
<td>(0.124)</td>
<td>(0.135)</td>
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<td>Previous Industry Experience</td>
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<td>0.002</td>
<td>-0.009</td>
<td>0.011*</td>
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</tr>
<tr>
<td></td>
<td>(0.003)</td>
<td>(0.004)</td>
<td>(0.006)</td>
<td>(0.006)</td>
<td>(0.006)</td>
<td>(0.006)</td>
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<tr>
<td>Experience Outside Industry</td>
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<td>-0.003</td>
<td>0.015***</td>
<td>0.004</td>
<td>0.019***</td>
<td>0.013**</td>
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<td></td>
<td>(0.003)</td>
<td>(0.004)</td>
<td>(0.005)</td>
<td>(0.006)</td>
<td>(0.005)</td>
<td>(0.006)</td>
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<td>Some College</td>
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<td>0.182</td>
<td>0.156</td>
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<td>0.229</td>
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<td>(0.111)</td>
<td>(0.137)</td>
<td>(0.176)</td>
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<td>College Deg.</td>
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<td>0.020</td>
<td>0.061</td>
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<td>(0.188)</td>
<td>(0.217)</td>
<td>(0.200)</td>
<td>(0.233)</td>
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<td>Grad. Deg.</td>
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<td>-0.027</td>
<td>-0.239</td>
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<td>-0.305</td>
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<tr>
<td></td>
<td>(0.123)</td>
<td>(0.148)</td>
<td>(0.195)</td>
<td>(0.222)</td>
<td>(0.208)</td>
<td>(0.238)</td>
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<tr>
<td>Prev. Startup Exp.</td>
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<td>0.035</td>
<td>0.178*</td>
<td>0.262**</td>
<td>0.188*</td>
<td>0.174*</td>
</tr>
<tr>
<td></td>
<td>(0.060)</td>
<td>(0.068)</td>
<td>(0.096)</td>
<td>(0.102)</td>
<td>(0.102)</td>
<td>(0.110)</td>
</tr>
<tr>
<td>Makes Product</td>
<td>0.080*</td>
<td>-0.009</td>
<td>0.204***</td>
<td>-0.002</td>
<td>0.364***</td>
<td>0.109</td>
</tr>
<tr>
<td></td>
<td>(0.044)</td>
<td>(0.046)</td>
<td>(0.070)</td>
<td>(0.068)</td>
<td>(0.074)</td>
<td>(0.073)</td>
</tr>
<tr>
<td>Intel. Property</td>
<td>0.028</td>
<td>-0.028</td>
<td>0.156**</td>
<td>0.145**</td>
<td>0.481***</td>
<td>0.203***</td>
</tr>
<tr>
<td></td>
<td>(0.045)</td>
<td>(0.049)</td>
<td>(0.072)</td>
<td>(0.073)</td>
<td>(0.076)</td>
<td>(0.078)</td>
</tr>
<tr>
<td>Home-based</td>
<td>-0.086</td>
<td>-0.167**</td>
<td>-0.421***</td>
<td>-0.575***</td>
<td>-0.832***</td>
<td>-0.885***</td>
</tr>
<tr>
<td></td>
<td>(0.059)</td>
<td>(0.066)</td>
<td>(0.094)</td>
<td>(0.099)</td>
<td>(0.100)</td>
<td>(0.106)</td>
</tr>
<tr>
<td>Part time Bus.</td>
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<td>-0.743***</td>
<td>0.088</td>
<td>-0.614***</td>
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<td>(0.074)</td>
<td>(0.083)</td>
<td>(0.118)</td>
<td>(0.124)</td>
<td>(0.125)</td>
<td>(0.133)</td>
</tr>
<tr>
<td>Incorporated</td>
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<td>0.340***</td>
<td>0.367***</td>
<td>0.390***</td>
<td>0.247**</td>
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<tr>
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<td>(0.063)</td>
<td>(0.073)</td>
<td>(0.100)</td>
<td>(0.109)</td>
<td>(0.106)</td>
<td>(0.117)</td>
</tr>
<tr>
<td>Employment</td>
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<td>0.013***</td>
<td>0.009***</td>
<td>0.008***</td>
<td>0.008***</td>
<td>0.009***</td>
</tr>
<tr>
<td></td>
<td>(0.001)</td>
<td>(0.002)</td>
<td>(0.002)</td>
<td>(0.003)</td>
<td>(0.002)</td>
<td>(0.004)</td>
</tr>
<tr>
<td>Credit Score</td>
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<td>0.002*</td>
<td>0.003**</td>
<td>0.006***</td>
<td>0.001</td>
<td>0.003*</td>
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<tr>
<td></td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
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<td>7,903</td>
<td>7,819</td>
<td>7,736</td>
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<tr>
<td>R-squared</td>
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</tbody>
</table>

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1
Table A.6: Local Banking Conditions and Racial Bias

Panel A reports regressions (Pooled OLS with year dummies) in which the dependent variable is the natural log of total business debt. Panel B reports Probit regressions in which the dependent variable is a dummy if the respondent had unmet capital needs, which is true if the respondent answered yes to “Did Not Apply for Fear of Rejection” or if they reported that they did not always get the full amount they asked for. Local bank share is the share of total county-level deposits held by local banks. Local bank herfindahl is the herfindahl of local banks at the county level computed using deposits. Standard errors in parentheses, with one, two and three asterisks denoting significance at the 10, 5 and 1 percent level. Controls from Table IV included but not shown.

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<th>Panel A: Dependent variable is Did Not Apply for Fear of Denial</th>
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<td>Black-owned Startup</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Local Bank Share</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Local Bank Share × Minority</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Local Bank Herfindahl</td>
</tr>
<tr>
<td>Bank Conc. × Minority</td>
</tr>
<tr>
<td>Credit Score</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Observations</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B: Dependent variable is Log(Business Debt)</th>
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</tr>
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<tr>
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</tr>
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<td></td>
</tr>
<tr>
<td>Local Bank Share × Minority</td>
</tr>
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<td>Local Bank Herfindahl</td>
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<td>Credit Score</td>
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</tr>
<tr>
<td>R-squared</td>
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</table>
Executive Summary:

The Action Framework is a fully integrated playbook that will help accelerate the region’s economic recovery from the COVID-19 pandemic — and do so in a way that provides greater economic opportunities for all residents and builds a more resilient economy that is better prepared to weather future shocks.

The key to the Action Framework’s success is regional unity advanced by the full engagement of our business community. The long-term economic success of our region hangs in the balance.

The good news is that we are off to a great start already. The chairs and vice chairs of the 11 industry and topic area committees have provided the first validation that our game plan design is up for the task. All reported that the Action Framework captured their committee’s program recommendations with no adjustments needed. This affirmation was followed by a critique by the more than 200 business leaders who created the Action Framework — the 18 thought leaders, 12 subject matter experts, 120 committee members, 10 Old Dominion University Strome College of Business interns, and the assigned staff personnel of coalition partners and consultant team. Their mid-January 2021 review of the Action Framework is summed up in this word cloud – COMPREHENSIVE, INCLUSIVE, COLLABORATIVE! This engaged group offered additional helpful input and offered a number of encouraging comments that are shared throughout this executive summary document.

With the Action Framework creators’ input now incorporated into the plan, the next step is to share the Action Framework with elected officials (mayors), governmental leaders (chief administrative officers) and community leaders. This will take place in February as a soft launch. In March, the final plan will be rolled out to Hampton Roads’ entire business community.

While economists caution that Hampton Roads should not expect a full recovery until at least 2022, we must do everything possible to accelerate this timeline, and in the process provide more economic opportunities for our residents and become better prepared to weather future shocks. The 757 Recovery & Resilience Action Framework is the business community’s game plan to make all of this happen!
Action Framework Overview

The 757 Recovery and Resilience Action Framework is a game plan created by and for the Hampton Roads business community to build a better, more resilient economy for the people of the 757. The Action Framework will help accelerate the region’s economic recovery from the COVID-19 pandemic — and do so in a way that provides greater economic opportunities for all residents while building a more resilient economy that will be better prepared to weather future shocks.

This document provides a broad overview of the Action Framework — a snapshot of what the Action Framework is, why it is needed, who created it, how it works, and when it will be implemented. This includes a vision for our regional economy, measurable goals, 5 strategic focus areas and 30 related programs, priorities, and accountability.

What: Action Framework Overview

The Action Framework is a dynamic playbook designed to guide the Hampton Roads region’s COVID-19 economic recovery and resilience-building efforts. The plan can best be understood through an appreciation of the planning tenets that shaped its design. These include:

1. The Action Framework is created by and for the Hampton Roads business community, a first of its kind approach for a regional economic development plan.

   When COVID-19 hit Hampton Roads, several leading regional business organizations came together as one coalition to help the business community navigate the crisis through a variety of initiatives, which included a series of business leader surveys, informational guides, high-level briefing calls, and the ongoing online www.757Recovery.com forum.

   Initial coalition members included the Hampton Roads Alliance, Reinvent Hampton Roads, Hampton Roads Chamber, Virginia Peninsula Chamber, Hampton Roads Workforce Council, Greater Peninsula Workforce Board, the Old Dominion University Strome College of Business, Norfolk State University, and the CIVIC Leadership Institute.

   In the second half of 2020, this coalition embarked on a comprehensive strategic planning process to create the Action Framework. The planning process engaged more than 200 business leaders, including 18 thought leaders, 12 subject matter experts, 11 committee Chairs, 11 committee Vice Chairs, 120 committee members, 10 Old Dominion University Strome College of Business student interns, the assigned staff personnel of coalition partners, and a consultant team. More than a thousand business leaders have provided input into the Action Framework through three online surveys.

   The Action Framework will be rolled out to the entire business community in March 2021. This is where the real work begins. The coalition of the leading regional business organizations and the Steering Committee who lead the creation of the Action Framework

Brandon Johnson
Director of Sales
Newport News Marriott at City Center

“The 757 Recovery and Resilience Action Framework is the key to the economic revitalization of Hampton Roads. This collaborative effort embodies the dynamic spirit and diverse culture of the region and will provide a foundation for continuous growth and excellence.”
Saige Hill
PhD Student and Researcher
Old Dominion University School of Public Service
will remain in place and expand. Moreover, over 1,000 business leaders will take an active role in advancing the Action Framework through an innovative ambassador program explained throughout this document.

2. **The Action Framework includes both important pre-existing economic development programs and exciting new initiatives.**

For the first time, all of our region’s economic development strategies and programs are included in one comprehensive, fully integrated game plan. This provides two critically important benefits. First, now we can integrate all of the programs seamlessly into a unified approach that leverages our intellectual and financial resources. Second, we now have an organized inventory of all economic development-related activities, enabling all business, government and community leaders in the Hampton Roads region to fully understand, embrace, and play an active role in advancing our economic recovery and growth.

3. **The Action Framework is hyper-focused on the greatest points of leverage that will accelerate our region’s economic recovery, which, in turn, will benefit other sectors.**

We started our planning effort with a question focused on the scope of our approach. *How do we help the community recover – should we embrace a narrow or broad perspective of who should be included in this planning initiative?*

The broadest view would include the entire Hampton Roads’ community - every major industry sector including government, business, military, non-profit, etc. This would make sense as almost every aspect of our community is connected and almost all sectors have been impacted by COVID.

We narrowed our scope, however, by reframing our question from “*how do we help the community recover*” to “*how do we help the community recover in the fastest time possible.*” We realized that we do not have time to organize and implement a broad-based, community-wide planning effort. Time is of the essence. The Action Framework must move at the speed of business. We also realized that an accelerated economic recovery will, in turn, help all other sectors recover. As everything is connected, a faster economic recovery will grow the sales tax base for local governments, increase the capacity of corporate and private philanthropic donors, and provide greater access to in-demand and high-paying jobs for military family members and transitioning personnel.

This logic placed the focus of the Action Framework on creating a plan by and for the business community to focus on the greatest points of leverage that will accelerate our region’s economic recovery, which, in turn, will benefit other sectors.

Even with our narrow business focus, we continue to appreciate the importance of all non-business sectors. As such, we are keeping local government leaders informed of our planning progress. This includes Chief Administrative Officers (CAOs) and economic
development leaders from the 757’s local jurisdictions. In addition, we continue to work closely with the Hampton Roads Military and Federal Facilities Alliance (HRMFFA) to keep the military informed.

In addition, we appreciate that the Action Framework’s programming could benefit the 757’s non-profit community, too. This includes our resiliency capacity-building programs like business model planning, DE&I (diversity, equity, and inclusion) training, health and well-being education, and early childcare support. All of these services, many for free, will be available for everyone.

4. **The Action Framework includes accountability for delivering and reporting results.**

The Action Framework’s strategic focus areas and related programs are organized by duties and lines of responsibility across the region’s lead business organizations — who does what, and when. Their collective work will be held accountable by a public-facing performance dashboard and supported by community-wide follow-up meetings where we will report progress.

5. **The Action Framework is powered by an army of change agents — more than 1,000 business leaders who will actively advance this initiative.**

The Action Framework will be powered by 757 Champions, over 1,000 business leaders who will help advance the game plan through some of these 12 supporting actions:

| 1. | Advance the Action Framework Theme |
| 2. | Support the Local “Did You Know” Pride-Building Campaign |
| 3. | Increase Your Business Resiliency - Diversity and Inclusion Training and Support |
| 4. | Increase Your Business Resiliency - B-model Advice and Training |
| 5. | Increase Your Business Resiliency - Employee Wellbeing Advice and Training |
| 6. | Use the new Minority Supplier Database |
| 7. | Help Recruit Additional 757 Champions |
| 8. | Learn Future Trends – Prepare to thrive in a Post-COVID World |
| 9. | Support a New Regional Branding Effort – Directly Tie Into It |
| 10. | Support a New Regional Branding Effort – Help Fund It |
| 12. | Attend Action Framework Events |

As the final Action Framework is coming together, we have signed up already over a hundred business leaders who will serve as 757 Champions!

There are many reasons the Action Framework is needed now more than ever.

- **As a region, we are slow to recover from economic shocks.** It took the United States and Virginia more than 70 months to recover all the jobs lost during the Great Recession. For Hampton Roads, it took over 100 months to add back jobs lost during the Great Recession, and the economic shock of COVID-19 has been greater. Through the Action Framework’s business leader survey, most of Hampton Roads’ executives feel it will take another year before we recover. In all likelihood, we should not expect a full recovery until at least 2022. We must do everything possible to reduce this recovery time.

- **There’s no one else on whom we can count.** So far, the federal response has not lessened the economic shock of the pandemic significantly, and we cannot expect the federal government to come to our rescue. Similarly, our state and local governments are all having to do more with less and are appropriately consumed with pandemic-specific issues.

- **We must prepare now for a new post-COVID-19 economy.** COVID-19 has transformed industry after industry. We must now reimagine what recovery will look like in a forever changed world. This is a time to question assumptions and old ways of doing things. Moreover, it’s time for bold thinking.

- **We must build a more equitable economy where everyone thrives.** The post-COVID-19 economy must provide economic empowerment for everyone. Our projects, initiatives and future priorities must be guided by equitable economic development. This new perspective requires time to incorporate into all programming.

- **We need to build our economic resilience to prepare for coming future shocks.** Our recovery needs to be orchestrated in a way that prepares Hampton Roads for future economic shocks — the next pandemic, flooding, sea level rise and military sequestration. This new perspective requires time, too.

- **We can’t afford to fall behind.** Other cities are not waiting for recovery, they are creating it. Across the country, other regions and cities have prepared and are following plans that are guiding their strategic COVID-19 economic recovery.

"The recovery from the pandemic is an opportunity and a challenge for the region to build upon its successes and learn from its failures. The Recovery and Resilience Action Framework represents a common vision of how we can grow faster, more equitably, and still maintain the quality of life that defines the area. In times of uncertainty and change, we must be bold rather than timid to build a better, equitable, and more sustainable future."

Robert McNab
Professor of Economics
Old Dominion University
At the heart of the Action Framework is literally a visual framework of how our game plan works.

This framework succinctly organizes and presents the 6 values, vision, 5 strategic focus areas, and the 30 program areas. It is the easiest way to understand how our Action Framework works.

**Goals & Objectives**

The over-arching goal of the Action Framework is to build a better, more resilient economy for the people of the 757.

The Action Framework has 3 measurable economic objectives:

1. Accelerate our region’s economic rebound. Move from low 30s out of 40 to a top-15 position in our peer group as measured by:
   - Job Growth
   - Wage Growth
   - GDP

2. Make the region’s overall economy and local companies more resilient to future shocks.

3. Ensure everyone is empowered by and benefits from our new economy.

**Values & Vision**

The Action Framework’s implementation design is guided by a first-of-its-kind vision for the economy we want to build for the people of the 757.

This vision was developed and refined through the work of the Integration Committee, which was charged with pulling together the input from thought leaders, subject matter experts, and the 10 industry and topic area committees (the 11th committee is the Integration Committee).

To arrive at the Action Framework’s vision, the Integration Committee followed a process outlined by SIR, a firm experienced in helping cities and organizations conduct values-based visioning. SIR’s process, whether for a company, organization or entire region, is based on identifying a set of defining characteristics or values held and embraced by key stakeholders such as a region’s residents in this case.
For the Action Framework, we determine the values we want associated with the Hampton Roads’ economy in 2030. SIR’s process of arriving at those values centered on identifying intersectional insights across three key questions:

1. What place-oriented values do residents care about Hampton Roads today?
2. What makes Hampton Roads unique from other places today?
3. What defining values will be important to Hampton Roads’ residents tomorrow?

A number of recent market research studies conducted in Hampton Roads provided many of the insights we needed. Several years ago, the Hampton Roads Planning District Commission (HRPDC) conducted a regional values and visioning study. This research, along with the Envision 2020 Regional Branding Initiative’s research conducted in 2019, addressed the first two questions. SIR’s Institute for Tomorrow research on the trends shaping the future of regions like Hampton Roads answered the third question. The insights from this research led to a final set of key characteristics that are not only valued by Hampton Roads residents today but will become even more important tomorrow:

- Inclusion & Equity
- Military Presence
- Welcoming Community Spirit
- Innovation & Creativity
- Coastal Lifestyle
- One Region Stronger Together

Combining all of these key characteristics, the vision concept came to life through this comprehensive expression of our vision for 757’s economy in 2030:

"Our economy is resilient and innovative. Here, we all work together to grow our economy and advance the well-being of all residents. We’re inspired by what we value: a commitment to inclusion and equity, a strong military presence, a welcoming community spirit, and our old salt, new vibe coastal lifestyle, making our region one of a kind, and one for all."

This statement was reduced to its simplest expression:

757 = One

Economic Empowerment and Growth for All

“The recovery and resilience action framework represents a common vision of how we can grow faster, more equitably, and still maintain the quality of life that defines the area. In times of uncertainty and change, we must be bold rather than timid to build a better, equitable, and more sustainable future.”

Robert McNab
Professor of Economics
Old Dominion University
5 Strategic Focus Areas

Inspired by a vision of economic empowerment and growth for all, the Action Framework advances five strategic focus areas:

1. Build Regional Unity
2. Grow New Jobs
3. Grow, Retain, and Attract Talent
4. Build Resiliency
5. Advance Regional Infrastructure

The Integration Committee arrived at these 5 strategies by synthesizing and integrating all of the input generated from thought leaders, subject matter experts, Action Framework committees, and input from the Steering Committee (Coalition Partners). This included reviewing hundreds of pages of plans, whitepapers and research reports. (See Appendix for links to some of these key inputs).

An overview of each strategic focus area, along with the supporting rationale includes:

1. **Build Regional Unity**:

   Throughout the Action Framework research and committee work, a lack of unity was routinely mentioned as the core element that has traditionally held the Hampton Roads region back. Today, only 15 percent of business leaders believe our region is collaborating well. As such, the more than 200 business leaders who worked on the Action Framework unanimously agreed that building regional unity was THE prerequisite for economic recovery.

   This unity transcends cooperation among local governments and involves collaboration and cooperation at every level — between and among businesses, higher education, nonprofits and the military.

   Enhanced region-wide collaboration starts through a better understanding of what the region includes and the many advantages it offers. There’s room for improvement in both regards. The Envision 2020 Branding research revealed that only half (51%) of business leaders identify with Hampton Roads and many don’t know which jurisdictions are part of the region. Per the Envision 2020 research, the “7 Cities” were most mentioned as being a part of the Hampton Roads region. However, half or less (50% to 21%) of business leaders included the 10 other jurisdictions, and only 50% said Williamsburg was part of the region. Business leaders’ knowledge of 12 basic facts about Hampton Roads were low, as well.

   "The Action Framework is leading by example. We're betting on ourselves as a region, a unified region. We're a region that can measure up to and exceed the capabilities of any other region in the nation. This is our time.”

   Tim Ryan
   Executive Director
   StartWheel
2. **Grow New Jobs:**

By every account, economic empowerment and growth for all comes down to generating not only more jobs but better, higher paying jobs.

3. **Grow, Retain, and Attract Talent:**

It’s not enough simply to create new jobs. For a region to recover and flourish, new and available jobs must be filled by qualified talent, which often requires education, training, and continued workforce development. With the rise of tech-enabled automation, well-choreographed reskilling, also known as up-skilling, will be in greater demand. In order to deliver on that demand, we need to invest in the entire talent development pipeline and to do so with a new equitable lens. This includes working with employers as partners in developing and training existing talent (those already working in the region) at every level, as well as attracting new, needed talent to the area.

4. **Build Resiliency:**

Most often, we hear “resiliency” being associated with environmental threats and future mitigation strategies. In the Action Framework, we view resiliency as any action that can help mitigate the impact of future shocks that will disrupt our economy, local businesses, nonprofits, and livelihoods. Addressing resiliency from this perspective will require a continuous effort to diversify the 757 economy and educate and train businesses to become more resilient by fortifying their business models, accelerating their diversity and inclusion practices, increasing employee health and well-being, and providing insights on how to access to high-quality early care.

5. **Advance Regional Infrastructure:**

A long-term commitment to the development and maintenance of our region’s infrastructure is vital to achieving our vision: **757=One. Economic Empowerment for All.**

Regional infrastructure is composed of the basic systems that undergird the structure of our economy. Obvious examples include transportation facilities, telecommunications networks, and sanitary sewer and water supply. Less obvious but equally important components include our transit system, ports, new fiber optic ring, HRSD: SWIFT project, transatlantic cables, and offshore wind facilities.

For the Action Framework, we are taking an even broader view of necessary infrastructure by including a sustainable regional branding effort and a business approach to addressing energy needs and sea level rise.

---

“Regions that rebound the most effectively from these unprecedented challenges will be those that leverage the power of the business community and the 757 Recovery and Resilience Action Framework does precisely that!”

Chris Stuart  
Vice President  
Top Guard Security
30 Program Areas

The five strategic pillars will be supported and advanced through 30 specific implementation programs.

Each of these programs has specific goals, action steps, and measures to track and report performance. Some of the program areas detail exciting new ways to advance the region while other program areas are critically important pre-existing efforts that are already hard at work. These pre-existing efforts are now integrated into the Framework.

In the full 757 Recovery and Resiliency Action Framework 100+ page PowerPoint document, all 30 programs have a separate micro plan that looks like this program example under Grow New Jobs Strategic Focus Area - Cultivating Promising New Industries: Off Shore Wind.

To arrive at these 30 program areas, the Integration Committee carefully reviewed the thought leader videos and white papers from all of the 10 Industry and Topic Area Committees. All specific candidate program recommendations were identified and inventoried. Through informal discussions, criteria for program selection was identified. This included:

- **Important:** The program area is underway and is critically important to the region’s economic development work (e.g., workforce development) or the program will be critically important in advancing the region’s recovery and resilience.

- **Immediate impact:** The program area can make an immediate difference.

- **Equitable, diverse and inclusive:** The program area can advance economic empowerment for all, on a macro (region-wide) or micro (organizational) level.

- **Concrete deliverable:** The program area can easily include key performance indicators. The Integration Committee used

“**What sets this Action Framework apart from predecessors is the grit of its stakeholders. We each know that “the way things have always been done” can no longer influence on our future and deliberately invited new faces to the table. You will see the difference in our actions, accountability, and impact but building a better tomorrow takes a region. The tide’s rising and we invite you to jump in the boat - we’re going places!”**

Lynelle Haugabrook
Marketing Manager
Northern Star Credit Union
an online digital rating and ranking system to prioritize and select the final 30 programs that are now included in the Action Framework.

- **Lead Convening Organization:** One organization has to be clearly identified as being accountable for leading the program area and tracking and reporting results.

  We have confidence that all 30 programs will be successful as the region’s leading business organizations are driving each one. They are fundamentally responsible for the content, resources and overall performance of each component.

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**Priorities**

The Action Framework is a three-year game plan that advances immediate, mid-term, and long-term actions and results. The Integration Committee assigned priorities to each of the 30 programs. Prioritization was based on the need to continue ongoing efforts like targeted business recruitment and workforce training to fill open jobs, as well as the ability to generate immediate impact with concrete deliverables.

The immediate action areas for 2021 include:

- **Build Regional Unity:**
  - Promote the Action Framework
  - Build a Network of 1,000+ Business and Nonprofit 757 Champions
  - Unify 757 Young Professional (aka NextGen) Organizations
  - Create and Run the “757 Did You Know” Pride-building Marketing Campaign
  - Build and Maintain the Action Framework’s Performance Dashboard

- **Grow New Jobs:**
  - Continue to support the 757’s core economic drivers: military, maritime and hospitality
  - Continue to work on ways to increase the Performance and Growth of Target Industries
  - Continue to cultivate promising new industries: offshore wind
  - Continue to support the leading high-growth companies
  - Continue to attract new companies to the 757 region

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“This plan provides a roadmap for a more resilient 757 and sets forth specific ways we can seize upon and accelerate our forward momentum.”

Joash Schulman  
Co-Founder  
Town Center Office Suites

“The Recovery and Resilience Action Framework has been built with inclusivity in mind. Easy to use tools and informational pieces will be available to all who wish to implement them. The framework will not only help our economy to rebound quicker from the current economic crisis, it will also enhance the areas of strength within our existing economy, laying the groundwork for an overall more resilient economy in the future. As business leaders, it is our responsibility to collaborate and get behind this effort. We have the opportunity to demonstrate to the entire nation why the 757 is THE best place to call home.”

Sarah Jane Kirkland  
President & CEO  
CIVIC Leadership Institute

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Sarah Jane Kirkland  
President & CEO  
CIVIC Leadership Institute
• **Grow, Retain, and Attract Talent:**
  – Continue to train and place qualified talent in unfilled jobs
  – Train and upskill the unemployed and underemployed
  – Retain new 757 graduates

• **Build Resiliency:**
  – Increase business resiliency: business model education & training
  – Increase business resiliency: diversity & inclusion education & training
  – Increase business resiliency: employee health and well-being education & training

• **Advance Regional Infrastructure:**
  – Create and share the conceptual national branding campaign on how we will advance our region’s story to the outside world
  – Line up needed resources for 2022 implementation of the national branding campaign

**Accountability**

The Action Framework will be held accountable for results. The ongoing performance of the Action Framework’s 30 program areas will be tracked and reported on a public-facing performance dashboard. Periodic, region-wide meetings will be held to report results.

Our regional business organizations (the Alliance, Chambers, CIVIC, ODU, Norfolk State, etc.) have been assigned to manage each strategic focus area and related programs.

This organizational design is a practical way to ensure all program content is created, the programs move forward, and results are delivered.

The active role of the regional business organizations should not be viewed as diminishing the critical role of and need for 757 Champions, the 1,000+ business leaders in the Action Framework’s implementation. The 757 Champions will ensure that the programming and content created by the institutional organizations will be used to strengthen the resiliency of companies and organizations across the region.

“What I like the most about the 757 Recovery and Resilience Action Framework appropriately gives goals and measurements for each step and each program priority. There is ownership for each initiative by specific organizations.”

Karen Joyner
Chief Executive Officer
Virginia Peninsula Foodbank

“Hundreds of 757 business leaders, representing the diversity of our region, came together in a remarkable fashion to build a brighter, more inclusive vision for our shared future. Now is the time for all of us get into the game, and get about the business of building a brilliant 757 for generations to come.”

Jim Kibler
CEO
Next Paradigm Advisors
Summary

In summary, the Action Framework is a fully integrated playbook that will help accelerate the region’s economic recovery from the COVID-19 pandemic — and do so in a way that provides greater economic opportunities for all residents and builds a more resilient economy that is better prepared to weather future shocks.

While economists caution that Hampton Roads should not expect a full recovery until at least 2022, we must do everything possible to accelerate this timeline, and in the process provide more economic opportunities for our residents and become better prepared to weather future shocks. The 757 Recovery & Resilience Action Framework is the business community’s game plan to make this happen!

For more information on the 757 Recovery & Resilience Action Framework, please Contact Doug Smith, President & CEO of the Hampton Roads Alliance. You can reach Doug at dougsmith@757alliance.com or 757-319-1015.

“The 757 Recovery and Resilience Action Framework is the key to the economic revitalization of Hampton Roads. This collaborative effort embodies the dynamic spirit and diverse culture of the region and will provide a foundation for continuous growth and excellence.”

Saige Hill
PhD Student and Researcher
Old Dominion University School of Public Service

“Prior to the pandemic, the 757 region was beginning to hit its stride with many great collaborative initiatives ongoing. This playbook is recognition of the fact that recovery and reignition of that momentum will require a collaborative, committed and comprehensive effort, designed and implemented by regional business leaders.”

Robert McKenna
President/CEO
Virginia Peninsula Chamber of Commerce
Glenn Carrington, Dean, Norfolk State Business School

Glenn Carrington Since 2017 Dean Carrington has been leading the way to prepare business students for the real business world and entrepreneurship--through school administration strategy and management, aggressive fundraising efforts, advocacy among business partners and with personal passion. Prior to Norfolk State, he spent more than three decades with leading professional accounting firms, serving Fortune 500 clients with a focus on corporate tax accounting and financial transactions. Early in his career, he served in the IRS Chief Counsel's office, beginning as an attorney-advisor in the Treasury Department's Honors Program. He is recognized for his hard work, teaming and fostering of mutual respect and appreciation among all of the professionals, business executives, faculty and students with whom he has worked.

Tom Sharbaugh, Professor of Practice and Director, Entrepreneur Assistance Clinic, Penn State Law in University Park

Professor Tom Sharbaugh brings more than 35 years of practice experience to the classroom. Before joining Penn State Law, Tom was the firm-wide managing partner of operations at the Morgan Lewis & Bockius LLP law firm, based in the firm’s Philadelphia office. In this position, which he held for 15 years, Tom was responsible for the day-to-day operations of the global law firm with more than 3,100 personnel. As a partner in the firm's Business & Finance Practice Group, he represented a wide variety of clients in transactional and corporate matters, including private equity funds in M&A and investment transactions. He has a particular interest in start-up and early stage businesses and their funding. He has written a number of articles and delivered many presentations on the legal issues confronting small businesses and the securities laws applicable to capital raising through unregistered offerings.
1982 to 1988 he was a partner of Saul Ewing LLP, where he represented middle market companies in general corporate matters. Tom also serves in several volunteer roles for a number of educational and non-profit institutions. At Penn State, he is the chair of the Annual Giving Advisory Council, the chair of the President’s Club, and a member of the Campaign Executive Committee for the current capital campaign, A Greater Penn State. Tom is also a member of the Board of Trustees of the Penn Medicine Health System in Philadelphia, the Chair of the Board of Managers of Pennsylvania Hospital in Philadelphia, and a member of the Board of Directors of the Mount Nittany Conservancy.

Charles Whiteman, Dean, Smeal College of Business, Penn State

Charles Whiteman The Dean of the Penn State Smeal College of Business oversees all aspects of one of the largest business schools in the nation. Smeal offers highly ranked programs to more than 5,000 students at all levels; supports the research activities of faculty members in six academic departments; is home to a network of leading research centers in business; and features an alumni network of more than 95,000 Smeal graduates around the world.

Whiteman, who has more than 32 years of experience in higher education and business, assumed the leadership position at Smeal in July 2012. Prior to joining Penn State, he was senior associate dean for the Tippie College of Business at the University of Iowa, where he was responsible for undergraduate and graduate degree programs; faculty and staff recruitment; promotion and tenure; budgetary operations; college facilities; technology operations; and strategic planning for the business school.

During a career that began as an instructor at Iowa in 1980, Whiteman advanced through the faculty ranks to become a chaired professor and served in a variety of administrative roles including chair of the Department of Economics, director of the Institute for Economic Research, and interim dean.

Whiteman holds a Ph.D. in economics from the University of Minnesota and a bachelor's degree in economics from the University of Kansas. He has conducted research that has been supported by a number of grants from the National Science Foundation, published dozens of academic papers, written two books, and served as associate editor of several economics journals. He has also advised the state of Iowa's Department of Management on economic issues and served as a visiting scholar at the Federal Reserve Banks of Kansas City, Atlanta, Cleveland, and Minneapolis.
Session 5: Perspectives of Venture Capitalists
6:25 - 6:55 p.m. EDT

Discussion Leader: Sabrina Conyers, Partner at Nelson Mullins Riley & Scarborough, Charlotte, North Carolina

Presenters: Ollen Douglass, Managing Director at Motley Fool Ventures; Ayana Parsons, Senior Partner, Board and CEO Inclusion at Korn Ferry and Co-Founder, Fearless Fund; and Sabastian V. Niles, Partner at Wachtell, Lipton, Rosen & Katz

Event Co-Chairs:

Samuel C. Thompson Jr.
Professor and Arthur Weiss Distinguished Faculty Scholar at Penn State Law

Sabrina Conyers
Partner at Nelson Mullins Riley & Scarborough

pennstatelaw.psu.edu/events/mbd-perspectives
MATERIALS FOR: SESSION 5: PERSPECTIVES OF VENTURE CAPITALISTS

DISCUSSION LEADER: SABRINA CONYERS, PARTNER AT NELSON MULLINS, CHARLOTTE, NORTH CAROLINA
PRESENTERS: OLLEN DOUGLASS, MANAGING DIRECTOR AT MOTLEY FOOL VENTURES; AYANA PARSONS, SENIOR PARTNER, BOARD AND CEO INCLUSION AT KORN FERRY AND CO-FOUNDER, FEARLESS FUND; AND SABASTIAN V. NILES, PARTNER AT WACHTELL, LIPTON, ROSEN & KATZ, NEW YORK CITY

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Private Equity, Venture Capital, and Hedge Funds

LAST UPDATED OCT 9, 2020  Lisa Lilliott Rydin | Email

• Getting Started
• Private Equity (PE)
• Venture Capital (VC)
• Hedge Funds (HF)
• Additional Resources
• Getting Help

GETTING STARTED

Introduction
Private equity, venture capital, and hedge funds are examples of alternative investments that have become increasingly popular since the mid-1990s. Compared to more traditional investments (e.g., stocks, bonds, cash, and mutual funds), alternative investments tend to be less liquid (i.e., more difficult to convert back to cash), more complicated, subject to fewer regulations, and often produce higher returns for investors.

Please see the individual sections of this Guide for more information.

PRIVATE EQUITY (PE)

Introduction
Private equity (PE) is ownership of (or an interest in) an entity that is not publicly traded. Often, it is high net worth individuals and/or firms that purchase shares of privately-held companies or acquire control of publicly-traded companies (and possibly take a public company private). The aim is to invest in companies that have growth potential and then use the private
equity investment to turnaround or expand the business. The company can then be sold for a profit.

Private equity firms (also known as private equity funds) offer investment opportunities to a limited number of accredited investors (limited partners) who are better able to understand and financially handle the risks of such investments. These limited partners often consist of university endowment funds, pension funds, wealthy people, and other companies. (Private equity firms typically serve as the general partner.)

Primary Law

In the U.S., private equity (PE) funds are typically formed as limited partnerships in the State of Delaware, pursuant to the Delaware Revised Uniform Limited Partnership Act (DRULPA) (though the laws of other states may be used instead). Private equity funds are typically based on individual (private) contractual arrangements and therefore are exempt from the disclosure and other requirements applicable to publicly traded companies or investments, such as:

• **US Investment Advisers Act of 1940 (Advisers Act)** — Regarding the registration of fund managers with the SEC.

• **Investment Company Act of 1940** — Regarding the management and operation of a “fund.”


• **Securities Act** — Regarding the issuance of securities to the public.

• **"Blue Sky Laws"** — A common term for state securities laws.

Unless exempt, PE funds may be subject to regulation by the following agencies:

• **Securities and Exchange Commission (SEC)**
The tradition of light regulation for PE funds changed in 2010 with the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5301 et seq.). More PE fund advisors are required to register with either the SEC or at the state level, resulting in increased recordkeeping obligations and the possibility of regulatory inspections.

Secondary Sources

U.S. Resources:

- **Private Equity Funds: Formation and Operation, by Phyllis Schwartz and Stephanie R. Breslow (available online)**

  The book provides guidance on every decision that has to be made in creating a new fund (including PIPEs, SPACs, mezzanine funds, and credit opportunity funds). It is designed to provide a comprehensive understanding of how private equity funds work and are regulated.

- **Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions, edited by Jack S. Levin, et al. (KF1428 .S77; available on Reserve)**

  Focuses on a series of typical transactions carried out with venture capital/private equity money (e.g., a new business start-up, a growth equity investment in an existing business, a leveraged buyout of a private or public company, a leveraged recapitalization, an equity-based executive compensation program, a restructuring or workout for an over-leveraged enterprise, devising an exit scenario for the successful venture financed company, and forming a private equity fund). With respect to each transaction, the tax, corporate law, partnership law, LLC law, securities regulation, bankruptcy, accounting, and other legal and practical issues typically encountered are explored, along with a myriad of potential solutions and practical structuring alternatives (e.g., the use of common and
preferred stock, convertible debentures, convertible preferred, warrants, and options).

- **Drafting Tax Provisions for Private M&A and Investment Funds, by Ivan Mitev**  
  (available via Wolters Kluwer's Cheetah database)

  Provides a comprehensive catalog of the standard terms and conditions in investment fund and private M&A documents. It interprets common tax language and provides examples of different drafting techniques. The publication also outlines precedents related to the private M&A and investment fund industry and identifies numerous negotiation points.

  (available via Westlaw)

  This reader-friendly guide offers practical guidance on a wide spectrum of issues that confront fund managers. It addresses manager compensation and exit strategies, including the sale or public offering by an investment adviser. Chapters cover structuring funds in a tax-efficient manner and in compliance with the U.S. federal securities laws.

- **Advanced Private Equity Term Sheets and Series A Documents, edited by Joseph W. Bartlett, Ross P. Barrett, and Michael Butler**  
  (available via Lexis Advance)

  Examines all of the deal terms you may encounter: anti-dilution protection, warrant coverage, liquidation preferences, and others. It provides clause-by-clause discussion of the Stock Purchase Agreement and model documents, opinion letters and a due diligence checklist contributed by a Big 4 accounting firm. There is current data from an industry-wide survey of West Coast and East Coast deal terms and trends, so you'll know whether a given provision is "market" or "industry standard".

- **Private Equity in the Age of Regulatory Scrutiny (Securities Practice Portfolio Series, No. 325)**  
  (available via Bloomberg Law)
This portfolio discusses the regulatory provisions that now apply to the private equity industry, including oversight and regulation of conflicts of interest, record-keeping requirements, rules governing offering materials, public disclosure obligations, and requirements to establish and maintain a strong compliance program headed by a chief compliance officer.

- **Introduction to Private Equity Fund Formation (Securities Practice Portfolio Series, No. 326) (available via Bloomberg Law)**

  This portfolio provides an overview of the legal and economic issues surrounding the formation of private equity funds.

- **Private Equity Funds (U.S. Income Portfolio Series, No. 735) (available via Bloomberg Law)**

  This portfolio offers an in-depth analysis of the U.S. federal income tax issues that arise in the representation of private equity funds (including venture capital) and their investors. Its purpose is to provide a source of guidance to tax practitioners who regularly practice in this area. By way of introduction, the Portfolio begins with a brief overview of the nature of these funds and how they differ from other types of investment partnerships. It then describes the general regulatory environment in which they operate.

**International Resources:**

- **Private Equity: Jurisdictional Comparisons, edited by Charles Martin & Simon Perry (K1116 .P75 2014)**

  Each jurisdictional chapter offers comprehensive details of the regulatory principles, legal structures and restrictions, and common business solutions for funds, debt finance, equity structures, exits and tax.

- **Getting the Deal Through (Lexology)**
The Getting the Deal Through (GTDT) module of Lexology lets you quickly compare laws across different countries and includes such Topics as "Private Equity (Fund Formation)" and "Private Equity (Transactions)."

- **Private Equity International (articles available electronically via Factiva)**

  Monthly magazine providing global news, features, comment, and analysis on PE and its practitioners. Hardcopies available in the East End of the Stamps Reading Room at HBS's Baker Library.

**Current Awareness**

Below are some resources for private equity news and developments:

- **American Investment Council**

  The American Investment Council (AIC) is an advocacy and resource organization established to develop and provide information about the private investment industry and its contributions to the long-term growth of the U.S. economy and retirement security of American workers. The website includes research reports, legislative & regulatory recommendations, and industry news.

- **Law360 - Private Equity**

  See the specific "Private Equity" newsletter. Law360 may also be accessed through a Lexis Advance account.

- **Harvard Law School Forum on Corporate Governance and Financial Regulation -- Private Equity**

- **Nixon Peabody's Private Equity Blog ("Hot Topics in the Middle Market")**

- **Olshan's Securities Law Blog**

  Provides commentary and news on the latest securities law developments impacting established and emerging growth publicly-traded issuers and
investment banks, as well as entrepreneurs and venture-backed private entities.

- **The Journal of Private Equity (available online)**
- **Private Equity International. The Annual Review**


**Databases and Other Resources**

- **Capital IQ (Harvard affiliation required)**

  Under the "Screening" tab, select "Transactions." Under "General Transaction Details," select "Primary Features." You can then add relevant Transaction Feature (listed under "Available Items"). You can also include other Transaction Details (or other listed Criteria) in your screening.

- **FactSet**

  To use FactSet you first need to create an individual account (follow the instructions on the Baker Library webpage, then go to my.factset.com to access the database). Use FactSet’s "Idea Screening" tab to find PE/VC transactions and investors.

- **Pitchbook**

  Information on companies, deals, funds, investors and service providers across the private investment lifecycle.

- **Preqin (Harvard affiliation required)**

  Information on private equity and venture capital companies, funds and deals. Subscription includes access to the following modules: Fund Manager Profiles, Funds In Market, Performance Analyst, Buyout Deals Analyst, Venture Deals Analyst, Investor Intelligence, Fund Terms Advisor, Hedge Funds, Infrastructure Online, and Real Estate Online.
VENTURE CAPITAL (VC)

Introduction
Venture capital (VC) is an important source of funding for new businesses (e.g., start-ups) that do not have access to other sources, such as business loans from banks or capital markets, but do have potential for long-term growth. Although these investments often involve high risk, they can also offer above-average returns. The VC investors often negotiate to obtain equity ownership, representation on the company’s board of directors, and/or an active role in managing the company’s operations.

Primary Law
Venture capital is a type of private equity investment (see "Private Equity," above) and historically, private equity investments have been lightly regulated. This changed in 2010 with the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5301 et seq.). The Dodd-Frank Act:

- Prohibited banks from using their own money (as opposed to customer deposits) to make certain investments, including private equity (known
as the Volker Rule). This restriction generally prevents banks from serving as venture capital investment firms.

- Required hedge fund managers and private equity fund managers to register their funds with the Securities and Exchange Commission (SEC), but not venture capital managers, provided at least 80% of their fund holdings are in "qualifying investments" (generally shares in private companies).

In 2012, the Jumpstart Our Business Startups Act (JOBS Act) (Pub. L. 112–06) relaxed many existing securities law requirements, including the advertising prohibition on venture capitalists and companies seeking private equity investments.

Secondary Sources

- **Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions, edited by Jack S. Levin, et al. (KF1428 .S77; available on Reserve)**

  Focuses on a series of typical transactions carried out with venture capital/private equity money (e.g., a new business start-up, a growth equity investment in an existing business, a leveraged buyout of a private or public company, a leveraged recapitalization, an equity-based executive compensation program, a restructuring or workout for an over-leveraged enterprise, devising an exit scenario for the successful venture financed company, and forming a private equity fund). With respect to each transaction, the tax, corporate law, partnership law, LLC law, securities regulation, bankruptcy, accounting, and other legal and practical issues typically encountered are explored, along with a myriad of potential solutions and practical structuring alternatives (e.g., the use of common and preferred stock, convertible debentures, convertible preferred, warrants, and options).

- **Venture Capital: Forms and Analysis (available via Lexis Advance)**
Provides a step-by-step framework for structuring, drafting and closing a venture capital deal, with a complete annotated set of the documents needed. It also features in-depth analysis from the perspective of both the company and the investor, as well as the latest guidance on best practices in venture transactions.

• **Advanced Private Equity Term Sheets and Series A Documents, edited by Joseph W. Bartlett, Ross P. Barrett, and Michael Butler (available via Lexis Advance)**

Examines all of the deal terms you may encounter: anti-dilution protection, warrant coverage, liquidation preferences, and others. It provides clause-by-clause discussion of the Stock Purchase Agreement and model documents, opinion letters and a due diligence checklist contributed by a Big 4 accounting firm. There is current data from an industry-wide survey of West Coast and East Coast deal terms and trends, so you'll know whether a given provision is "market" or "industry standard".

• **Venture Capital & Public Offering Negotiation, by Michael J. Halloran, et al. (KF1366 .V463)**

Includes detailed practical information on all the latest developments in the start-up financing and IPO process, including: limited liability company arrangements, technology-based partnering arrangements, IRS "check-the-box" regulations, the latest SEC policies and rule revisions, emerging ERISA issues, federal securities exemptions for venture financing, and more.

• **Venture Capital 2019: Nuts and Bolts (available via PLI PLUS)**

A Practising Law Institute (PLI) course handbook.

• **Advanced Venture Capital 2018 (available via PLI PLUS)**

A Practising Law Institute (PLI) course handbook.

• **Private Equity Funds (U.S. Income Portfolio Series, No. 735) (available via Bloomberg Law)**
This portfolio offers an in-depth analysis of the U.S. federal income tax issues that arise in the representation of private equity funds (including venture capital) and their investors. Its purpose is to provide a source of guidance to tax practitioners who regularly practice in this area. By way of introduction, the Portfolio begins with a brief overview of the nature of these funds and how they differ from other types of investment partnerships. It then describes the general regulatory environment in which they operate.

Current Awareness
Below are some resources for venture capital news and developments:

- **National Venture Capital Association**
  
  The National Venture Capital Association (NVCA) serves as the preeminent trade association for the venture community. The NVCA advocates for public policy that supports the American entrepreneurial ecosystem and serves as the leading resource for venture capital data, practical education, peer-led initiatives, and networking. Their website includes legislative/regulatory policy recommendations, industry reports, and even some free model legal documents.

- **The CLS Blue Sky Blog**
  
  Columbia Law School's blog on corporations and the capital markets.

- **Olshan's Securities Law Blog**
  
  Provides commentary and news on the latest securities law developments impacting established and emerging growth publicly-traded issuers and investment banks, as well as entrepreneurs and venture-backed private entities.

- **The Venture Alley (DLA Piper)**
The Venture Alley is a blog about business and legal issues important to entrepreneurs, startups, venture capitalists and angel investors.

- **Venture Capital Journal**

  Founded in 1961, Venture Capital Journal covers investment trends, financing techniques and news from across the Venture Capital industry.

**Databases and Other Resources**

- **Capital IQ (Harvard affiliation required)**

  Under the "Screening" tab, select "Transactions." Under "General Transaction Details," select "Primary Features." You can then add relevant Transaction Feature (listed under "Available Items"). You can also include other Transaction Details (or other listed Criteria) in your screening.

- **FactSet**

  To use FactSet you first need to create an individual account (follow the instructions on the Baker Library webpage, then go to my.factset.com to access the database). Use FactSet's "Idea Screening" tab to find PE/VC transactions and investors.

- **Pitchbook**

  Information on companies, deals, funds, investors and service providers across the private investment lifecycle.

- **Preqin (Harvard affiliation required)**

  Information on private equity and venture capital companies, funds and deals. Subscription includes access to the following modules: Fund Manager Profiles, Funds In Market, Performance Analyst, Buyout Deals Analyst, Venture Deals Analyst, Investor Intelligence, Fund Terms Advisor, Hedge Funds, Infrastructure Online, and Real Estate Online.
• **Thomson ONE (available only to authorized visitors at HBS's Baker Library)**

  Includes information on PE and VC companies and funds, portfolio companies and broad industry data. Emphasis is on the US but has some international coverage.

• **VentureXpert (available through SDC Platinum, only at HBS’s Baker Library)**

  Comprehensive information covering venture, buyouts, funds, private equity, firms, executives, portfolio companies and limited partners.

• **Zephyr**

  Database of global merger and acquisition (M&A) activity, initial public offerings (IPOs), joint ventures, and private equity deals.

**HEDGE FUNDS (HF)**

**Introduction**

Hedge funds (HF) are a type of investment partnership where a number of investors (i.e., the limited partners) pool their funds together to be invested by a professional fund manager (i.e., the general partner) according to the fund's investment strategy — which may be innovative or otherwise nontraditional when compared to more familiar investment options. While structurally similar to a mutual fund, HFs generally invest more aggressively and are limited to "qualified" investors (i.e., those who meet certain net worth requirements, making them better able to tolerate the increased investment risk). Compared to the heavily regulated mutual funds, HFs operate with a wide degree of investment latitude and are often leveraged to maximize their returns.

HFs differ from private equity (PE) firms in that HFs usually focus on short or medium term liquid securities that are more quickly convertible to cash. HFs also do not have direct control over the business or asset in which they are investing. By contrast, PE firms are geared toward longer-term investment
strategies in illiquid assets, where they have more control or influence over operations to influence the long-term returns.

Primary Law
U.S. hedge funds (HFs) have significant freedom in their investment activities because they are designed to be exempt from many of the registration and reporting requirements of the otherwise applicable securities laws, for example:

- **US Investment Advisers Act of 1940 (Advisers Act)** — Regarding the registration of fund managers with the SEC.
- **Investment Company Act of 1940** — Regarding the management and operation of a "fund."
- **Securities Act** — Regarding the issuance of securities to the public.
- **"Blue Sky Laws"** — A common term for state securities laws.

Unless exempt, HFs are subject to regulation by the following agencies:

- **Securities and Exchange Commission (SEC)**
- **Financial Industry Regulatory Authority (FINRA)**
- **US Commodity Futures Trading Commission (CFTC)**

The tradition of light regulation for HFs changed in 2010 with the **Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5301 et seq.)**. More HF advisors are required to register with either the SEC or at the state level, resulting in increased recordkeeping obligations and the possibility of regulatory inspections.

For a summary of U.S. hedge fund regulation, see **The History of Hedge Fund Regulation in the United States**, by Wulf A. Kaal and Dale A. Oesterle.
Secondary Sources

• **Hedge Fund Regulation, by Scott J. Lederman (KF1078 .L432)**

  Designed to provide comprehensive understanding of hedge funds, from their history and investment strategies to the legal and compliance considerations affecting their structuring, management and market activities. It provides a single source that examines all aspects of these innovative investment vehicles and addresses current regulatory concerns that impact hedge funds, their managers and investors.

• **Hedge Fund Regulation, by Scott J. Lederman (available via PLI PLUS)**

  The above volume is also available online to Harvard Affiliates via the PLI PLUS platform.

• **Hedge Funds and the Law, by Dick Frase and Peter Astleford (K1116 .A88 2016)**

  Provides a comprehensive guide to setting up and operating hedge funds, covering all the key legal, regulatory, and tax matters that need to be considered and covered when setting up a fund. The new 2nd edition is fully updated to cover the AIFMD and the Dodd Frank Act in the US.

• **Hedge Funds: Formation, Operation and Regulation, by Stephanie R. Breslow, David J. Efron, Marc E. Elowitz, Steven J. Fredman, David Nissenbaum, and Paul N. Roth (KF1078 .B74; available on Reserve)**

  Provides an expert look at the state of the industry, including legal and practical insights into taxation, regulation, documentation, and strategic issues. Addresses hedge fund investment strategies and structuring a hedge fund management company, domestic and off-shore hedge fund structures and tax considerations, terms, fees and related considerations, regulatory requirements and fiduciary obligations of investment advisors, and fund documentation. Includes marketing materials, offering memoranda and governing documents.
• **Hedge Funds and Other Private Funds: Regulation and Compliance, by Thomas P. Lemke, Gerald T. Lins, Kathryn L. Hoenig, Patricia S. Rube (available via Westlaw)**

Provides detailed analysis, practical guidance, and primary source materials relating to legal, regulatory, and compliance issues for the formation and operation of hedge, offshore, and other private funds. It is organized in chronological order to follow the life cycle of a mutual fund, and covers registration, choice of vehicle, choice of fund structure and type, tax, insurance, regulatory and administrative issues, trustee selection, and the SEC’s EDGAR database.


This reader-friendly guide offers practical guidance on a wide spectrum of issues that confront fund managers. It addresses manager compensation and exit strategies, including the sale or public offering by an investment adviser. Chapters cover structuring funds in a tax-efficient manner and in compliance with the U.S. federal securities laws.

• **Drafting Tax Provisions for Private M&A and Investment Funds, by Ivan Mitev (available via Wolters Kluwer's Cheetah database)**

Provides a comprehensive catalog of the standard terms and conditions in investment fund and private M&A documents. It interprets common tax language and provides examples of different drafting techniques. The publication also outlines precedents related to the private M&A and investment fund industry and identifies numerous negotiation points.


A concise yet comprehensive guide to the law of hedge funds. Practical and user-friendly, it covers all the relevant legal aspects involved, including choice of jurisdiction and vehicle, service providers, prime brokerage, fund
directors, the regulatory environment in the UK, the EU and the USA, marketing in various different jurisdictions, taxation, employment and the in-house perspective.

- **Hedge Funds (U.S. Income Portfolio Series, No. 736) (available via Bloomberg Law)**

  This portfolio addresses the full range of U.S. tax issues that typically arise in the representation of hedge funds. The purpose of this Portfolio is to provide a source of guidance to tax practitioners who regularly advise hedge funds, their portfolio managers and their investors. It also includes descriptions of basic fund prototypes, the relevant regulatory environment, alternative fund structures, and common economic terms and variations thereon.

**Current Awareness**

Below are some resources for hedge fund news and developments:

- **Managed Funds Association**

  The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. Website includes legislative/regulatory policy recommendations, industry news and information, and hedge fund educational materials (see the MFA Site Map).

- **Hedge Fund Law Report**

  A favored source of actionable intelligence on hedge fund law and regulation. Provides incisive analysis of key developments on topics including rule-making, compliance, case law, regulation, enforcement, taxation, derivatives, marketing, best practices and more.

- **The CLS Blue Sky Blog**

  Columbia Law School's blog on corporations and the capital markets.
• **Cole, Frieman & Mallon's Hedge Fund Law Blog**

A blog maintained by Cole-Frieman & Mallon LLP, a boutique investment management law firm.

• **Journal of Alternative Investments**

Articles written for hedge fund managers, portfolio managers, academics, and senior investment officials at corporations and financial institutions.

Databases and Other Resources

• **Morningstar Direct (available only to authorized visitors at HBS's Baker Library)**

Morningstar Direct includes data on closed-end funds, equity ownership, exchange traded funds, hedge funds, market indexes, money market funds, offshore funds, open-end mutual funds, pensions and life insurance, stocks, and 529 plans.

• **Preqin (Harvard affiliation required)**

Information on private equity and venture capital companies, funds and deals. Subscription includes access to the following modules: Fund Manager Profiles, Funds In Market, Performance Analyst, Buyout Deals Analyst, Venture Deals Analyst, Investor Intelligence, Fund Terms Advisor, Hedge Funds, Infrastructure Online, and Real Estate Online.

ADDITIONAL RESOURCES

Additional Resources to Consider
Some other related resources to consider:

• **Entrepreneurship and Innovation in Evolving Economies: The Role of Law, edited by Megan M. Carpenter (K487 .E3 E58; also available online to Harvard Affiliates)**

• **IPR Journal Platform (formerly known as "Institutional Investor Journals;" available online to Harvard Affiliates)** - Online access to a wide range of investment
management-related journals, including the Journal of Alternative Investments, the Journal of Derivatives, the Journal of Financial Data Science, the Journal of Fixed Income, the Journal of Index Investing, the Journal of Investing, the Journal of Portfolio Management, the Journal of Private Equity, the Journal of Retirement, the Journal of Structured Finance, the Journal of Trading, and the Journal of Wealth Management.

- **Research Handbook on Hedge Funds, Private Equity, and Alternative Investments**, edited by Phoebus Athanassiou (Available online to Harvard Affiliates) - Provides a comprehensive source of analysis and research on alternative investment funds in the EU, the US and other leading jurisdictions. Expert contributors offer an unparalleled perspective on the contemporary alternative funds industry, the main areas of regulatory policy concern surrounding its activities, and the role that alternative funds have played in recent financial crises, as well as an account of the rules governing their operation in selected jurisdictions.

Legal research platforms also contain information on PE, VC, and HF matters. See:

- **Bloomberg Law**: [Private Funds Reference Library](#) and the Private Funds section of the [Practical Guidance Library](#).

- **Westlaw**: Practical Law's Corporate and M&A Practice Center contains a [Private Equity Topic](#) (that includes VC and HF), containing Practice Notes, Standard Documents, Checklists, Articles, non-U.S. guidance, and more.

- **Lexis Advance**: The Lexis Practice Advisor module contains a [Private Equity & Investment Management Practice Area](#) (that includes VC and HF), containing Practice Notes, Forms, Checklists, Articles, Secondary Materials, and more.

- **PLI PLUS (available online to Harvard Affiliates)**: Electronic access to PLI Press publications, including treatises, journals, course handbooks, journals, "answer books," and forms. PLI Press is the publishing division of the
Practising Law Institute (PLI) and focuses on high-quality analysis and practice guidance.

Some resources from Harvard Business School's Baker Library:

- **Venture Capital & Private Equity Research Guide**
- **Hedge Funds Research Guide**
- **"Fast Answers"**:
  - Q: How can I find socially responsible private equity or venture capital funds?
  - Q: How can I screen for private equity or venture capital firms investing in a particular industry, stage of investment, and/or geography?
  - Q: How can I generate a list of private investments in public equity (PIPEs)?
  - Q: How do I screen for hedge funds based on performance, or find descriptions and rankings of hedge funds?
- **Bloomberg Terminal Tips for HBS's Investment Management course**
Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions

2020 Edition

Jack S. Levin
Kirkland & Ellis LLP

Donald E. Rocap
Kirkland & Ellis LLP

Special Editor
Martin D. Ginsburg
Georgetown University Law Center

Professor Ginsburg, the finest tax lawyer and human being of all time, passed away on 6/27/10.

This volume is current through October 23, 2020
Chapter 1. Introduction

Many precedents helpful for an understanding of the principles discussed in this treatise are reproduced in the Appendix, including tax, SEC, bankruptcy, fraudulent conveyance, and Delaware corporate, partnership and LLC statutes, as well as tax and SEC regulations and rulings, a few court decisions, several key articles, and other precedents.

Scattered throughout this treatise as “Appendix References” are citations to those precedents most relevant to the topic being discussed which can be found in the Appendix to this treatise (except that referenced portions of the 5-volume Ginsburg Levin and Rocap, Mergers, Acquisitions, and Buyouts treatise [updated and republished by Wolters Kluwer semi-annually] are not reproduced in the Appendix).

Unless otherwise specifically stated, this treatise assumes that all individuals are either U.S. citizens or residents, that all entities are formed in the U.S., and that all businesses and assets are located in the U.S. (i.e., this treatise generally does not deal with the complexities of cross-border transactions).

§102 GENERAL DESCRIPTION OF PRIVATE EQUITY AND VENTURE CAPITAL INVESTING

The PE/VC community, which has grown geometrically since the 1970s, includes (1) thousands of freestanding investment funds formed (generally as partnerships) solely or principally to make PE/VC investments, (2) the PE, VC, and merchant banking subsidiaries (or divisions) of large institutions (such as BHCS, insurance companies, investment banks, or even large industrial companies), (3) the many freestanding specialized investment entities formed solely or principally to make PE/VC investments (such as publicly held or privately held SBICs and publicly held BDCs), and (4) an individual or group of individuals who make multiple PE/VC investments, either as individuals or through an entity formed by them.

A PE/VC fund generally raises its capital from a limited number of sophisticated investors, in a private placement (including public and private employee benefit plans, university endowment funds, wealthy families, sovereign wealth funds, bank holding companies, and insurance companies) and splits the profits achieved by the fund between the PE/VC professionals and the capital providers/investors on a pre-negotiated basis (typically with 20% of the net profits allocated to the PE/VC professionals as a carried interest and the remaining 80% of the profits allocated among the PE/VC professionals and the capital providers in proportion to the capital supplied by each). PE/VC professionals generally plan and execute PE/VC transactions, including start-ups, growth-equity investments, leveraged and management buyouts, leveraged recapitalizations, industry consolidations, and troubled-company turn-arounds.

§103 DISTINGUISHING PRIVATE EQUITY/ VENTURE CAPITAL INVESTING FROM OTHER TYPES OF INVESTING

The first feature tending to distinguish PE/VC investing is the PE/VC professional’s active involvement in identifying the investment, negotiating and structuring
the transaction, and monitoring and guiding (but not managing on a day-to-day basis) the portfolio company after the investment has been made. Often the PE/VC professional serves as a board member and/or financial adviser to the portfolio company. Hence, PE/VC investing is significantly different from the purchase, holding, and sale of a diversified pool of stock and debt investments by a mutual fund or other money manager.

A second feature tending to distinguish PE/VC investing is that PE/VC investments generally are not intended to be held indefinitely. Rather, they are intended to be held for a limited number of years with the expectation that there will be substantial growth in equity value followed by a sale. For example, a PE/VC fund ordinarily has a limited term, often 10 to 13 years, and hence goes through cycles, with PE/VC investments being made during the first 5 years, value-added monitoring and growth continuing during the several years following each investment, often 1 or several add-on investments made by the original and/or other PE/VC investors, most investments sold within 3 to 7 years after the original investment in the portfolio company, and all investments sold (or occasionally distributed in kind to the investors) within 10 to 13 years after the fund’s formation.

Beginning in the late 2010s a number of PE/VC professionals have begun to form longer-term funds (designed to last perhaps 15 years or more rather than the standard 10 years), asserting 2 supposed advantages:

- A longer-hold period (perhaps 10 to 15 years) will allow greater appreciation as compared to the traditional 3- to 7-year hold period, which can result in a forced sale of a portfolio company when it is still maturing and continues to be an attractive investment.
- The substantial costs of forming a new fund (legal and accounting fees, GP travel expenses, money raiser fees and expenses), which are often borne in substantial part by (i.e., allocated to) the LP investors are reduced when funds are formed less frequently.

The PE/VC investor normally does not intend to maintain long-term control over the portfolio company or to build a career running the portfolio company. Rather, the PE/VC investor generally evaluates alternative exit strategies when making the initial investment in the portfolio company. Often the original investment documents contain the terms, or at least the outline, of the PE/VC investor’s anticipated exit strategy. Hence, PE/VC investing is significantly different from acquiring a company with the intent of managing it for the indefinite future and profiting indefinitely from the operating cash flow produced by the business.

A third feature tending to distinguish PE/VC investing is that the securities purchased are generally privately held by a small group as opposed to publicly traded.

- When a PE/VC investor organizes a new business start-up, the newly formed company (“Newco”) is almost always privately held at the outset.
- Where a PE/VC investor makes a growth-equity investment in an existing company (“Oldco”), Oldco is usually privately held.

In those few circumstances where PE/VC makes a growth-equity investment in a publicly held Oldco, PE/VC generally buys a class of Oldco securities that is not publicly traded. For example, where Oldco’s common
Chapter 1. Introduction

stock is publicly traded, PE/VC may buy Oldco (1) convertible preferred stock or convertible subordinated debentures (convertible into Oldco common stock) or (2) non-convertible preferred stock or non-convertible subordinated debentures together with warrants to purchase Oldco common stock.

And even when PE/VC infrequently buys a class of publicly traded Oldco common stock, PE/VC typically acquires such stock from Oldco in a private placement subject to SEC restrictions and with additional negotiated rights (e.g., registration rights, preemptive rights, warrants to buy additional Oldco stock at a fixed price, or more board seats, etc.) which make PE/VC’s stock different from Oldco’s publicly traded common stock.

* Even where the target company in a buyout is publicly held (before the buyout), the new company formed to effectuate the buyout (“Newco”) is almost always privately held immediately after the buyout, i.e., the buyout transaction takes the target company private.

In sum, a PE/VC investment is normally made in a privately held company, and in the relatively infrequent cases in which the investment is into a publicly held company, the PE/VC investors generally hold non-public securities.

While PE/VC’s exit strategy often involves taking the portfolio company public and ultimately selling PE/VC’s stock into the public market, public trading of the portfolio company’s stock is generally part of the end game, not the opening gambit. Thus, PE/VC investing is considerably different from buying, holding, and selling publicly traded equity securities.

A fourth feature tending to distinguish PE/VC investing is that PE/VC generally undertakes risky investments in order to obtain a very high return on its capital. PE/VC does not purchase debt instruments simply to obtain an interest yield. Rather, the principal goal of a PE/VC transaction is to obtain geometric returns when the portfolio company is successful and its common stock or common equivalents soar in value. Hence, a PE/VC transaction generally involves the purchase of 1 or more of the following:

* Common stock.
* Convertible preferred stock or convertible subordinated debt with a relatively low yield (all or a portion of which may be deferred) but with attractive features allowing conversion into common stock.
* Non-convertible preferred stock or non-convertible subordinated debt with a relatively low yield but accompanied by warrants to purchase common stock.
* Debt instruments that can be purchased at a deep discount to face, generally because the portfolio company is over-leveraged or financially troubled and PE/VC plans to participate in a turn-around transaction.

PE/VC generally purchases a relatively risky slice of the portfolio company’s capital structure (and is frequently structurally or contractually subordinated to a substantial amount of the portfolio company’s leverage, i.e., debt), risks losing most or all of its investment if the portfolio company does not prosper, and expects to be handsomely rewarded if the portfolio company does prosper. PE/VC requires a high return on successful investments to cover losses suffered on port-
folio companies which fail—i.e., provide a high compound internal rate of return ("IRR") on its aggregate invested capital as compensation for the high risk of such investments.

This feature—purchasing risky equity-oriented securities and seeking a high compound yield on successful transactions—distinguishes PE/VC transactions from the purchase of debt securities.

One type of transaction which falls just short of the PE/VC transactions featured in this treatise is mezz lending, i.e., a layer of financing which is more risky than senior bank debt but less risky than a typical PE/VC investment, thus placing the mezz investment between PE/VC's common and preferred stock investment and the bank's senior debt investment (as the mezzanine in a theater sits between the ground floor and the balcony). Such a mezz lender (like a PE/VC investor) generally employs active investment professionals who negotiate the purchase of privately placed securities in PE/VC transactions, such as buyouts, but the mezz securities are normally purchased directly from the portfolio company and are predominantly debt securities, generally high-yield subordinated debt (or possibly senior preferred stock), with a relatively small equity kicker, i.e., a slice of common stock, warrants, conversion rights, or contingent additional interest to compensate the mezz lender for the risk of buying subordinated debt.

The senior bank lender generally locks its entire yield in the form of contractual interest payments (albeit often at rates which fluctuate with market interest indexes) and specified fees, although infrequently the senior lender may take a small equity kicker when financing a buyout. The mezz lender, by contrast, normally takes a portion of its yield in the form of an equity kicker, and thus shares an expectancy (with PE/VC) in the portfolio company's future equity appreciation. However, mezz debt is at least 1 level more senior in the capital structure than PE/VC's investment (in junior subordinated debt, preferred stock, or most likely common stock) and hence is significantly less risky than PE/VC's investment. Moreover, the mezz lender's focus, more like the senior lender's and less like PE/VC's, is on its high interest yield and relative safety of debt principal. The mezz lender's equity kicker is designed to augment its interest yield but does not play the central role that it does with PE/VC.

The PE/VC investor, on the other hand, focuses on common stock or common equivalent securities, with any purchase of subordinated debentures and/or preferred stock generally designed merely to fill a hole in the financing or to provide PE/VC with some priority over management in liquidation or return of capital.

A fifth feature tending to distinguish PE/VC investing is that PE/VC generally invests in a portfolio company only when convinced that the portfolio company has (or that PE/VC has recruited) a superior management team to operate the portfolio company. PE/VC generally cannot be induced to put its money behind a management team in which it does not have confidence, no matter how attractive the portfolio company's product, concept, or business plan. A frequently heard PE/VC maxim is that an attractive portfolio company has 3 key attributes: superior management, superior management, and superior management.

Where PE/VC disregards this maxim and backs weak management, PE/VC too often is soon faced with an unpalatable choice: either continue with suboptimal management and risk the portfolio company's falling behind its busi-
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ness plan or fire management and seek superior replacements, risking significant business disruption during which well-managed competitors often can overcome the portfolio company’s early lead. A second, but less obvious, reason to avoid weak management is that, when management must be replaced mid-stream, PE/VC must devote an inordinate amount of time recruiting and training new management, diverting PE/VC from its other portfolio companies.

A sixth (although not inevitable) feature tending to distinguish PE/VC investing is that PE/VC often seeks control of the portfolio company in the early years or, if control is not obtainable, at least board representation. This is because PE/VC does not view itself as supplying capital alone, but also as providing important advice on financial and strategic planning and oversight for the portfolio company’s management in order to add value to PE/VC’s investment.

A seventh feature of PE/VC investing is that the same group of PE/VC professionals often form multiple funds (i.e., a family of funds) to make investments in different types of portfolio company businesses, different geographical areas, different-sized businesses, etc., e.g., one fund to specialize in high-tech start-up businesses in the U.S., another fund to invest in large retail businesses in Europe, another to invest in Asian middle market real estate, etc.

Where a portfolio company needs more money than the lead PE/VC is willing to commit, the lead PE/VC may bring 1 or more additional PE/VCs into the deal. The lead PE/VC normally plays the principal role in structuring and negotiating the investment, but each PE/VC (at least each PE/VC with a substantial investment) monitors its own investment, and PE/VCs do not inevitably act in concert (except insofar as their interests coincide) on issues involving the portfolio company.

In recent years, hedge funds have begun to invade the PE/VC turf. Hedge funds (like PE/VC funds) are generally private partnerships, composed of wealthy, sophisticated investors, seeking very high returns on capital by using aggressive investment strategies. However, a hedge fund (unlike a PE/VC fund) traditionally:

1. Invests principally in publicly traded assets (e.g., stocks, bonds, currency futures, interest rate futures), in which the fund may take both long and short positions, and generally uses substantial leverage (i.e., debt) at the fund level,

2. Plans to continue forever, i.e., does not sell investments and return investors’ capital (and profits) by a specified deadline, while a PE/VC fund by contrast generally completes its new investments within 3-to-5 years after formation, thereafter may make some add-on investments into existing portfolio companies (for expansion or occasionally to restructure an over-leveraged balance sheet), completes its sale cycle within 10 years after formation, and then dissolves, so that the PE/VC principals generally form a new PE/VC fund every 3-to-5 years, and

3. Allows investors to withdraw capital and/or profits quarterly after an initial (approximately 1-to-2 year) lockup period (or to contribute new capital quarterly).

However, as competition for traditional hedge fund high-yield investments has intensified, resulting in a decline in hedge fund yields, many hedge funds, seeking higher yields, have devoted a portion of their capital to PE/VC-type non-traded
investments, while concomitantly imposing a restriction on the investors' right to withdraw quarterly the portion of their capital devoted to such long-term PE/VC investments (so-called side-pocket investments).

**104 HIGH COST OF PRIVATE EQUITY/VENTURE CAPITAL MONEY**

PE/VC money may not on its face cost the portfolio company as much as a bank loan, a private placement of senior debt securities, or a public issuance of senior debt securities. That is, there frequently are few or no fixed interest or debt service payments on PE/VC money. However, if the portfolio company is successful, PE/VC money is inevitably more expensive to the portfolio company's other common shareholders. This is because PE/VC, as a condition to investing in the portfolio company, demands a substantial portion of the portfolio company's common equivalents—common stock, warrants, and/or conversion privileges—which will have substantial value if the portfolio company is successful.

Hence, as a general rule, where a portfolio company can obtain traditional debt financing, it finds this route less expensive to its existing common shareholders than PE/VC financing. However, the very factors which make a portfolio company attractive to PE/VC—a speculative situation with substantial opportunity for value enhancement if (but only if) the business succeeds—often make the portfolio company too risky to qualify for unsupported bank or other traditional debt financing. Once the portfolio company obtains PE/VC financing, it usually can leverage its new-found PE/VC equity by obtaining bank (or subordinated/mezz) loans senior to the new PE/VC money.

Moreover, obtaining a PE/VC investor generally brings the portfolio company more than capital. As discussed above, one or more top-flight PE/VC professionals generally serve on portfolio company's board, providing the portfolio company with high-quality financial and strategic advice and management oversight. Thus, a PE/VC relationship gives the portfolio company substantial benefit not normally obtainable through a traditional bank financing or a private or public debt flotation (although strong-willed portfolio company management not desiring any such PE/VC oversight may not appreciate the benefit). Such PE/VC advice can, of course, be a double-edged sword: where PE/VC obtains control but the portfolio company then fails to meet its business plan, portfolio company's management may find themselves seeking alternative employment.

**105 TYPICAL PRIVATE EQUITY/VENTURE CAPITAL TRANSACTIONS**

105.1 *Traditional Start-Up Transaction*

The phrase "venture capital" is sometimes used narrowly to refer only to financing the start-up (or early stage growth) of a new business, a transaction which generally involves negotiation between 1 or more professional VCs and 1
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or more entrepreneurs seeking to start the business. Such a Newco start-up trans-
action is discussed in Chapter 2, and the pros and cons of organizing Newco as an S
company, a partnership, or an LLC, rather than as a traditional C corporation, are
discussed in Chapter 3.

Such start-up transactions can be categorized into (1) seed money and (2) early
stage. Seed money refers to financing a potential business requiring substantial
research, development, and/or other threshold activities before the entrepreneur
can begin revenue-generating activities. Early stage venture capital, on the other
hand, refers to financing an entrepreneur who has passed the seed-money stage
and is ready actually to begin (or has recently begun and now seeks to expand)
revenue-generating activities.

Start-up transactions can further be broken down into high-tech, low-tech, and
no-tech, depending on the degree of cutting edge technology necessary for
the business to succeed. Businesses financed by VC investors can range from a
high-tech bio-genetic engineering company to a low-tech manufacturing enter-
prise to a no-tech retail or fast food chain.

Naturally, a VC investor is more likely to supply start-up money where the
entrepreneur is a successful inventor and/or executive with a proven track record.

§105.2 Growth-Equity Transaction

Frequently, an existing business enterprise needs money for expansion—to
build a new plant, to develop a new product, to begin national distribution of a
local or regional product, to acquire an add-on business, etc. The enterprise’s
capital requirements may exceed the amount it is able to raise from traditional
sources, such as a secured loan from a bank lender, a private placement of debt
with an insurance company, a private offering of equity to Oldco’s shareholders
and their friends and family, or a public offering of debt or equity securities (or,
with respect to the last alternative, it may be premature for Oldco to go public).

In these circumstances, a business seeking money for expansion might turn to
a PE investor to supply its capital needs, or perhaps to supply enough equity
capital to serve as a base for borrowing the remainder of its capital needs from
traditional lenders. Such a PE investment in an existing company (“Oldco”) is
called a growth-equity investment.

Such a business may have been financed during its start-up phase with venture
capital, may then have grown by obtaining growth-equity capital, and may there-
after raise one or more rounds of mature private equity financing while contemplating
a future IPO (frequently called a “crossover” or “pre-IPO” round of financing).

While a PE growth-equity investment is generally into a privately held Oldco,
PE may under certain circumstances invest in a publicly traded Oldco. In this
case, PE is likely to buy securities of a type not publicly traded (e.g., preferred
stock convertible into publicly traded common stock). Less commonly, PE may
buy securities (directly from Oldco) of the publicly traded class (typically common
stock), but at a substantial discount from the public-market price and/or with
other valuable rights (e.g., preemptive rights, options or warrants to buy additional
stock at a fixed price, 1 or more board seats, etc.). Although Oldco is publicly
traded, such stock acquired in a private transaction (rather than in the public
market) is subject to SEC restrictions on resale, so that PE normally obtains registration rights from Oldco as a condition of making the investment.

Where the investment in Oldco is relatively large, PE may organize a consortium or syndicate of PE investors, who will usually co-invest in the same strip of securities. While a growth-equity investment is generally designed to provide Oldco with expansion capital, there are cases where Oldco is seeking the new investment in order to redeem (for cash) Oldco stock from existing large shareholders. One or more Oldco shareholders may be seeking such a stock redemption to pay estate tax (where a large shareholder has died) or for liquidity (where the shareholder has recently retired or is engaged in estate planning). Such a growth-equity investment to finance a redemption is called a recapitalization and, when financed primarily with borrowed money, a leveraged recapitalization.

Because Oldco in a growth-equity investment is generally more mature than Newco in a start-up, a growth-equity transaction is often called a later-stage investment (as compared to a seed-money or early stage growth investment in a start-up or young company). Where the investment is into a more mature Oldco seeking growth-equity money, PE's investment risks and potential gains are generally lower than in a start-up.

A traditional growth-equity investment into Oldco is examined in Chapter 4.

In many proposed growth-equity investments, PE concludes that the key management executives do not own sufficient Oldco stock to incent their future performance, i.e., that too large a percentage of Oldco's stock is in the hands of passive shareholders and too small a percentage is in the hands of key managers. In this case, a front-end restructuring of Oldco's equity ownership is often an essential step to induce PE to invest in Oldco. Chapter 4 discusses several methods for achieving this equity restructuring objective.

§105.3 Troubled-Company Turn-Around Investment

Occasionally, PE may make a growth-equity investment in a company ("Badco") which is suffering losses, is over-leveraged, and/or is experiencing other financial or business reverses. PE may also purchase Badco distressed debt trading at a deep discount with the goal of obtaining equity in, and even control of, Badco through a bankruptcy or other restructuring of Badco.

PE may make such a "turn-around" investment into an unrelated Badco in which PE has not previously invested. Or PE may have been Badco's original sponsor, i.e., today's Badco may, a few years ago, have been the Newco which, with much optimism and with PE's money, acquired Target in a highly leveraged (but so far unsuccessful) buyout.

Whether or not PE made a prior investment in Badco, PE's new turn-around investment generally presents the same issues, except that, where PE was Badco's original sponsor, there is greater pressure on PE to make the new turn-around investment, to protect both its original Badco investment and its business reputation. Such turn-around financing into a troubled Badco is almost always riskier than traditional growth-equity financing of a sound, well-managed company.

A turn-around investment in an over-leveraged, financially troubled Badco is analyzed in Chapter 8.
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§105.4 Leveraged or Management Buyout

When an established business ("Target") is for sale, there are at least 3 classes of potential buyers:

- A strategic buyer is a company which already owns a business similar or complementary to Target's and believes that combining the buyer's existing business with Target's business will produce a synergistic increase in value.
- A long-term investor is a person or group desiring to enter Target's industry (e.g., a company engaged in other businesses seeking diversification or the former managers of another company in Target's industry seeking a new situs for their talents) which has (or can borrow) the capital necessary to buy Target.
- A financial buyer is a PE investor (or group of such investors) able to raise the funds necessary to buy Target, generally with the goal of holding Target for 3 to 7 years, improving Target's business performance, expanding Target's geographical reach and facilities, perhaps making add-on acquisitions, and then reselling Target at a substantial profit.

Where a PE investor (or group) is planning a leveraged buyout (an "LBO"), PE generally forms a new company ("Newco") to buy Target, arranges for Newco or Target to borrow a majority of the necessary funds (hence the use of the term "leveraged" buyout), and contributes a minority of the necessary money as equity capital. In an LBO variation PE does not form Newco but instead invests directly in Target, which borrows additional funds and redeems all or most of its old shareholders with the new equity and debt money, perhaps in a manner designed to avoid push-down purchase accounting (i.e., to avoid restating upward the accounting book value of Target's assets on Target's financial statements and hence to minimize post-buyout depreciation/amortization reductions in Target's accounting earnings).

In any LBO, Newco generally arranges its LBO borrowings in several tranches—from senior lenders, senior subordinated lenders, and junior subordinated lenders. In order to obtain each successively more junior layer of debt financing, Newco must offer a progressively higher interest rate and/or a progressively larger equity kicker (Newco's common stock, warrants, a conversion privilege, or contingent additional interest based on Newco's results) to each more subordinated layer.

However, the essence of an LBO is that only Newco and/or Target is liable to the lender for the borrowed money. That is, PE typically does not guarantee any of Newco's debt (other than possibly a guarantee with recourse only to Newco's stock owned by the PE guarantor, which does not expose PE's assets other than Newco's investment).

Typically, as part of the LBO arrangements, PE obtains top management talent (either newly recruited executives or Target's most talented existing executives) to run Newco-Target after the LBO and incents them with cheap common stock or with common equivalents, such as stock options, often subject to complex time and/or performance vesting.

Sometimes, Target's management (rather than PE) originates the deal, and Target's management executives then seek to recruit a PE (or PE group) to provide equity financing for the acquisition. This most often happens where Target's old
owners have offered to sell Target to Target's existing management team if they can raise the necessary financing. In such case, the transaction is generally called a management buyout (an "MBO").

Throughout this treatise the term "buyout" is used to include both a traditional PE-led LBO and a management-led MBO.

Buyouts come in at least 3 varieties, with the applicable tax, SEC, accounting, and other legal and practical implications of each varying significantly from the other 2 variations:

- The simplest version of a buyout is the purchase of a Target division or wholly owned subsidiary from a much larger corporation ("Bigco"), often where Bigco had previously acquired Target in an effort to diversify Bigco's business operations (i.e., when Bigco was seeking to become a conglomerase) but Bigco has since concluded that Target no longer fits Bigco's long-term—often back to core business—strategy. This type of LBO is often called a spin-out or carve-out (from Bigco) of the Target business.
- A somewhat more complicated buyout variation is presented where Target is privately held by a family or relatively small group of persons, i.e., Target is not a Bigco division or consolidated subsidiary.
- The most complicated buyout variation is presented where Target is itself a publicly traded corporation, often with stock trading at a disappointing price, so that Target's board of directors decides to maximize shareholder value by selling Target, in which case Newco's purchase of public Target is called a going-private transaction.

These 3 buyout variations are discussed in Chapter 5. Chapter 6 discusses the terms and tax ramifications of debt and equity securities frequently used in buyouts, as well as in the other PE transactions described above and below.

§105.5 Industry Consolidation

Often PE identifies a fragmented industry, i.e., an industry in which there are many small or relatively small competitors and no or few market leaders have appeared. PE then recruits a top-flight management team with experience in the industry and, together with the management team, forms Newco as a "platform" to assemble a significant, or perhaps even leadership, presence in the fragmented industry by (1) acquiring selected strategically located industry players in a series of buyouts or roll-ups, (2) starting up new businesses in those markets where there is no desirable target business or the existing businesses in such market are overpriced, and (3) amalgamating the buyouts and start-ups into a regionally or nationally important player in the otherwise fragmented industry.

Often the term "platform" is used where the consolidation begins with a reasonably large buyout of an established business, followed by numerous add-on acquisitions, and the term "roll-up" is used where there is no large initial acquisition but only a series of reasonably small acquisitions.
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Chapter 7 discusses industry consolidations, including the advisability of using a holding corporation, holding partnership, or holding LLC as an umbrella entity over the various business enterprises being assembled.

105.6 Exit Strategies

When PE/VC invests in a transaction of the types identified above, its goal is to liquidate the investment at a substantial profit when portfolio company’s value has been maximized through astute management supplemented by PE/VC’s supervision and advice, add-on acquisitions, and the like (i.e., when portfolio company has matured to the point where its value is no longer growing geometrically), generally 3 to 7 years after PE/VC’s initial investment in portfolio company.

When structuring its original investment—in a start-up, growth-equity, buyout, industry consolidation, or troubled company—PE/VC is already planning its ultimate exit strategies. Indeed, contracts signed at the time of the initial investment generally give PE/VC certain future rights to control its exit strategy. This is especially important where PE/VC will not (or may not) control portfolio company at the back end when the exit strategy is executed, perhaps because portfolio company’s business expansion was so explosive that capital constrained PE/VC was unable to participate in its subsequent rounds of financing.

Even where PE/VC will control portfolio company at the time of the end game, the actual exit strategy employed (e.g., a sale of portfolio company’s stock) may require cooperation from some shareholders who will not (or may not) be in agreement with the timing, price, or other terms as proposed by PE/VC. For these reasons, it is important that PE/VC obtain, at the front end when making its investment, contractual rights to control the back-end exit strategy.

PE/VC’s exit scenarios may include:

1. sales of portfolio company stock to the public in an IPO or a post-IPO SEC-registered offering or pursuant to SEC Rule 144 or
2. sale of portfolio company to a large company (“Bigco”) in exchange for Bigco stock (in a tax-free reorganization) or partly for Bigco stock and partly for cash, or solely for cash, or partly for cash and partly for Bigco debt instruments on the installment method or
3. sale of PE/VC’s securities back to portfolio company, possibly at a fixed time and price (e.g., a scheduled redemption of PE/VC’s preferred stock) or possibly at PE/VC’s option and possibly for a FV determined by appraisal or by formula (e.g., a common stock variable-price put).

Chapter 9 discusses exit strategies.

105.7 Formation of Private Equity, Venture Capital, or Leveraged Buyout Fund

Where PE/VC professionals are employed by a large institution, such as a bank holding company or an insurance company, they generally invest the institution’s money and hence do not form a fund. Frequently, however, a group of individuals...
experienced in PE/VC investing (often former executives of a large institution’s PE/VC operation) form a PE, VC, or buyout fund (a “PE/VC fund”).

In this case the PE/VC professionals often raise capital from a limited number of sophisticated investors, including public and private employee benefit plans, university endowment funds, wealthy individuals and families (and family investment companies), insurance companies, bank holding companies, sovereign wealth funds, and other non-U.S. investors. Such a PE/VC fund is generally formed as a partnership or LLC (to avoid entity level taxation) and generally splits the fund’s profits between the PE/VC professionals and the capital providers/investors on a pre-negotiated basis, typically with 20% of the net profits going to the PE/VC professionals as a carried interest and the remaining 80% to the PE/VC professionals and the capital providers in proportion to the capital supplied, perhaps with the capital providers first entitled to a fixed compound IRR (e.g., 8%) on their net invested capital (calculated from time to time) as a hurdle that must be met before the PE/VC professionals are entitled to their carried interest participation (typically with a carried interest catch-up once the hurdle has been achieved).

A PE/VC fund may in limited circumstances seek to qualify as an SBIC.

Occasionally a PE/VC fund offers equity interests to the public (rather than only to a limited number of sophisticated investors), in which case the fund generally qualifies as a publicly held BDC.

The PE/VC fund generally makes new investments into portfolio companies for a limited period of time, e.g., 5 years after formation, engages in value-adding monitoring during the several years following each investment, sells each investment as soon as it matures, distributes the proceeds to the fund’s partners as sales occur, and completes the sale of virtually all its investments (or occasionally distributes in kind to the investors) within 10 to 13 years after the fund’s formation. Hence, approximately 4 to 5 years after a PE/VC fund’s formation, the PE/VC professionals, if they have developed (or are able to convince investors that they are developing) a successful track record, generally seek to form a second fund, so that they have money for future investments, with such new future funds to follow every 4 to 5 years or so, as long as their investment record is sufficiently attractive.

Chapter 10 discusses the formation of a PE/VC fund.

¶106 HISTORY OF PRIVATE EQUITY/VENTURE CAPITAL INVESTING

¶106.1 Ancient History

While professional PE/VC investing as described above is a fairly recent phenomenon (dating from approximately the 1970s), “private risk capital” investing has existed in 1 form or another in every society that had significant commercial activity. A few examples:

- Marcus Licinius Crassus, reputedly the richest man in Julius Caesar’s Rome, financed many enterprises, including a private fire department. Though
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most of Rome's buildings were made of wood in the first century B.C., republican Rome lacked a public fire department. Crassus capitalized on this deficiency. When a building caught fire, his business agents and firefighters would repair swiftly to the scene of the conflagration. If they believed the building (or the adjoining structures) worth saving, the agents would offer to buy it (or them) for cash (at an appropriate discount). If the owner refused, the firefighters would leave without taking remedial action. If the owner agreed to sell, Crassus' agents would close the purchase and his firefighters would then attempt to save the building. While not every such Crassus investment was a success, Crassus apparently did very well on a fully distributed portfolio basis.

- In 1492, Christopher Columbus obtained from Ferdinand and Isabella of Spain the PE/VC capital necessary to finance his exploration of the New World.

- In 16th and 17th century England, aristocrats and other wealthy families financed risky commercial and industrial enterprises—mostly foreign trade, exploration, and privateering, constituting the high-tech of that era—and were known as "adventurers." For example, the Merchant Adventurers, licensed by Henry VII, played an important part in opening trade with "Muscovy" and served as a model for companies formed later to exploit the New World.

106.2 Industrial Revolution and Merchant Bankers

With the 19th century industrial revolution, banks became the main source of business financing. Business enterprise had become so common that it was no longer viewed as inherently high-risk.

Hence, early versions of PE/VC began to focus on financing a business that lacked access to bank financing, frequently by providing equity capital as the underpinning for a bank loan. As in earlier times, such equity financing was largely provided by amateur venture capitalists—wealthy families, the entrepreneur's friends, local business acquaintances, etc.

However, as the scale of business endeavors, and hence their capital needs, escalated (building transcontinental railways, shipping wheat from the Ukraine or the American West to growing European cities, etc.), PE/VC became more institutionalized. In England, merchant banks emerged as the principal providers of high-risk capital to business enterprises around the world, investing both capital obtained from their partners and capital obtained from other rich individuals and families. While the English aristocracy and other wealthy English families had long invested in risky business enterprises, the merchant banks were more professional and could raise more capital than the amateur investors.

English merchant banks helped to finance the U.S. industrial revolution and provided a model for U.S. merchant banks (such as J.P. Morgan) financing new industries, like steel and oil. However, merchant banks tended to focus more on new enterprises requiring substantial capital from the start than on small businesses. Hence, small businesses continued to rely on family, friends, and wealthy amateurs willing to take a flyer on a new enterprise.
§106.3 U.S. in the 1940s and Thereafter

PE/VC investing in the U.S. today largely reflects the marriage of the two traditions discussed above: "professional" merchant banking and "amateur" venture investing by wealthy individuals and families.

Beginning in the 1940s, several very wealthy American families began the move from amateur to professional PE/VC status by developing the continuity of focus and the staffing which enabled them regularly to find, evaluate, consummate, and monitor risk-oriented investments.

Passage of the Small Business Investment Act in 1958 was a critical event, because it gave public recognition—and government financial backing—to professional PE/VC investing as an independent, profitable activity. The Act also permitted banks (and BHCs) to invest in SBICs. The entry of banks into PE/VC investing in the late 1950s, and the growth of these endeavors through the 1960s and 1970s, were key steps in the formation of a professional, institutionalized, PE/VC industry in the U.S. Many of the professionals who helped to found the modern PE/VC industry in the 1970s through 1990s obtained their training at bank SBICs.

Beginning in the late 1970s, private and public employee benefit plans and university endowment funds began investing a small (but steadily increasing) portion of their enormous available funds in PE/VC funds. As this huge pool of previously risk-averse capital began to seek skilled PE/VC professionals to handle a slice of their investment capital, the formation of PE/VC funds—often staffed by experienced former executives from the PE/VC subsidiaries of banks and insurance companies—received a tremendous boost.

Today's PE/VC industry is an extraordinary mixture of institutional PE/VC subsidiaries (investing money supplied by a parent bank or insurance company), private funds (investing money supplied by sophisticated investors; including public and private employee benefit plans and university endowment funds, wealthy U.S. families and their family investment funds, insurance companies, banks, wealthy foreign families, foreign governments, and overseas sovereign wealth funds), and wealthy individuals and families (angel investors) investing their own money.

These institutional PE/VC subsidiaries and private funds focus on a wide range of risk-oriented investment opportunities from seed money and early stage start-ups to later-stage growth-equity investments, recapitalizations, buyouts, turnarounds, and industry consolidations, while angel investors typically focus on smaller seed money and early stage investments.

PE/VC funds formed in the late 1970s were generally $100 million or less in size and made individual investments ranging from a few hundred thousand dollars to a few million dollars each. Many recent PE/VC funds have capital exceeding $1 billion (and a few exceeding $10 billion), and can make equity investments exceeding a billion dollars each.

Thus, the PE/VC industry has moved from specialty financing into the top ranks of mainstream American (and global) business.
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§107 SHIFTING SANDS OF FEDERAL TAX RATES

Most of the transactions discussed in this treatise (e.g., a PE/VC fund formation, a Newco start-up, or an LBO), if effectuated now, would produce tax ramifications far into the future. However, predictions as to whether future top individual or corporate tax rates will rise or decline are unfortunately pure guesswork because of the conflicting political and economic philosophies of the U.S.'s 2 principal political parties.

The 2019 corporate income tax rate (for OI or CG) is 21%.

The top 2019 individual income tax rates are 37% for OI and STCG, 20% for qualified dividend income ("QDI"), and 20% for LTCG (with an even lower rate for LTCG on "small business stock" held more than 5 years). However, 2 income-based Medicare taxes effectively increase these top individual income tax rates, at least for high income individuals.

These individual rates apply not only to income directly earned by an individual, but also to income flowing through to an individual equity owner from a partnership, LLC, S corp, or sole proprietorship, with a possible reduction of the 37% top OI rate, perhaps to as low as 29.6% for "qualified business" OI flowing through a partnership, LLC, S corp, or sole proprietorship to a "qualified" individual (achieved by granting such a qualified individual a deduction which may be as large as 20% of his or her "qualified" business OI).2

Discussion of Individual Tax Rates

Throughout this treatise, unless otherwise specifically stated, discussion of individual income tax rates takes into account only federal income, taxes and does not take into account (a) the uncapped Medicare taxes on compensation, self-employment income, and net investment income, discussed at §107(5), (b) the special deduction for up to 20% of an individual's qualified business OI, discussed at §302.2, or (c) state, local, and non-U.S. taxes.

Unless otherwise stated, when this treatise discusses the LTCG tax rate for an individual taxpayer, we refer to the regular (20%) LTCG rate, rather than the reduced §1202 rate.

In more detail:

1 Top federal income tax rate for individual's OI, previously 39.6%, was reduced to 37% for 2018 through 2025, but is scheduled to revert to 39.6% beginning in 2026.

2 For this purpose, "individual" generally includes a trust for the benefit of an individual and the estate of an individual.

3 37% x 80% = 29.6%. 

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Fearless Fund invests in women of color led businesses seeking pre-seed, seed level or series A financing. Our mission is to bridge the gap in venture capital funding for women of color founders building scalable, growth aggressive companies.

FEARLESS FUND TEAM

Arian Simone, General Partner

Arian Simone, President and Chief Executive Officer of Fearless Fund, is a serial entrepreneur, philanthropist, angel investor, author, and PR & marketing specialist. Arian received her MBA from Florida A&M and has over 17 years of entrepreneurial experience: from pioneering and growing a successful PR and marketing firm to founding Fearless Magazine and the Fearless Platform in 2010, with a mission of inspiring millennial entrepreneurial women. Her background has allowed her to foster significant relationships in the entertainment industry with billion-dollar corporate clients such as the Sony Pictures, Universal Pictures, Walt Disney Pictures and more.

Keshia Knight Pulliam, General Partner

Keshia Knight Pulliam, Chief Development Officer of Fearless Fund, is the youngest person to ever be nominated for an Emmy Award. Decades after making her debut in entertainment she continues to be among the most loved and respected actresses in the business. After eight seasons of playing the iconic Rudy Huxtable on the groundbreaking Emmy and Golden Globe award winning television show “The Cosby Show”, Keshia decided to turn her focus toward education. Keshia graduated with honors from Spelman College in 2001 with a B.A. in
Sociology and a concentration in Film. Upon graduation from Spelman College, Keshia continued acting and won 4 NAACP Image awards for work on “The House of Payne”. In 2010, Keshia started her non-profit The Kamp Kizzy Foundation and, in 2016, expanded her brand to launch her weekly podcast Kandidly Keshia and spice line Keshia’s Kitchen.

Ayana Parsons, General Partner

Ayana Parsons is Chief Operating Officer of Fearless Fund. With nearly 20 years of experience as both a corporate executive and organizational consultant, Ayana leverages her expertise in consumer markets, international business strategy and operations, top team effectiveness, board effectiveness and inclusive talent management to help drive organizational growth and transformation. Previously, Ayana served as the Global Head of Retail, Consumer Goods and Lifestyle Industries at the World Economic Forum. Ayana graduated summa cum laude with a BS in Management and her MBA in Marketing from Florida A&M University.

Rodney Sampson, fund advisor

Rodney Sampson is a serial entrepreneur who cofounded, built and sold Multicast Media Technologies, EFactor (EFCT) and Intellectual Currency, a world class integrated go-to-market, publishing, diversity and advisory firm with clients ranging from major Hollywood film studios, cable networks, tech companies, global corporations, publishers and African heads of state. In 2013, Sampson co-founded Opportunity Hub as a follow up to the highly successful Kingonomics’ book release. Today, as Executive Chairman & CEO of Opportunity Hub, Sampson is focused on scaling its suite of collaborative and interconnected technology products, programs, initiatives and fund globally. Sampson is also a Nonresident Senior Fellow in the Metropolitan Policy Program at the Brooking Institution in Washington, DC and a Professor of Entrepreneurship at Morehouse College in Atlanta, GA. Sampson previously served as the 1st Head of Diversity at Mark Burnett Productions, executive producers of the hit ABC show, ABC’s Shark Tank.

Tracy Gray, fund advisor

Tracy Gray is currently the Founder and Managing Partner of The 22 Fund, a growth venture capital and advisory firm focused on increasing the export capacity of Southern California companies, positioning these companies to accelerate growth and scale via international sales. She is also an Executive in Residence at the Los Angeles Cleantech Incubator (LACI) and chairs LACI’s Diversity in Entrepreneurship Advisory Council. In addition, Ms. Gray is the founder of the non-profit We Are Enough (WAE). WAE’s only mission is to educate ALL women on how and why to invest in women-owned, for-profit businesses or with a “gender lens.” Ms. Gray was formerly Senior Advisor to the LA Mayor, an investment professional at a venture capital fund and a systems engineer on the Space Shuttle program. Ms. Gray holds a B.S. in Mathematical Science with an aeronautics emphasis from the UC Santa Barbara and dual MBAs from Columbia University and UC, Berkeley.
Sequoia Taylor, venture partner

Sequoia Taylor is the Managing Partner of SPRY VC, a liquidity advisory firm based in San Francisco. SPRY has completed over $200 million in private placement transactions since 2016. Ms. Taylor has over 10 years of experience as an investment banker and operator. Since then, she has spent time at UBS, Raymond James, and other venture backed startups. Notably, she served as a founding employee at a SaaS company backed by Y-combinator, Andreessen Horowitz, and NEA. Prior to this experience, Ms. Taylor worked as interim Chief of Staff to the CEO of a leading ad tech startup that was acquired by Acxiom for $300mm. Ms. Taylor holds a B.A. from Wellesley College.

If you are an accredited investor Interested in investing with Fearless Fund, please reach out to hello@fearless.fund

Mission

Fearless Fund invests in women of color led businesses seeking pre-seed, seed level or series A financing. Our mission is to bridge the gap in venture capital funding for women of color founders building scalable, growth aggressive companies. Fearless Fund is built by women of color for women of color.

The Fearless Foundation, is a 501c3 organization with a mission to educate entrepreneurs through training, reduce racial inequities, and empower African-Americans to gain access to capital. You can make a contribution towards the advancement of this class of entrepreneurs and have massive social impact.
OUR PROGRAMS

MASTERCARD IMPACT FUND COVID RELIEF GRANT PROGRAM

The Fearless Fund is disbursing 10 business grants to 10 women of color entrepreneurs in the amount of $10,000 each for Covid relief.

According to ABC News, "COVID-19 pandemic has disproportionately impacted African Americans, both physically and financially leaving black Americans to experience the economic brunt of the pandemic" (2020).

Experts have shown the number of Black owned businesses fell from 1.1 million in February to 640,000 in April, showing a 41% decline compared to an overall decline of 35%. Black small businesses also tend to have smaller payrolls and total sales; nearly 70% of them only have one to four employees, and 45% have annual revenues of $100,000 or less.

Eligibility criteria

- Must have a woman of color leadership with at least one woman of color co-founder that will hold significant equity in the company.
- Comprised of a quality, resilient management team with a least one full time founder.
- Demonstrated deep industry knowledge as well as understanding of their product and the competitive landscape.
• Enthusiasm and confidence in their ability to execute.
• Founding stage company that may have proof of concept and/or a minimum viable product.

GVR AND GVR JR

The Get Ready Venture Program is a 12-month training program for WOC business owners to acquire the needed training, mentorship, knowledge, and skills needed to gain access to capital. This program will provide access to a pipeline of over 1000 WOC entrepreneurs.

Student benefits include:

• Monthly Masterclasses taught by leading industry experts
• Monthly calls with Fearless Fund General Partner(s)
• Facebook Community for contained networking, learning and resource sharing
• Quarterly pitch workshops designed to help tailor participants pitches to grab investors’ attention

Topics covered in program (list not inclusive of all topics):

• Product-Market-Fit • How to Raise Capital
• Marketing- General/Digital
• Preparing for Exit/Acquisition
• Setting up a Pitch Deck
• Pitch Coaching
• How to Build Your MVP (Min/Most Viable Product)
• Diligence Procedures
• Corporate Governance & Legal Set Up
HBCU PROGRAM

Our Why: Historically Black Colleges and Universities are entrenched in important history that is reflective of both our culture and identity. We feel it is important to reach emerging collegiate students and propel them into entrepreneurship, and give them tools that will allow them to gain access to capital.

Description: The Fearless Foundation Historically Black Colleges and University initiative is a track of our Get Ready Venture program were we seek emerging high school graduates to acquire the needed training, mentorship, skills and knowledge to matriculate into collegiate life through the advancement of entrepreneurship.
SESSION 5 PRESENTERS: PERSPECTIVES ON MINORITY BUSINESS DEVELOPMENT

Sabrina Conyers, partner at Nelson Mullins Riley & Scarborough, Charlotte, North Carolina

Sabrina Conyers is a partnership and corporate tax attorney with more than 15 years of experience providing domestic and international tax planning, general corporate, corporate governance, private equity, and real estate finance planning and advisory services to clients. She has served as lead counsel, negotiator, and facilitator for transactions ranging in value up to $2 billion. Her clients include corporations, investment banks, private equity funds, and private companies (including partnerships, S Corporations and real estate developers). Ms. Conyers represents clients in structuring, negotiating, and documenting the tax consequences of their partnerships and joint ventures, mergers and acquisitions (M&A), real estate and REIT transactions, domestic and cross-border financings and other corporate combinations and reorganizations. Ms. Conyers advises clients on transactions involving limited partnerships, limited liability companies, joint ventures, and other strategic alliances.

Ollen Douglass, Managing Director at Motley Fool Ventures

Ollen Douglass Prior to joining the Fund, Ollen was CFO of The Motley Fool Holdings, Inc. for 14 years. During that time, he was responsible for the overall financial health of The Fool and helped guide the company through periods of major growth, contraction, and market volatility. Ollen’s oversight duties included The Fool’s finance and accounting groups as well as legal, benefits, sales, business development, real estate, business intelligence, international and asset management. His financing experience spans the full spectrum from bank financing to venture financing. During Ollen’s management of the pilot program, Motley Venture Partners, he and the team compiled a portfolio of private companies that will be contributed to the Fund. Today, Ollen serves on the board of Eyrus, InHerSight, and Young Artists of America. He has been a recipient of the Motley Fool Founders’ award and Favorite Fool award. He was twice nominated for Greater Washington CFO of the Year and is a member of the 2019 class of Greater Washington Minority Business Leaders. Prior to joining The Fool, Ollen worked in mortgage banking, focusing on mortgage servicing, fair lending and risk management. He was also an auditor for KPMG and is a CPA (inactive). Ollen graduated from the University of Baltimore with a bachelor’s degree in accounting and lives in the Washington area with his wife and three sons.
Sabastian V. Niles is a Partner at Wachtell, Lipton, Rosen & Katz where he focuses on rapid response shareholder and stakeholder activism and preparedness, takeover defense and corporate governance; risk oversight, including as to ESG, cybersecurity and crisis situations; U.S. and cross-border mergers, acquisitions, buyouts, investments, divestitures and strategic partnerships; and other corporate and securities law matters and special situation. Sabastian advises worldwide and across industries, including technology, financial institutions, media, energy and natural resources, healthcare and pharmaceuticals, construction and manufacturing, real estate/REITs and consumer goods and retail. He has counseled boards of directors and management teams on self-assessments, engagement with institutional investors and proxy advisory firms and navigating activist situations involving Barry Rosenstein/JANA Partners, Bill Ackman/Pershing Square, Carl Icahn, Daniel Loeb/Third Point, David Einhorn/Greenlight Capital, Glenn Welling/Engaged Capital, Jeff Smith/Starboard Value, Jeffrey Ubben/ValueAct, Jonathan Litt/Land & Buildings, Keith Meister/Covex, Mick McGuire/Marcato, Nelson Peltz/Trian, Scott Ferguson/Sachem Head, Paul Singer/Elliott Management, Relational Investors and Tom Sandell/Sandell Asset Management, among many others. In addition to serving as Consulting Editor for the New York Stock Exchange’s Corporate Governance Guide, Sabastian writes frequently on corporate law matters and has been a featured speaker at corporate strategy and investor forums. His speaking engagements have addressed topics such as Shareholder Activism; The New Paradigm of Corporate Governance; Hostile Takeovers; Strategic Transactions and Governance; M&A Trends; Board-Shareholder Engagement; Confidentiality Agreements in M&A Transactions; Negotiating Strategic Alliances with U.S. Companies; Current Issues in Technology M&A; Corporate Governance: Ethics, Transparency and Accountability; and Developments in Cross-Border Deals. Sabastian received his juris doctorate from Harvard Law School, where he co-founded the Harvard Association of Law and Business (and continues to serve on the Advisory Board) and won the U.S. National ABA Negotiation Championship representing the Harvard Program on Negotiation. He received B.S., B.A. and B.S. degrees in Finance, Economics and Decision & Information Sciences, respectively, from the University of Maryland, where he won two National Championships and four Regional Championships in intercollegiate mock trial.
Ayana Parsons, Senior Partner, Board and CEO Inclusion at Korn Ferry and Co-Founder, Fearless Fund
As a core member of Korn Ferry’s Global Consumer Practice, Ayana leads Chief Marketing Officer, President, CEO and Board searches at consumer- and customer-centric organizations of all sizes. Ayana’s international experience, coupled with her cross-industry background and passion for people, gives her a unique vantage point from which to solve her clients’ most pressing recruitment and succession planning challenges. Prior to joining Korn Ferry, Ayana was with another global consulting firm where she placed C-Suite executives at several of the world’s leading companies and led numerous succession planning and talent pipelining engagements for her clients. Before embarking on her career in executive talent and leadership, Ayana served as the Global Head of Retail, Consumer Goods and Lifestyle Industries at the World Economic Forum where she led the preeminent global discussions in Davos, Switzerland on all topics related to her respective industries. With nearly 20 years of experience as both a practitioner and consultant, Ayana leverages her expertise in international business, executive search, top team effectiveness, succession planning, diversity & inclusion, marketing and general management to deliver differentiated value to her clients. A seasoned industry executive, Ayana’s earlier career spanned sales, marketing and general management roles at several of the world’s most admired companies including Philips, Pfizer, Kimberly-Clark and Procter & Gamble. Ayana attended Oral Roberts University on a division I basketball scholarship, completing her studies at Florida A&M University where she holds a master’s degree in business administration. Ayana is based in Atlanta, where she is actively involved in the local community. In her free time, Ayana enjoys working out, attending sporting events, traveling and spending quality time with her husband and two young daughters.
Session 6: Perspectives of Private Equity and the Role of Reparations
6:55 - 7:25 p.m. EDT

Discussion Leader: Sabrina Conyers, Partner at Nelson Mullins Riley & Scarborough, Charlotte, North Carolina

Presenters: Bernel Hall, CEO of Invest Newark and Principal of the New Jersey 40 Acres and a Mule Fund; and Mark Storslee, Assistant Professor of Law at Penn State Law in University Park

Event Co-Chairs:

Samuel C. Thompson Jr.
Professor and Arthur Weiss Distinguished Faculty Scholar at Penn State Law

Sabrina Conyers
Partner at Nelson Mullins Riley & Scarborough

pennstatelaw.psu.edu/events/mbd-perspectives
MATERIALS FOR: SESSION 6: PERSPECTIVES OF PRIVATE EQUITY AND THE ROLE OF REPARATIONS

DISCUSSION LEADER: SABRINA CONYERS, PARTNER AT NELSON MULLINS, CHARLOTTE, NORTH CAROLINA
PRESENTERS: BERNEL HALL, CEO OF INVEST NEWARK AND PRINCIPAL OF THE NEW JERSEY 40 ACRES AND A MULE FUND; AND MARK STORSLEE, ASSISTANT PROFESSOR OF LAW AT PENN STATE LAW IN UNIVERSITY PARK

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NEWARK, NJ — A program initiative initially based in Newark to provide capital to the city’s Black and Latinx business owners and communities is now planned to expand across the state.

The Newark FAM Fund (Newark 40 Acres and a Mule Fund), which launched in 2020, is seeking to raise $100 million and is planned to expand the program to eight cities across New Jersey, officials announced on Thursday. The initiative is aimed to combat social and economic inequalities as a result of systemic racism.

Following today’s announcement, the program was renamed The New Jersey 40 Acres and a Mule Fund to acknowledge a partnership between the cities: Newark, Orange, East Orange, Paterson, Camden, Trenton, Irvington and Atlantic City.

“Today is a pivotal moment in the quest for racial equality for economic development in the state of New Jersey,” Bernel Hall, managing partner of the New Jersey FAM Fund said.

Hall explained that the goal is to raise $10 million by the end of the first quarter of 2021, which he said the fund is quickly approaching and is expecting commitments from additional investors in the coming weeks.

The median net worth of New Jersey’s white families is $309,000, while the median for New Jersey’s Latinx and Black families is just $7,020 and $5,900 - one of the worst racial wealth gaps in the nation, according to the New Jersey Institute for Social Justice. The objective of the fund is to close these gaps by providing Black and Latinx business owners with a more level playing field with their competitors.

When the fund originally launched, it came at a pivotal time for small businesses in Newark, many of which did not receive emergency federal Payroll Protection Program (PPP) loans to support operations during the pandemic. Most of the $77.3 million distribution in Brick City went to C-type corporations, according to data from the U.S. Small Business Association.

“This was an idea birthed out of the pandemic and the issues that businesses were going through, and the lack of PPP that was seeming to get to our community,” Baraka said. “Particularly, small Black and brown businesses in our city really had no way to compete to get this PPP and had no way to get access to capital and revenue, so they were just being pushed to the wayside.”
Given the program’s early success, Baraka wanted to do more for other minority business owners.

“At first, we were just thinking about Newark, but our people move around from city-to-city throughout the state, and I would be remiss for us to just try to help businesses in Newark,” he said. “If we do what we truly need to do in terms of reducing this wealth gap, then we need to invite the other municipalities that look like us into this fold and give them the opportunity to partner with us on this journey.”

Upon announcement of the fund’s expansion, Hall said that investors such as AT&T, Panasonic, RWJBarnabas Health and Shaquille O’Neal, a Newark native, among others have already committed to the fund.

“The past year has been extremely difficult and put a spotlight on the racial wealth gap that exists in our country, but we cannot pretend that this problem is something new,” Hall said. “We look forward to expanding this initiative as partners come to the table. Through the fund, our goal is to help Black and Latinx business owners and developers to expand their operations, create jobs and generate wealth for the communities that they serve.”

Mayors from the program’s newest cities commended the fund’s efforts and expressed their content to partner with it.

“When the difference in median net worth between white families and Black/Latinx families is nearly 200%, that is much more than a social disparity. That kind of gap is representative of the inequitable financial policies that have kept Black and Latinx businesses and families behind the national curve for decades,” East Orange Mayor Ted Green said. “This initiative is how we start to bring balance to the communities that have been devastated the most. This is how we make amends and bring generational wealth into our communities.”

“We’re proud to stand with Mayor Baraka and other city leaders who understand that an equitable business environment is crucial to maintaining the diverse identity of our urban communities,” Trenton Mayor Reed Gusciora said. “Despite decades of institutional and financial obstacles, many of our Black and Latino residents still put in the hard work to become entrepreneurs. We need programs like the one announced today to help make sure those historical challenges are not an impediment to their long-term success.”

“The NJ FAM Fund will help level the playing field for the Black and Latinx businesses not only in Camden but in urban areas across New Jersey,” Camden Mayor Frank Moran said. “The small business community has traditionally been the foundation of our local economy. As elected officials, it is our objective to identify resources which can not only help support but foster economic growth. Since the onset of the pandemic, so many of our Black and Latinx businesses have been impacted and are now facing dire circumstances. The NJ FAM Fund represents an outstanding collaborative effort to support these struggling businesses while shrinking the racial wealth gap.”
“There is strength in solidarity and I am honored to join forces with my conscientious colleagues to support this imperative initiative,” Paterson Mayor Sayegh said. “We are mayors meeting the moment and our Latinx and Black businesses need our leadership now more than ever.”

“During these trying times this will assist African American & Latino Business as we restart and recover our Economy,” Atlantic City Mayor Marty Small Sr. said. “The great city of Atlantic City looks forward as a participating municipality to support current business and bring new industries to diversify our economy.”

“Although it is reported that minority-owned businesses represent the fastest growing business sector in the U.S. economy, Black and Latinx business owners continue to face significantly more obstacles starting their businesses and maintaining growth,” Irvington Mayor Tony Vauss said. "Our country’s current economic crisis presents a significantly heightened challenge. Therefore, it made sense for us mayors of urban communities to work together to create the NJ FAM Fund in order to help the businesses that are the heart of our communities, Black and Latinx businesses."

“On behalf of the city of Orange Township, I am excited to work with Newark Mayor Ras Baraka alongside other urban cities to help build up Black and Latino businesses,” Orange Mayor Dwayne Warren said. "Determining how we invest our budget dollars in small businesses in our communities is one of the many initiatives underway as we move our state forward. This FAM fund serves as a reminder of the work we need to continue to do to create equity in the business sector."
The Case for Reparations

Two hundred fifty years of slavery. Ninety years of Jim Crow. Sixty years of separate but equal. Thirty-five years of racist housing policy. Until we reckon with our compounding moral debts, America will never be whole.

Editor’s Note: We’ve gathered dozens of the most important pieces from our archives on race and racism in America. Find the collection here.

And if thy brother, a Hebrew man, or a Hebrew woman, be sold unto thee, and serve thee six years; then in the seventh year thou shalt let him go free from thee. And when thou sendest him out free from thee, thou shalt not let him go away empty: thou shalt furnish him liberally out of thy flock, and out of thy floor, and out of thy winepress: of that wherewith the LORD thy God hath blessed thee thou shalt give unto him. And thou shalt remember that thou wast a bondman in the land of Egypt, and the LORD thy God redeemed thee: therefore I command thee this thing today.

— Deuteronomy 15: 12–15

Besides the crime which consists in violating the law, and varying from the right rule of reason, whereby a man so far becomes degenerate, and declares himself to quit the principles of human nature, and to be a noxious creature, there is commonly injury done to some person or other, and some other man receives damage by his transgression: in which case he who hath received any damage, has, besides the right of punishment common to him with other men, a particular right to seek reparation.

— John Locke, “Second Treatise”

By our unpaid labor and suffering, we have earned the right to the soil, many times over and over, and now we are determined to have it.

— Anonymous, 1861

I. “So That’s Just One Of My Losses”
Clyde Ross was born in 1923, the seventh of 13 children, near Clarksdale, Mississippi, the home of the blues. Ross’s parents owned and farmed a 40-acre tract of land, flush with cows, hogs, and mules. Ross’s mother would drive to Clarksdale to do her shopping in a horse and buggy, in which she invested all the pride one might place in a Cadillac. The family owned another horse, with a red coat, which they gave to Clyde. The Ross family wanted for little, save that which all black families in the Deep South then desperately desired—the protection of the law.

Clyde Ross, photographed in November 2013 in his home in the North Lawndale neighborhood of Chicago, where he has lived for more than 50 years. When he first tried to get a legitimate mortgage, he was denied; mortgages were effectively not available to black people. (Carlos Javier Ortiz)

In the 1920s, Jim Crow Mississippi was, in all facets of society, a kleptocracy. The majority of the people in the state were perpetually robbed of the vote—a hijacking engineered through the trickery of the poll tax and the muscle of the lynch mob. Between 1882 and 1968, more black people were lynched in Mississippi than in any other state. “You and I know what’s the best way to keep the nigger from voting,” blustered Theodore Bilbo, a Mississippi senator and a proud Klansman. “You do it the night before the election.”

The state’s regime partnered robbery of the franchise with robbery of the purse. Many of Mississippi’s black farmers lived in debt peonage, under the sway of cotton kings who were at once their landlords, their employers, and their primary merchants. Tools and necessities were advanced against the return on the crop, which was determined by the employer. When farmers were deemed to be in debt—and they often were—the negative balance was then carried over to the next season. A man or woman who protested this arrangement did so at the risk of grave injury or death. Refusing to work meant arrest under vagrancy laws and forced labor under the state’s penal system.

Well into the 20th century, black people spoke of their flight from Mississippi in much the same manner as their runagate ancestors had. In her 2010 book, The Warmth of Other Suns, Isabel Wilkerson tells the story of Eddie Earvin, a spinach picker who fled Mississippi in 1963, after being made to work at gunpoint. “You didn’t talk about it or tell nobody,” Earvin said. “You had to sneak away.”

“Some of the land taken from black families has become a country club in Virginia,” the AP reported.

When Clyde Ross was still a child, Mississippi authorities claimed his father owed $3,000 in back taxes. The elder Ross could not read. He did not have a lawyer. He did not know anyone at the local courthouse. He could not expect the police to be impartial. Effectively, the Ross family had no way to contest the claim and no protection under the law. The authorities seized the land. They seized the buggy. They took the cows, hogs, and mules. And so for the upkeep of separate but equal, the entire Ross family was reduced to sharecropping.
This was hardly unusual. In 2001, the Associated Press published a three-part investigation into the theft of black-owned land stretching back to the antebellum period. The series documented some 406 victims and 24,000 acres of land valued at tens of millions of dollars. The land was taken through means ranging from legal chicanery to terrorism. “Some of the land taken from black families has become a country club in Virginia,” the AP reported, as well as “oil fields in Mississippi” and “a baseball spring training facility in Florida.”

Clyde Ross was a smart child. His teacher thought he should attend a more challenging school. There was very little support for educating black people in Mississippi. But Julius Rosenwald, a part owner of Sears, Roebuck, had begun an ambitious effort to build schools for black children throughout the South. Ross’s teacher believed he should attend the local Rosenwald school. It was too far for Ross to walk and get back in time to work in the fields. Local white children had a school bus. Clyde Ross did not, and thus lost the chance to better his education.

Then, when Ross was 10 years old, a group of white men demanded his only childhood possession—the horse with the red coat. “You can’t have this horse. We want it,” one of the white men said. They gave Ross’s father $17.

“I did everything for that horse,” Ross told me. “Everything. And they took him. Put him on the racetrack. I never did know what happened to him after that, but I know they didn’t bring him back. So that’s just one of my losses.”
The losses mounted. As sharecroppers, the Ross family saw their wages treated as the landlord’s slush fund. Landowners were supposed to split the profits from the cotton fields with sharecroppers. But bales would often disappear during the count, or the split might be altered on a whim. If cotton was selling for 50 cents a pound, the Ross family might get 15 cents, or only five. One year Ross’s mother promised to buy him a $7 suit for a summer program at their church. She ordered the suit by mail. But that year Ross’s family was paid only five cents a pound for cotton. The mailman arrived with the suit. The Rosses could not pay. The suit was sent back. Clyde Ross did not go to the church program.

reporter’s notebook

**Elegant Racism**

“If you sought to advantage one group of Americans and disadvantage another, you could scarcely choose a more graceful method than housing discrimination.”

[Read more](#)

It was in these early years that Ross began to understand himself as an American—he did not live under the blind decree of justice, but under the heel of a regime that elevated armed robbery to a governing principle. He thought about fighting. “Just be quiet,” his father told him. “Because they’ll come and kill us all.”

Clyde Ross grew. He was drafted into the Army. The draft officials offered him an exemption if he stayed home and worked. He preferred to take his chances with war. He was stationed in California. He found that he could go into stores without being bothered. He could walk the streets without being harassed. He could go into a restaurant and receive service.

Ross was shipped off to Guam. He fought in World War II to save the world from tyranny. But when he returned to Clarksdale, he found that tyranny had followed him home. This was 1947, eight years before Mississippi lynched Emmett Till and tossed his broken body into the Tallahatchie River. The Great Migration, a mass exodus of 6 million African Americans that spanned most of the 20th century, was now in its second wave. The black pilgrims did not journey north simply seeking better wages and work, or bright lights and big adventures. They were fleeing the acquisitive warlords of the South. They were seeking the protection of the law.

Clyde Ross was among them. He came to Chicago in 1947 and took a job as a taster at Campbell’s Soup. He made a stable wage. He married. He had children. His paycheck was his own. No Klansmen stripped him of the vote. When he walked down the street, he did not have to move because a white man was walking past. He did not have to take off his hat or avert his gaze. His journey from peonage to full citizenship seemed near-complete. Only one item was missing—a home, that final badge of entry into the sacred order of the American middle class of the Eisenhower years.

In 1961, Ross and his wife bought a house in North Lawndale, a bustling community on Chicago’s West Side. North Lawndale had long been a predominantly Jewish neighborhood, but a handful of middle-class African Americans had lived there starting in the ’40s. The community was anchored by the sprawling Sears, Roebuck headquarters. North Lawndale’s Jewish People’s Institute actively encouraged blacks to move into the neighborhood, seeking to make it a “pilot
community for interracial living.” In the battle for integration then being fought around the country, North Lawndale seemed to offer promising terrain. But out in the tall grass, highwaymen, nefarious as any Clarksdale kleptocrat, were lying in wait.

From the 1930s through the 1960s, black people across the country were largely cut out of the legitimate home-mortgage market.

Three months after Clyde Ross moved into his house, the boiler blew out. This would normally be a homeowner’s responsibility, but in fact, Ross was not really a homeowner. His payments were made to the seller, not the bank. And Ross had not signed a normal mortgage. He’d bought “on contract”: a predatory agreement that combined all the responsibilities of homeownership with all the disadvantages of renting—while offering the benefits of neither. Ross had bought his house for $27,500. The seller, not the previous homeowner but a new kind of middleman, had bought it for only $12,000 six months before selling it to Ross. In a contract sale, the seller kept the deed until the contract was paid in full—and, unlike with a normal mortgage, Ross would acquire no equity in the meantime. If he missed a single payment, he would immediately forfeit his $1,000 down payment, all his monthly payments, and the property itself.

The men who peddled contracts in North Lawndale would sell homes at inflated prices and then evict families who could not pay—taking their down payment and their monthly installments as profit. Then they’d bring in another black family, rinse, and repeat. “He loads them up with payments they can’t meet,” an office secretary told The Chicago Daily News of her boss, the speculator Lou Fushanis, in 1963. “Then he takes the property away from them. He’s sold some of the buildings three or four times.”

Ross had tried to get a legitimate mortgage in another neighborhood, but was told by a loan officer that there was no financing available. The truth was that there was no financing for people like Clyde Ross. From the 1930s through the 1960s, black people across the country were largely cut out of the legitimate home-mortgage market through means both legal and extralegal. Chicago whites employed every measure, from “restrictive covenants” to bombings, to keep their neighborhoods segregated.

Their efforts were buttressed by the federal government. In 1934, Congress created the Federal Housing Administration. The FHA insured private mortgages, causing a drop in interest rates and a decline in the size of the down payment required to buy a house. But an insured mortgage was not a possibility for Clyde Ross. The FHA had adopted a system of maps that rated neighborhoods according to their perceived stability. On the maps, green areas, rated “A,” indicated “in demand” neighborhoods that, as one appraiser put it, lacked “a single foreigner or Negro.” These neighborhoods were considered excellent prospects for insurance. Neighborhoods where black people lived were rated “D” and were usually considered ineligible for FHA backing. They were colored in red. Neither the percentage of black people living there nor their social class mattered. Black people were viewed as a contagion. Redlining went beyond FHA-backed loans and spread to the entire mortgage industry, which was already rife with racism, excluding black people from most legitimate means of obtaining a mortgage.

Explore Redlining in Chicago
A 1939 Home Owners’ Loan Corporation “Residential Security Map” of Chicago shows discrimination against low-income and minority neighborhoods. The residents of the areas marked in red (representing “hazardous” real-estate markets) were denied FHA-backed mortgages. (Map development by Frankie Dintino)

“A government offering such bounty to builders and lenders could have required compliance with a nondiscrimination policy,” Charles Abrams, the urban-studies expert who helped create the New York City Housing Authority, wrote in 1955. “Instead, the FHA adopted a racial policy that could well have been culled from the Nuremberg laws.”

The devastating effects are cogently outlined by Melvin L. Oliver and Thomas M. Shapiro in their 1995 book, *Black Wealth/White Wealth*:

Locked out of the greatest mass-based opportunity for wealth accumulation in American history, African Americans who desired and were able to afford home ownership found themselves consigned to central-city communities where their investments were affected by the “self-fulfilling prophecies” of the FHA appraisers: cut off from sources of new investment[,] their homes and communities deteriorated and lost value in comparison to those homes and communities that FHA appraisers deemed desirable.

In Chicago and across the country, whites looking to achieve the American dream could rely on a legitimate credit system backed by the government. Blacks were herded into the sights of unscrupulous lenders who took them for money and for sport. “It was like people who like to go out and shoot lions in Africa. It was the same thrill,” a housing attorney told the historian Beryl Satter in her 2009 book, *Family Properties*. “The thrill of the chase and the kill.”

reporter’s notebook

**The American Case Against a Black Middle Class**

“When a black family in Chicago saves up enough to move out of the crowded slums into Cicero, the neighborhood riots.”

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The kill was profitable. At the time of his death, Lou Fushanis owned more than 600 properties, many of them in North Lawndale, and his estate was estimated to be worth $3 million. He’d made much of this money by exploiting the frustrated hopes of black migrants like Clyde Ross. During this period, according to one estimate, 85 percent of all black home buyers who bought in Chicago bought on contract. “If anybody who is well established in this business in Chicago doesn’t earn $100,000 a year,” a contract seller told *The Saturday Evening Post* in 1962, “he is loafing.”

Contract sellers became rich. North Lawndale became a ghetto.

Clyde Ross still lives there. He still owns his home. He is 91, and the emblems of survival are all around him—awards for service in his community, pictures of his children in cap and gown. But when I asked him about his home in North Lawndale, I heard only anarchy.
“We were ashamed. We did not want anyone to know that we were that ignorant,” Ross told me. He was sitting at his dining-room table. His glasses were as thick as his Clarksdale drawl. “I’d come out of Mississippi where there was one mess, and come up here and got in another mess. So how dumb am I? I didn’t want anyone to know how dumb I was.

“When I found myself caught up in it, I said, ‘How? I just left this mess. I just left no laws. And no regard. And then I come here and get cheated wide open.’ I would probably want to do some harm to some people, you know, if I had been violent like some of us. I thought, ‘Man, I got caught up in this stuff. I can’t even take care of my kids.’ I didn’t have enough for my kids. You could fall through the cracks easy fighting these white people. And no law.”

Blacks were herded into the sights of unscrupulous lenders who took them for money and for sport.

But fight Clyde Ross did. In 1968 he joined the newly formed Contract Buyers League—a collection of black homeowners on Chicago’s South and West Sides, all of whom had been locked into the same system of predation. There was Howell Collins, whose contract called for him to pay $25,500 for a house that a speculator had bought for $14,500. There was Ruth Wells, who’d managed to pay out half her contract, expecting a mortgage, only to suddenly see an insurance bill materialize out of thin air—a requirement the seller had added without Wells’s knowledge. Contract sellers used every tool at their disposal to pilfer from their clients. They scared white residents into selling low. They lied about properties’ compliance with building codes, then left the buyer responsible when city inspectors arrived. They presented themselves as real-estate brokers, when in fact they were the owners. They guided their clients to lawyers who were in on the scheme.

The Contract Buyers League fought back. Members—who would eventually number more than 500—went out to the posh suburbs where the speculators lived and embarrassed them by knocking on their neighbors’ doors and informing them of the details of the contract-lending trade. They refused to pay their installments, instead holding monthly payments in an escrow account. Then they brought a suit against the contract sellers, accusing them of buying properties and reselling in such a manner “to reap from members of the Negro race large and unjust profits.”

**Video: The Contract Buyers League**

The story of Clyde Ross and the Contract Buyers League

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In return for the “deprivations of their rights and privileges under the Thirteenth and Fourteenth Amendments,” the league demanded “prayers for relief”—payback of all moneys paid on
contracts and all moneys paid for structural improvement of properties, at 6 percent interest minus a “fair, non-discriminatory” rental price for time of occupation. Moreover, the league asked the court to adjudge that the defendants had “acted willfully and maliciously and that malice is the gist of this action.”

Ross and the Contract Buyers League were no longer appealing to the government simply for equality. They were no longer fleeing in hopes of a better deal elsewhere. They were charging society with a crime against their community. They wanted the crime publicly ruled as such. They wanted the crime’s executors declared to be offensive to society. And they wanted restitution for the great injury brought upon them by said offenders. In 1968, Clyde Ross and the Contract Buyers League were no longer simply seeking the protection of the law. They were seeking reparations.

II. “A Difference of Kind, Not Degree”

According to the most-recent statistics, North Lawndale is now on the wrong end of virtually every socioeconomic indicator. In 1930 its population was 112,000. Today it is 36,000. The halcyon talk of “interracial living” is dead. The neighborhood is 92 percent black. Its homicide rate is 45 per 100,000—triple the rate of the city as a whole. The infant-mortality rate is 14 per 1,000—more than twice the national average. Forty-three percent of the people in North Lawndale live below the poverty line—double Chicago’s overall rate. Forty-five percent of all households are on food stamps—nearly three times the rate of the city at large. Sears, Roebuck left the neighborhood in 1987, taking 1,800 jobs with it. Kids in North Lawndale need not be confused about their prospects: Cook County’s Juvenile Temporary Detention Center sits directly adjacent to the neighborhood.

North Lawndale is an extreme portrait of the trends that ail black Chicago. Such is the magnitude of these ailments that it can be said that blacks and whites do not inhabit the same city. The average per capita income of Chicago’s white neighborhoods is almost three times that of its black neighborhoods. When the Harvard sociologist Robert J. Sampson examined incarceration rates in Chicago in his 2012 book, Great American City, he found that a black neighborhood with one of the highest incarceration rates (West Garfield Park) had a rate more than 40 times as high as the white neighborhood with the highest rate (Clearing). “This is a staggering differential, even for community-level comparisons,” Sampson writes. “A difference of kind, not degree.”

Interactive Census Map

Explore race, unemployment, and vacancy rates over seven decades in Chicago. (Map design and development by Frankie Dintino)

In other words, Chicago’s impoverished black neighborhoods—characterized by high unemployment and households headed by single parents—are not simply poor; they are “ecologically distinct.” This “is not simply the same thing as low economic status,” writes Sampson. “In this pattern Chicago is not alone.”
The lives of black Americans are better than they were half a century ago. The humiliation of Whites Only signs are gone. Rates of black poverty have decreased. Black teen-pregnancy rates are at record lows—and the gap between black and white teen-pregnancy rates has shrunk significantly. But such progress rests on a shaky foundation, and fault lines are everywhere. The income gap between black and white households is roughly the same today as it was in 1970. Patrick Sharkey, a sociologist at New York University, studied children born from 1955 through 1970 and found that 4 percent of whites and 62 percent of blacks across America had been raised in poor neighborhoods. A generation later, the same study showed, virtually nothing had changed. And whereas whites born into affluent neighborhoods tended to remain in affluent neighborhoods, blacks tended to fall out of them.

This is not surprising. Black families, regardless of income, are significantly less wealthy than white families. The Pew Research Center estimates that white households are worth roughly 20 times as much as black households, and that whereas only 15 percent of whites have zero or negative wealth, more than a third of blacks do. Effectively, the black family in America is working without a safety net. When financial calamity strikes—a medical emergency, divorce, job loss—the fall is precipitous.

And just as black families of all incomes remain handicapped by a lack of wealth, so too do they remain handicapped by their restricted choice of neighborhood. Black people with upper-middle-class incomes do not generally live in upper-middle-class neighborhoods. Sharkey’s research shows that black families making $100,000 typically live in the kinds of neighborhoods inhabited by white families making $30,000. “Blacks and whites inhabit such different neighborhoods,” Sharkey writes, “that it is not possible to compare the economic outcomes of black and white children.”

A national real-estate association advised not to sell to “a colored man of means who was giving his children a college education.”

The implications are chilling. As a rule, poor black people do not work their way out of the ghetto—and those who do often face the horror of watching their children and grandchildren tumble back.

Even seeming evidence of progress withers under harsh light. In 2012, the Manhattan Institute cheerily noted that segregation had declined since the 1960s. And yet African Americans still remained—by far—the most segregated ethnic group in the country.

With segregation, with the isolation of the injured and the robbed, comes the concentration of disadvantage. An unsegregated America might see poverty, and all its effects, spread across the country with no particular bias toward skin color. Instead, the concentration of poverty has been paired with a concentration of melanin. The resulting conflagration has been devastating.

One thread of thinking in the African American community holds that these depressing numbers partially stem from cultural pathologies that can be altered through individual grit and exceptionally good behavior. (In 2011, Philadelphia Mayor Michael Nutter, responding to violence among young black males, put the blame on the family: “Too many men making too
many babies they don’t want to take care of, and then we end up dealing with your children.” Nutter turned to those presumably fatherless babies: “Pull your pants up and buy a belt, because no one wants to see your underwear or the crack of your butt.”) The thread is as old as black politics itself. It is also wrong. The kind of trenchant racism to which black people have persistently been subjected can never be defeated by making its victims more respectable. The essence of American racism is disrespect. And in the wake of the grim numbers, we see the grim inheritance.

The Contract Buyers League’s suit brought by Clyde Ross and his allies took direct aim at this inheritance. The suit was rooted in Chicago’s long history of segregation, which had created two housing markets—one legitimate and backed by the government, the other lawless and patrolled by predators. The suit dragged on until 1976, when the league lost a jury trial. Securing the equal protection of the law proved hard; securing reparations proved impossible. If there were any doubts about the mood of the jury, the foreman removed them by saying, when asked about the verdict, that he hoped it would help end “the mess Earl Warren made with Brown v. Board of Education and all that nonsense.”

An unsegregated America might see poverty spread across the country, with no particular bias toward skin color.

The Supreme Court seems to share that sentiment. The past two decades have witnessed a rollback of the progressive legislation of the 1960s. Liberals have found themselves on the defensive. In 2008, when Barack Obama was a candidate for president, he was asked whether his daughters—Malia and Sasha—should benefit from affirmative action. He answered in the negative.

The exchange rested upon an erroneous comparison of the average American white family and the exceptional first family. In the contest of upward mobility, Barack and Michelle Obama have won. But they’ve won by being twice as good—and enduring twice as much. Malia and Sasha Obama enjoy privileges beyond the average white child’s dreams. But that comparison is incomplete. The more telling question is how they compare with Jenna and Barbara Bush—the products of many generations of privilege, not just one. Whatever the Obama children achieve, it will be evidence of their family’s singular perseverance, not of broad equality.

III. “We Inherit Our Ample Patrimony”

In 1783, the freedwoman Belinda Royall petitioned the commonwealth of Massachusetts for reparations. Belinda had been born in modern-day Ghana. She was kidnapped as a child and sold into slavery. She endured the Middle Passage and 50 years of enslavement at the hands of Isaac Royall and his son. But the junior Royall, a British loyalist, fled the country during the Revolution. Belinda, now free after half a century of labor, beseeched the nascent Massachusetts legislature:

The face of your Petitioner, is now marked with the furrows of time, and her frame bending under the oppression of years, while she, by the Laws of the Land, is denied the employment of one morsel of that immense wealth, apart whereof hath been accumulated by her own industry,
and the whole augmented by her servitude.

WHEREFORE, casting herself at your feet if your honours, as to a body of men, formed for the extirpation of vassalage, for the reward of Virtue, and the just return of honest industry—she prays, that such allowance may be made her out of the Estate of Colonel Royall, as will prevent her, and her more infirm daughter, from misery in the greatest extreme, and scatter comfort over the short and downward path of their lives.

Belinda Royall was granted a pension of 15 pounds and 12 shillings, to be paid out of the estate of Isaac Royall—one of the earliest successful attempts to petition for reparations. At the time, black people in America had endured more than 150 years of enslavement, and the idea that they might be owed something in return was, if not the national consensus, at least not outrageous.

“A heavy account lies against us as a civil society for oppressions committed against people who did not injure us,” wrote the Quaker John Woolman in 1769, “and that if the particular case of many individuals were fairly stated, it would appear that there was considerable due to them.”

As the historian Roy E. Finkenbine has documented, at the dawn of this country, black reparations were actively considered and often effected. Quakers in New York, New England, and Baltimore went so far as to make “membership contingent upon compensating one’s former slaves.” In 1782, the Quaker Robert Pleasants emancipated his 78 slaves, granted them 350 acres, and later built a school on their property and provided for their education. “The doing of this justice to the injured Africans,” wrote Pleasants, “would be an acceptable offering to him who ‘Rules in the kingdom of men.’ ”
Edward Coles, a protégé of Thomas Jefferson who became a slaveholder through inheritance, took many of his slaves north and granted them a plot of land in Illinois. John Randolph, a cousin of Jefferson’s, willed that all his slaves be emancipated upon his death, and that all those older than 40 be given 10 acres of land. “I give and bequeath to all my slaves their freedom,” Randolph wrote, “heartily regretting that I have been the owner of one.”

In his book *Forever Free*, Eric Foner recounts the story of a disgruntled planter reprimanding a freedman loafing on the job:

Planter: “You lazy nigger, I am losing a whole day’s labor by you.”

Freedman: “Massa, how many days’ labor have I lost by you?”

In the 20th century, the cause of reparations was taken up by a diverse cast that included the Confederate veteran Walter R. Vaughan, who believed that reparations would be a stimulus for the South; the black activist Callie House; black-nationalist leaders like “Queen Mother” Audley Moore; and the civil-rights activist James Forman. The movement coalesced in 1987 under an umbrella organization called the National Coalition of Blacks for Reparations in America (N’COBRA). The NAACP endorsed reparations in 1993. Charles J. Ogletree Jr., a professor at Harvard Law School, has pursued reparations claims in court.

But while the people advocating reparations have changed over time, the response from the country has remained virtually the same. “They have been taught to labor,” the *Chicago Tribune* editorialized in 1891. “They have been taught Christian civilization, and to speak the noble English language instead of some African gibberish. The account is square with the ex-slaves.”

Not exactly. Having been enslaved for 250 years, black people were not left to their own devices. They were terrorized. In the Deep South, a second slavery ruled. In the North, legislatures, mayors, civic associations, banks, and citizens all colluded to pin black people into ghettos, where they were overcrowded, overcharged, and undereducated. Businesses discriminated
against them, awarding them the worst jobs and the worst wages. Police brutalized them in the streets. And the notion that black lives, black bodies, and black wealth were rightful targets remained deeply rooted in the broader society. Now we have half-stepped away from our long centuries of despoilment, promising, “Never again.” But still we are haunted. It is as though we have run up a credit-card bill and, having pledged to charge no more, remain befuddled that the balance does not disappear. The effects of that balance, interest accruing daily, are all around us.

Broach the topic of reparations today and a barrage of questions inevitably follows: Who will be paid? How much will they be paid? Who will pay? But if the practicalities, not the justice, of reparations are the true sticking point, there has for some time been the beginnings of a solution. For the past 25 years, Congressman John Conyers Jr., who represents the Detroit area, has marked every session of Congress by introducing a bill calling for a congressional study of slavery and its lingering effects as well as recommendations for “appropriate remedies.”

A country curious about how reparations might actually work has an easy solution in Conyers’s bill, now called HR 40, the Commission to Study Reparation Proposals for African Americans Act. We would support this bill, submit the question to study, and then assess the possible solutions. But we are not interested.

reporter’s notebook

What We Should Be Asking About Reparations

“As any contemplation of compensated emancipation must grapple with how several counties, and some states in the South, would react to finding themselves suddenly outnumbered by free black people.”

Read more

“It’s because it’s black folks making the claim,” Nkechi Taifa, who helped found N’COBRA, says. “People who talk about reparations are considered left lunatics. But all we are talking about is studying [reparations]. As John Conyers has said, we study everything. We study the water, the air. We can’t even study the issue? This bill does not authorize one red cent to anyone.”

That HR 40 has never—under either Democrats or Republicans—made it to the House floor suggests our concerns are rooted not in the impracticality of reparations but in something more existential. If we conclude that the conditions in North Lawndale and black America are not inexplicable but are instead precisely what you’d expect of a community that for centuries has lived in America’s crosshairs, then what are we to make of the world’s oldest democracy?

One cannot escape the question by hand-waving at the past, disavowing the acts of one’s ancestors, nor by citing a recent date of ancestral immigration. The last slaveholder has been dead for a very long time. The last soldier to endure Valley Forge has been dead much longer. To proudly claim the veteran and disown the slaveholder is patriotism à la carte. A nation outlives its generations. We were not there when Washington crossed the Delaware, but Emanuel Gottlieb Leutze’s rendering has meaning to us. We were not there when Woodrow Wilson took us into World War I, but we are still paying out the pensions. If Thomas Jefferson’s genius matters, then so does his taking of Sally Hemings’s body. If George Washington crossing the Delaware matters, so must his ruthless pursuit of the runagate Oney Judge.
Black families making $100,000 typically live in the kinds of neighborhoods inhabited by white families making $30,000.

In 1909, President William Howard Taft told the country that “intelligent” white southerners were ready to see blacks as “useful members of the community.” A week later Joseph Gordon, a black man, was lynched outside Greenwood, Mississippi. The high point of the lynching era has passed. But the memories of those robbed of their lives still live on in the lingering effects. Indeed, in America there is a strange and powerful belief that if you stab a black person 10 times, the bleeding stops and the healing begins the moment the assailant drops the knife. We believe white dominance to be a fact of the inert past, a delinquent debt that can be made to disappear if only we don’t look.

There has always been another way. “It is in vain to alledge, that our ancestors brought them hither, and not we,” Yale President Timothy Dwight said in 1810.

We inherit our ample patrimony with all its incumbrances; and are bound to pay the debts of our ancestors. This debt, particularly, we are bound to discharge: and, when the righteous Judge of the Universe comes to reckon with his servants, he will rigidly exact the payment at our hands. To give them liberty, and stop here, is to entail upon them a curse.

**IV. “The Ills That Slavery Frees Us From”**

America begins in black plunder and white democracy, two features that are not contradictory but complementary. “The men who came together to found the independent United States, dedicated to freedom and equality, either held slaves or were willing to join hands with those who did,” the historian Edmund S. Morgan wrote. “None of them felt entirely comfortable about the fact, but neither did they feel responsible for it. Most of them had inherited both their slaves and their attachment to freedom from an earlier generation, and they knew the two were not unconnected.”

Slaves in South Carolina prepare cotton for the gin in 1862. (Timothy H. O’sullivan/Library of Congress)

When enslaved Africans, plundered of their bodies, plundered of their families, and plundered of their labor, were brought to the colony of Virginia in 1619, they did not initially endure the naked racism that would engulf their progeny. Some of them were freed. Some of them intermarried. Still others escaped with the white indentured servants who had suffered as they had. Some even rebelled together, allying under Nathaniel Bacon to torch Jamestown in 1676.

One hundred years later, the idea of slaves and poor whites joining forces would shock the senses, but in the early days of the English colonies, the two groups had much in common. English visitors to Virginia found that its masters “abuse their servantes with intollerable oppression and hard usage.” White servants were flogged, tricked into serving beyond their contracts, and traded in much the same manner as slaves.
This “hard usage” originated in a simple fact of the New World—land was boundless but cheap labor was limited. As life spans increased in the colony, the Virginia planters found in the enslaved Africans an even more efficient source of cheap labor. Whereas indentured servants were still legal subjects of the English crown and thus entitled to certain protections, African slaves entered the colonies as aliens. Exempted from the protections of the crown, they became early America’s indispensable working class—fit for maximum exploitation, capable of only minimal resistance.

For the next 250 years, American law worked to reduce black people to a class of untouchables and raise all white men to the level of citizens. In 1650, Virginia mandated that “all persons except Negroes” were to carry arms. In 1664, Maryland mandated that any Englishwoman who married a slave must live as a slave of her husband’s master. In 1705, the Virginia assembly passed a law allowing for the dismemberment of unruly slaves—but forbidding masters from whipping “a Christian white servant naked, without an order from a justice of the peace.” In that same law, the colony mandated that “all horses, cattle, and hogs, now belonging, or that hereafter shall belong to any slave” be seized and sold off by the local church, the profits used to support “the poor of the said parish.” At that time, there would have still been people alive who could remember blacks and whites joining to burn down Jamestown only 29 years before. But at the beginning of the 18th century, two primary classes were enshrined in America.

“The two great divisions of society are not the rich and poor, but white and black,” John C. Calhoun, South Carolina’s senior senator, declared on the Senate floor in 1848. “And all the former, the poor as well as the rich, belong to the upper class, and are respected and treated as equals.”

In 1860, the majority of people living in South Carolina and Mississippi, almost half of those living in Georgia, and about one-third of all Southerners were on the wrong side of Calhoun’s line. The state with the largest number of enslaved Americans was Virginia, where in certain counties some 70 percent of all people labored in chains. Nearly one-fourth of all white Southerners owned slaves, and upon their backs the economic basis of America—and much of the Atlantic world—was erected. In the seven cotton states, one-third of all white income was derived from slavery. By 1840, cotton produced by slave labor constituted 59 percent of the country’s exports. The web of this slave society extended north to the looms of New England, and across the Atlantic to Great Britain, where it powered a great economic transformation and altered the trajectory of world history. “Whoever says Industrial Revolution,” wrote the historian Eric J. Hobsbawm, “says cotton.”
In this artistic rendering by Henry Louis Stephens, a well-known illustrator of the era, a family is in the process of being separated at a slave auction. (Library of Congress)

The wealth accorded America by slavery was not just in what the slaves pulled from the land but in the slaves themselves. “In 1860, slaves as an asset were worth more than all of America’s manufacturing, all of the railroads, all of the productive capacity of the United States put together,” the Yale historian David W. Blight has noted. “Slaves were the single largest, by far, financial asset of property in the entire American economy.” The sale of these slaves—“in whose bodies that money congealed,” writes Walter Johnson, a Harvard historian—generated even more ancillary wealth. Loans were taken out for purchase, to be repaid with interest. Insurance policies were drafted against the untimely death of a slave and the loss of potential profits. Slave sales were taxed and notarized. The vending of the black body and the sundering of the black family became an economy unto themselves, estimated to have brought in tens of millions of dollars to antebellum America. In 1860 there were more millionaires per capita in the Mississippi Valley than anywhere else in the country.
Beneath the cold numbers lay lives divided. “I had a constant dread that Mrs. Moore, her mistress, would be in want of money and sell my dear wife,” a freedman wrote, reflecting on his time in slavery. “We constantly dreaded a final separation. Our affection for each was very strong, and this made us always apprehensive of a cruel parting.”

Forced partings were common in the antebellum South. A slave in some parts of the region stood a 30 percent chance of being sold in his or her lifetime. Twenty-five percent of interstate trades destroyed a first marriage and half of them destroyed a nuclear family.

When the wife and children of Henry Brown, a slave in Richmond, Virginia, were to be sold away, Brown searched for a white master who might buy his wife and children to keep the family together. He failed:

The next day, I stationed myself by the side of the road, along which the slaves, amounting to three hundred and fifty, were to pass. The purchaser of my wife was a Methodist minister, who was about starting for North Carolina. Pretty soon five waggon-loads of little children passed, and looking at the foremost one, what should I see but a little child, pointing its tiny hand towards me, exclaiming, “There’s my father; I knew he would come and bid me good-bye.” It was my eldest child! Soon the gang approached in which my wife was chained. I looked, and beheld her familiar face; but O, reader, that glance of agony! may God spare me ever again enduring the excruciating horror of that moment! She passed, and came near to where I stood. I seized hold of her hand, intending to bid her farewell; but words failed me; the gift of utterance had fled, and I remained speechless. I followed her for some distance, with her hand grasped in mine, as if to save her from her fate, but I could not speak, and I was obliged to turn away in silence.

In a time when telecommunications were primitive and blacks lacked freedom of movement, the parting of black families was a kind of murder. Here we find the roots of American wealth and democracy—in the for-profit destruction of the most important asset available to any people, the family. The destruction was not incidental to America’s rise; it facilitated that rise. By erecting a slave society, America created the economic foundation for its great experiment in democracy. The labor strife that seeded Bacon’s rebellion was suppressed. America’s indispensable working class existed as property beyond the realm of politics, leaving white Americans free to trumpet their love of freedom and democratic values. Assessing antebellum democracy in Virginia, a visitor from England observed that the state’s natives “can profess an unbounded love of liberty and of democracy in consequence of the mass of the people, who in other countries might become mobs, being there nearly altogether composed of their own Negro slaves.”

V. The Quiet Plunder

The consequences of 250 years of enslavement, of war upon black families and black people, were profound. Like homeownership today, slave ownership was aspirational, attracting not just those who owned slaves but those who wished to. Much as homeowners today might discuss the addition of a patio or the painting of a living room, slaveholders traded tips on the best methods for breeding workers, exacting labor, and doling out punishment. Just as a homeowner today might subscribe to a magazine like This Old House, slaveholders had journals such as De Bow’s
*Review*, which recommended the best practices for wringing profits from slaves. By the dawn of the Civil War, the enslavement of black America was thought to be so foundational to the country that those who sought to end it were branded heretics worthy of death. Imagine what would happen if a president today came out in favor of taking all American homes from their owners: the reaction might well be violent.

Click the image above to view the full document.

“This country was formed for the *white*, not for the black man,” John Wilkes Booth wrote, before killing Abraham Lincoln. “And looking upon *African slavery* from the same standpoint held by those noble framers of our Constitution, I for one have ever considered it one of the greatest blessings (both for themselves and us) that God ever bestowed upon a favored nation.”

In the aftermath of the Civil War, Radical Republicans attempted to reconstruct the country upon something resembling universal equality—but they were beaten back by a campaign of “Redemption,” led by White Liners, Red Shirts, and Klansmen bent on upholding a society “formed for the *white*, not for the black man.” A wave of terrorism roiled the South. In his massive history *Reconstruction*, Eric Foner recounts incidents of black people being attacked for not removing their hats; for refusing to hand over a whiskey flask; for disobeying church procedures; for “using insolent language”; for disputing labor contracts; for refusing to be “tied like a slave.” Sometimes the attacks were intended simply to “thin out the niggers a little.”

Terrorism carried the day. Federal troops withdrew from the South in 1877. The dream of Reconstruction died. For the next century, political violence was visited upon blacks wantonly, with special treatment meted out toward black people of ambition. Black schools and churches were burned to the ground. Black voters and the political candidates who attempted to rally them were intimidated, and some were murdered. At the end of World War I, black veterans returning to their homes were assaulted for daring to wear the American uniform. The demobilization of soldiers after the war, which put white and black veterans into competition for scarce jobs, produced the Red Summer of 1919: a succession of racist pogroms against dozens of cities ranging from Longview, Texas, to Chicago to Washington, D.C. Organized white violence against blacks continued into the 1920s—in 1921 a white mob leveled Tulsa’s “Black Wall Street,” and in 1923 another one razed the black town of Rosewood, Florida—and virtually no one was punished.
A postcard dated August 3, 1920, depicts the aftermath of a lynching in Center, Texas, near the Louisiana border. According to the text on the other side, the victim was a 16-year-old boy.

The work of mobs was a rabid and violent rendition of prejudices that extended even into the upper reaches of American government. The New Deal is today remembered as a model for what progressive government should do—cast a broad social safety net that protects the poor and the afflicted while building the middle class. When progressives wish to express their disappointment with Barack Obama, they point to the accomplishments of Franklin Roosevelt. But these progressives rarely note that Roosevelt’s New Deal, much like the democracy that produced it, rested on the foundation of Jim Crow.

“The Jim Crow South,” writes Ira Katznelson, a history and political-science professor at Columbia, “was the one collaborator America’s democracy could not do without.” The marks of that collaboration are all over the New Deal. The omnibus programs passed under the Social Security Act in 1935 were crafted in such a way as to protect the southern way of life. Old-age insurance (Social Security proper) and unemployment insurance excluded farmworkers and domestics—jobs heavily occupied by blacks. When President Roosevelt signed Social Security into law in 1935, 65 percent of African Americans nationally and between 70 and 80 percent in the South were ineligible. The NAACP protested, calling the new American safety net “a sieve with holes just big enough for the majority of Negroes to fall through.”

The oft-celebrated G.I. Bill similarly failed black Americans, by mirroring the broader country’s insistence on a racist housing policy. Though ostensibly color-blind, Title III of the bill, which aimed to give veterans access to low-interest home loans, left black veterans to tangle with white
officials at their local Veterans Administration as well as with the same banks that had, for years, refused to grant mortgages to blacks. The historian Kathleen J. Frydl observes in her 2009 book, *The GI Bill*, that so many blacks were disqualified from receiving Title III benefits “that it is more accurate simply to say that blacks could not use this particular title.”

In Cold War America, homeownership was seen as a means of instilling patriotism, and as a civilizing and anti-radical force. “No man who owns his own house and lot can be a Communist,” claimed William Levitt, who pioneered the modern suburb with the development of the various Levittowns, his famous planned communities. “He has too much to do.”

But the Levittowns were, with Levitt’s willing acquiescence, segregated throughout their early years. Daisy and Bill Myers, the first black family to move into Levittown, Pennsylvania, were greeted with protests and a burning cross. A neighbor who opposed the family said that Bill Myers was “probably a nice guy, but every time I look at him I see $2,000 drop off the value of my house.”

The neighbor had good reason to be afraid. Bill and Daisy Myers were from the other side of John C. Calhoun’s dual society. If they moved next door, housing policy almost guaranteed that their neighbors’ property values would decline.

In August 1957, state police pull teenagers out of a car during a demonstration against Bill and Daisy Myers, the first African Americans to move into Levittown, Pennsylvania. (AP Photo/Bill Ingraham)

Whereas shortly before the New Deal, a typical mortgage required a large down payment and full repayment within about 10 years, the creation of the Home Owners’ Loan Corporation in 1933 and then the Federal Housing Administration the following year allowed banks to offer loans requiring no more than 10 percent down, amortized over 20 to 30 years. “Without federal intervention in the housing market, massive suburbanization would have been impossible,” writes Thomas J. Sugrue, a historian at the University of Pennsylvania. “In 1930, only 30 percent of Americans owned their own homes; by 1960, more than 60 percent were home owners. Home ownership became an emblem of American citizenship.”

That emblem was not to be awarded to blacks. The American real-estate industry believed segregation to be a moral principle. As late as 1950, the National Association of Real Estate Boards’ code of ethics warned that “a Realtor should never be instrumental in introducing into a neighborhood … any race or nationality, or any individuals whose presence will clearly be detrimental to property values.” A 1943 brochure specified that such potential undesirables might include madams, bootleggers, gangsters—and “a colored man of means who was giving his children a college education and thought they were entitled to live among whites.”

The federal government concurred. It was the Home Owners’ Loan Corporation, not a private trade association, that pioneered the practice of redlining, selectively granting loans and insisting that any property it insured be covered by a restrictive covenant—a clause in the deed forbidding
the sale of the property to anyone other than whites. Millions of dollars flowed from tax coffers into segregated white neighborhoods.

One man said his black neighbor was “probably a nice guy, but every time I look at him I see $2,000 drop off the value of my house.”

“For perhaps the first time, the federal government embraced the discriminatory attitudes of the marketplace,” the historian Kenneth T. Jackson wrote in his 1985 book, Crabgrass Frontier, a history of suburbanization. “Previously, prejudices were personalized and individualized; FHA exhorted segregation and enshrined it as public policy. Whole areas of cities were declared ineligible for loan guarantees.” Redlining was not officially outlawed until 1968, by the Fair Housing Act. By then the damage was done—and reports of redlining by banks have continued.

The federal government is premised on equal fealty from all its citizens, who in return are to receive equal treatment. But as late as the mid-20th century, this bargain was not granted to black people, who repeatedly paid a higher price for citizenship and received less in return. Plunder had been the essential feature of slavery, of the society described by Calhoun. But practically a full century after the end of the Civil War and the abolition of slavery, the plunder—quiet, systemic, submerged—continued even amidst the aims and achievements of New Deal liberals.

VI. Making The Second Ghetto

Today Chicago is one of the most segregated cities in the country, a fact that reflects assiduous planning. In the effort to uphold white supremacy at every level down to the neighborhood, Chicago—a city founded by the black fur trader Jean Baptiste Point du Sable—has long been a pioneer. The efforts began in earnest in 1917, when the Chicago Real Estate Board, horrified by the influx of southern blacks, lobbied to zone the entire city by race. But after the Supreme Court ruled against explicit racial zoning that year, the city was forced to pursue its agenda by more-discreet means.

Like the Home Owners’ Loan Corporation, the Federal Housing Administration initially insisted on restrictive covenants, which helped bar blacks and other ethnic undesirables from receiving federally backed home loans. By the 1940s, Chicago led the nation in the use of these restrictive covenants, and about half of all residential neighborhoods in the city were effectively off-limits to blacks.

It is common today to become misty-eyed about the old black ghetto, where doctors and lawyers lived next door to meatpackers and steelworkers, who themselves lived next door to prostitutes and the unemployed. This segregationist nostalgia ignores the actual conditions endured by the people living there—vermin and arson, for instance—and ignores the fact that the old ghetto was premised on denying black people privileges enjoyed by white Americans.

In 1948, when the Supreme Court ruled that restrictive covenants, while permissible, were not enforceable by judicial action, Chicago had other weapons at the ready. The Illinois state legislature had already given Chicago’s city council the right to approve—and thus to veto—any public housing in the city’s wards. This came in handy in 1949, when a new federal housing act
sent millions of tax dollars into Chicago and other cities around the country. Beginning in 1950, site selection for public housing proceeded entirely on the grounds of segregation. By the 1960s, the city had created with its vast housing projects what the historian Arnold R. Hirsch calls a “second ghetto,” one larger than the old Black Belt but just as impermeable. More than 98 percent of all the family public-housing units built in Chicago between 1950 and the mid-1960s were built in all-black neighborhoods.

Governmental embrace of segregation was driven by the virulent racism of Chicago’s white citizens. White neighborhoods vulnerable to black encroachment formed block associations for the sole purpose of enforcing segregation. They lobbied fellow whites not to sell. They lobbied those blacks who did manage to buy to sell back. In 1949, a group of Englewood Catholics formed block associations intended to “keep up the neighborhood.” Translation: keep black people out. And when civic engagement was not enough, when government failed, when private banks could no longer hold the line, Chicago turned to an old tool in the American repertoire—racial violence. “The pattern of terrorism is easily discernible,” concluded a Chicago civic group in the 1940s. “It is at the seams of the black ghetto in all directions.” On July 1 and 2 of 1946, a mob of thousands assembled in Chicago’s Park Manor neighborhood, hoping to eject a black doctor who’d recently moved in. The mob pelted the house with rocks and set the garage on fire. The doctor moved away.

In 1947, after a few black veterans moved into the Fernwood section of Chicago, three nights of rioting broke out; gangs of whites yanked blacks off streetcars and beat them. Two years later, when a union meeting attended by blacks in Englewood triggered rumors that a home was being “sold to niggers,” blacks (and whites thought to be sympathetic to them) were beaten in the streets. In 1951, thousands of whites in Cicero, 20 minutes or so west of downtown Chicago, attacked an apartment building that housed a single black family, throwing bricks and firebombs through the windows and setting the apartment on fire. A Cook County grand jury declined to charge the rioters—and instead indicted the family’s NAACP attorney, the apartment’s white owner, and the owner’s attorney and rental agent, charging them with conspiring to lower property values. Two years after that, whites picketed and planted explosives in South Deering, about 30 minutes from downtown Chicago, to force blacks out.

The September 1966 Cicero protest against housing discrimination was one of the first nonviolent civil-rights campaigns launched near a major city. (Associated Press)

When terrorism ultimately failed, white homeowners simply fled the neighborhood. The traditional terminology, white flight, implies a kind of natural expression of preference. In fact, white flight was a triumph of social engineering, orchestrated by the shared racist presumptions of America’s public and private sectors. For should any nonracist white families decide that integration might not be so bad as a matter of principle or practicality, they still had to contend with the hard facts of American housing policy: When the mid-20th-century white homeowner claimed that the presence of a Bill and Daisy Myers decreased his property value, he was not merely engaging in racist dogma—he was accurately observing the impact of federal policy on market prices. Redlining destroyed the possibility of investment wherever black people lived.
VII. “A Lot Of People Fell By The Way”

Speculators in North Lawndale, and at the edge of the black ghettos, knew there was money to be made off white panic. They resorted to “block-busting”—spooking whites into selling cheap before the neighborhood became black. They would hire a black woman to walk up and down the street with a stroller. Or they’d hire someone to call a number in the neighborhood looking for “Johnny Mae.” Then they’d cajole whites into selling at low prices, informing them that the more blacks who moved in, the more the value of their homes would decline, so better to sell now. With these white-fled homes in hand, speculators then turned to the masses of black people who had streamed northward as part of the Great Migration, or who were desperate to escape the ghettos: the speculators would take the houses they’d just bought cheap through block-busting and sell them to blacks on contract.

To keep up with his payments and keep his heat on, Clyde Ross took a second job at the post office and then a third job delivering pizza. His wife took a job working at Marshall Field. He had to take some of his children out of private school. He was not able to be at home to supervise his children or help them with their homework. Money and time that Ross wanted to give his children went instead to enrich white speculators.

“The problem was the money,” Ross told me. “Without the money, you can’t move. You can’t give them the right kind of food. Can’t make the house look good. They think this neighborhood is where they supposed to be. It changes their outlook. My kids were going to the best schools in this neighborhood, and I couldn’t keep them in there.”

Mattie Lewis came to Chicago from her native Alabama in the mid-‘40s, when she was 21, persuaded by a friend who told her she could get a job as a hairdresser. Instead she was hired by Western Electric, where she worked for 41 years. I met Lewis in the home of her neighbor Ethel Weatherspoon. Both had owned homes in North Lawndale for more than 50 years. Both had bought their houses on contract. Both had been active with Clyde Ross in the Contract Buyers League’s effort to garner restitution from contract sellers who’d operated in North Lawndale, banks who’d backed the scheme, and even the Federal Housing Administration. We were joined by Jack Macnamara, who’d been an organizing force in the Contract Buyers League when it was founded, in 1968. Our gathering had the feel of a reunion, because the writer James Alan McPherson had profiled the Contract Buyers League for The Atlantic back in 1972.
Weatherspoon bought her home in 1957. “Most of the whites started moving out,” she told me. “The blacks are coming. The blacks are coming.” They actually said that. They had signs up: Don’t sell to blacks.”

Before moving to North Lawndale, Lewis and her husband tried moving to Cicero after seeing a house advertised for sale there. “Sorry, I just sold it today,” the Realtor told Lewis’s husband. “I told him, ‘You know they don’t want you in Cicero,’ ” Lewis recalls. “‘They ain’t going to let nobody black in Cicero.’ ”

In 1958, the couple bought a home in North Lawndale on contract. They were not blind to the unfairness. But Lewis, born in the teeth of Jim Crow, considered American piracy—black people keep on making it, white people keep on taking it—a fact of nature. “All I wanted was a house. And that was the only way I could get it. They weren’t giving black people loans at that time,” she said. “We thought, ‘This is the way it is. We going to do it till we die, and they ain’t never going to accept us. That’s just the way it is.’ ”

“The only way you were going to buy a house was to do it the way they wanted,” she continued. “And I was determined to get me a house. If everybody else can have one, I want one too.” I had worked for white people in the South. And I saw how these white people were living in the
North and I thought, ‘One day I’m going to live just like them.’ I wanted cabinets and all these things these other people have.”

White flight was not an accident—it was a triumph of racist social engineering.

Whenever she visited white co-workers at their homes, she saw the difference. “I could see we were just getting ripped off,” she said. “I would see things and I would say, ‘I’d like to do this at my house.’ And they would say, ‘Do it,’ but I would think, ‘I can’t, because it costs us so much more.’”

I asked Lewis and Weatherspoon how they kept up on payments.

“You paid it and kept working,” Lewis said of the contract. “When that payment came up, you knew you had to pay it.”


Ethel Weatherspoon at her home in North Lawndale. After she bought it in 1957, she says, “most of the whites started moving out.” (Carlos Javier Ortiz)

“You cut down on things for your child, that was the main thing,” said Lewis. “My oldest wanted to be an artist and my other wanted to be a dancer and my other wanted to take music.”

Lewis and Weatherspoon, like Ross, were able to keep their homes. The suit did not win them any remuneration. But it forced contract sellers to the table, where they allowed some members of the Contract Buyers League to move into regular mortgages or simply take over their houses outright. By then they’d been bilked for thousands. In talking with Lewis and Weatherspoon, I was seeing only part of the picture—the tiny minority who’d managed to hold on to their homes. But for all our exceptional ones, for every Barack and Michelle Obama, for every Ethel Weatherspoon or Clyde Ross, for every black survivor, there are so many thousands gone.
Deputy sheriffs patrol a Chicago street in 1970 after a dozen Contract Buyers League families were evicted. (Courtesy of Sun-Times Media)

“A lot of people fell by the way,” Lewis told me. “One woman asked me if I would keep all her china. She said, ‘They ain’t going to set you out.’ ”

VIII. “Negro Poverty is not White Poverty”

On a recent spring afternoon in North Lawndale, I visited Billy Lamar Brooks Sr. Brooks has been an activist since his youth in the Black Panther Party, when he aided the Contract Buyers League. I met him in his office at the Better Boys Foundation, a staple of North Lawndale whose mission is to direct local kids off the streets and into jobs and college. Brooks’s work is personal. On June 14, 1991, his 19-year-old son, Billy Jr., was shot and killed. “These guys tried to stick him up,” Brooks told me. “I suspect he could have been involved in some things … He’s always on my mind. Every day.”

Brooks was not raised in the streets, though in such a neighborhood it is impossible to avoid the influence. “I was in church three or four times a week. That’s where the girls were,” he said, laughing. “The stark reality is still there. There’s no shield from life. You got to go to school. I lived here. I went to Marshall High School. Over here were the Egyptian Cobras. Over there were the Vice Lords.”

Brooks has since moved away from Chicago’s West Side. But he is still working in North Lawndale. If “you got a nice house, you live in a nice neighborhood, then you are less prone to violence, because your space is not deprived,” Brooks said. “You got a security point. You don’t need no protection.” But if “you grow up in a place like this, housing sucks. When they tore down the projects here, they left the high-rises and came to the neighborhood with that gang
mentality. You don’t have nothing, so you going to take something, even if it’s not real. You don’t have no street, but in your mind it’s yours.”

**Video: The Guardian of North Lawndale**

Visit North Lawndale today with Billy Brooks

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We walked over to a window behind his desk. A group of young black men were hanging out in front of a giant mural memorializing two black men: In Lovin Memory Quentin aka “Q,” July 18, 1974 ❤ March 2, 2012. The name and face of the other man had been spray-painted over by a rival group. The men drank beer. Occasionally a car would cruise past, slow to a crawl, then stop. One of the men would approach the car and make an exchange, then the car would drive off. Brooks had known all of these young men as boys.

“That’s their corner,” he said.

We watched another car roll through, pause briefly, then drive off. “No respect, no shame,” Brooks said. “That’s what they do. From that alley to that corner. They don’t go no farther than that. See the big brother there? He almost died a couple of years ago. The one drinking the beer back there … I know all of them. And the reason they feel safe here is cause of this building, and because they too chickenshit to go anywhere. But that’s their mentality. That’s their block.”

Brooks showed me a picture of a Little League team he had coached. He went down the row of kids, pointing out which ones were in jail, which ones were dead, and which ones were doing all right. And then he pointed out his son—“That’s my boy, Billy,” Brooks said. Then he wondered aloud if keeping his son with him while working in North Lawndale had hastened his death. “It’s a definite connection, because he was part of what I did here. And I think maybe I shouldn’t have exposed him. But then, I had to,” he said, “because I wanted him with me.”

From the White House on down, the myth holds that fatherhood is the great antidote to all that ails black people. But Billy Brooks Jr. had a father. Trayvon Martin had a father. Jordan Davis had a father. Adhering to middle-class norms has never shielded black people from plunder. Adhering to middle-class norms is what made Ethel Weatherspoon a lucrative target for rapacious speculators. Contract sellers did not target the very poor. They targeted black people who had worked hard enough to save a down payment and dreamed of the emblem of American citizenship—homeownership. It was not a tangle of pathology that put a target on Clyde Ross’s back. It was not a culture of poverty that singled out Mattie Lewis for “the thrill of the chase and the kill.” Some black people always will be twice as good. But they generally find white predation to be thrice as fast.
Is affirmative action meant to increase “diversity”? If so, it only tangentially relates to the specific problems of black people.

Liberals today mostly view racism not as an active, distinct evil but as a relative of white poverty and inequality. They ignore the long tradition of this country actively punishing black success—and the elevation of that punishment, in the mid-20th century, to federal policy. President Lyndon Johnson may have noted in his historic civil-rights speech at Howard University in 1965 that “Negro poverty is not white poverty.” But his advisers and their successors were, and still are, loath to craft any policy that recognizes the difference.

After his speech, Johnson convened a group of civil-rights leaders, including the esteemed A. Philip Randolph and Bayard Rustin, to address the “ancient brutality.” In a strategy paper, they agreed with the president that “Negro poverty is a special, and particularly destructive, form of American poverty.” But when it came to specifically addressing the “particularly destructive,” Rustin’s group demurred, preferring to advance programs that addressed “all the poor, black and white.”

reporter’s notebook
White Racism vs. White Resentment
“The idea that Affirmative Action justifies white resentment may be the greatest argument made for reparations—like ever.”
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The urge to use the moral force of the black struggle to address broader inequalities originates in both compassion and pragmatism. But it makes for ambiguous policy. Affirmative action’s precise aims, for instance, have always proved elusive. Is it meant to make amends for the crimes heaped upon black people? Not according to the Supreme Court. In its 1978 ruling in Regents of the University of California v. Bakke, the Court rejected “societal discrimination” as “an amorphous concept of injury that may be ageless in its reach into the past.” Is affirmative action meant to increase “diversity”? If so, it only tangentially relates to the specific problems of black people—the problem of what America has taken from them over several centuries.

This confusion about affirmative action’s aims, along with our inability to face up to the particular history of white-imposed black disadvantage, dates back to the policy’s origins. “There is no fixed and firm definition of affirmative action,” an appointee in Johnson’s Department of Labor declared. “Affirmative action is anything that you have to do to get results. But this does not necessarily include preferential treatment.”

Yet America was built on the preferential treatment of white people—395 years of it. Vaguely endorsing a cuddly, feel-good diversity does very little to redress this.

Today, progressives are loath to invoke white supremacy as an explanation for anything. On a practical level, the hesitation comes from the dim view the Supreme Court has taken of the reforms of the 1960s. The Voting Rights Act has been gutted. The Fair Housing Act might well be next. Affirmative action is on its last legs. In substituting a broad class struggle for an anti-racist struggle, progressives hope to assemble a coalition by changing the subject.
The politics of racial evasion are seductive. But the record is mixed. Aid to Families With Dependent Children was originally written largely to exclude blacks—yet by the 1990s it was perceived as a giveaway to blacks. The Affordable Care Act makes no mention of race, but this did not keep Rush Limbaugh from denouncing it as reparations. Moreover, the act’s expansion of Medicaid was effectively made optional, meaning that many poor blacks in the former Confederate states do not benefit from it. The Affordable Care Act, like Social Security, will eventually expand its reach to those left out; in the meantime, black people will be injured.

Billy Brooks, who assisted the Contract Buyers League, still works in the neighborhood, helping kids escape poverty and violence. (Carlos Javier Ortiz)

“All that it would take to sink a new WPA program would be some skillfully packaged footage of black men leaning on shovels smoking cigarettes,” the sociologist Douglas S. Massey writes. “Papering over the issue of race makes for bad social theory, bad research, and bad public policy.” To ignore the fact that one of the oldest republics in the world was erected on a foundation of white supremacy, to pretend that the problems of a dual society are the same as the problems of unregulated capitalism, is to cover the sin of national plunder with the sin of national lying. The lie ignores the fact that reducing American poverty and ending white supremacy are not the same. The lie ignores the fact that closing the “achievement gap” will do nothing to close the “injury gap,” in which black college graduates still suffer higher unemployment rates than white college graduates, and black job applicants without criminal records enjoy roughly the same chance of getting hired as white applicants with criminal records.

Chicago, like the country at large, embraced policies that placed black America’s most energetic, ambitious, and thrifty countrymen beyond the pale of society and marked them as rightful targets for legal theft. The effects reverberate beyond the families who were robbed to the community that beholds the spectacle. Don’t just picture Clyde Ross working three jobs so he could hold on to his home. Think of his North Lawndale neighbors—their children, their nephews and nieces—and consider how watching this affects them. Imagine yourself as a young black child watching your elders play by all the rules only to have their possessions tossed out in the street and to have their most sacred possession—their home—taken from them.

The message the young black boy receives from his country, Billy Brooks says, is “‘You ain’t shit. You not no good. The only thing you are worth is working for us. You will never own anything. You not going to get an education. We are sending your ass to the penitentiary.’ They’re telling you no matter how hard you struggle, no matter what you put down, you ain’t shit. ‘We’re going to take what you got. You will never own anything, nigger.’”

IX. Toward A New Country

When Clyde Ross was a child, his older brother Winter had a seizure. He was picked up by the authorities and delivered to Parchman Farm, a 20,000-acre state prison in the Mississippi Delta region.
“He was a gentle person,” Clyde Ross says of his brother. “You know, he was good to everybody. And he started having spells, and he couldn’t control himself. And they had him picked up, because they thought he was dangerous.”

Built at the turn of the century, Parchman was supposed to be a progressive and reformist response to the problem of “Negro crime.” In fact it was the gulag of Mississippi, an object of terror to African Americans in the Delta. In the early years of the 20th century, Mississippi Governor James K. Vardaman used to amuse himself by releasing black convicts into the surrounding wilderness and hunting them down with bloodhounds. “Throughout the American South,” writes David M. Oshinsky in his book *Worse Than Slavery*, “Parchman Farm is synonymous with punishment and brutality, as well it should be … Parchman is the quintessential penal farm, the closest thing to slavery that survived the Civil War.”

When the Ross family went to retrieve Winter, the authorities told them that Winter had died. When the Ross family asked for his body, the authorities at Parchman said they had buried him. The family never saw Winter’s body.

And this was just one of their losses.

Scholars have long discussed methods by which America might make reparations to those on whose labor and exclusion the country was built. In the 1970s, the Yale Law professor Boris Bittker argued in *The Case for Black Reparations* that a rough price tag for reparations could be determined by multiplying the number of African Americans in the population by the difference in white and black per capita income. That number—$34 billion in 1973, when Bittker wrote his book—could be added to a reparations program each year for a decade or two. Today Charles Ogletree, the Harvard Law School professor, argues for something broader: a program of job training and public works that takes racial justice as its mission but includes the poor of all races.

To celebrate freedom and democracy while forgetting America’s origins in a slavery economy is patriotism à la carte.

Perhaps no statistic better illustrates the enduring legacy of our country’s shameful history of treating black people as sub-citizens, sub-Americans, and sub-humans than the wealth gap. Reparations would seek to close this chasm. But as surely as the creation of the wealth gap required the cooperation of every aspect of the society, bridging it will require the same.

When we think of white supremacy, we picture Colored Only signs, but we should picture pirate flags.

Perhaps after a serious discussion and debate—the kind that HR 40 proposes—we may find that the country can never fully repay African Americans. But we stand to discover much about ourselves in such a discussion—and that is perhaps what scares us. The idea of reparations is frightening not simply because we might lack the ability to pay. The idea of reparations threatens something much deeper—America’s heritage, history, and standing in the world.
The early American economy was built on slave labor. The Capitol and the White House were built by slaves. President James K. Polk traded slaves from the Oval Office. The laments about “black pathology,” the criticism of black family structures by pundits and intellectuals, ring hollow in a country whose existence was predicated on the torture of black fathers, on the rape of black mothers, on the sale of black children. An honest assessment of America’s relationship to the black family reveals the country to be not its nurturer but its destroyer.

And this destruction did not end with slavery. Discriminatory laws joined the equal burden of citizenship to unequal distribution of its bounty. These laws reached their apex in the mid-20th century, when the federal government—through housing policies—engineered the wealth gap, which remains with us to this day. When we think of white supremacy, we picture Colored Only signs, but we should picture pirate flags.

On some level, we have always grasped this.

“Negro poverty is not white poverty,” President Johnson said in his historic civil-rights speech.

Many of its causes and many of its cures are the same. But there are differences—deep, corrosive, obstinate differences—radiating painful roots into the community and into the family, and the nature of the individual. These differences are not racial differences. They are solely and simply the consequence of ancient brutality, past injustice, and present prejudice.

We invoke the words of Jefferson and Lincoln because they say something about our legacy and our traditions. We do this because we recognize our links to the past—at least when they flatter us. But black history does not flatter American democracy; it chastens it. The popular mocking of reparations as a harebrained scheme authored by wild-eyed lefties and intellectually unserious black nationalists is fear masquerading as laughter. Black nationalists have always perceived something unmentionable about America that integrationists dare not acknowledge—that white supremacy is not merely the work of hotheaded demagogues, or a matter of false consciousness, but a force so fundamental to America that it is difficult to imagine the country without it.

And so we must imagine a new country. Reparations—by which I mean the full acceptance of our collective biography and its consequences—is the price we must pay to see ourselves squarely. The recovering alcoholic may well have to live with his illness for the rest of his life. But at least he is not living a drunken lie. Reparations beckons us to reject the intoxication of hubris and see America as it is—the work of fallible humans.

Won’t reparations divide us? Not any more than we are already divided. The wealth gap merely puts a number on something we feel but cannot say—that American prosperity was ill-gotten and selective in its distribution. What is needed is an airing of family secrets, a settling with old ghosts. What is needed is a healing of the American psyche and the banishment of white guilt.

What I’m talking about is more than recompense for past injustices—more than a handout, a payoff, hush money, or a reluctant bribe. What I’m talking about is a national reckoning that would lead to spiritual renewal. Reparations would mean the end of scarfing hot dogs on the Fourth of July while denying the facts of our heritage. Reparations would mean the end of
yelling “patriotism” while waving a Confederate flag. Reparations would mean a revolution of the American consciousness, a reconciling of our self-image as the great democratizer with the facts of our history.

X. “There Will Be No ‘Reparations’ From Germany”

We are not the first to be summoned to such a challenge.

In 1952, when West Germany began the process of making amends for the Holocaust, it did so under conditions that should be instructive to us. Resistance was violent. Very few Germans believed that Jews were entitled to anything. Only 5 percent of West Germans surveyed reported feeling guilty about the Holocaust, and only 29 percent believed that Jews were owed restitution from the German people.

reporter’s notebook

The Auschwitz All Around Us

“It’s very hard to accept white supremacy as a structure erected by actual people, as a choice, as an interest, as opposed to a momentary bout of insanity.”

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“The rest,” the historian Tony Judt wrote in his 2005 book, Postwar, “were divided between those (some two-fifths of respondents) who thought that only people ‘who really committed something’ were responsible and should pay, and those (21 percent) who thought ‘that the Jews themselves were partly responsible for what happened to them during the Third Reich.’”

Germany’s unwillingness to squarely face its history went beyond polls. Movies that suggested a societal responsibility for the Holocaust beyond Hitler were banned. “The German soldier fought bravely and honorably for his homeland,” claimed President Eisenhower, endorsing the Teutonic national myth. Judt wrote, “Throughout the fifties West German officialdom encouraged a comfortable view of the German past in which the Wehrmacht was heroic, while Nazis were in a minority and properly punished.”

Konrad Adenauer, the postwar German chancellor, was in favor of reparations, but his own party was divided, and he was able to get an agreement passed only with the votes of the Social Democratic opposition.

“If I could take German property without sitting down with them for even a minute but go in with jeeps and machine guns,” said David Ben-Gurion, “I would do that.”

Among the Jews of Israel, reparations provoked violent and venomous reactions ranging from denunciation to assassination plots. On January 7, 1952, as the Knesset—the Israeli parliament—convened to discuss the prospect of a reparations agreement with West Germany, Menachem Begin, the future prime minister of Israel, stood in front of a large crowd, inveighing against the country that had plundered the lives, labor, and property of his people. Begin claimed that all Germans were Nazis and guilty of murder. His condemnations then spread to his own young state. He urged the crowd to stop paying taxes and claimed that the nascent Israeli nation
characterized the fight over whether or not to accept reparations as a “war to the death.” When alerted that the police watching the gathering were carrying tear gas, allegedly of German manufacture, Begin yelled, “The same gases that asphyxiated our parents!”

Begin then led the crowd in an oath to never forget the victims of the Shoah, lest “my right hand lose its cunning” and “my tongue cleave to the roof of my mouth.” He took the crowd through the streets toward the Knesset. From the rooftops, police repelled the crowd with tear gas and smoke bombs. But the wind shifted, and the gas blew back toward the Knesset, billowing through windows shattered by rocks. In the chaos, Begin and Prime Minister David Ben-Gurion exchanged insults. Two hundred civilians and 140 police officers were wounded. Nearly 400 people were arrested. Knesset business was halted.

Begin then addressed the chamber with a fiery speech condemning the actions the legislature was about to take. “Today you arrested hundreds,” he said. “Tomorrow you may arrest thousands. No matter, they will go, they will sit in prison. We will sit there with them. If necessary, we will be killed with them. But there will be no ‘reparations’ from Germany.”

Nahum Goldman, the president of the Jewish Claims Commission (center), signs 1952 reparations agreements between Germany and Israel. The two delegations entered the room by different doors, and the ceremony was carried out in silence. (Associated Press)

Survivors of the Holocaust feared laundering the reputation of Germany with money, and mortgaging the memory of their dead. Beyond that, there was a taste for revenge. “My soul would be at rest if I knew there would be 6 million German dead to match the 6 million Jews,” said Meir Dworzecki, who’d survived the concentration camps of Estonia.

Ben-Gurion countered this sentiment, not by repudiating vengeance but with cold calculation: “If I could take German property without sitting down with them for even a minute but go in with jeeps and machine guns to the warehouses and take it, I would do that—if, for instance, we had the ability to send a hundred divisions and tell them, ‘Take it.’ But we can’t do that.”

The reparations conversation set off a wave of bomb attempts by Israeli militants. One was aimed at the foreign ministry in Tel Aviv. Another was aimed at Chancellor Adenauer himself. And one was aimed at the port of Haifa, where the goods bought with reparations money were arriving. West Germany ultimately agreed to pay Israel 3.45 billion deutsche marks, or more than $7 billion in today’s dollars. Individual reparations claims followed—for psychological trauma, for offense to Jewish honor, for halting law careers, for life insurance, for time spent in concentration camps. Seventeen percent of funds went toward purchasing ships. “By the end of 1961, these reparations vessels constituted two-thirds of the Israeli merchant fleet,” writes the Israeli historian Tom Segev in his book The Seventh Million. “From 1953 to 1963, the reparations money funded about a third of the total investment in Israel’s electrical system, which tripled its capacity, and nearly half the total investment in the railways.”

Israel’s GNP tripled during the 12 years of the agreement. The Bank of Israel attributed 15 percent of this growth, along with 45,000 jobs, to investments made with reparations money. But
Segev argues that the impact went far beyond that. Reparations “had indisputable psychological and political importance,” he writes.

Reparations could not make up for the murder perpetrated by the Nazis. But they did launch Germany’s reckoning with itself, and perhaps provided a road map for how a great civilization might make itself worthy of the name.

Assessing the reparations agreement, David Ben-Gurion said:

For the first time in the history of relations between people, a precedent has been created by which a great State, as a result of moral pressure alone, takes it upon itself to pay compensation to the victims of the government that preceded it. For the first time in the history of a people that has been persecuted, oppressed, plundered and despoiled for hundreds of years in the countries of Europe, a persecutor and despoiler has been obliged to return part of his spoils and has even undertaken to make collective reparation as partial compensation for material losses.

Something more than moral pressure calls America to reparations. We cannot escape our history. All of our solutions to the great problems of health care, education, housing, and economic inequality are troubled by what must go unspoken. “The reason black people are so far behind now is not because of now,” Clyde Ross told me. “It’s because of then.” In the early 2000s, Charles Ogletree went to Tulsa, Oklahoma, to meet with the survivors of the 1921 race riot that had devastated “Black Wall Street.” The past was not the past to them. “It was amazing seeing these black women and men who were crippled, blind, in wheelchairs,” Ogletree told me. “I had no idea who they were and why they wanted to see me. They said, ‘We want you to represent us in this lawsuit.’”

In the spring of 1921, a white mob leveled “Black Wall Street” in Tulsa, Oklahoma. Here, wounded prisoners ride in an Army truck during the martial law imposed by the Oklahoma governor in response to the race riot. (Hulton-Deutsch Collection/Corbis)

A commission authorized by the Oklahoma legislature produced a report affirming that the riot, the knowledge of which had been suppressed for years, had happened. But the lawsuit ultimately failed, in 2004. Similar suits pushed against corporations such as Aetna (which insured slaves) and Lehman Brothers (whose co-founding partner owned them) also have thus far failed. These results are dispiriting, but the crime with which reparations activists charge the country implicates more than just a few towns or corporations. The crime indicts the American people themselves, at every level, and in nearly every configuration. A crime that implicates the entire American people deserves its hearing in the legislative body that represents them.

John Conyers’s HR 40 is the vehicle for that hearing. No one can know what would come out of such a debate. Perhaps no number can fully capture the multi-century plunder of black people in America. Perhaps the number is so large that it can’t be imagined, let alone calculated and dispensed. But I believe that wrestling publicly with these questions matters as much as—if not more than—the specific answers that might be produced. An America that asks what it owes its most vulnerable citizens is improved and humane. An America that looks away is ignoring not
just the sins of the past but the sins of the present and the certain sins of the future. More important than any single check cut to any African American, the payment of reparations would represent America’s maturation out of the childhood myth of its innocence into a wisdom worthy of its founders.

In 2010, Jacob S. Rugh, then a doctoral candidate at Princeton, and the sociologist Douglas S. Massey published a study of the recent foreclosure crisis. Among its drivers, they found an old foe: segregation. Black home buyers—even after controlling for factors like creditworthiness—were still more likely than white home buyers to be steered toward subprime loans. Decades of racist housing policies by the American government, along with decades of racist housing practices by American businesses, had conspired to concentrate African Americans in the same neighborhoods. As in North Lawndale half a century earlier, these neighborhoods were filled with people who had been cut off from mainstream financial institutions. When subprime lenders went looking for prey, they found black people waiting like ducks in a pen.

“Wells Fargo mortgage had an emerging-markets unit that specifically targeted black churches.”

“High levels of segregation create a natural market for subprime lending,” Rugh and Massey write, “and cause riskier mortgages, and thus foreclosures, to accumulate disproportionately in racially segregated cities’ minority neighborhoods.”

Plunder in the past made plunder in the present efficient. The banks of America understood this. In 2005, Wells Fargo promoted a series of Wealth Building Strategies seminars. Dubbing itself “the nation’s leading originator of home loans to ethnic minority customers,” the bank enrolled black public figures in an ostensible effort to educate blacks on building “generational wealth.” But the “wealth building” seminars were a front for wealth theft. In 2010, the Justice Department filed a discrimination suit against Wells Fargo alleging that the bank had shunted blacks into predatory loans regardless of their creditworthiness. This was not magic or coincidence or misfortune. It was racism reifying itself. According to The New York Times, affidavits found loan officers referring to their black customers as “mud people” and to their subprime products as “ghetto loans.”

“We just went right after them,” Beth Jacobson, a former Wells Fargo loan officer, told The Times. “Wells Fargo mortgage had an emerging-markets unit that specifically targeted black churches because it figured church leaders had a lot of influence and could convince congregants to take out subprime loans.”

In 2011, Bank of America agreed to pay $355 million to settle charges of discrimination against its Countrywide unit. The following year, Wells Fargo settled its discrimination suit for more than $175 million. But the damage had been done. In 2009, half the properties in Baltimore whose owners had been granted loans by Wells Fargo between 2005 and 2008 were vacant; 71 percent of these properties were in predominantly black neighborhoods.
Ta-Nehisi Coates is a former national correspondent for The Atlantic. He is the author of *The Beautiful Struggle*, *Between the World and Me*, *We Were Eight Years in Power*, and *The Water Dancer*. 
Opinion: Would reparations for slavery be constitutional?

Writer Ta-Nehisi Coates testifies on slavery reparations at a June hearing of a House Judiciary subcommittee. (Zach Gibson/Getty Images)

Opinion by Charles Lane
Editorial writer and columnist
August 12, 2019 at 6:25 p.m. EDT

Reparations to African Americans for slavery, and the systemic oppression that followed, is now the stuff of congressional hearings and Democratic presidential debates. Twenty-nine percent of Americans support reparations, according to Gallup, up from 14 percent in 2002.

Increasingly, advocates ask not “if” but “how.” Vox reports the main questions are “what a reparations program would look like, who would benefit, who would pay, and how it would be funded.”

They left one out: Would reparations be constitutional?

Maybe not. Any financial benefits awarded to African Americans in compensation for historical discrimination would collide with well-established Supreme Court precedents.

That doctrine emerged out of two decades of affirmative-action cases, from the mid-1970s to the mid-1990s, during which a center-right court wrestled with how much “reverse discrimination” against whites to allow for the sake of correcting black America’s historical disadvantages.

ADVERTISING

The court’s answer: not much. Under the 14th Amendment, a race-conscious policy, state or federal, could be enacted only if it passed “strict scrutiny” — that is, if it was “narrowly tailored” to meet a “compelling” government interest, through the “least restrictive” means available.

“Diversity” in higher education was a compelling interest, the court ruled, and could be addressed through admissions programs that took race into account but provided all applicants individualized consideration.
In most contexts, though, the court required government to show that it was redressing harm clearly caused by a discriminatory policy, and that government had exhausted other remedies before trying race-conscious ones.

Under this standard, government contracting set-asides intended to support historically disadvantaged African American (or other minority) businesses, in preference to some white-owned ones, were unconstitutional, the court held, because, even in the former Confederate capital, Richmond, the location of a landmark 1989 case, it was too hard to prove that any given minority business suffered discrimination at the hands of the contracting agency.

Justice Thurgood Marshall protested. “A profound difference separates governmental actions that themselves are racist, and governmental actions that seek to remedy the effects of prior racism or to prevent neutral governmental activity from perpetuating the effects of such racism,” he wrote.

But Justice Sandra Day O’Connor had the last word, noting in 1995 that “any individual suffers an injury when he or she is disadvantaged by the government because of his or her race, whatever that race may be.”

Union Army Gen. William T. Sherman’s January 1865 Special Field Order 15, calling for redistribution of white-owned lands to the freed slaves, might have survived “strict scrutiny,” because it compensated people personally victimized by slavery. (Alas, President Andrew Johnson reversed it by fiat.)

Also clearly constitutional: reparations paid to Japanese Americans for their internment during World War II. Like Sherman’s order, this 1988 federal measure compensated the actual victims of a discrete policy.

In his seminal 2014 Atlantic article, “The Case for Reparations,” Ta-Nehisi Coates implied that the situation of African Americans today is essentially similar to that of the newly emancipated in 1865, or the World War II internees, in that they still suffer, not just from slavery, but from much more recent policies such as mid-20th-century federally backed housing discrimination.

Yet today’s conservative-majority court would almost certainly note that subsequent legal reforms such as the 1968 Fair Housing Act or the 1977 Community Reinvestment Act mitigate societal or governmental accountability, and weaken the link between past policy and current hardship.

Even a not-so-conservative jurist might worry that reparations compensate people who do not deserve or need it, while excluding those who do. In 1989, Justice John Paul Stevens looked askance at the Richmond contracting set-aside because it “encompasses persons who have never been in business in Richmond, minority contractors who may have been guilty of discriminating against members of other minority groups.”

As for finding a plaintiff to claim harm from reparations, courts have regularly granted whites and — in a case against Harvard’s admissions program — Asians the right to sue for “reverse
discrimination.” They would likely allow a member of a historically oppressed group to sue for being omitted from blacks-only reparations. A German American sued against compensation for Japanese Americans, on the grounds that he, too, had been detained in World War II. (The U.S. court of appeals in Washington ultimately denied his claim on the merits.)

Erwin Chemerinsky, dean of the University of California at Berkeley School of Law, suggests that reparations could be constitutional if framed as an award to descendants of slaves — not African Americans. (Problem: What about descendants of pre-Civil War free people of color, or immigrants from Africa and the West Indies?) Alternatively, reparations could take the form of a wealth transfer to all low-income Americans, which would disproportionately benefit black people.
Washington, April 14, 2021

Washington, D.C. - Today, House Judiciary Committee Chairman Jerrold Nadler (D-NY) delivered the following opening remarks, as prepared, during the markup of H.R. 40, the Commission to Study and Develop Reparation Proposals for African Americans Act:

"H.R. 40, the 'Commission to Study and Develop Reparation Proposals for African Americans Act,' is historic legislation that would establish a commission to examine the shameful legacy of slavery and Jim Crow in this country, and to develop proposals on how we can best move forward as a nation.

"This legislation is long overdue.

"For nearly three decades, the former Chairman of the House Judiciary Committee, John Conyers of Michigan, introduced H.R. 40. Our colleague, the Gentlewoman from Texas, Ms. Jackson Lee, has taken up sponsorship of this legislation, and I am pleased to be an original cosponsor.

"H.R. 40 is intended to begin a national conversation about how to confront the brutal mistreatment of African Americans during chattel slavery, Jim Crow segregation, and the enduring structural racism that remains endemic to our society today.

"Even long after slavery was abolished, the anti-Black racism that undergirded it reflected and defined part of our nation’s attitudes, shaping its policies and institutions. Today, we still live with racial disparities in access to education, health care, housing, insurance, employment and other social goods that are directly attributable to the damaging legacy of slavery and government-sponsored
red racial discrimination. These disparities in terms of disproportionate burdens on African Americans have only been exacerbated by the COVID-19 pandemic.

"It is important to recognize that H.R. 40 makes no conclusion about how to properly atone for, and make recompense for, the legacy of slavery and its lingering consequences. It does not mandate financial payments of any kind and it does not prejudge the outcome of the commission’s work. Instead, it sets forth a process by which a diverse group of experts and stakeholders can study the complex issues involved and make recommendations.

"In fact, most serious reparations models that have been proposed to date have focused on reparative community-based programs of employment, health care, housing, and educational initiatives—righting wrongs that cannot be fixed with checks alone.

"This moment of national reckoning comes at a time when our nation must find constructive ways to confront a rising tide of racial and ethnic division.

"On January 6, we saw the ugly confluence of such divisions, as white nationalist groups appeared to be among those playing a central role in the violent assault on the United States Capitol. And we continue to see unarmed Black people killed by police at a disproportionate rate, with another tragic death just this week.

"White nationalism and police-community conflict are just part of the long legacy of anti-Black racism that has shaped our nation’s laws, institutions, and societal attitudes. That racism and division hold back our country’s longstanding efforts to carry out what the Preamble to our Constitution says it is designed to do—to form 'a more perfect union.'

"Reparations in the context of H.R. 40 are ultimately about respect and reconciliation—and the hope that one day, all Americans can walk together toward a more just future.

"I hope that the commission established by H.R. 40 can help us better comprehend our own history and bring us closer to racial understanding and advancement.

"The discussion of reparations is a journey in which the road traveled is almost more important than the exact destination. Passing H.R. 40 is an important first step.

"I am pleased that the Judiciary Committee is beginning this journey today and I urge all my colleagues to support this important legislation."

II. H.R. 40,
To address the fundamental injustice, cruelty, brutality, and inhumanity of slavery in the United States and the 13 American colonies between 1619 and 1865 and to establish a commission to study and consider a national apology and proposal for reparations for the institution of slavery, its subsequent de jure and de facto racial and economic discrimination against African Americans, and the impact of these forces on living African Americans, to make recommendations to the Congress on appropriate remedies, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES
JANUARY 4, 2021

Ms. JACKSON LEE (for herself, Ms. PLASKETT, Mr. RUSH, Mr. ESPAILLAT, Mrs. WATSON COLEMAN, Ms. NORTON, Ms. CASTOR of Florida, Ms. LEE of California, Mr. KHANNA, Mrs. BEATTY, Mr. MCNERNEY, Mr. NORCROSS, Mr. RUPPERSBERGER, Ms. ESHOO, Mr. COOPER, Mr. CONNOLLY, Ms. MENG, Mr. RASKIN, Mr. WELCH, Mrs. TRAHAN, Ms. PRESSLEY, Ms. CLARKE of New York, Mr. JEFFRIES, Mr. SARBAES, Mr. BISHOP of Georgia, Ms. DEGETTE, Mr. KILDEE, Ms. BONAMICI, Mr. GREEN of Texas, Ms. MOORE of Wisconsin, Mrs. DINGELL, Ms. ADAMS, Ms. WILLIAMS of Georgia, Mr. BEYER, Mr. CLARK of Massachusetts, Mr. CROW, Mr. SUOZZI, Mr. CICILLINE, Mr. NADLER, Mr. MCGOVERN, Ms. DELBENE, Mr. LYNCH, Mr. JONES, Mr. BlUMENAUER, Mr. KEATING, Mr. NEGUSE, Ms. BLUNT ROCHESTER, Mr. EVANS, Ms. SPEIER, Ms. MCCOLLUM, Ms. JAYAPAL, Mr. MEEKS, Ms. STRICKLAND, Ms. SCANLON, Ms. VELÁZQUEZ, Mr. DEUTCH, Mr. COHEN, Mr. PAYNE, Mr. MORELLE, Ms. WILSON of Florida, Mrs. DEMINGS, Mr. BERA, Mr. TAKANO, Mr. BRENDAN F. BOYLE of Pennsylvania, Ms. SCHAKOWSKY, Mrs. LAWRENCE, Ms. TITUS, Mr. LIEU, Mr. MFUME, Mr. CARSON, Ms. FUDGE, Mr. DAVID SCOTT of Georgia, Ms. BARRAGÁN, Mr. QUIGLEY, Mr. DANNY K. DAVIS of Illinois, Mr. VARGAS, Mr. LARSON of Connecticut, Mr. THOMPSON of Mississippi, Mr. BROWN, Ms. WASSERMAN SCHULTZ, Mr. LOWENTHAL, Mr. KILMER, Mr. NEAL, Mr. PallONE, Ms. SEWELL, Ms. MATSUI, Mr. LAWSON of Florida, Mr. THOMPSON of California, Mr. YARMUTH, Mr. COSTA, Mr. HORSFORD, Ms. PINGREE, Mr. SOTO, Ms. DEAN, Mrs. HAYES, Mr. CASTEN, Mr. DeSAULNIER, Mr. POCAN, Mr. Gomez, Mr. VEASEY, Miss RICE of New York, Ms. LOFGREN, Mr. JOHNSON of Georgia, Ms. KAPTUR, Ms. OMAR, Ms. BASS, Mr. PETERS, Ms. GARCIA of Texas, Ms. ESCOBAR, Mr. SwalWELL, Mr. BUTTERFIELD, Ms. KELLY of Illinois, Mr. BOWMAN, Ms. OCASIO-CORTEZ, Ms. TLAIB, Ms. CHU, Mr. PANETTA, Mr. FOSTER, and Ms. BUSH) introduced the following bill; which was referred to the Committee on the Judiciary

A BILL

To address the fundamental injustice, cruelty, brutality, and inhumanity of slavery in the United States and the 13 American colonies between 1619 and 1865 and to establish a commission to study and consider a national apology and proposal for reparations for the institution of slavery, its subsequent de jure and de facto racial and economic discrimination against
African Americans, and the impact of these forces on living African Americans, to make recommendations to the Congress on appropriate remedies, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Commission to Study and Develop Reparation Proposals for African Americans Act”.

SEC. 2. FINDINGS AND PURPOSE.

(a) FINDINGS.—The Congress finds that—

(1) approximately 4,000,000 Africans and their descendants were enslaved in the United States and colonies that became the United States from 1619 to 1865;

(2) the institution of slavery was constitutionally and statutorily sanctioned by the Government of the United States from 1789 through 1865;

(3) the slavery that flourished in the United States constituted an immoral and inhumane deprivation of Africans’ life, liberty, African citizenship rights, and cultural heritage, and denied them the fruits of their own labor;

(4) a preponderance of scholarly, legal, community evidentiary documentation and popular culture markers constitute the basis for inquiry into the on-going effects of the institution of slavery and its legacy of persistent systemic structures of discrimination on living African Americans and society in the United States;

(5) following the abolition of slavery the United States Government, at the Federal, State, and local level, continued to perpetuate, condone and often profit from practices that continued to brutalize and disadvantage African Americans, including share cropping, convict leasing, Jim Crow, redlining, unequal education, and disproportionate treatment at the hands of the criminal justice system; and

(6) as a result of the historic and continued discrimination, African Americans continue to suffer debilitating economic, educational, and health hardships including but not limited to having nearly 1,000,000 Black people incarcerated; an unemployment rate more than twice the current White unemployment rate; and an average of less than $1/16 of the wealth of White families, a disparity which has worsened, not improved over time.

(b) PURPOSE.—The purpose of this Act is to establish a commission to study and develop Reparation proposals for African Americans as a result of—
(1) the institution of slavery, including both the Trans-Atlantic and the domestic
“trade” which existed from 1565 in colonial Florida and from 1619 through 1865
within the other colonies that became the United States, and which included the Federal
and State governments which constitutionally and statutorily supported the institution
of slavery;

(2) the de jure and de facto discrimination against freed slaves and their
descendants from the end of the Civil War to the present, including economic, political,
educational, and social discrimination;

(3) the lingering negative effects of the institution of slavery and the
discrimination described in paragraphs (1) and (2) on living African Americans and on
society in the United States;

(4) the manner in which textual and digital instructional resources and
technologies are being used to deny the inhumanity of slavery and the crime against
humanity of people of African descent in the United States;

(5) the role of Northern complicity in the Southern based institution of slavery;

(6) the direct benefits to societal institutions, public and private, including higher
education, corporations, religious and associational;

(7) and thus, recommend appropriate ways to educate the American public of the
Commission’s findings;

(8) and thus, recommend appropriate remedies in consideration of the
Commission’s findings on the matters described in paragraphs (1), (2), (3), (4), (5), and
(6); and

(9) submit to the Congress the results of such examination, together with such
recommendations.

SEC. 3. ESTABLISHMENT AND DUTIES.

(a) Establishment.—There is established the Commission to Study and Develop
Reparation Proposals for African Americans (hereinafter in this Act referred to as the
“Commission”).

(b) Duties.—The Commission shall perform the following duties:

(1) Identify, compile and synthesize the relevant corpus of evidentiary
documentation of the institution of slavery which existed within the United States and
the colonies that became the United States from 1619 through 1865. The Commission’s
documentation and examination shall include but not be limited to the facts related
to—
(A) the capture and procurement of Africans;

(B) the transport of Africans to the United States and the colonies that became the United States for the purpose of enslavement, including their treatment during transport;

(C) the sale and acquisition of Africans as chattel property in interstate and intrastate commerce;

(D) the treatment of African slaves in the colonies and the United States, including the deprivation of their freedom, exploitation of their labor, and destruction of their culture, language, religion, and families; and

(E) the extensive denial of humanity, sexual abuse and the chattellization of persons.

(2) The role which the Federal and State governments of the United States supported the institution of slavery in constitutional and statutory provisions, including the extent to which such governments prevented, opposed, or restricted efforts of formerly enslaved Africans and their descendants to repatriate to their homeland.

(3) The Federal and State laws that discriminated against formerly enslaved Africans and their descendants who were deemed United States citizens from 1868 to the present.

(4) The other forms of discrimination in the public and private sectors against freed African slaves and their descendants who were deemed United States citizens from 1868 to the present, including redlining, educational funding discrepancies, and predatory financial practices.

(5) The lingering negative effects of the institution of slavery and the matters described in paragraphs (1), (2), (3), (4), (5), and (6) on living African Americans and on society in the United States.

(6) Recommend appropriate ways to educate the American public of the Commission’s findings.

(7) Recommend appropriate remedies in consideration of the Commission’s findings on the matters described in paragraphs (1), (2), (3), (4), (5), and (6). In making such recommendations, the Commission shall address among other issues, the following questions:

(A) How such recommendations comport with international standards of remedy for wrongs and injuries caused by the State, that include full reparations and special measures, as understood by various relevant international protocols, laws, and findings.
(B) How the Government of the United States will offer a formal apology on behalf of the people of the United States for the perpetration of gross human rights violations and crimes against humanity on African slaves and their descendants.

(C) How Federal laws and policies that continue to disproportionately and negatively affect African Americans as a group, and those that perpetuate the lingering effects, materially and psycho-social, can be eliminated.

(D) How the injuries resulting from matters described in paragraphs (1), (2), (3), (4), (5), and (6) can be reversed and provide appropriate policies, programs, projects and recommendations for the purpose of reversing the injuries.

(E) How, in consideration of the Commission’s findings, any form of compensation to the descendants of enslaved African is calculated.

(F) What form of compensation should be awarded, through what instrumentalities and who should be eligible for such compensation.

(G) How, in consideration of the Commission’s findings, any other forms of rehabilitation or restitution to African descendants is warranted and what the form and scope of those measures should take.

(c) REPORT TO CONGRESS.—The Commission shall submit a written report of its findings and recommendations to the Congress not later than the date which is one year after the date of the first meeting of the Commission held pursuant to section 4(c).

SEC. 4. MEMBERSHIP.

(a) NUMBER AND APPOINTMENT.— (1) The Commission shall be composed of 13 members, who shall be appointed, within 90 days after the date of enactment of this Act, as follows:

(A) Three members shall be appointed by the President.

(B) Three members shall be appointed by the Speaker of the House of Representatives.

(C) One member shall be appointed by the President pro tempore of the Senate.

(D) Six members shall be selected from the major civil society and reparations organizations that have historically championed the cause of reparatory justice.

(2) All members of the Commission shall be persons who are especially qualified to serve on the Commission by virtue of their education, training, activism or experience, particularly in the field of African American studies and reparatory justice.
(b) **TERMS.**—The term of office for members shall be for the life of the Commission. A vacancy in the Commission shall not affect the powers of the Commission and shall be filled in the same manner in which the original appointment was made.

(c) **FIRST MEETING.**—The President shall call the first meeting of the Commission within 120 days after the date of the enactment of this Act or within 30 days after the date on which legislation is enacted making appropriations to carry out this Act, whichever date is later.

(d) **QUORUM.**—Seven members of the Commission shall constitute a quorum, but a lesser number may hold hearings.

(e) **CHAIR AND VICE CHAIR.**—The Commission shall elect a Chair and Vice Chair from among its members. The term of office of each shall be for the life of the Commission.

(f) **COMPENSATION.**—(1) Except as provided in paragraph (2), each member of the Commission shall receive compensation at the daily equivalent of the annual rate of basic pay payable for GS–18 of the General Schedule under section 5332 of title 5, United States Code, for each day, including travel time, during which he or she is engaged in the actual performance of duties vested in the Commission.

(2) A member of the Commission who is a full-time officer or employee of the United States or a Member of Congress shall receive no additional pay, allowances, or benefits by reason of his or her service to the Commission.

(3) All members of the Commission shall be reimbursed for travel, subsistence, and other necessary expenses incurred by them in the performance of their duties to the extent authorized by chapter 57 of title 5, United States Code.

**SEC. 5. POWERS OF THE COMMISSION.**

(a) **HEARINGS AND SESSIONS.**—The Commission may, for the purpose of carrying out the provisions of this Act, hold such hearings and sit and act at such times and at such places in the United States, and request the attendance and testimony of such witnesses and the production of such books, records, correspondence, memoranda, papers, and documents, as the Commission considers appropriate. The Commission may invoke the aid of an appropriate United States district court to require, by subpoena or otherwise, such attendance, testimony, or production.

(b) **POWERS OF SUBCOMMITTEES AND MEMBERS.**—Any subcommittee or member of the Commission may, if authorized by the Commission, take any action which the Commission is authorized to take by this section.

(c) **OBTAINING OFFICIAL DATA.**—The Commission may acquire directly from the head of any department, agency, or instrumentality of the executive branch of the Government, available information which the Commission considers useful in the discharge
of its duties. All departments, agencies, and instrumentalities of the executive branch of the
Government shall cooperate with the Commission with respect to such information and shall
furnish all information requested by the Commission to the extent permitted by law.

SEC. 6. ADMINISTRATIVE PROVISIONS.

(a) Staff.—The Commission may, without regard to section 5311(b) of title 5, United
States Code, appoint and fix the compensation of such personnel as the Commission
considers appropriate.

(b) Applicability of Certain Civil Service Laws.—The staff of the
Commission may be appointed without regard to the provisions of title 5, United
States Code, governing appointments in the competitive service, and without regard to the
provisions of chapter 51 and subchapter III of chapter 53 of such title relating to
classification and General Schedule pay rates, except that the compensation of any
employee of the Commission may not exceed a rate equal to the annual rate of basic pay
payable for GS–18 of the General Schedule under section 5332 of title 5, United States
Code.

(c) Experts and Consultants.—The Commission may procure the services of
experts and consultants in accordance with the provisions of section 3109(b) of title 5,
United States Code, but at rates for individuals not to exceed the daily equivalent of the
highest rate payable under section 5332 of such title.

(d) Administrative Support Services.—The Commission may enter into
agreements with the Administrator of General Services for procurement of financial and
administrative services necessary for the discharge of the duties of the Commission.
Payment for such services shall be made by reimbursement from funds of the Commission
in such amounts as may be agreed upon by the Chairman of the Commission and the
Administrator.

(e) Contracts.—The Commission may—

(1) procure supplies, services, and property by contract in accordance with
applicable laws and regulations and to the extent or in such amounts as are provided in
appropriations Acts; and

(2) enter into contracts with departments, agencies, and instrumentalities of the
Federal Government, State agencies, and private firms, institutions, and agencies, for
the conduct of research or surveys, the preparation of reports, and other activities
necessary for the discharge of the duties of the Commission, to the extent or in such
amounts as are provided in appropriations Acts.

SEC. 7. TERMINATION.
The Commission shall terminate 90 days after the date on which the Commission submits its report to the Congress under section 3(c).

SEC. 8. AUTHORIZATION OF APPROPRIATIONS.

To carry out the provisions of this Act, there are authorized to be appropriated $12,000,000.
Sabrina Conyers, partner at Nelson Mullins Riley & Scarborough, Charlotte, North Carolina

Sabrina Conyers is a partnership and corporate tax attorney with more than 15 years of experience providing domestic and international tax planning, general corporate, corporate governance, private equity, and real estate finance planning and advisory services to clients. She has served as lead counsel, negotiator, and facilitator for transactions ranging in value up to $2 billion. Her clients include corporations, investment banks, private equity funds, and private companies (including partnerships, S Corporations and real estate developers). Ms. Conyers represents clients in structuring, negotiating, and documenting the tax consequences of their partnerships and joint ventures, mergers and acquisitions (M&A), real estate and REIT transactions, domestic and cross-border financings and other corporate combinations and reorganizations. Ms. Conyers advises clients on transactions involving limited partnerships, limited liability companies, joint ventures, and other strategic alliances.

Bernel Hall, CEO of Invest Newark and Principal of the New Jersey 40 Acres and a Mule Fund

Bernel Hall Over the past 20 years, Bernel Hall has executed over $5 billion in real estate investment, lending, and disposition transactions for multifamily, retail, office, and hotel properties in 36 states throughout the US. A former investment banker, public housing executive, and real estate finance professor, Mr. Hall is an expert in large, multi-faceted public-private real estate transactions. As CEO of Halltown Real Estate Advisors, Mr. Hall served as real estate investment advisor to some of the largest housing authorities in the country. As part of his tenure with the Atlanta Housing Authority (“AHA”), Mr. Hall established an $100 million co-investment vehicle between AHA, HUD, and the Atlanta Economic Development Authority (“Invest Atlanta”). During his tenure with the New York City Housing Authority (“NYCHA”), Mr. Hall oversaw the execution of over $1.5 billion in real estate disposition, development, and joint venture transactions. Previously, Mr. Hall worked in Goldman Sachs’ Urban Investment Group where he was responsible for sourcing and evaluating urban-based multifamily, retail, and mixed-use real estate private equity investments. Prior to his work at Goldman Sachs, Mr. Hall
executed $785 million in real estate acquisitions, loans, and joint ventures transactions for UBS Investment Bank. Mr. Hall began his career with Bank of America in the Firm’s Construction Lending and Real Estate Investment Banking Groups. Mr. Hall taught Real Estate Portfolio Management and Financial Modeling at NYU’s Schack Real Estate Institute and has also served as a guest lecturer for the New Jersey Redevelopment Authority. Mr. Hall is a licensed Uniform Investment Advisor (Series 65) and possesses a Bachelor of Science from North Carolina State University and a M.B.A. from the Harvard Business School.

Mark Storslee, Assistant Professor of Law at Penn State Law in University Park

Mark Storslee is an Assistant Professor at Penn State Law. His research focuses on the First Amendment freedoms of religion and speech, and topics in constitutional law generally. He has published in the University of Chicago Law Review, the University of Pennsylvania Law Review, The Review of Politics, and Political Theology among other journals. He is also a co-editor of Comparative Religious Ethics: Critical Concepts in Religious Studies (Routledge, 2014). Mark holds a law degree from Stanford Law School and a PhD in Religious Studies from the University of Virginia. After law school, he clerked for Judge Diarmuid O’Scannlain on the U.S. Court of Appeals for the Ninth Circuit and served as executive director of the Constitutional Law Center at Stanford Law School. In 2020, Storslee was awarded the Harold Berman Award for Excellence in Scholarship by the Law and Religion Section of the Association of American Law Schools.
Perspectives on Minority Business Development
Tuesday, April 20, 4:00-8:45 p.m. EDT

Session 7: Perspectives of the Tax Policy Experts
7:35 - 8:05 p.m. EDT

Discussion Leader: Sabrina Conyers, Partner at Nelson Mullins Riley & Scarborough, Charlotte, North Carolina

Presenters: Beverly Moran, Professor Emerita of Law, Vanderbilt Law School; and Loren Ponds, Partner at Miller & Chevalier Chartered

Event Co-Chairs:

Samuel C. Thompson Jr.
Professor and Arthur Weiss Distinguished Faculty Scholar
at Penn State Law

Sabrina Conyers
Partner at Nelson Mullins Riley & Scarborough

pennstatelaw.psu.edu/events/mbd-perspectives
MATERIALS FOR: SESSION 7: PERSPECTIVES OF THE TAX POLICY EXPERTS

DISCUSSION LEADER: SABRINA CONYERS, PARTNER AT NELSON MULLINS, CHARLOTTE, NORTH CAROLINA
PRESENTERS: BEVERLY MORAN, PROFESSOR EMERITA OF LAW, VANDERBILT LAW SCHOOL; AND LOREN PONDS, PARTNER AT MILLER & CHEVALIER CHARTERED

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1996

A Black Critique of the Internal Revenue Code

Beverly I. Moran

William Whitford

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A BLACK CRITIQUE OF THE INTERNAL REVENUE CODE

BEVERLY I. MORAN & WILLIAM WHITFORD*

I. INTRODUCTION

This article raises the question of whether the Internal Revenue Code systematically favors whites over blacks. In recent years a small number of scholars in the legal academy have become known as critical race theorists.1 One main thrust of critical race theory is a belief that racial subordination is everywhere, a structural aspect of all parts of American

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* Professors of Law, University of Wisconsin Law School. Copyright © 1996 by Beverly I. Moran.

We would like to thank the University of Wisconsin Graduate and Law Schools (including the Smongeski Fund) and the Center for Race and Ethnicity at the University of Wisconsin-Milwaukee for helping to fund this project. This work was first presented in 1991 at a Minority Teacher's Workshop organized by the Association of American Law Schools. Since that time, Beverly Moran has presented the marriage penalty and home ownership studies at the University of Chicago, 1994, and the International Academy of Law and Mental Health in Montreal, 1994. The entire study was last presented by Beverly Moran and William Whitford at the State University of New York Law School at Buffalo in 1995. We received valuable comments and suggestions at each occasion. We have also benefited from helpful comments on a recent draft from: Professors Boris Bittker; Roy Brooks; Richard Delgado; Howard Erlanger; Hendrik Hartog; David Hill; Dan Schneider; Franklin Wilson; Hal Winsborough; Ms. Jacqueline Macaulay; and Ms. Marilyn Brookens.

We owe an indescribable debt to Amon Emeka and Anjeanette M.B. Emeka, Ph.D. candidates in Sociology at the University of Wisconsin-Madison. They conducted the many regression equations reported in this article and did most of the social science literature research as well. This project would not have been possible without them. In the last stages of preparing this article, we received excellent assistance from Tara Bohling, J.D. 1996, University of Wisconsin-Madison.

The project would not have been possible without all of this assistance, but only we remain responsible for any errors.

society. If this part of critical race theory has merit, then every important American institution should reflect racial subordination, even such a seemingly neutral institution as the American tax system.

A tax professor’s question whetted our interest in the racial neutrality of the Internal Revenue Code. Responding to Professor Jerome Culp’s article *Toward a Black Legal Scholarship*, which argues that the white academy has ignored generations of distinct black legal thought, the professor asked: “Is there a black view on income averaging?” In context, the professor was obviously attempting to assert the racial neutrality of tax law.

Our response to this question is that, yes, there is a black view on income averaging—that it is not very important. Income averaging is an attempt to right the perceived wrong that due to our system of annual accounting periods, people with fluctuating incomes are forced to pay high tax rates when their average income is in fact quite low. When it existed, income averaging allowed taxpayers with fluctuating incomes to average their incomes over several accounting periods, thereby placing themselves in lower tax brackets. When Congress compressed the difference between rates in 1986, the perceived wrong of high rates disappeared and Congress repealed income averaging. While the income of blacks can certainly vacillate—blacks are disproportionately among the first to be laid off in periods of economic retrenchment, for example—most blacks rarely make enough to worry about high tax rates. Consequently, it is likely that blacks rarely used income averaging. Thus, a Congress oriented solely to the interests of blacks

5. Under former I.R.C. §§ 1301-1305 (1994), if a taxpayer’s income in a taxable year exceeded 140% of his average income for the preceding three years, the excess was taxed as if it had been earned in equal installments over the four-year span.
9. Thirty-nine percent of black households survive on incomes of $11,612 or less, while only six percent of black households bring in “high incomes” of $50,000 or more. Melvin L. Oliver & Thomas M. Shapiro, *Black Wealth/White Wealth: A New Perspective on Racial Inequality* 100-01 (1995).
would never have perceived the original wrong that income averaging was intended to cure.

Our thinking about income averaging led us to ask how one might determine whether the tax code is racially discriminatory. Discrimination connotes that persons who are similarly situated except for race are not treated similarly. This definition presupposes, however, some standard for determining when people are similarly situated. In the context of the Internal Revenue Code, everyday tax policy analysis provides us a ready tool for this analysis. In *Commissioner v. Glenshaw Glass*, the Supreme Court defined income as "all accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." Since then generations of tax scholars have used this definition to craft a conception of a comprehensive income tax base. Our standard for when persons are similarly situated, therefore, is when they have the same income, and we too use the *Glenshaw Glass* definition of income.

Of course, many provisions of the Internal Revenue Code deviate from the ideal of taxing all income in the comprehensive income tax base. Sometimes the Code compromises the ideal in order to achieve a more administratively practical rule. More often, Congress has decided to encourage particular lifestyles or behaviors by holding out tax benefits as an incentive. For example, the exclusion of interest on tax free bonds explicitly removes from the tax base "accessions to income, clearly realized, and over which taxpayers have complete dominion." Congress has adopted the exclusion to make the purchase of state and local bonds more attractive to rich taxpayers, and thereby reduce the cost of borrowing for states and municipalities.

Our hypothesis is that deviations from the ideal of a comprehensive income tax systematically favor whites over blacks. While many studies about the impact of tax law rely on data from returns, we were unable to do so because tax returns are not coded by race. In the absence of tax return data, we have turned to social science studies of the lifestyles and behaviors of whites and blacks. This evidence will enable us to estimate what proportion of each group is seemingly eligible for various tax benefits. We define as a tax benefit any opportunity for deductions or exclusions from income that deviate from the ideal of a comprehensive income tax base, or opportunities to postpone reporting income to a time

10. In tax law this concept is called horizontal equity and is often used in tax policy analysis. For a discussion of horizontal equity see 1 BORIS I. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS § 3.1.4 (1981).
12. Id. at 431.
14. 1 BITTKER, supra note 10, § 15.2.1.
later than when it should be reported according to the ideal of the comprehensive tax base. Our evidence about the availability of these tax benefits to whites and blacks comes both from existing social science studies conducted for other purposes and from our own analysis of some important demographic databases. We describe these databases in the Appendix.

We have limited our study to black/white differences in the enjoyment of tax benefits, though we recognize that other racial and ethnic groups in America claim to be systematically subordinated. The social science data on which we rely is scarce enough for blacks, and even less available for other groups. We hope future research can extend our study to other racial and ethnic groups.

In studying the differential enjoyment of various tax benefits, we look just at the immediate effect of these provisions. We recognize that the ultimate impact of a tax benefit is uncertain. Tax benefits create incentives for particular lifestyles and behaviors. As taxpayers respond to these incentives, the demand, and therefore the market price, for various things and services rises or falls. For example, if taxpayers have responded to the various incentives for homeownership by increasing the demand for homes, the price of homes may have increased. If the price increase is large enough, taxpayers buying such homes may be no better off, even with the tax benefits of homeownership, than if the tax benefit was never enacted. However, the marketplace effects of tax benefits are virtually impossible to measure. We accordingly limit our study to estimating the differences in the degree to which blacks and whites utilize tax benefits.

We would like to study the impact of all major tax benefits in the Code. However, reviewing existing social science data and conducting our own statistical studies on black/white lifestyle differences is time consuming and expensive. Limited resources have prevented us from studying all major tax benefits. In this article we report on the results of our study of tax benefits in four categories. We cannot reach a conclusion about whether the Internal Revenue Code as a whole is systematically biased in favor of whites. Even though we will find evidence that whites gain more from various tax benefits than blacks, other tax benefits that we have not studied (such as the earned income credit) may offer greater benefits to blacks. Nonetheless, our study will test our method—the use of demographic social science studies and

15. For a discussion of the true value of a tax preference see CHIRELSTEIN, supra note 4, at 361-67.
databases to draw conclusions about the racial impact of various tax benefits. Furthermore, because we study very important tax benefits, and find them systematically biased in favor of whites, we add credibility to our hypothesis with respect to the Code as a whole. We hope to later extend our study to other tax benefits.

The tax benefits that we have studied fall into four broad categories:

(1) Some benefits granted to wealth and wealth transfers, specifically the exclusion of gifts, basis adjustment rules at the time of gift and at death, reduced rates for capital gains, and various aspects of the realization requirement for determining the timing of income.

(2) Four benefits of homeownership, specifically the home mortgage interest deduction, the real property tax deduction, the rollover of gains on the sale of a principal residence, and the one time exclusion of $125,000 of gain on the sale of a principal residence by a person over fifty-five years of age.

(3) Several employee benefits, specifically Keogh plans, IRAs, employer provided pensions, and employer provided health insurance.

(4) The different tax rate treatment of single and married persons, which is sometimes called the “marriage penalty.”

17. I.R.C. § 102(a).
18. I.R.C. §§ 1014(a), 1015(a).
19. I.R.C. § 1(h).
22. I.R.C. § 1034(a).
23. I.R.C. § 121(a)-(b).
24. I.R.C. § 401(c).
27. I.R.C. § 106.
A. Critical Race Theory and Method

Critical race theory has generated heated debates about method. In particular, critical race theorists' use of narrative has sparked controversy.28 For us, narrative is a powerful and worthwhile method. Narrative allows one person to experience another person's life in an intimate and meaningful way. For example, Patricia Williams is well known for her ability to reach whites with her stories of everyday black life. When Professor Williams writes about being denied entrance to a store because of her race,29 she opens this experience to whites in an intimate way that statistics cannot replicate.

Narrative also allows the use of ridicule and exaggeration to expose situations that are otherwise ignored. For instance, Professor Derrick Bell often uses such devices as a means of exposing society's faults. When Professor Bell writes about licensing white people to discriminate,30 or when he writes about whites selling blacks to aliens from outer space,31 he exposes a black American truth—the tenuous status of blacks on these shores.

Thus narrative has its place within critical race theory. But our primary interest in critical race theory is its substantive theory of racial subordination, not its methods. In our view, hostile critics of critical race theory have placed too much emphasis on the use of narrative, and not enough emphasis on the theory of systematic racial subordination in American society. Our use of social science methodology will prevent individuals from avoiding our conclusions by attacking narrative as a method.

B. Use of Controls

In studying racial subordination, we had to decide whether we were interested solely in the differential impact of tax benefits by race, or whether we were interested in the differential impact by race after

31. Id. at 158-94.
controlling for income and other indicants of socio-economic status (SES). We decided that we were interested in both. It is commonly assumed that blacks cluster in the lower economic classes, and that most tax benefits favor the wealthy more than the poor. If these assumptions are correct, it follows that tax benefits in the Internal Revenue Code directly benefit whites as a group more than blacks. But our version of the racial subordination theory is stronger than this.

We believe that even if income is held constant, the Internal Revenue Code systematically disfavors the financial interests of blacks. We believe that, even at the same incomes, the typical black and the typical white lead different lives, largely as a result of the American history of racial subordination. These different lives, we hypothesize, trigger different tax results.

Because we want to test the stronger version of our hypothesis, we have always controlled for income in our analysis of the social science data. A more difficult decision has been whether to control for other indicants of socio-economic status as well. Many social scientists engaged in race relations research believe that by controlling for as many SES characteristics as possible, the effect of race in human relationships is minimized or eliminated entirely. Minimizing the effect of race is appropriate when a study is interested in the influence of skin color alone. We do not hypothesize, however, that blacks pay more taxes because tax administrators respond to skin color (though that may happen), but rather because blacks are more likely to have lifestyles that are less advantaged by tax benefits. As a result, for our purposes controlling for all possible SES characteristics would constitute nothing more than defining in nonracial terms the very lifestyles that cause blacks to be disadvantaged by the tax code.32

At the same time we are concerned that if we only control for income, some readers will dismiss our findings as not truly driven by racial differences. Furthermore, much of the quantitative social science literature concerning black/white lifestyle differences uses controls in addition to income in order to isolate the effects of race. We rely extensively on this literature in our analysis and will report on its use of controls.

In doing our own data analysis, we have adopted a compromise position. We have analyzed data about lifestyle differences using race and income alone as relevant categories, but we have also analyzed and will report about black/white lifestyle differences after controlling for a limited

32. As the Yiddish saying goes: "If your grandmother had balls, she would be your grandfather."
number of additional characteristics of SES. In the Appendix, we report in detail on the controls used in our data analyses.

C. The Significance of Our Work

For the most part we reserve our conclusions until we have presented the data. But we must address preliminarily the potential significance of a finding of systematic racial subordination in the Internal Revenue Code. If these findings have no significance, then there is no point to conducting our study.

First, we want to make clear that we are not asking a question about discriminatory intent. We do not hypothesize that members of Congress set out to harm blacks through the Internal Revenue Code. Nonetheless, in America a gap exists between blacks and most lawmakers because many whites and blacks do not interact in any meaningful way. Legislators are affected by this social segregation. Black life remains largely unknown to most of the white world, and to most white legislators. Hence legislators are largely unaware of the Internal Revenue Code’s impact on blacks. We believe that this ignorance is one of the reasons for structural racial subordination in America.

Second, although we cannot possibly come to a definitive conclusion about the entire Internal Revenue Code, we will present evidence suggesting that certain provisions benefit whites more than blacks. If the Code as a whole reflects racial subordination, we believe such a finding has value as social science. It would offer support for the basic substantive theory of critical race theory—that racial subordination is everywhere.

However, as lawyers concerned with racial justice in America, we also believe that if the Internal Revenue Code systematically subordinates black interests, then Congress should change it. To develop possible changes, we have invented a metaphor of a Black Congress that is exclusively oriented to the interests of blacks as a group. We will suggest changes in the Internal Revenue Code that such a Congress might consider. Because no change should be enacted without consideration of the Code as a whole, and because we studied a limited number of provisions, we make no final recommendations. Our suggestions should not only stimulate interest in possible reforms, but also illustrate how the actual Congress, largely unaware of black lifestyles, might have created a Code that systematically subordinates black interests.

We next present our evidence about how the provisions that we studied have different impacts on blacks and whites. Afterwards we will elaborate on our conclusions.
II. WEALTH

A. Tax Benefits

We looked at four code sections that protect wealth, both while the original owner holds it and when the original owner passes it on to other people, usually younger family members. These four provisions are the Section 1014 basis adjustment, the Section 1 reduced rate for capital gains income, the Section 102 exclusion for gifts and the Section 1015 gift basis. In addition, we considered two unwritten rules that work to benefit wealth—the realization requirement and tax-free financing.

Each of these sections and rules allow taxpayers with wealth to avoid income taxes that would be due under the Glenshaw Glass goal of taxing all “accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.”

These provisions are relevant to our topic of black/white differences in tax benefits for two reasons. First, on average blacks own less assets than whites. Second, to maximize the tax benefits of many of these provisions an individual needs not only to own property, but to own the right types of property. As we will show, the small percentage of blacks who do own assets are likely to own the wrong type of assets to maximize tax benefits.

We discuss each of the provisions before turning to analysis of their racial impact. Investments in home equity are an important category of wealth, but because special tax provisions pertain to them, we reserve our discussion of this form of wealth until the next section.

1. REALIZATION AND REFINANCING

When a taxpayer earns a salary, his increase in wealth is immediately subject to tax. In contrast, when many assets appreciate in value in their owners’ hands, the increased value is not immediately taxed. A nonstatutory rule called “realization” determines the time of taxation.

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34. See discussion of the social science literature and our results infra pp. 766, 769-70, 771-72.
35. See discussion of the social science literature and our results infra pp. 767-68, 770-72.
36. See infra p. 775.
A multitude of rules determine when realization occurs with respect to different assets. For example, interest on bank accounts (both checking and savings, including certificates of deposit requiring a penalty for early withdrawal) is realized when it accrues and is immediately taxed. But appreciation in the value of stock, real estate, and many other assets is not deemed to be realized until there is a "sale or exchange."

The realization requirement often permits taxpayers to delay paying the tax on an accession to wealth. Delayed taxation is usually advantageous to a taxpayer because he can then invest the resources that would otherwise have gone to taxes. Further, if realization occurs only after a sale or exchange, the taxpayer has considerable control over the timing of taxation, and can plan to realize the accession to wealth in a year in which he has little other income, or even an excess of realized losses, thereby avoiding taxation at higher rates or altogether.

From the taxpayer's perspective, one problem with the realization requirement is that, in order to obtain its benefits, the taxpayer must often hold onto his property. Fortunately for those with assets to spare, the Code provides several ways around this limitation. Most importantly, the taxpayer can exploit the principle that borrowed monies are not income because the corresponding obligation to repay means there is no accession to wealth. Taxpayers with appreciated property can borrow against that appreciation without having a realization event. By using the borrowed funds, wealthy taxpayers can enjoy property appreciation without a corresponding tax cost. There are other ways to accomplish this objective as well. For example, some swaps of property are considered "like kind" exchanges, which the statute exempts from immediate recognition of untaxed appreciation.

2. SECTION 1014 BASIS ADJUSTMENT

When a taxpayer owns the type of property for which appreciation in value is not recognized in the year in which it occurs, the taxpayer can avoid liability for the appreciation altogether by owning the property until death. Section 1014 provides that the heir of property acquires a basis in the inherited property equal to its fair market value at the time of the decedent's death. Any previously untaxed (because "unrealized") appreciation in the value of the property escapes tax altogether. This is

40. I.R.C. § 1222.
41. CHIRELSTEIN, supra note 4, § 3.01.
42. See, e.g., I.R.C. §§ 1031(a), 1034(a). For a discussion of like kind exchanges see CHIRELSTEIN, supra note 4, § 15.01-02.
true even if the decedent enjoyed the benefit of that appreciation by, for example, using the property as collateral for a loan.

In order for a taxpayer to obtain Section 1014's benefits, the type of property involved is crucial. First, Section 1014 only benefits property that has appreciated in value. Property that has declined in value receives a stepped down basis on the owner's death, and thus nobody takes a deduction for the lost value. Second, even if the property appreciates, Section 1014 only benefits those who inherit property with unrealized gains. Bank accounts can appreciate as they accumulate interest but that interest is realized and taxed each year. When the heirs receive the contents of those already-taxed accounts, there is no built in—you untaxed—gain for Section 1014 to protect.

3. CAPITAL GAINS

If a taxpayer sells appreciated property prior to death, he must pay tax on the appreciation. However, if the property is a "capital asset," that accession to wealth may be taxed at favorable capital gains rates. Essentially, the capital gains rate is a special (lower) rate of tax on the sale of investment property as opposed to the common (higher) rate on "ordinary" income. Avoiding technical detail, ordinary income consists of such items as salary, dividends and interest, while capital gains come from the sale or exchange of capital assets such as stocks and real estate. The practical result of the difference between "ordinary income" and "capital gains" is that the highest rate of federal tax on ordinary income is 39.6% while the highest capital gains rate is 28%. Although some argue that Congress should lower or repeal the capital gains tax, the more than forty percent increase in tax from 28% to 39.6% is enough to keep wealthy taxpayers focused on the capital gains rate.

43. See I.R.C. §§ 1(h), 1221, 1222. Section 1222 divides capital gains and losses into two classes: 1) long-term arising from the sale or exchange of capital assets held for more than one year; 2) short-term arising from the sale or exchange of capital assets held for one year or less. Net long-term gains are treated preferentially, while net short-term gains are taxed at ordinary rates. Section 1245 limits the ability of taxpayers to receive capital treatment on the sale of business assets whose cost has been recovered through depreciation deductions from ordinary income. A taxpayer's gain on the sale of his property is taxed as ordinary income to the full extent of his prior depreciation deductions.

44. For a discussion of the definition of capital asset see CHIRELSTEIN, supra note 4, § 17.01-05.

45. I.R.C. § 1(a)-(d), (h).

Owning the right kind of property is crucial to capital gains treatment. First, preferential treatment goes only to property that produces a gain on sale. Depreciated properties, such as cars and real estate in inner city slum neighborhoods, are disfavored if they are capital assets because a taxpayer is often unable to deduct losses resulting from these properties. Further, the capital gains rate only applies when the property is of a type where its appreciation is not immediately realized. Finally, the taxpayer must hold the property for investment rather than for sale to customers. Thus investors are favored over small businessmen. As we will see, all these requirements have adverse effects on blacks because they disfavor the very assets that blacks tend to own.

4. GIFTS

Surely an extra $5000 received without an obligation to repay is an "accession to wealth." Yet, under Section 102 this $5000 (or $50,000 or $500,000) escapes income taxation if it meets the Code's "gift" definition. Under Commissioner v. Duberstein, a transfer with no obligation to repay constitutes a "gift" for tax purposes only if it results from the donor's "detached and disinterested generosity." In combination with other rules, the net result of the "detached and disinterested generosity" requirement is that gifts from strangers (such as prizes and awards) are usually taxed. In contrast, gifts from family members and friends commonly receive the Section 102 exclusion. Moreover, wealthy people generally count other wealthy people as their family and friends, while low-asset individuals can only hope to get wealth transfers from strangers and lotteries. The gift exclusion under Section 102 thus favors the more fortunate both because wealthy individuals have access to more gifts and because they have access to the "right" gifts.

47. Capital losses are generally deductible only to the extent that they offset capital gains. In the case of a noncorporate taxpayer, up to $3000 of capital losses in excess of capital gains can be deducted from ordinary income. Any capital loss balance is carried forward into succeeding taxable years where it can be applied against capital gains (and to a lesser extent against ordinary income) in each succeeding year until fully utilized. I.R.C. §§ 1211(b), 1212(b) (1994).

48. For example, the capital gains rate does not apply to appreciating bank accounts.

49. I.R.C. § 1221(1).


51. See I.R.C. § 74 (including in gross income amounts received as prizes and awards). But see I.R.C. § 117 (excluding from gross income amounts received as a qualified scholarship).
This emphasis on the right gifts only increases when we consider the rules in Section 1015 that govern the donee's basis in gifts. Under Section 1015 the donee takes the donor's basis so long as the gift has appreciated in value. This provision allows a high bracket donor to arrange for gains to be taxed at the rates applied to a donee, who may be selected for the gift because of his low bracket. But the donee's basis in property that has depreciated in the donor's hands is the fair market value of the property at the time of gift. Thus no one gets the tax benefit of deducting the loss that resulted from the depreciation in value. Therefore, the basis rules mean that only taxpayers who have property with unrealized appreciation can reduce taxes by giving that property to family members.

B. Wealth and the Social Science Literature

Until the 1970s, studies of race and economics focused on income rather than wealth. Studies of wealth differences by race were few and far between. Once the importance of wealth and race was acknowledged, the reason for the dearth of studies changed from lack of interest to problems with data collection. Income surveys are relatively easy because researchers can obtain income information from pay stubs, tax returns and bank records. Because value is constantly affected by ever-changing market conditions, information on home and car equity or the value of household goods is harder to obtain. Even today, social scientists point out that wealth data is suspect if for no other reason than that the wealthy are uncooperative subjects with a tendency to substantially underestimate their holdings.

1. EARLY WEALTH RESEARCH

Despite data collection problems, social scientists conducted several race and wealth studies from the 1960s through the 1980s. For these

52. I.R.C. § 1015(a).
55. Oliver & Shapiro, supra note 9, at 57 (stating that "[s]urveys of assets and wealth invariably underrepresent the upper levels, primarily because of the difficulty in obtaining the cooperation of enough very wealthy subjects."); O'Hare, supra note 54, at 8 (finding that "income from investments tends to be underreported more than income from other sources").
purposes, probably the most important databases created during this period were the United States Bureau of the Census' 1979 Income Survey Development Program (IDSDP) and the Survey of Income and Program Participation (SIPP), which the Bureau has conducted annually since 1984. The early studies were often limited to gross comparisons, lacking controls. For example, as late as 1983, William O'Hare complained that he could not use IDSDP data to look at "the wealth of blacks and whites with similar socioeconomic characteristics."° Instead, applying gross averages to IDSDP, O'Hare showed that, in 1979, the average black household had one-third of the wealth of its average white counterpart. 1 He further showed that although blacks made up twelve percent of the nation's households, they held only four percent of all personal wealth. 2 Contrasting this information with black mean income figures from the U.S. Bureau of the Census, O'Hare pointed out that while average white income was 1.6 times greater than black income, white wealth was three times larger than black wealth. 3

Despite limitations on the data, some authors did try to make more precise comparisons between more similarly situated blacks and whites. As early as 1971, Henry Terrell took a step beyond comparing averages when he looked at the relative size of wealth accumulation by comparing blacks and whites in similar income ranges. Using mean income within seven groups, Terrell showed that black wealth ranged from a low of 16.1% of white wealth in the $2500 to $4999 category, to a high of 47.3% of white wealth in the $15,000 to $19,999 income group. 4

Social scientists also became interested in the different types of assets owned by individuals of different races. For social scientists, asset composition is important because some assets are investments that tend to increase wealth while others are largely for consumption (e.g., homes and cars) and do not enhance future income or wealth. Using different databases and slightly different controls, Lorman Lundsten and Harold Black, O'Hare, and Terrell all looked at asset composition and came to much the same conclusions. To quote Terrell: "Black families have a definite tendency toward accumulation in assets yielding consumption services (cars, trucks, and housing) while white families hold a greater

56. O'HARE, supra note 54, at 27.
57. Id. at 3.
58. Id.
59. Id. at 7.
60. Terrell, supra note 53, at 364.
Three types of assets are likely to bring income in return: financial assets, rental property, and ownership of businesses or farms. Black households have a much smaller proportion of their wealth invested in such assets than do white households. . . . Thus, the wealth of white families actually expands their income, to a much greater extent than for black families. Wealth that is tied up in a home, a car, or household goods . . . represents consumption rather than investment, because these assets do not regularly generate income; over two-thirds of black wealth is tied up in these durable goods. Thus, this difference in the distribution of wealth is also likely to perpetuate itself.  

These social scientists found significant differences in the types of assets that blacks and whites owned.

The early commentators on race and asset composition did not classify assets according to which ones yielded tax benefits. One table published by O'Hare is suggestive, however. The following table concerns what O'Hare called "financial assets." It shows holdings in various asset categories by race. Significantly, the greatest differences in holdings between blacks and whites are for stocks and mutual funds. These are assets which allow the owner to reap the benefit of the realization requirement, and therefore also allow the possibility of escaping tax on gain altogether by holding the asset until death. For the most part, the other categories shown in the table consist of assets for which the tax system recognizes appreciation in the year it accrues (e.g., savings accounts).  

62. Terrell, supra note 53, at 366.  
63. O'HARE, supra note 54, at 14.  
64. Table 1 is reproduced from O'HARE, supra note 54, at 12.
TABLE 1
Distribution of Financial Assets, 1979

<table>
<thead>
<tr>
<th>Type of Financial Asset</th>
<th>Percent of households with this type of asset</th>
<th>Average holdings for households with this type of asset</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Black</td>
<td>White</td>
</tr>
<tr>
<td>Total</td>
<td>78.0%</td>
<td>95.3%</td>
</tr>
<tr>
<td>Cash, checking accounts</td>
<td>70.7%</td>
<td>91.1%</td>
</tr>
<tr>
<td>Savings accounts</td>
<td>48.2%</td>
<td>77.0%</td>
</tr>
<tr>
<td>Savings bonds</td>
<td>10.8%</td>
<td>22.9%</td>
</tr>
<tr>
<td>CDs, bonds, loans</td>
<td>1.6%</td>
<td>17.5%</td>
</tr>
<tr>
<td>Stocks, mutual funds</td>
<td>3.4%</td>
<td>21.8%</td>
</tr>
</tbody>
</table>

2. OLIVER AND SHAPIRO

The early studies of race and wealth came to remarkably similar conclusions of dramatic differences in asset values and asset composition. However, these early studies did not control for such supposedly race neutral factors as region, age, income and education. Although the idea of using controls was attractive, the data on wealth and race took some time to catch up to the ideal. To a large extent, more recent SIPP databases have solved this problem. Using these databases, in 1995 Melvin Oliver and Thomas Shapiro produced their important book entitled *Black Wealth/White Wealth.* They used both gross comparisons and multiple regression analyses to study the differences in black and white wealth and asset composition.

Oliver and Shapiro confirmed the general conclusions reached in the 1970s and 1980s, except they found that the wealth gap between blacks and whites is even larger than previously estimated:

African Americans have not shared equally in the nation’s prosperity. They earn less than whites, and they possess far less wealth, whatever measure one may use. . . . The black-to-

65. OLIVER & SHAPIRO, supra note 9.
The white median income ratio has hovered in the mid-50 to mid-60 percentage range for the past twenty years or so. The median wealth data expose even deeper inequalities. Whites possess nearly twelve times as much median net worth as blacks, or $43,800 versus $3,700.\footnote{66}

The earlier studies had estimated a black/white wealth gap of smaller magnitude.

Oliver and Shapiro also used a large number of controls in their work, including income, age, sex, marriage, children, number of people who work within the household, education, occupation, work history, and region.\footnote{67} Terrell used some of these controls in the 1970s, but not nearly as many nor on so large a database.\footnote{68} With these controls Oliver and Shapiro confirmed that nonracial factors standing alone cannot explain the black/white wealth gap. Blacks whom Oliver and Shapiro viewed as "middle class" because of income, occupation and education had significantly fewer assets than similarly-situated whites:

Most significant, we believe, is that blacks' claim to middle-class status is based on income and not assets. ... Recalling the overall black-to-white income ratio of 0.62, ... the gap for white-collar workers narrows to 0.7, and further tapers to 0.76 for college graduates. Turning to net worth ... the least amount of inequality occurs among middle-income earners, where the ratio registers 0.35; but even among households with similar income flows the difference amounts to over $28,000. White-collar occupations disclose the most inequality: the black middle class owns fifteen cents for every dollar owned by the white middle class.\footnote{69}

Thus Oliver and Shapiro, by looking at similarly-situated blacks and whites, showed that race neutral factors did not fully account for differences in wealth.

Oliver and Shapiro also studied asset composition. They differentiated between "net worth" and "net financial assets." They defined "net worth" as all assets less debt and "net financial assets" as net worth less equity in homes or cars.\footnote{70} Net financial assets are most likely
to produce additional income and wealth. Net worth, with its inclusion of assets that are permanently dedicated to consumption (i.e., houses and cars), is more likely to produce no change in wealth or even a net decline. Oliver and Shapiro found that “the average white household controls $6,999 in net financial assets while the average black household retains no [net financial asset] nest egg whatsoever,” 71 and that “The net worth middle class blacks command . . . largely represents housing equity, because neither the middle-income earners nor the well educated nor white-collar workers [who are black] control anything other than petty net financial assets.” 72 A regression equation that controlled for region of residence, educational background, age, income, occupational prestige, as well as a number of other race neutral factors, found race was a highly significant predictor of the amount of net financial assets. 73

C. Results of Our Study

Our review of the social science literature confirms a wide gap in black and white wealth, both in gross averages and after controlling for such factors as income, education, region, marriage, and children. The studies also confirm that blacks hold a higher percentage of their wealth in consumption items than whites do, and a lesser percentage in financial and investment assets.

We have conducted our own analysis of available databases for two reasons. First, because we are concerned about tax consequences, we are interested in different categorizations of assets than the social scientists are. Social scientists group houses and cars together as consumption items. 74 Yet we know that the Internal Revenue Code strongly favors investment in housing, so much so that we will discuss it separately in our next section. Similarly, the social scientists’ concept of investment or financial assets fails to distinguish between assets which can benefit from the realization requirement and capital gains rates, such as stocks and bonds, and assets which do not so benefit, such as bank deposits. Our own data analysis takes account of these tax concerns in estimating differences by race in the composition of asset holdings.

Our other addition to the social science literature is to estimate the difference by race in the amounts received by inheritance or gift. Amounts received by gift and inheritance are tax free to the recipient. Equally important, amounts received by inheritance that have previously

71. Id. at 86.
72. Id. at 95.
73. Id. at 130.
74. OLIVER & SHAPIRO, supra note 9, at 106.
appreciated in value are eligible for the stepped up basis at death which enables the total avoidance of tax on a gain. Hence a study of gifts and inheritance is important to a full understanding of the different wealth-related tax benefits that blacks and whites enjoy.

1. ANALYSIS OF RACE AND ASSET COMPOSITION

Our analysis of asset composition, which segregates assets into “tax favored” and “tax disfavored” groupings, relies on data that the SIPP surveys gathered. We more fully describe these databases in the Appendix. Race is the crucial variable in all of our regression equations. We controlled for various other independent variables to see if race remains a statistically significant predictor of asset holdings in various tax favored categories. We explain our selection of the variables we used as controls in the Appendix as well.

We first constructed a dependent variable of total net worth. Using controls for income, education, age, region and marital status, we ran a regression to determine whether race was a statistically significant predictor of total net worth, as measured in this data set. We found that it was, just as other researchers had previously found using the same and different databases. Table A in the Appendix contains the detailed results of our regression.

In order to separate tax favored assets from disfavored assets we used the SIPP databases to get measures of wealth in equity in one’s home, equity in real estate aside from one’s own home, stocks and mutual fund shares, and equity in vehicles. The first three of these categories are tax favored investments. But because vehicles generally decline in value, and the loss is not deductible if the vehicle is held for personal use, vehicles are tax disfavored.

Because we have run regressions on each of these new dependent variables, for logistical reasons (division by zero) we had to perform the analysis using only respondents whose wealth was greater than zero. However, that subset of respondents causes us to overlook the fact that more blacks than whites have no wealth at all. As a result, the wealth differences between the two racial groups that we report are most likely smaller than they are in the general population.

Table 2 shows the mean amounts owned in each asset category, by black and white respondents separately. The last two columns report the percentage of total holdings in these four asset categories that consist of assets in each individual category, again for black and white respondents separately.

75. I.R.C. § 262(a) (1994).
This table indicates that blacks who own assets are less likely to hold assets that are tax favored. Investments in home equity need special consideration because of the many tax incentives for homeownership, so we discuss that data in more depth in the next section. Table 2 shows that blacks hold a much smaller percentage of their wealth in stock and mutual funds and real estate equity. These are both asset categories where tax favored appreciation in value is common. In contrast, blacks hold a greater percentage than whites of their wealth in equity in vehicles. Assuming that almost all these vehicles are held for personal use, this is a tax disfavored investment.

We used regression analysis to ensure that the differences displayed in Table 2 are not byproducts of socio-economic and demographic differences between blacks and whites.\(^{76}\) Tables B, C, and D in the Appendix report the results of the regressions for each of the asset categories except home equity, which is discussed in the next section. The tables show that the differences by race in percentage of assets held in the different categories in Table 2 are statistically significant after controlling for various measures of socio-economic status, as well as age and region of residence. Whites thus hold more tax-favored assets than

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\(^{76}\) The controls used in the regression equations are explained in the section of the Appendix discussing controls infra pp. 818-20.
blacks, even after controlling for relevant socio-economic and demographic factors.

2. GIFTS AND INHERITANCE

Analysts have sometimes speculated that blacks receive less in gifts and by inheritance than whites, and that this disparity accounts for at least part of the well-documented race and wealth disparity. But little data analysis actually addresses this question. Because of the important tax benefits associated with gifts and inheritance, we decided to look at this issue in depth. The SIPP database did not have enough information on what people receive and what people give, but we were able to get relevant data from the National Survey of Families and Households (NSFH), a database compiled in 1988-89 and more fully described in the Appendix.

Unfortunately, although the NSFH supplies data by race on the values of gifts and inheritances, it does not break down the values according to the type of asset that was received or inherited. This information is important because some of the tax benefits associated with gifts and inheritances depend on the donor or decedent transferring property with untaxed appreciation that has resulted from the realization requirement. For example, cash gifts and bequests get none of the benefits of avoiding tax on previously unrealized appreciation, whereas gifts and bequests of appreciated stock commonly capture this tax benefit.

To partially rectify this data deficiency, we constructed a variable from the NSFH database that measured the value of assets held by blacks and whites at age sixty-five in four asset categories: home, other real estate, business or farm property, and motor vehicles. Our intent was to get some measure of the value of assets that blacks and whites owned at a time near death, as a way of estimating the differential potential by race of taking advantage of the stepped up basis for property transferred by bequest. However, our constructed variable is far from perfect because it does not include the value of stocks and bonds, which are most likely to benefit from basis adjustments at the time of gift or death. Furthermore, our variable includes motor vehicles, which rarely benefit from such adjustments.

78. See supra pp. 759-63.
79. The recipient's basis in depreciated property under I.R.C. § 1014 and § 1015 is the fair market value of the property at the time of the gift or at the time of the decedent's death.
Table 3 reports the differences by race for the value of gifts given and received, inheritances received, and value of assets held at age sixty-five. The data comes from NSFH.

**TABLE 3**  

Gifts and Inheritance by Race

<table>
<thead>
<tr>
<th></th>
<th>Black (mean per person)</th>
<th>White (mean per person)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gifts Given</strong></td>
<td>$236</td>
<td>$1054</td>
</tr>
<tr>
<td><strong>Gifts Received</strong></td>
<td>$172</td>
<td>$1033</td>
</tr>
<tr>
<td><strong>Inheritances Received</strong></td>
<td>$1485</td>
<td>$5348</td>
</tr>
<tr>
<td><strong>Value of Property at Age 65</strong></td>
<td>$15,346</td>
<td>$81,936</td>
</tr>
</tbody>
</table>

The differences by race reported in Table 3 are very dramatic and indicate a wide variance in the degree to which blacks and whites enjoy the tax benefits associated with gifts and inheritance. In order to determine whether these differences were simply a product of status differences between blacks and whites, we ran regression equations with respect to the value of gifts received, inheritances received, and property held at age sixty-five. We controlled in each instance for income, education, age, region and marital status. Race remained a statistically significant predictor with respect to these dependent variables. We reproduce the relevant data in Tables E, F, and G of the Appendix.

**D. Conclusion**

It must be emphasized that we have not measured directly the differential impact on blacks and whites of the tax rules we have discussed, because we have been unable to directly examine returns. The evidence that we have gathered cannot account for the fact that not all taxpayers who are eligible for a tax benefit claim it. Nonetheless, we have gathered very strong inferential evidence to support the hypothesis that whites benefit more than blacks from the tax provisions we have studied, each of which deviates from an ideal income tax as set forth in *Glenshaw Glass*. After we consider the available evidence bearing on a similar hypothesis with respect to the tax incentives for homeownership, we will offer some suggestions about tax policy.
III. HOMES

A. Tax Benefits

As we saw in Part II, property that appreciates in value brings with it many tax benefits. If an owner-occupied home has appreciated in value, it can reap wealth-related tax benefits just like any other wealth. In addition to the general benefits that flow to appreciated property, owner-occupied homes come with four tax benefits of their own. Here we discuss Section 1034, which pushes realization past the date of sale; Section 121, which results in $125,000 of gain escaping tax completely; and two provisions that allow yearly deductions for the costs of owning a home—the Section 163 deduction for mortgage interest and the Section 164 deduction for real property taxes. We begin by briefly reviewing these provisions.

1. GAIN ON THE SALE OF A PRINCIPAL RESIDENCE

Under Section 1034 a taxpayer can sell his principal residence at a profit and avoid any tax on the sale if he purchases a more expensive principal residence within two years. Under Section 121 a person aged fifty-five or over can also sell his principal residence and keep up to $125,000 of gain tax free, regardless of whether he purchases a new residence. Sections 1034 and 121 work in conjunction so that a person aged fifty-five or over can sell his home, purchase a new (more expensive) home, keep $125,000 of gain tax free and defer tax on any additional gain as well.

Both sections are a great help to homeowners of all ages and are particularly useful for those who intend to use their homes as a tax-free retirement account. Unlike Individual Retirement Accounts or pensions, for which earnings are taxed on distribution, Section 121 ensures that $125,000 of a home's appreciation is never taxed, even when that gain is not used for housing.

However, for the purposes of our study, there is a catch to the benefits conferred by Sections 1034 and 121. First, in order to get any benefits from these sections, the taxpayer must own a home, something we will see that blacks do much less often than whites. Second, the extent of the benefits increase as the amount of appreciation in home

80. The tax advantages of appreciated property are discussed supra pp. 759-63.
81. I.R.C. § 1034(a).
82. I.R.C. § 121(a)-(b).
83. See the discussion of pensions in the Employee Benefits section infra pp. 784-86.
value increases. As we will see, when blacks do own homes, their dwellings are likely to appreciate in value less than white homes do.

2. HOME MORTGAGE INTEREST AND PROPERTY TAX DEDUCTIONS

In 1986, Congress eliminated the deduction for most personal interest expenditures. However, homeowners may deduct interest on mortgages running as high as $1,000,000. In addition, homeowners may still deduct an additional $100,000 of interest on loans secured by homes even if the principal loan amount is not used for a home purchase.

Congress also eliminated the deduction for state and local sales taxes that are paid for personal, as opposed to business, items. However, the deduction for state and local property taxes survived.

It is commonly assumed that the mortgage interest and property tax deductions benefit homeowners as compared with taxpayers who decide to defer home purchases in order to spend their resources on other types of consumption. But we cannot know for sure whether such discrimination occurs, because it is impossible to know whether the tax benefits of homeownership have caused the market price of owner-occupied homes to have increased relative to the price of other forms of consumption. If so, in effect the taxpayer fully pays for the tax benefits of homeownership “up front.” Relative to prices in a world that did not include these tax benefits, renters may pay less for their accommodation and homeowners may pay more for their homes.

We can be certain, however, that the tax benefits of homeowning are greater for homeowners with high incomes than for homeowners with lower incomes, because the tax benefits of deductions are always a function of income bracket. A taxpayer in the 39.6% bracket benefits more from a deduction of $100 than a taxpayer in the 15% bracket.

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85. I.R.C. § 163(h)(1) (1994). An interest expenditure is personal rather than business when the loan proceeds are used for personal consumption, such as acquisition of a personal car.
89. I.R.C. § 164(a)(1).
90. See discussion supra p. 754.
91. The value in tax savings of a deduction is equal to the amount of the deduction multiplied by the tax rate. Hence, a $100 deduction is worth $39.60 to an individual in the 39.6% tax bracket, but only worth $15 to an individual in the 15% tax bracket.
If homeowning blacks, on average, have a lower income than homeowning whites, this principle alone assures that the tax benefits of deducting mortgage interest and property taxes are racially skewed. Of particular interest to our study is the likelihood that the tax benefits of these deductions are also a function of home value. If we assume that on average higher value homes carry larger mortgages which require larger interest payments, then owners of high value homes get bigger interest deductions and save more taxes. Similarly, although property tax rates vary by community, owners of higher value homes likely pay more in property taxes and thus benefit more from the property tax deduction. In our subsequent analysis, by seeking evidence of whether blacks are likely to own lower-valued homes, we focus particularly on this aspect of the interest and property tax deductions.

B. Homes and the Social Science Literature

In our study we place wealth ahead of homeownership. We do this even though housing is a form of wealth, often a family’s primary form of wealth. Nevertheless, we believe that the Internal Revenue Code’s many structural and statutory benefits for wealth cast a greater shadow on the entire Code than benefits for homeownership alone. There are relatively few social science studies of black/white differences in wealth, however. In contrast, there are many social science studies of black/white differences in homeownership. We divide our discussion of these studies into two categories, those bearing on differences in ownership rates, and those bearing on differences in the value of homes.

There is a uniform consensus that blacks are less likely than whites to own a home. Writing in 1980, Mary Jackman and Robert Jackman reported that “Whites are considerably more likely to be owners than blacks; 71.3 percent of the whites and 41.2 percent of the blacks indicated that they own their home.” Other studies show ownership disparity rates of a similar range. As one would expect, and as illustrated in Table 3 below, all studies show that elderly blacks are more likely to own homes than young and middle-aged blacks, a fact that will affect our

92. This seems very likely. O’HARE, supra note 54, at 3, reports that the annual income of black families is about sixty percent that of white families.


"black analysis" of Section 121's exclusion of gains on the sale of a home by people aged fifty-five or over. 

For the most part, published studies also find a black/white differential ownership of homes after controlling for appropriate indicants of socio-economic status. The following table, reproduced from Oliver & Shapiro, is exemplary of the findings of several different researchers.

**TABLE 4: Home Ownership by Race and Income**

<table>
<thead>
<tr>
<th>Household Income</th>
<th>Whites</th>
<th>Blacks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>0.638</td>
<td>0.416</td>
</tr>
<tr>
<td>&lt;$11,611</td>
<td>0.473</td>
<td>0.274</td>
</tr>
<tr>
<td>$11,611-24,999</td>
<td>0.549</td>
<td>0.408</td>
</tr>
<tr>
<td>$25,000-34,999</td>
<td>0.615</td>
<td>0.454</td>
</tr>
<tr>
<td>$35,000-49,999</td>
<td>0.765</td>
<td>0.668</td>
</tr>
<tr>
<td>&gt;$50,000</td>
<td>0.854</td>
<td>0.75</td>
</tr>
</tbody>
</table>

Data Source: *1987 Survey of Income and Program Participation Survey—Wave 4*

This table, then, illustrates that whites are more likely than blacks to own homes.

Some commentators have disagreed with the implications of this table, arguing that if different controls are used, it can be shown that blacks are more likely than similarly-situated whites to own homes. Howard Birnbaum and Rafael Weston have argued that if an appropriate measure of wealth is used as a control, blacks are even more likely to own their homes than whites. 

James Long and Steven Caudill found that permanent income and central city location, rather than race, explain

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95. See the Black Congress section *infra* pp. 790-91.
96. OLIVER & SHAPIRO, *supra* note 9, at 109.
the differences in black/white homeownership rates. However, a minority of analysts reach such conclusions.

In regard to studies of home values, Long and Caudill's 1992 study shows that black couples own a disproportionately lower share of aggregate housing wealth, both because they are less likely to be homeowners and because they are more likely to own homes with low market values. When they used controls, Long and Caudill found that race explained differences in the value of homes, as opposed to the rate of homeownership.

Toby Parcel focused his study on equity in owner occupied housing. Parcel limited his study to male homeowners in the labor force and imposed controls for earnings, age, marital status, and area of current residence. Using these limitations on the data and additional controls to ferret out other factors that increase or decrease homeowner equity, Parcel found that for every $1000 increase in earnings, whites increase their home equity by $514 on average while black home equity does not increase at all.

There are fewer studies that have looked at appreciation in housing value, a critical question for tax analysis. Oliver and Shapiro have done the most extensive study, and the following quotation summarizes their findings:

Among blacks and whites who bought less expensive homes [between 1978 and 1988], the typical white homeowner's equity increased by $40,700 with an average black increase of $27,500. Among those buying less expensive homes, white home values grew 122 percent in comparison to 79 percent for blacks. Among those buying

98. Long and Caudill state that:
Of all the potential differences between black and white households controlled for in the model, permanent-income and central-city-residence differentials are most important by far, each responsible for over 30 percent of the observed black-white homeownership gap. The remaining racial disparities are statistically significant but relatively unimportant as far as contributing to the homeownership gap between black and white couples.


99. Id. at 99.

100. Id. at 95-97.

101. Equity is defined as fair market value less mortgage. Toby L. Parcel, Wealth Accumulation of Black and White Men: The Case of Housing Equity, 30 SOC. PROBS. 199, 202 (1982).

102. Id. at 202-03.

103. Id. at 205.
more expensive homes, the typical white home appreciated $47,800, or 56 percent, while the value of an average black one went up $34,900 or 44 percent. . . . [T]hose who bought homes between 1967 and 1977 . . . have enjoyed a longer period of equity accumulation, one including the recent era of high inflation. Whites who bought less expensive homes . . . benefited from a $60,000 gain in home equity versus $28,700 for blacks in the same purchase bracket. . . . Among those buying more expensive homes, the characteristic white home went up almost $78,000 in value and the typical black home value increased by $38,700; blacks experienced an impressive 88 percent growth in equity, but whites’ home equity rose 148 percent.

A regression analysis confirms the importance of race in housing appreciation, even when non-race-related factors affecting home values are taken into account. 104

Although Oliver and Shapiro find that the value of black housing and housing appreciation is lower, they make one additional finding of potentially great importance. They find that housing constitutes a significantly greater percentage of black wealth (62.5%) than of white wealth (43.3%). 105 Even though blacks own less housing value than similarly-situated whites, they own even less of other kinds of assets, except, as noted in our wealth discussion, equity in vehicles. This finding is consistent with the findings of other commentators, as discussed in Part II.

C. Results of Our Study

Because there have been so many studies of race and home ownership, less need exists for us to do our own data analysis. The studies have conflicted, however, on whether blacks own fewer homes than whites when controls for socio-economic status and other appropriate factors are considered. For this reason, we did a limited study using data from the 1988 National Survey of Families and Households, which contains a randomly-drawn sample of over 9000 families and households.

In this database, 38.8% of the blacks owned their homes, while 61.6% of the non-hispanic whites did so. A regression analysis controlling for family income, age, urban residence, education, and marital status showed that race was a statistically significant predictor of

104. Oliver & Shapiro, supra note 9, at 148, 150.
105. Id. at 106.
homeownership in this sample. Table H of the Appendix reports this data.

Using the SIPP data that we reported in Part II, we analyzed the value of home equity for blacks and whites. As reported in Table I of the Appendix, we find that blacks have less home equity than whites after controlling for socio-economic and demographic factors. This confirms prior research. In contrast to some other studies, however, we find that blacks and whites tend to devote approximately the same proportion of their total wealth to home equity, once we control for socio-economic status and demographics. Other studies have shown blacks with a higher proportion of their total wealth in housing than whites even after using similar controls.\textsuperscript{106}

\textbf{D. A Black Congress on Wealth and Homeownership}

In our introduction, we asked how a Black Congress would write tax rules on income averaging. Now we ask that question about wealth and homeownership.

The data on blacks and wealth tells us that blacks own very little wealth and that this lack of wealth is at least partially responsible for the continuing black/white wealth gap. Blacks inherit very little wealth and they do not acquire very much more during their lifetimes. As a consequence, blacks receive very little benefit from the Code sections discussed in Part II. In particular, blacks are much less likely than whites to own assets, such as stocks and bonds, that benefit from the realization requirement, a necessary prerequisite to benefiting from the stepped up basis at death and a usual prerequisite to benefiting from the favorable capital gains tax rates.

A partial exception to this generalization concerns homes. The tax benefits that apply to stocks and bonds also apply to homes. Appreciation in home value is not taxed until realized, and can avoid tax altogether if the owner transfers it at death. Homeowners benefit additionally from some special tax provisions, such as forgiveness of tax on $125,000 in gain for realizations during the owner’s lifetime. Although whites own more homes and more valuable homes than blacks, even after controlling for appropriate nonrace variables, many blacks do own homes that appreciate in value. The social science studies indicate that blacks have at least as high a percentage of their wealth invested in homes as whites

\textsuperscript{106}. O’HARE, \textit{supra} note 54, at 9 (finding that “equity in a home accounted for almost half of the wealth of blacks (46 percent) but less than a third of the wealth of whites (32 percent)’’); OLIVER \& SHAPIRO, \textit{supra} note 9, at 106 (finding that home equity accounted for 62.5\% of the wealth of blacks and 43.3\% of the wealth of whites); Birnbaum \& Weston, \textit{supra} note 97, at 107.
do, and perhaps a greater percentage. Unlike the tax benefits that apply primarily to other forms of wealth, from which few blacks gain, many blacks benefit from the tax benefits of homeownership.

But while blacks benefit, whites benefit even more. White homes appreciate more, and hence receive more favorable treatment of gains from investments in homes. Moreover, because white homes are more valuable, on average whites benefit more than blacks from the deductions for home mortgage interest and property taxes.

Vehicle equity is one form of investment for which no tax benefits exist. In fact, the Code disfavors investment in vehicle equity, because unlike losses in investments in most other kinds of assets except homes, owners cannot deduct declines in vehicle value. Since the Code views such declines in value as consumption expenses, this tax result is commonly considered consistent with the *Glenshaw Glass* vision of income. It is still worth noting, however, that although whites on average own more total vehicle equity, even after controlling for income and other measures of status, blacks indisputably invest a higher percentage of their wealth in vehicles than whites do. But hence the one category of assets which blacks favor in their investment behavior, in comparison with white investment behavior, receives no tax benefits.

As we turn to suggestions about how a Black Congress might amend the Code in light of our findings, two preliminary comments are appropriate. First, if a Black Congress truly existed, we would not expect it to act solely in the interest of blacks, any more than we expect the current Congress, which is mostly white, to act solely in the interest of whites. Our Black Congress, oriented solely to the interest of blacks, is purely a metaphor, useful for analytic purposes.

Second, our Black Congress is not solely motivated by the goal of minimizing black taxes. Blacks are interested in government spending; consequently, some of our recommendations will reflect concerns about the level of government revenues. Moreover, the tax provisions we are considering all have ostensible purposes which may benefit blacks. For example, the realization requirement and the stepped up basis at death are commonly justified as making the tax system more administrable. The realization requirement permits a sale or exchange to measure the amount of asset appreciation, rather than relying on some alternative valuation method. The stepped up basis at death avoids the necessity for determining a decedent’s basis in property, which can be very difficult when the person has kept inadequate records. Not all of the supposed benefits are administrative. The special tax benefits for homeowning, for

107. See Table 2 and discussion *supra* p. 770, and Table D in the Appendix *infra* p. 808.
instance, are justified as explicit incentives for taxpayers to own rather than rent their residences, apparently on the theory that homeowners on average are more stable and responsible citizens.\textsuperscript{108} We do not agree with all of these justifications, but it is not the point of this article to debate about them. However, a Black Congress would consider these usual justifications for tax benefits.

We next offer some suggested tax reforms that a Black Congress might consider in light of our findings.

1. \textit{Replace the current home mortgage interest deduction and the deduction for real property taxes with a credit (of an undetermined percentage) that begins to decline to zero once adjusted gross income on a joint return exceeds $50,000.}

Currently, taxpayers are allowed a deduction for home mortgage interest and real property taxes. The benefit of deductions is a function of bracket, benefiting wealthier taxpayers more than less wealthy ones. Credits, which a taxpayer subtracts directly from the taxes he owes, save a taxpayer the amount of the credit, regardless of his bracket. Because whites have higher-valued homes on average and hence probably pay more interest and taxes, they would receive a greater proportion of total tax benefits from credits than their proportion in the population or even in the homeowning population. But at least a switch from deductions to credits would distribute more of the tax benefits of homeownership to blacks than is currently the case, while still preserving tax incentives for homeownership.

Currently, a taxpayer cannot deduct the home mortgage interest that is generated by mortgage principal in excess of $1,000,000. Furthermore, both the interest deduction and the real property tax deduction are reduced when adjusted gross income on a joint return exceeds $114,700.\textsuperscript{109} In order to maintain this principle of phasing out the tax benefit for the most wealthy, our proposed credit begins to decline to zero once taxpayers reach an adjusted gross income of $50,000 a year. Because most black families earn less than $50,000,\textsuperscript{110} they will not be adversely affected by this limitation.

\textsuperscript{108} S. REP. NO. 313, 99th Cong., 2d Sess. 804 (1986) (stating that “encouraging home ownership is an important policy goal”).

\textsuperscript{109} I.R.C. § 68(a), (b)(1) (1994) (adjusting the $100,000 applicable amount for inflation).

\textsuperscript{110} Only six percent of black families have incomes greater than $50,000. OLIVER & SHAPIRO, \textit{supra} note 9, at 102.
2. Maintain the Section 121 exclusion for $125,000 of gain on the sale of a personal residence, and maintain the Section 1034 rollover of gain on the sale of a principal residence.

Because homeownership is one of the most common forms of black investment, we suggest maintaining the $125,000 exclusion for gain on the sale of a personal residence for homeowners aged fifty-five and over, and the postponement of realization permitted by the rollover of gain. Because black homes are generally lower-valued, there is no need to increase the $125,000 limit. Tax benefits for this type of gain may help blacks accumulate wealth that they can bequeath, so that blacks can begin inheriting wealth.

3. Tax property appreciation as it accrues on investments in publicly traded securities and nonresidential real estate.

Except for homes and vehicles, blacks generally do not own property. Instead, blacks earn income in the form of wages that are immediately subject to tax. Depository accounts are probably the most common form of black wealth other than homes and vehicles. Hence repeal of the realization requirement would raise considerable revenue without adversely affecting blacks. We believe that limiting repeal of the realization requirement to publicly traded securities and nonresidential real estate is an eminently practical reform, because it is possible to measure the extent of appreciation on these assets without a sale or exchange. Public listings report the trading value of securities, and property tax assessments provide a usually reliable estimate of the market value of real estate.

4. Repeal special tax rates for capital gains.

It is very unlikely that many blacks benefit directly from special rates for capital gains. Homes are eligible for these favorable rates, but with the stepped up basis at death, the exclusion of $125,000 of gain for homes sold by an owner aged fifty-five or over, and the Section 1034 rollover of gain, most gain on homes is probably not ever subject to tax. While some argue that favorable rates for capital gains stimulate economic
activity which trickles down to taxpayers who never enjoy a capital gain,\textsuperscript{111} we have little faith in trickle down economics.

5. \textit{Maintain the Section 102 exclusion for income from gifts and inheritances.}

Although blacks receive few gifts or bequests that benefit from this exclusion, we decline to recommend changing it for two reasons. First, any change in this provision must be coordinated with gift and estate taxes because it may not be appropriate to tax both the grantor and the recipient. But consideration of gift and estate taxes is beyond the scope of this article.

Second, a Black Congress might want to preserve some incentives for savings and intergenerational transfers of wealth. The story of black American life has been one of inability to pass wealth from generation to generation, whether because of slavery, racism, or poverty. The inability to transfer wealth has adversely affected black wealth. We believe that a Black Congress would prefer to encourage, rather than discourage, such transfers.

IV. EMPLOYEE BENEFITS

\textit{A. Tax Benefits}

Under the ideal comprehensive income tax system based on the \textit{Glenshaw Glass} definition of income as "accessions to wealth," whether a taxpayer received a payment for wages in cash or in kind would not matter. A person who received $10,000 in cash would be taxed the same amount as someone who received an employer purchased life insurance policy worth $10,000. Nonetheless many employee benefits are never taxed to the employee even though they have value and the employer treats the benefit as a deductible expense. Examples include parking valued at under $155 a month;\textsuperscript{112} health insurance;\textsuperscript{113} life insurance;\textsuperscript{114} educational assistance;\textsuperscript{115} discounts on clothing,

\begin{itemize}
\item \textsuperscript{111} For a discussion of this issue, see Robert Dodge, \textit{Economists Have Questions About Dole Tax Cut}, DALLAS MORNING NEWS, Aug. 11, 1996, at 1H.
\item \textsuperscript{112} I.R.C. § 132(f)(2)(B) (1994). This benefit is capped at $155 per month.
\item \textsuperscript{113} I.R.C. § 106.
\item \textsuperscript{114} I.R.C. § 79(a). To the extent that the cost of the life insurance exceeds $50,000, it is included in the gross income of the employee. I.R.C. § 79(a)(1).
\item \textsuperscript{115} The amount of any reduction in tuition provided to an employee of an educational organization for education (below the graduate level) at such organization is not included in the gross income of the employee. I.R.C. § 117(d). Employees of other
appliances and other retail goods when the employee works for the retail store;\textsuperscript{116} and airline tickets for airline employees.\textsuperscript{117} Another group of employee benefits are taxed, but the imposition of the tax is delayed. Employee benefits that defer taxes include employer paid pensions;\textsuperscript{118} employee contributions to pensions;\textsuperscript{119} employee contributions to tax deferred annuities (sometimes called 401(k) plans or 403(b) plans);\textsuperscript{120} and Keogh plans, which are self-directed pension plans for the self-employed.\textsuperscript{121}

The employee benefits that escape tax entirely or that are taxed later than they would be under a \textit{Glenshaw Glass} definition of income provide significant tax savings. We focus our study on the two benefits that produce the largest tax savings: pensions (including tax deferred annuities), and employer-paid health insurance.\textsuperscript{122} We are interested, of course, in whether blacks receive proportionately fewer benefits than whites.

\textbf{B. Employee Benefits and the Social Science Literature}

Social scientists have long been interested in studying income differences by race, and their work has naturally involved employee benefits, since they are an important component of income. For our purposes, the most appropriate database is the U.S. Census Bureau’s \textit{1988 Current Population Survey} on employee benefits.\textsuperscript{123} Joni Hersch and Shelley White-Means have published the most significant analysis of this data for our purposes.\textsuperscript{124} A limit of this study, however, is that respondents were asked only whether they received a particular type of benefit, without ascertaining its value. Hersch and White-Means compensated for this deficiency by assuming that each benefit a respondent received had an average value for benefits institutions can receive up to $5250 of educational assistance from their employers tax free. I.R.C. § 127.

116. I.R.C. § 132(a)(2), (c). To the extent that the employee discount exceeds the gross profit percentage of the price at which the property is being offered by the employer to customers, it is included in gross income. I.R.C. § 132(c)(1)(A).

117. I.R.C. § 132(a)(1), (b).


120. I.R.C. §§ 401(k), 403(b).

121. I.R.C. § 401(c).


123. For a discussion of the database see infra Appendix, Part II.

in that industry.\textsuperscript{125} They limited their analysis to wage and salary workers employed privately in nonagricultural employment and between the ages of eighteen and sixty-five.\textsuperscript{126} For this sample, they studied only health and pension benefits and not contributions to 401(k) plans. Hersch and White-Means found that 52\% of white men in private employment in 1988 were covered by employer provided pension plans and that 75\% received employer provided health care. In contrast, only 39\% of all other workers in private employment (white women, black men, black women, etc.) were covered by employer provided pension plans and only 58\% received employer paid health insurance.\textsuperscript{127} However, the authors acknowledge that part of these differences is accounted for by the fact that white men are more likely than other groups to accept benefits for which they are eligible.\textsuperscript{128} Moreover, Hersch and White-Means' statistics combine race and gender. Data from our research, which we will report below, suggests that the "benefits gap" reported by Hersch and White-Means is more accounted for by gender differences than race differences.

In addition, Hersch and White-Means did not directly measure the extent to which the above percentages were related to age, education, and other non-race and non-gender worker characteristics. However, they did construct a total compensation variable consisting of both wages and benefits. Hersch and White-Means used a regression equation to determine whether race and gender differences in total compensation could be explained by other worker characteristics. Their conclusions were as follows:

The wage and total compensation equations indicate that almost half of the log earnings gap between white and black men is explained by differences in qualifications. The remaining 54\% may be interpreted as attributable to discrimination. However, for women, particularly black women, the log wage and log compensation gaps are largely unexplained by differences in qualifications, suggesting that discrimination may be an important component of the gender-race wage gap. Over 65\% of the log earnings gap between white women and white men and about 80\% of the log earnings gap between black women and

\textsuperscript{125} Hersch & White-Means relied on the U.S. Chamber of Commerce 1988 survey of employee benefits for the average value of benefits in a particular industry. \textit{Id.} at 853.

\textsuperscript{126} \textit{Id.}

\textsuperscript{127} \textit{Id.} at 851.

\textsuperscript{128} \textit{Id.} at 855.
Finally, Hersch and White-Means measured how adding benefits to wages increased or reduced the wage gap between white men and the other groups. Their conclusions were mixed. Counting benefits decreased the earnings gap when black men or women were compared with white men, but it increased the gap when white women were compared with white men. In no case, however, did adding benefits to wages make a great difference in the "gaps" between the groups they studied. Because fringe benefits contribute so little to the narrowing of any wage gap, Hersch and White-Means concluded that:

While fringe benefits in the form of health care are heralded as equalizers in the employment setting, they have only a small impact on gender and race differences in earnings gaps and/or the returns to qualifications. Women, particularly black women, still face a large compensation disadvantage relative to white men.

C. Results of Our Study

For several reasons, we did our own analysis of the same data used by Hersch and White-Means. We were interested in results for the entire labor force, not just the private sector, nonagricultural employees Hersch and White-Means studied. Since public sector employees are generally assumed to receive extensive benefits, and public sector employment is generally assumed to be less subject to racial discrimination than private

130. The following table is reproduced from id. at 856:

<table>
<thead>
<tr>
<th>Earnings Measure</th>
<th>WP/WM</th>
<th>BM/WM</th>
<th>BF/WM</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>All Workers</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hourly wage</td>
<td>71.3</td>
<td>82.8</td>
<td>64.8</td>
</tr>
<tr>
<td>Hourly wage + benefits</td>
<td>70.3</td>
<td>82.6</td>
<td>64.8</td>
</tr>
<tr>
<td><strong>Benefit-Sector workers</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hourly wage</td>
<td>72.4</td>
<td>81.5</td>
<td>67.0</td>
</tr>
<tr>
<td>Hourly wage + benefits</td>
<td>71.9</td>
<td>82.1</td>
<td>67.6</td>
</tr>
</tbody>
</table>

Earnings ratios are based on geometric means.

131. Id. at 864-65.
employment, public sector employees were an ideal group to test our hypotheses. We also wanted to look at the data on participation in 401(k) and Keogh plans, in addition to receipt of health and pension benefits included in Hersch and White-Means' study. Finally, since the census data measured only receipt of employee benefits, not their value, we did not want to try to estimate their value as Hersch and White-Means did. Instead, we simply studied whether there are racially-explained differences in the receipt of any of the four types of employee benefits that we analyzed.

Unfortunately, the census data did not include enough respondents participating in Keogh plans to permit us to draw any statistically significant results. Table 5 reports the extent of participation in other benefits for blacks and whites respectively.

### Table 5
Participation in Employer-Provided Benefits by Race

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Blacks</th>
<th>Whites</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health Insurance</td>
<td>0.83</td>
<td>0.82</td>
</tr>
<tr>
<td>401(k)*</td>
<td>0.12</td>
<td>0.17</td>
</tr>
<tr>
<td>Pension</td>
<td>0.77</td>
<td>0.79</td>
</tr>
</tbody>
</table>

* Difference is significant with 99% confidence

We used regression equations to determine whether there were racially significant differences in the receipt of these benefits after controlling for essentially the same worker characteristics that Hersch and White-Means did.\(^{132}\) We found that at the 95% confidence level race was a significant predictor of receipt of pension benefits and that at the 99% confidence level race was a predictor of participation in a 401(k) plan. However, race was not a statistically significant predictor of receipt of health benefits. The relevant tables showing the results of these regressions are reproduced in the Appendix as Tables J, K, and L.

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132. Hersch and White-Means look at employment in the "benefit sector" as a function of age, marital status, number of children, education, hours worked, union status, metropolitan location, location in the South, family income, industry, occupation, and firm size. *Id.* at 858.
D. Conclusion

Because blacks are less likely to be employed and, when employed, to enjoy benefits, blacks are less likely to receive tax favored employee benefits of all kinds. We found evidence that, when controlling for relevant socio-economic and demographic factors, blacks are less likely than whites to participate in employer-provided pension and 401(k) plans. However, when controlling for relevant socio-economic and demographic factors, there is no evidence that blacks are less likely to receive employer provided health insurance.

Our findings pertain just to participation in benefit programs. The value of benefits received, which Hersch and White-Means crudely estimated, is more relevant to tax concerns, since as the value of excluded or deferred benefits increase, the tax benefits grow as well. Although we have no direct evidence on point, it seems likely that the value of employer-provided health benefits is more or less the same for all workers, since the Code requires that employer provided health benefits be “non-discriminatory” if they are to be excluded from the employee’s income. To be non-discriminatory, “benefits provided for participants who are highly compensated individuals [must be] provided for all other participants,” and a health plan must benefit at least seventy percent of all employees.

On the other hand, the analogous non-discrimination rules for employer-provided pension plans permit employers to contribute amounts to pensions proportionate to wages. Thus highly compensated employees receive more tax deferred contributions than others. Because blacks are less likely to be highly compensated, when they do participate in employer provided pension and 401(k) plans, they are likely to receive less pension benefits than whites.

Finally, we emphasize that the benefit of all exclusions or deferrals of income are a function of the relevant tax bracket. Because blacks on average are in lower marginal brackets than whites, even if they receive employee benefits of equivalent dollar value to whites—as they may with respect to health benefits—the tax savings to the average black is less than the tax savings to the average white.

134. I.R.C. § 105(b)(4).
136. I.R.C. § 401(a)(5)(B); see also I.R.C. §401(f) (permitting modest deviations in favor of highly compensated employees from even a proportionate standard).
E. A Black Congress on Employee Benefits

The first observation a Black Congress might make about tax excluded and deferred employee benefits is that the degree of racial skewing is not nearly as great as it is for the tax benefits discussed in Part II. Accordingly, employee benefits are not likely to be at the top of a Black Congress' tax reform agenda.

However, because there is evidence that the tax benefits of pension and 401(k) plans are skewed racially, a Black Congress might nonetheless consider employee benefit reform. Before we discuss what reforms it might consider, however, we will discuss the very interesting situation regarding health benefits.

We have not found evidence that, when appropriate controls are used, blacks receive health benefits less often than whites. Of course, because whites on average are in higher brackets, they benefit more from the tax exclusion. Still, Hersch and White-Means found that the wages of black men are a higher percentage of white men's earnings when benefits are added to wages. We suspect this finding results from the non-discrimination rules respecting health benefits. If one adds a constant to two numbers, one of which is larger than the other, the absolute difference between the two numbers remains the same but the lower number nonetheless becomes a higher percentage of the other.

Some commentators contend, however, that the non-discrimination rules that tie tax benefits to a wide distribution of employee benefits actually work against blacks and other low income workers. They claim that these rules force employers to provide benefits that low income workers do not want and which make low income workers too expensive to employ. To attract high income employees, who value tax free benefits more than low income employees because of their marginal bracket, the employer is forced to give expensive employee benefits to the high rate group. However, because of the Internal Revenue Code's non-discrimination rules, the employer must include low rate employees in its employee benefits package as well. But, the argument proceeds, to pay for these increased benefits to low wage employees, the employer pays lower wages to his low income employees. Increased employee benefits in return for decreased cash wages is a bad trade for low tax rate employees because the value ratio of employee benefits to tax benefits is smaller for low tax rate employees. Thus the argument concludes that the Internal Revenue Code's forced inclusion of high tax rate and low tax rate

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137. See supra note 124 and accompanying text.
138. For example, the absolute difference between 3 and 5 is 2, and 3 is 60% of 5. The absolute difference between 4 and 6 is also 2, but 4 is approximately 67% of 6.
workers in the same employee benefits package distorts income between the groups by giving high rate employees too few benefits and low rate employees too many. 139

Evaluation of this nonempirical, a priori argument is beyond the scope of this article, except for one observation. The non-discrimination rules do not necessarily result in low tax rate employees receiving cash wage reductions exceeding the value of the benefits they receive. High tax rate employees may receive wage reductions exceeding the cost of providing the health benefits to them, so that the employer is able to fund the benefits for low rate employees required by the non-discrimination rules. In other words, the non-discrimination rules may require high tax rate employees to share some of their tax benefits with low tax rate employees.

Given the ambiguity respecting whether blacks are benefited or harmed by the exclusion of health benefits from income, we doubt that a Black Congress would want to change this tax benefit. But this discussion about the possible impact of the non-discrimination rules suggests an interesting approach to reform of the tax treatment of employer provided pension benefits. The non-discrimination rules currently applicable to pension benefits cannot leverage high rate employees to share their benefits with low rate employees, because they do not require a parity in the absolute value of the pension benefits provided to high and low rate employees. Instead, the non-discrimination rules require only that employer contributions to pension funds be approximately proportionate to taxable wages for high and low wage employees. To limit the racial skewing of the tax benefits from the tax deferral of employer pension contributions, however, the non-discrimination rules might be amended to require that the contributions have the same absolute value. As a less radical alternative, the amount of annual employer pension contributions that receive tax deferred treatment might be capped. Here the goal is to allow the tax benefits of deferral for employer contributions sufficient to provide a middle, or even an upper middle, income lifestyle, without providing the same tax benefit for contributions to pensions that are principally a vehicle for investing accumulated wealth.

A Black Congress’ approach to 401(k) plans might be to repeal them. The evidence of racial skewing of the tax benefits of 401(k) plans is strong, even after controlling for relevant worker characteristics. Blacks may work less frequently for employers who offer 401(k) plans. Further, since participation in 401(k) plans is voluntary for employees, blacks may

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139. For an article that makes this argument, see Frank A. Scott et al., Effects on the Tax Treatment of Fringe Benefits on Labor Market Segmentation, 42 Indus. & Lab. Rel. Rev. 216, 220 (1989).
not choose to participate in the same proportions as whites with similar salaries and opportunities. Because of the differential wealth of blacks and whites with similar incomes, it may be more burdensome for blacks to voluntarily defer receipt of income. Thus blacks benefit relatively little from the availability of 401(k) plans, just as they benefit relatively little from preferential rates for capital gains or the stepped up basis at death. 140

V. MARriage Penalty

A. Tax Benefits

Section 1 of the Internal Revenue Code establishes different tax schedules depending on whether the taxpayer(s): (1) are married and file a joint return; (2) file as a head of household; 141 (3) are not married and file a single return; or (4) are married but file separate returns. In this section we will focus on the first and third rate schedules, which are the ones most frequently used.

The joint return enables many married couples to pay a lower total tax on their combined income than they would if they were each single and paid taxes on the income each earned or received. We will call this a “marriage bonus.” However, the joint return benefits a married couple only when there is a gap between each partner’s income. At all levels of income, if each partner’s income is the same, the couple will pay at least as much combined tax as they would if each remained single. Moreover, at higher income levels, the joint return status makes husbands and wives who earn close to the same amount of income pay more tax than they would if they remained single. When this latter situation occurs, it is called a “marriage penalty.” 142

Section 1 rate schedules are adjusted annually with respect to the amounts of taxable income at which higher tax rates apply (e.g., 28%...
rather than 15%).\(^{143}\) So long as the combined taxable income of a couple is less than the amount at which the single taxpayer's rate shifts from 15\% to 28\%—$22,100 in 1995—there can be no marriage bonus or penalty. All the taxable income will be taxed at 15\%, whether it is earned by one person or jointly and whether the taxpayers are married or single.\(^{144}\)

For joint returns in 1995, the rate shifted from 15\% to 28\% for taxable income over $36,900.\(^{145}\) If a couple has a taxable income between the rate shift levels for single and joint returns, there is a possibility of a marriage bonus. If the income is earned by only one partner, some of it which would be taxed at a higher rate on a single return (28\%), is taxed at a lower rate on a joint return (all income at 15\%). Although a marriage bonus is possible even when both partners have some taxable income, the marriage bonus is always greatest for a given combined taxable income when all that income is attributed to one partner. The population of one wage earner married couples are therefore the greatest beneficiaries of the marriage bonus.

Once a couple's taxable income rises above the rate shift level for joint returns, however, the couple faces the possibility of a marriage penalty. If each partner earns a taxable income of $20,000 for example, it will all be taxed at 15\% if they file two single returns. But if this same couple is married and files jointly, some of their combined income will be taxed at 28\%.\(^{146}\) The marriage penalty will be greatest for any given combined taxable income when each partner has the same taxable income. That is the situation in which the greatest proportion of the combined income taxed at a higher joint rate (e.g. 28\%) would have been taxed at a lower single rate (e.g. 15\%) if the parties had remained single. The

\(^{143}\) I.R.C. § 1(f).

\(^{144}\) However, there can be a marriage penalty at lower income levels due to the standard deduction under I.R.C. § 63(c)(2) ($5000 for joint returns, $3000 for single returns). Moreover, because the earned income credit is phased-out as income rises, and combined income is used for a married couple filing jointly, in some circumstances one would receive a higher earned income credit if single than if married. See Daniel R. Feenberg & Harvey S. Rosen, Recent Developments in the Marriage Tax, 48 NAT'L TAX J. 91, 92-93 (1995). However, in this article we explore only marriage bonuses and penalties resulting from the Section 1 rate schedules, because our social science data is most relevant to this issue.

\(^{145}\) See I.R.C. § 1(a)(2), (f)(1).

\(^{146}\) Married partners derive no rate advantage from filing separate returns. The taxable incomes at which rates shift for married filing separately returns is exactly 50\% of the income at which the rates shift for married filing jointly returns (e.g., in 1993, the rate shifted from 15\% to 28\% at a taxable income of $18,450 for married filing separately returns). I.R.C. § 1(a), (d). In the example in the text, therefore, if the couple were married they could not avoid a 28\% rate on some of the taxable income by electing to file separate returns.
possibility for a marriage penalty or bonus continues to exist at all higher incomes until the lower income partner has an individual taxable income of $250,000. Taxable incomes above that amount were taxed, in 1995, at 39.6%, the highest possible rate, whether reported on a single or a joint return.147

Our first hypothesis is that married blacks are more likely than married whites to live in two wage earner couples. Since there is never a marriage penalty without two wage earners, and one wage earner couples gain the greatest marriage bonuses, if the hypothesis is true then white couples enjoy more and larger marriage bonuses than black couples. Our second hypothesis is that when both spouses work, and have combined incomes high enough to risk substantial marriage penalties, the gap between the husband’s and wife’s wages in white families is on average higher than the average gap in wages between black spouses. If this is true, then black couples are more likely to suffer substantial marriage penalties than white couples.148

147. See I.R.C. § 1(a), (c), (f)(1). The combined effects of the marriage bonus and penalty can be illustrated by comparing the following three couples (A, B, and C). Couple A is married and files a joint return. Couples B and C are unmarried and file four separate returns. Each couple has a combined taxable income of $40,000 in 1995.

Couple A pays a 15% rate on $36,900 (= $5535) and a 28% rate on $3100 (= $868), for a tax of $6403. Couple B consists of two individuals filing single returns, each with a taxable income of $20,000. All their income is taxed at a 15% rate, for a tax of $6000. Comparing Couple B with Couple A indicates that the latter pays a “marriage penalty” of $403.

Couple C consists of two individuals filing single returns, but one partner has no taxable income. The other partner has a taxable income of $40,000. $22,100 is taxed at a 15% rate (= $3315) and $17,900 is taxed at a 28% rate (= $5012), for a tax of $8327. Comparing Couple C with Couple A indicates that at this combined income, there is a marriage bonus for single income couples (which could also be called a “single penalty”) of $1924.

148. As in all parts of this paper, we are looking here only at the relation between race and a small part of the tax code. In particular, we are not looking here at the special head of household rate schedule, which sometimes taxes income of a qualifying single person at lower rates than other single people. It is possible the head of household rate schedule benefits blacks more than whites. However, we do not explore that question here.

We also do not discuss the married filing separately rate schedule. That schedule is rarely selected, as it rarely is to the tax advantage of a married couple to file separately. See supra note 146. Hence, this rate schedule is usually ignored in discussions of the marriage penalty.
B. Marriage Penalty and the Social Science Literature

Very little social science literature examines the precise topic of income differences between married partners by race. However, several articles address general patterns of racial differences in labor force participation among married women. That literature contains two critical findings.

1. Black wives participate in the labor force at a greater rate than white wives. Accordingly, there are more dual wage earner families among blacks than whites. It follows that black families are less likely to receive the biggest marriage bonuses, which go to single wage earner families.

2. Black wives earn incomes much closer to their black husbands’ incomes than white wives make in comparison to their white husbands, especially at higher income levels. This means that black couples are more likely to suffer the most substantial marriage penalties.

Joyce Beckett reviewed nine studies of social science databases comparing black and white wives during various periods from 1960 to 1976.\textsuperscript{149} She found that black wives were more eager to work than white wives and black husbands were more eager than white husbands to have their wives work.\textsuperscript{150} The more educated the black husband, the more likely he was to have a working black wife.\textsuperscript{151} Even children did not negatively affect black wives’ participation in the labor force.\textsuperscript{152} In contrast, working white wives tended to have husbands with lower socioeconomic status and with greater than average periods of unemployment. Beckett concluded that these black/white differences in wives’ participation in the labor force could not be fully attributed to any other demographic characteristics other than race.\textsuperscript{153}

\textsuperscript{150.} Id. at 465.
\textsuperscript{151.} Id. at 464-65.
\textsuperscript{152.} Id. at 466.
\textsuperscript{153.} Id. at 464.
Writing in the same period, Duran Bell used a regression analysis to explain differences in black/white wife labor force participation. Bell’s work confirmed that black families with working black wives were the most “stable and better educated black families, whereas the white working wife emerged from the lesser educated, poorer, and more unstable white families.” James Smith looked at how female labor force participation affected individual families’ economic well being as well as income distributions across families. Comparing black and white wives, Smith found that black wives’ incomes moved their families above the black average income while white wives’ wages tended to move their families up to the white average income. The tendency of black wives to push black family income into higher tax brackets is just the type of behavior that triggers bigger marriage penalties.

More recently, in 1990, James Geschwender and Rita Carroll-Seguin came to similar conclusions: “African-American families have been able to achieve a standard of living comparable to that of the middle-class European-Americans because African-American wives have been far more likely than European-American wives to work, and to work full-time.” According to Geschwender and Carroll-Seguin, there are proportionally more dual earner families among blacks than whites. Their main concern was recent social science studies claiming that blacks have “closed the economic gap” with whites. They objected to this assertion by countering that black economic improvement reflects black wives’ labor force participation.

Even though the racial discrepancy in the number of working wives is decreasing, Geschwender and Carroll-Seguin conclude that working black wives contribute a higher portion of family income than do working white wives. For example, in 1987 the average dual income white family made $41,023. With the husband alone in the work force, the average white family income was $27,394 or only $13,629 (49%) less. On the other hand, the average dual income for a black family was $33,333, and black family income was $16,822 when only the husband worked. This

155. Id. at 472.
157. Id. at S172.
159. Id. at 285.
contrast suggests that black wives make on average $16,511 a year, or 98.2% of black husbands' income.160

Thus, the social science literature indicates that black working wives are more likely to widen the disparity between the middle and lower classes in the black community, while working white wives often lessen income dispersion in their communities. Rather than pulling their families from the lower classes to the middle class, black wives pull their families from the lower rungs of the middle class to its higher rungs, where the families suffer the marriage penalties that result from two spouses earning similar incomes.161

C. Results of Our Study

Previous studies have not had tax consequences primarily in mind and hence have not conducted a couple by couple analysis of income difference. Using a sample called the PUMS Couples File drawn from the 1980 United States Census data, we constructed a variable that measured the proportion of family income earned by the wife for married couples with incomes that triggered the marriage penalty. We were uncertain, however, about what combined income triggered the penalty because in 1980 Section 1 rate schedules were radically different from those in place today. Furthermore, the census data reports total income, not taxable income, and we could not know what deductions, personal exemptions, etc., particular taxpayers used to calculate taxable income. In the end we constructed our variable only for couples with a combined

160. Id. at 294.

161. Quester and Green set about showing that there are no significant differences in labor force participation rates among black married women and white married women. Aline O. Quester & William H. Green, The Labor Market Experience of Black and White Wives in the Sixties and Seventies, 66 Soc. Sci. Q. 854 (1985). They posit that previous studies that showed black/white differences were flawed because husband's income was presumed to have a linear relationship to wife's labor force participation. Instead, Quester and Green find that there are threshold levels of family income at which the slope of the line increases or decreases. Id. at 865. Controlling for the wife's education, health, residence, age, presence of preschool-age children and the previously mentioned non-linearity, Quester and Green find few racial differences in wife's labor force participation. Id. Nonetheless, the authors do make one observation which is relevant to our study, and, in our view, discredits their own conclusions. Quester and Green find that the threshold levels of family income have differing effects for blacks and whites:

The negative effect of income on market participation for black wives appears only after [family] income has reached a fairly high level. The pattern for white wives is one of participation probabilities slowly increasing until income reaches the first threshold, fairly sharply decreasing until the second threshold, and thereafter more slowly decreasing.

Id. at 862.
income exceeding $30,350 in 1980 dollars. We are confident that we have identified a population that would be subject to the marriage penalty if their incomes were adjusted for inflation and if 1995 rate schedules were applied to them.\footnote{That is, if income kept up with inflation, the population in this sample would have combined incomes in excess of $60,000, yielding taxable incomes well within the income ranges yielding marriage penalties when the income is split between each spouse.}

The design of our variable left us with a sample of 17,578 married women of which 5884 were black. In this sample the average black wife earned 29.5% of her family’s income, while the average white wife earned only 18% of her family’s income. This percentage difference indicates that within this sub-sample, black couples were more likely to be subject to marriage penalties, and at any given combined income, to higher marriage penalties.\footnote{We could not determine from census data what unmarried persons were living together in a single household. Thus, we could not determine which couples were avoiding the marriage penalty by avoiding marriage while in all other respects living together as a couple. It is possible, of course, that blacks are more likely than whites to so behave. We do know that blacks are more likely to be single. In 1991, 43.1% of black men and 38.4% of black women were married, while 62.4% of white men and 59.0% of white women were married. \textit{U.S. Bureau of the Census, Current Population Reports, The Black Population in the United States} 5 (1991). But we do not know what proportion of single whites and blacks live with another person as a couple.

All we can conclude from our data, therefore, is that within the population of married couples, blacks are more likely to suffer from the marriage penalty than whites. We do not know whether the apparent racial skewing of the marriage penalty would disappear if we were able to examine all couples, married and unmarried.}

We used a regression analysis to assure ourselves that the racial differences in this data are not solely byproducts of socio-economic and demographic differences between blacks and whites. As shown in Table M in the Appendix, we found that race was a highly significant predictor of a wife’s proportion of family income even when we accounted for such other variables as the husband’s income and the education of the wife.\footnote{The wife’s education is a proxy for her potential earning capacity.}

\section*{D. The Black Congress and the Marriage Penalty}

Section 1 rate schedules create both marriage bonuses and marriage penalties, depending on the combined taxable income of a couple and its distribution between them. The social science evidence demonstrates quite convincingly that black couples are less likely than white couples to enjoy a marriage bonus, because married black women are more likely to be in the labor force. And because black wives generally contribute a
higher percentage to the total family income, black couples are more likely to suffer a marriage penalty, and a higher marriage penalty, than white couples. Regression equations confirm that these correlations do not disappear when controls are introduced for education, husbands’ incomes, and other possible race neutral factors which might account for black wives’ high participation in the labor force and high contribution to total family income.

What would a Black Congress do with this information? We will discuss three possible actions. The simplest solution would be to adopt a one rate schedule for all individuals. Married couples would each file separate returns and each partner’s taxable income would be taxed at the same rate at which it would have been taxed if they were single. There would be no separate schedule for heads of households, nor would there be a marriage bonus for couples with only one wage earner, regardless of income. Moreover, there would be no marriage penalty for couples with two wage earners, regardless of the percentage of combined income that the lower income spouse contributed.

This reform has been previously advocated for reasons of gender equity. We believe that we are the first to suggest it for reasons of racial equity. Though simple, this solution might be unacceptable because it would eliminate the marriage bonus. Longstanding congressional policy favors use of the tax code to encourage marriage and to encourage women to be primarily homemakers. Though we disagree with this policy, a Black Congress might want to keep these incentives in place. Some blacks receive a marriage bonus, of course, even if a disproportionate amount of the benefits go to whites. A Black Congress may decide that there are social gains from women working mostly in the home, such as better quality childcare.

A Black Congress would still want to eliminate the marriage penalty while preserving the marriage bonus. A simple approach would be to provide for elective filing status by married taxpayers on each year’s


Married taxpayers would have the choice to file as single people or as a married couple with a joint return.

A more radical alternative would be to allow both married and single couples to get the best tax result depending on their changing income combinations, by filing as two single persons or as married couple filing jointly, regardless of actual marital status. We know that blacks are more likely to be single than whites. We do not know whether there are more black than white couples who are living together but unmarried and who would enjoy a marriage bonus if they did marry. But enough black couples may be in this situation that a Black Congress would want to ensure that single working couples never pay more taxes than married working couples.

This more radical solution to the marriage bonus/penalty problem might also find favor in a gay Congress because gay people often live together as couples but are not yet provided the option of legal marriage. Under such a system, some method would be necessary for verifying relationships between unmarried persons as satisfying the criteria for the filing status election. The current controversy over providing benefits to the partners of gay employees may be of help in this regard. As states and cities begin to develop definitions and registration procedures for gay and other single couples, the federal government can follow suit and piggy back on the expanded state definitions in allowing elective tax filing status.

VI. CONCLUSION

Our article explores the critical race theory tradition that racial subordination infects virtually all American institutions. We have tested this hypothesis against the Internal Revenue Code. We have presented evidence that members of the black community receive, on average, fewer of the tax benefits we have studied than the average member of the white community. Our evidence is strongest with respect to the tax provisions we discussed in our wealth section. Blacks have less of the type of investment wealth which benefits from the realization requirement and special rates for capital gains. Blacks also receive fewer gifts and inheritances, a form of tax free accessions to wealth. When blacks do have wealth, they are more likely to invest in assets that are not tax favored, such as vehicles. Blacks do invest in homes, the primary asset

167. In a different context, the Internal Revenue Service has issued proposed regulations that would allow business entities, other than those automatically classified as corporations for federal tax purposes, to choose their classification. IRS Regulations, 71 TAX NOTES 881 (1996).
168. See supra note 163.
for most American families, but black homes are on average less valuable and generally appreciate at a slower rate than white homes. As a result, the homeownership tax benefits, particularly the deductibility of home mortgage interest and property taxes, are more beneficial to whites than blacks.

The results of our study of black/white differences in the tax benefits associated with employee benefits is more mixed. We found that, once the data is controlled with appropriate socio-economic and demographic factors, blacks and whites participate equally in employer provided health plans. However, fewer blacks than whites participate in employer provided pension plans and 401(k) plans, which enjoy very substantial tax deferral advantages.

Section 1 rate schedules provide bonuses to some couples and penalties to other couples for being married. Because of extensive participation in the work force by black women, blacks are less likely to enjoy marriage bonuses and more likely to incur marriage penalties. This relationship between race and marriage bonuses and penalties remains after controlling for family income and other relevant economic variables.

Much of our analysis used regression equations to control for relevant demographic and socio-economic status (the independent variables) in an attempt to support the “null hypothesis”—that race does not matter—by trying to explain variance in the enjoyment of tax benefits (the dependent variable) as reflecting the influence of causes other than race. In nearly every instance we failed to find support for the null hypothesis because race remained a statistically significant predictor of enjoyment of tax benefits in our regression equations. However, regression equations are only as good as the selection of the independent variable candidates. Another researcher might select different independent variables and succeed in constructing an equation in which race is not a statistically significant predictor of enjoyment of these tax benefits. Until and if such a regression is created, however, we think our regressions are the best evidence available.

Before we go further, we must repeat two caveats we made in our introduction. First, because we have studied only some provisions of the Internal Revenue Code, we make no claim that the Internal Revenue Code as a whole subordinates black economic interests. Further study of other provisions may discover some which favor blacks over whites. However, we do believe that this study demonstrates the utility of our methodology. Further, we have studied some of the most significant tax benefits

169. And because of the non-discrimination provisions in the Internal Revenue Code, we presume that medical plans have approximately equal value for all employees, regardless of class, gender or race. See supra notes 133-35 and accompanying text.
applicable to the individual income tax. If the tax benefits studied in our wealth section and the benefits associated with employer provided pension plans are skewed as substantially to whites as our analysis suggests, the entire Code is likely skewed in the favor of whites. 170

Second, we make no accusations of discriminatory intent. We suggest that the Code reflects systematic black political underrepresentation in the halls of power. As a result, black people are not in the consciousness of Congress as it enacts the Internal Revenue Code. Indeed, we suspect many legislators will be taken aback by our evidence of racial skewing in the distribution of tax benefits. We have used our metaphor of a Black Congress to emphasize how a tax code focused on the economic interests of blacks might look.

We suggest that a Black Congress would look favorably on a number of radical changes in the Internal Revenue Code. We repeat only the most prominent here. We have advocated changing the current deductions for home mortgage interest and real property taxes into credits that diminish as income rises. 171 We suggested the elimination of both the capital gains rate and the realization requirement for the taxation of gain on many kinds of appreciated property. 172 We proposed changes in the non-discrimination requirement for employer provided pension plans to require parity in dollar contributions for all employees, rather than parity in percentage of earnings. 173 Finally, we recommended that a single rate schedule apply to all taxpayers, married or single, to eliminate both the marriage bonus and the marriage penalty. 174

Anyone who wished to shift more of the tax burden away from lower income persons and towards the more wealthy would tend to favor these proposals. Given the general economic situation of blacks in America, that such persons would make political alliance with those taking a black-oriented view of the Internal Revenue Code should not be surprising. However, we want to stress once again that we have provided evidence that the Code provisions we have studied disfavor blacks as a group, even holding income and other measures of socio-economic status constant. Thus, even high income blacks are less likely to benefit from employer

170. Estimates of the "tax expenditure" budget consistently indicate that the two largest "tax expenditures"—that is, lost revenue because of deviations from the Glenshaw Glass definition of income—are the deductibility of interest on home mortgages and the exclusion of employer contributions to pension plans. See KLEIN & BANKMAN, supra note 122, at 26-27.
171. See supra p. 786-87.
172. See supra p. 782.
173. See supra p. 789-91.
provided pensions and more likely to suffer marriage penalties than are whites with equivalent incomes.175

All tax benefits as we have defined them—deviations from a comprehensive income tax base as defined in *Glenshaw Glass*—have some underlying public policy goal. Sometimes that goal is to achieve a more easily administered income tax, as reflected in the realization principle. Sometime that goal is to provide an incentive for particular lifestyles, such as getting married, investing in 401(k) plans or capital assets, owning homes, etc. If blacks are not responding in sufficient numbers to these incentives, one possible response is that the tax benefits should be made stronger to provide even greater incentives for the desired behaviors.

Our response to this argument176 is that the social science literature we introduced in this article clearly confirms that in many cases blacks have no access to tax favored choices. Black homes appreciate less, partly because of widespread discrimination in housing markets. Blacks do not enjoy marriage bonuses and suffer marriage penalties, in part because employment discrimination prevents black husbands from earning as much as white husbands. Most outstandingly, the glaring discrepancies in black and white wealth and inheritances make it almost impossible for most blacks to invest in capital assets and in other tax favored ways. The country could and should adopt programs that would improve the ability of blacks to make lifestyle decisions that are now tax favored. No-one can doubt that black poverty is a product of our country’s unfortunate racial history—centuries of slavery followed by de jure and de facto racial segregation. It is a history that needs to be corrected, but it will not be corrected overnight.

In the meantime, the Internal Revenue Code should not perpetuate and aggravate the inequities between blacks and whites. The importance of achieving public policy goals must be balanced against any racially skewing effects of these provisions. If other types of tax provisions can achieve public policy goals without skewing the Code against blacks,

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175. *See supra* p. 786-87, 796-97.

176. An alternative response is that lifestyle choices are constantly in flux and no more so than in the past three decades. Blacks have often said that we are the canaries in the mine of American society. This was true for drug use which was originally confined to the black community and which has spread throughout our society. It was also true for illegitimate births which are now so prevalent in all races. It is true in terms of married women working outside the home, which was virtually unheard of among whites years ago although it was quite common among blacks. The lifestyles that blacks lead today may be the lifestyles that whites lead tomorrow. If whites want to keep the Internal Revenue Code best serving their interests, they must pay attention to how the Code ill serves blacks.
those other provisions certainly are preferable. If legislators cannot accommodate both public policy goals and black/white equity, then they will have to make hard choices. But even analysts who cannot support our rather radical proposals for the Internal Revenue Code need to address the question of the racially skewed impact of the tax benefits we have studied. Ignoring the impact that the Internal Revenue Code has on black welfare is a tradition that must stop.
APPENDIX

This Appendix has three sections. Part I contains the tables referred to in the text. Part II contains a description of the databases used to construct the tables. Part III contains a discussion of the controls we used in doing the regressions reported in the tables.

PART I: Tables

In each table we report a regression coefficient (b) and a measure of statistical significance (t). Regression coefficients are estimates of the change in the dependent variable for a unit change in a given independent variable (e.g., age or income). For example, in Table A, the coefficient for Education is 1,716.55. This means that for each additional grade completed by the respondent, the amount of gifts received over a given period increased by an average of $1,716.65. The preceding example is based on an ordinary least squares regression. However, when dependent variables are binary or zero-sum variables, for technical reasons we have used logistic regressions. The interpretation of the regression coefficient (b) is not as straightforward in those circumstances.

t is a standard measure of statistical significance used in regression equations. It is dependent on a number of factors, particularly the size of the sample and the amount of variability within it. In the tables we identify the independent variables that are significantly correlated with the dependent variable with 95% or 99% confidence by printing the results in italics.
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<thead>
<tr>
<th>VARIABLE</th>
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<th>t</th>
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</thead>
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<tr>
<td>Age</td>
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<td>Region (1 = South)</td>
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<td>2583.58</td>
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<td>Education (Highest grade attended)</td>
<td>1716.65</td>
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<td>Marital Status (1 = Married)</td>
<td>-6570.63</td>
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<tr>
<td>Race (1 = White)</td>
<td>13761.21</td>
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Data Source: 1984 Survey of Income and Program Participation—Wave 4
n = 52,223: Italics indicate statistical significance with 99% confidence.
# TABLE B

## Race and Holdings of Stocks and Mutual Funds

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<td>b</td>
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</tr>
<tr>
<td>Children in HH (1 = yes)</td>
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</tr>
<tr>
<td>Respondents Age</td>
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<td>High School Grad (1 = yes)</td>
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<td>College Grad (1 = yes)</td>
<td>2403.28</td>
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<tr>
<td>Southern Residence (1 = yes)</td>
<td>615.09</td>
<td>0.94</td>
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<td>Marital Status (1 = married)</td>
<td>-3078.96</td>
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<td>Monthly Family Income/100</td>
<td>492.28</td>
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<td>Race (1 = white)</td>
<td>1096.02</td>
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Data Source: 1984 Survey of Income and Program Participation—Wave 4

*Italics indicate statistical significance with 95% confidence.*
### TABLE C
Race and Non Owner Occupied Real Estate

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<th>VARIABLE</th>
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<td></td>
</tr>
<tr>
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<td>Respondents Age</td>
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<td>21.55</td>
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<td>College Grad (1 = yes)</td>
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<td>Southern Residence (1 = yes)</td>
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<td>0.004</td>
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<td>Marital Status (1 = married)</td>
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<td>Monthly Family Income/100</td>
<td>464.28</td>
<td>45.78</td>
<td>0.001</td>
<td>20.55</td>
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<td>Race (1 = white)</td>
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Data Source: 1984 Survey of Income and Program Participation—Wave 4
Italics indicate statistical significance with 95% confidence.
### TABLE D
Race and Equity in Vehicles

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<td>Monthly Family Income/100</td>
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<td>1560.92</td>
<td>19.2</td>
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Data Source: 1984 Survey of Income and Program Participation—Wave 4
Italics indicate statistical significance with 95% confidence.
TABLE E  
Value of Gifts Received

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<td>Family Income</td>
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<td>Southern Residence (1 = South)</td>
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<td>Marital Status (1 = Married)</td>
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<td>Education</td>
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<tr>
<td>Race (1 = White)</td>
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Data Source: 1988 National Survey of Families and Households  
n = 9,660: Italics indicate statistical significance with 95% confidence.

TABLE F  
Inheritance Received

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<td>Southern Residence (1 = South)</td>
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<td>Marital Status (1 = Married)</td>
<td>-379.08</td>
<td>-0.53</td>
</tr>
<tr>
<td>Education</td>
<td>-16.5</td>
<td>-1.83</td>
</tr>
<tr>
<td>Race (1 = White)</td>
<td>3915.82</td>
<td>4.29</td>
</tr>
</tbody>
</table>

Data Source: 1988 National Survey of Families and Households  
n = 9,660: Italics indicate statistical significance with 95% confidence.
TABLE G
Generational Transfer of Wealth

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>b</th>
<th>t</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family Income</td>
<td>-0.28</td>
<td>-1.68</td>
</tr>
<tr>
<td>Marital Status (1 = Married)</td>
<td>54023.97</td>
<td>3.49</td>
</tr>
<tr>
<td>Southern Residence (1 = South)</td>
<td>-18437.79</td>
<td>-1.14</td>
</tr>
<tr>
<td>Education</td>
<td>-320.45</td>
<td>-1.86</td>
</tr>
<tr>
<td>Race (1 = White)</td>
<td>45688.43</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Data Source: 1988 National Survey of Families and Households
n = 1,686: Italics indicate statistical significance with 95% confidence.

TABLE H
Race and Home Ownership

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>b</th>
<th>t</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Family Income</td>
<td>0.04</td>
<td>19</td>
</tr>
<tr>
<td>Age in Years</td>
<td>0.04</td>
<td>13</td>
</tr>
<tr>
<td>Age (categorical)</td>
<td>0.26</td>
<td>2</td>
</tr>
<tr>
<td>Urban/Non-Urban Residence</td>
<td>-0.2</td>
<td>-3</td>
</tr>
<tr>
<td>Highest Grade Completed</td>
<td>-0</td>
<td>-1</td>
</tr>
<tr>
<td>Marital Status</td>
<td>1.01</td>
<td>15</td>
</tr>
<tr>
<td>Race (B/W)</td>
<td>0.36</td>
<td>4</td>
</tr>
<tr>
<td>Constant</td>
<td>-3.1</td>
<td>-17</td>
</tr>
</tbody>
</table>

Data Source: 1988 National Survey of Households and Families
Italics indicate statistical significant at the .01 level.
### TABLE I
Race and Home Equity

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>$ Amounts</th>
<th>Proportion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>b</td>
<td>i</td>
</tr>
<tr>
<td>Children in HHI (1 = yes)</td>
<td>21950.3</td>
<td>1.91</td>
</tr>
<tr>
<td>Respondents Age</td>
<td>576.93</td>
<td>53.95</td>
</tr>
<tr>
<td>High School Grad (1 = yes)</td>
<td>8395.34</td>
<td>18.43</td>
</tr>
<tr>
<td>College Grad (1 = yes)</td>
<td>2238.3</td>
<td>4.51</td>
</tr>
<tr>
<td>Southern Residence (1 = yes)</td>
<td>-1562.5</td>
<td>-3.64</td>
</tr>
<tr>
<td>Marital Status (1 = married)</td>
<td>591.58</td>
<td>1.53</td>
</tr>
<tr>
<td>Monthly Family Income/100</td>
<td>815.08</td>
<td>9.49</td>
</tr>
<tr>
<td>Race (1 = white)</td>
<td>9641.68</td>
<td>16.13</td>
</tr>
</tbody>
</table>

Data Source: 1984 Survey of Income and Program Participation—Wave 4
*Italicics indicate statistical significances with 95% confidence.*
## TABLE J
Race and Employer Provided Health Insurance

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>$b$</th>
<th>$t$</th>
</tr>
</thead>
<tbody>
<tr>
<td>RACE</td>
<td>0.1097</td>
<td>0.92</td>
</tr>
<tr>
<td>TENURE2</td>
<td>0.0969</td>
<td>16.17</td>
</tr>
<tr>
<td>EDUC</td>
<td>0.0801</td>
<td>5.33</td>
</tr>
<tr>
<td>FT</td>
<td>2.5184</td>
<td>31.38</td>
</tr>
<tr>
<td>PROFMAN</td>
<td>0.0576</td>
<td>0.71</td>
</tr>
<tr>
<td>METRO</td>
<td>0.0811</td>
<td>1.08</td>
</tr>
<tr>
<td>SOUTH</td>
<td>0.1433</td>
<td>2.07</td>
</tr>
<tr>
<td>UNIONMEM</td>
<td>1.0765</td>
<td>10.02</td>
</tr>
<tr>
<td>FIRM SIZE</td>
<td>0.2337</td>
<td>3.48</td>
</tr>
<tr>
<td>BRACKET2</td>
<td>0.845</td>
<td>6.38</td>
</tr>
<tr>
<td>CONSTANT</td>
<td>-2.7432</td>
<td></td>
</tr>
</tbody>
</table>

n = 10,721: Italics indicate statistical significance with 95% confidence.
### TABLE K
Race and 401(k) Plans

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>b</th>
<th>t</th>
</tr>
</thead>
<tbody>
<tr>
<td>RACE</td>
<td>0.3913</td>
<td>4.03</td>
</tr>
<tr>
<td>TENURE2</td>
<td>0.042</td>
<td>14.48</td>
</tr>
<tr>
<td>EDUC</td>
<td>0.1439</td>
<td>11.89</td>
</tr>
<tr>
<td>FT</td>
<td>1.3522</td>
<td>9.78</td>
</tr>
<tr>
<td>PROFMAN</td>
<td>0.2294</td>
<td>3.82</td>
</tr>
<tr>
<td>METRO</td>
<td>0.0976</td>
<td>1.65</td>
</tr>
<tr>
<td>SOUTH</td>
<td>-0.1853</td>
<td>-3.56</td>
</tr>
<tr>
<td>UNIONMEM</td>
<td>-0.3415</td>
<td>-5.53</td>
</tr>
<tr>
<td>FIRM SIZE</td>
<td>0.6217</td>
<td>11.14</td>
</tr>
<tr>
<td>BRACKET2</td>
<td>0.3982</td>
<td>6.67</td>
</tr>
<tr>
<td>PUBLIC</td>
<td>-0.3854</td>
<td>-6.24</td>
</tr>
<tr>
<td>CONSTANT</td>
<td>-5.7229</td>
<td></td>
</tr>
</tbody>
</table>

n = 10,836: Italics indicate statistical significance with 95% confidence.
# TABLE L
Race and Employer-Provided Pension Plans

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>b</th>
<th>t</th>
</tr>
</thead>
<tbody>
<tr>
<td>RACE</td>
<td>0.2664</td>
<td>2.35</td>
</tr>
<tr>
<td>TENURE2</td>
<td>0.2152</td>
<td>25.93</td>
</tr>
<tr>
<td>EDUC</td>
<td>0.055</td>
<td>3.43</td>
</tr>
<tr>
<td>FT</td>
<td>1.903</td>
<td>17.99</td>
</tr>
<tr>
<td>PROFMAN</td>
<td>0.13</td>
<td>1.57</td>
</tr>
<tr>
<td>METRO</td>
<td>-0.139</td>
<td>1.78</td>
</tr>
<tr>
<td>SOUTH</td>
<td>-0.0505</td>
<td>-0.74</td>
</tr>
<tr>
<td>UNIONMEM</td>
<td>0.78</td>
<td>7.91</td>
</tr>
<tr>
<td>FIRM SIZE</td>
<td>0.0372</td>
<td>0.52</td>
</tr>
<tr>
<td>BRACKET2</td>
<td>0.6555</td>
<td>5.76</td>
</tr>
<tr>
<td>PUBLIC</td>
<td>0.7589</td>
<td>8.93</td>
</tr>
<tr>
<td>CONSTANT</td>
<td>-2.8518</td>
<td></td>
</tr>
</tbody>
</table>

n = 8,952: Italics indicate statistical significance with 95% confidence.
### TABLE M
Race and Proportion of Family Income Earned by Wife

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>b</th>
<th>t</th>
</tr>
</thead>
<tbody>
<tr>
<td>WIFRACE</td>
<td>0.051</td>
<td>22.928</td>
</tr>
<tr>
<td>PREVMAR</td>
<td>0.018</td>
<td>6.659</td>
</tr>
<tr>
<td>HUSNOWRK</td>
<td>-1.241</td>
<td>-0.134</td>
</tr>
<tr>
<td>EDUCW</td>
<td>0.015</td>
<td>39.458</td>
</tr>
<tr>
<td>SOUTH</td>
<td>0.004</td>
<td>1.659</td>
</tr>
<tr>
<td>CHILDREN</td>
<td>-0.009</td>
<td>-9.988</td>
</tr>
<tr>
<td>URBAN</td>
<td>0.013</td>
<td>3.973</td>
</tr>
<tr>
<td>OTHERINC</td>
<td>-0.009</td>
<td>-128.295</td>
</tr>
<tr>
<td>PREKKID</td>
<td>-0.014</td>
<td>-4.765</td>
</tr>
<tr>
<td>(Constant)</td>
<td>0.286</td>
<td>40.931</td>
</tr>
</tbody>
</table>

n = 17,578: Italics indicate statistical significance with 99% confidence.
Part II: Databases

We used four databases in our data analyses: the Survey of Income and Program Participation (SIPP), the National Survey of Families and Households (NSFH), the U.S. Census May 1988 Current Population Survey (CPS), and the 1980 Census, PUMS Couples File. In this part of the Appendix, we provide some information about each database.

The Survey of Income and Program Participation (SIPP) was begun in 1984 by the Bureau of Census. It is a large, random field survey of the U.S. population designed to track entry into and exit from participation in various government funded social programs. The large number of households in the sample and the range and depth of questions concerning demographic detail and work experience allows an expanded analysis of black-white differences.

A SIPP panel consists of households which are interviewed every four months during a two-and-a-half-year period. A new panel is introduced every year. The SIPP database is premised on basic demographic questions that are repeated at each interview and topical "waves" that are only asked once. The repeated questions concern basic demographic and social characteristics for each member of the household including labor force activity and types and amounts of income. The more in-depth "waves" cover such topics as "assets" and "government program participation." We used Wave 4 of the 1987 Panel to examine wealth, race and taxation.

The National Survey of Families and Households (NSFH) consists of interviews with a national sample of 13,017 respondents. The field work began in March 1987 and was concluded in May 1988. The survey includes a main sample of 9643 respondents who represent the noninstitutional United States population aged nineteen and older. The remaining 3374 respondents are the spouses or cohabiting partners of the main respondents. In addition, to obtain a sample of minority groups that was large enough to support inferences made from the data, several population groups were double sampled.

One adult per household was randomly selected to be the primary respondent. A shorter self-administered questionnaire was given to the spouse or cohabiting partner of the primary respondent. Several portions

177. For a more complete description of the SIPP database and its use in studying wealth, see OLIVER & SHAPIRO, supra note 9, at 55-65.

178. Wave 4 of the 1987 Panel includes information on assets and liabilities. The assets covered include: savings accounts, stocks, business equity, mutual funds, bonds, Keogh and IRA accounts, and equity in homes and vehicles. Wave 4 does not cover pension funds; a problem for our study of employee benefits.
of the main interview were self-administered to facilitate the collection of sensitive information and to ease the flow of the interview.

The end result is a data set that is large enough and broad enough to draw inferences from. Of particular interest for us is the 3026 blacks in the NSFH sample. In our study we have drawn on data from the NSFH sample about work patterns and income sources, home ownership, inheritance and gifts.

In order to study race differences in employee benefit plan participation, we used the U.S. Census May 1988 Current Population Survey of Employee Benefits. This data set includes information on wages, industry, occupation, union status, region, education, marital status, and age, found in the May Current Population Survey conducted by the Census every year, but in addition includes information on employee benefits, firm size, and tenure with employer. The CPS Survey of Employee Benefits does not include information on the dollar value of benefits available.

We used the 1980 Census, PUMS Couples File to study the income of couples and to ascertain the likelihood of receiving a marriage bonus or penalty. The File consists of data taken from a random sample of decennial census respondents who are asked to complete a very detailed questionnaire. The PUMS Couples File is compiled by the Census from this data.
Table N shows the controls other than race that we have employed in our regressions.

**TABLE N**
Controls Used in Logistic Regressions

<table>
<thead>
<tr>
<th>MARRIAGE PENALTY</th>
<th>EMPLOYEE BENEFITS</th>
<th>HOME-OWNERSHIP</th>
<th>WEALTH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Race</td>
<td>Race</td>
<td>Race</td>
<td>Race</td>
</tr>
<tr>
<td>Income</td>
<td>Income</td>
<td>Income</td>
<td>Income</td>
</tr>
<tr>
<td>Education</td>
<td>Education</td>
<td>Education</td>
<td>Education</td>
</tr>
<tr>
<td>Region</td>
<td>Region</td>
<td>Region</td>
<td>Region</td>
</tr>
<tr>
<td>Areatype</td>
<td>Areatype</td>
<td>Areatype</td>
<td>Areatype</td>
</tr>
<tr>
<td>Previous Marriage</td>
<td></td>
<td>Marital Status</td>
<td>Marital Status</td>
</tr>
<tr>
<td>Children/Young children</td>
<td>Tenure in Job</td>
<td>Age</td>
<td>Age</td>
</tr>
<tr>
<td>Husband's labor force participation</td>
<td>Various aspects of employment</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

We discuss each of these controls, beginning with those we used most frequently in our analyses.

**EDUCATION.** Because socio-economic status is largely dependent on education, we included some measure of education in all equations. In trying to tease out the effects of education on the marriage penalty tax rates, we were most interested in wives' education because the labor force participation of married women is largely a function of their educational attainment, and the married women's labor force participation is the factor that qualifies couples for the marriage penalty. In other situations we measured the educational attainment of the person responding to the interview.

**INCOME.** Another variable that reflects socio-economic status is income. In all our equations we employed some measure of income to

---

179. OLIVER & SHAPIRO, supra note 9, at 70.
180. O'HARE, supra note 54, at 1.
to control for the possibility that race differences in tax benefits are a function of income rather than race.

In the case of the marriage penalty, we used a measure which represents all family income not earned by the wife—OTHERINC—because some married women might work more than others because the other income source for their families is inadequate. In the analysis of homeownership and wealth, all family income is measured. In our analysis of employee benefits, we classified respondents as high income (over $35,000) or low income (BRACKET2 in Tables J, K & L).

REGION. We controlled in each instance for region because blacks are most heavily concentrated in the South, a significantly poorer part of the country. As a result, observed racial disparities might actually reflect regional differences.

AGE. We included a measure of age in wealth and homeownership because increased age is directly related to increased wealth and homeownership. Because the black population is significantly younger and has shorter life expectancies than the white population, observed racial differences in wealth and homeownership may be merely a function of age rather than race. In our employee benefits analysis, we controlled for tenure in the job, which is also related to age. In our marriage penalty analysis, however, we did not control for age.

MARITAL STATUS. Marriage joins together individuals and their incomes and wealth. Accordingly, married people may be more likely to own homes and other assets than unmarried people. Because whites marry at a much higher rate than blacks, we controlled for marital status when looking at homes and wealth.

While we did not have to control for current marital status when studying the marriage penalty, we did control for whether a respondent had been previously married. We believe that it is possible that previously married wives are more impressed with the fragility of marriage and more concerned about developing a career as a source of economic security.

We did not control for marital status in our analysis of employee benefits.

AREATYPE. Here we consider whether the respondent lives in an urban or non-urban area. Area type is important for the marriage penalty rate because married women in urban areas are more likely to work than

181. *Id.* at 16.
182. *Id.* at 14.
184. *Id.* at 170.
married women in non-urban areas.\textsuperscript{185} For homes, area type is important because housing in urban areas is more scarce than in non-urban areas.\textsuperscript{186} Because blacks are overwhelmingly urban dwellers,\textsuperscript{187} area type may be more important to home ownership than race.

Area type does not appear in our wealth or employee benefit analysis. Although rural people tend to have lower incomes, we have already controlled for income.

**EMPLOYMENT.** The decisions of wives to enter the paid labor force may be dependent on the stability of their husbands’ work. In our analysis of marriage bonuses and penalties, we included \textsc{husnowrk}, a measure of the number of weeks in the past year that a wife’s husband did not work.

In our analysis of employee benefits, we included a number of variables related to the respondent’s employment, including full or part time, public or private employer, firm size for private employers, white or blue collar occupation, and union status.

**CHILDREN.** The number and age of children in a family influences married women’s labor force participation.\textsuperscript{188} In our study of the marriage penalty, we use \textsc{prekkid} and \textsc{children} to measure the effect that the presence of preschool age children, and the effect that the presence of each additional child (regardless of age), respectively has on a wife’s labor force participation. We did not control for children in our other analyses.

\textsuperscript{185} See id. at 239 (showing that a higher percentage of the black and white metropolitan populations work than the non-metropolitan populations).

\textsuperscript{186} See Heather Timmons, Big Lenders Aiding Push in Bronx Homeownership, AM. BANKER, Aug. 20, 1996, at 15 (citing a study finding that the “shortage of affordable urban housing is dangerous”).

\textsuperscript{187} FARLEY & ALLEN, supra note 183, at 135-36.

\textsuperscript{188} PHYLLIS A. WALLACE, BLACK WOMEN IN THE LABOR FORCE 34-36 (1980).
Race And Wealth Disparity: The Role Of Law And The Legal System

Beverly Moran
Vanderbilt University

Stephanie M. Wildman
Santa Clara University

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Race And Wealth Disparity: The Role Of Law And The Legal System

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RACE AND WEALTH DISPARITY: THE ROLE OF LAW AND THE LEGAL SYSTEM

Beverly Moran* and Stephanie M. Wildman**

Many authors in the forthcoming book Race and Wealth Disparities: A Multidisciplinary Discourse assume that law plays some role in the creation and maintenance of wealth disparities based upon race.¹ Yet some lawyers, judges, legislators, professors, and law students would strongly dispute that view. Many legal workers, like other Americans, believe in a legal system that aspires to, and often achieves, neutrality in matters of class and equality in matters of race.² They do not view law and the legal system as one way that American society polices race and wealth disparities. Because American law seems removed from race and wealth concerns, legal workers see no place for such considerations in their education or practice.

¹ RACE AND WEALTH DISPARITIES: A MULTIDISCIPLINARY DISCOURSE (Beverly Moran ed., forthcoming 2007). Most of the chapters in this text, by authors from disciplines ranging from sociology and psychology to history, economics, and literary criticism, consider the relevance of law to their discipline. See, e.g., Tony N. Brown & Daniel B. Cornfield, A Selective Review of Sociological Perspectives on the Relationship Between Race and Wealth, in RACE AND WEALTH DISPARITIES, supra (laws affecting unionization); William J. Collins & Robert A. Margo, Racial Differences in Wealth: A Brief Historical Overview, in RACE AND WEALTH DISPARITIES, supra (laws that prohibited blacks from owning property); M. Elizabeth Kirkland & Sheila R. Peters, “Location, Location, Location” Residential Segregation and Wealth Disparity, in RACE AND WEALTH DISPARITIES, supra (laws that enforced segregation); Dr. Roland Mitchell & Dr. Reavis L. Mitchell, History and Education: Mining the Gap, in RACE AND WEALTH DISPARITIES, supra (public education laws and segregation); Cecelia Tichi, Wealth Whitewash: Creative Writers Confront Whites’ Downward Mobility in America’s Newest Gilded Age, in RACE AND WEALTH DISPARITIES, supra (bankruptcy and property taxation); Kenneth K. Wong, Federalism and Equity: Evolution of Federal Educational Policy, in RACE AND WEALTH DISPARITIES, supra (“No Child Left Behind” federal legislation).

² See, e.g., Terry Carter, Divided Justice, NAT’L B. ASS’N MAG., Jan./Feb. 1999, at 16-17 (reporting that 80.7 percent of white attorneys and 59.1 percent of black attorneys polled were “hopeful” that the justice system would eliminate racial bias).
In response to the prevalent view that American law and legal institutions are class and color blind, this Article provides examples of how legal institutions sometimes do create and maintain racialized wealth disparities. The Article offers examples of this phenomenon by examining a sequence of federal judicial decisions, the federal taxing statutes, the role of legal education, and access to legal services. These examples are instructive because they cut across a broad spectrum of components of the American legal system. By revisiting issues of race and wealth in different legal settings from the Constitution to federal cases, the tax system, and legal education and practice, this Article confirms that race and wealth are both involved in legal outcomes and ignored by legal actors and institutions in a systematic way. Legal actors and citizens of all vocations need to look more critically at the American legal landscape and critique the influence of race and wealth.

America’s foundational aspirations toward equality and neutrality allow legal actors to ignore the effect that race and wealth disparities have upon law and the legal system, even when those actors acknowledge how often law fails to achieve these ideals. Legal realists, critical legal theorists, critical race theorists, feminist theorists, and others have noted the contradiction between legal doctrines and legal realities. Yet, despite its contradictions and failures, the urge towards equality and neutrality creates opportunities for change. As E.P. Thompson observed, “people are not as stupid as some . . . suppose them to be. They will not be mystified by the first man who puts on a wig.” For Thompson, neutrality and equality provide opportunities to redress an unequal class system even while these concepts also protect ruling class interests. Thompson reasons that a “partial and unjust” law cannot gain pop-

3. See, e.g., KARL N. LLEWELLYN, JURISPRUDENCE: REALISM IN THEORY AND IN PRACTICE (1962); MAX RADIN, LAW AS LOGIC AND EXPERIENCE (1940).
7. English judges wear wigs, so Thompson’s reference is to the role of law (represented by the man in the wig) in perpetuating or combating injustice. See E.P. THOMPSON, WHIGS AND HUNTERS: THE ORIGIN OF THE BLACK ACT 262–63 (1975).
ular support and so is not useful in maintaining class hierarchy.\textsuperscript{8} Thus, the aspiration for universality and equity can sometimes force law to follow its “own logic and criteria of equity.”\textsuperscript{9}

\textbf{THE AMERICAN CONFLICT BETWEEN EQUALITY, NEUTRALITY, AND ASSIGNED RACE ROLES}

From its beginnings, the American legal system has articulated two distinct, yet contradictory, views of human relations. The Declaration of Independence aspired to equality among people and neutral application of law.\textsuperscript{10} Yet at the same time, Article I, section 2 of the United States Constitution provided that the census shall count “the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons.”\textsuperscript{11} This constitutional provision allocated roles by race for the construction of political rights: Indians outside American society; black slaves; and white male full citizens, whether free or bound for a term of years.

Ironically, neutrality and equality can support subordination and hierarchy. Anatole France illustrated this point when he sarcastically applauded the majestic equalitarianism of the law, which “forbids the rich as well as the poor to sleep under bridges, to beg in the streets, and to steal bread.”\textsuperscript{12}

In 1943, Robert Hale echoed France’s sentiment, as he wrote about the law’s role in creating unequal bargaining relationships and unequal wealth effects. Hale explained that wealth gives its owner control over his or her own life and leisure and over other people’s lives as well.\textsuperscript{13} Hale illustrated this control of the wealthy

\textsuperscript{8} Id.
\textsuperscript{9} Id. Thompson allows that a legal system may not achieve neutrality and fairness:

It is true that certain categories of person may be excluded from this logic (as children or slaves), that other categories may be debarred from access to parts of the logic (as women or, for many forms of eighteenth-century law, those without certain kinds of property), and that the poor may often be excluded, through penury, from the law’s costly procedures.

\textsuperscript{10} “We hold these truths to be self-evident, that all men are created equal; that they are endowed by their Creator, with certain unalienable Rights, that among these are life, liberty and the pursuit of happiness.” \textit{The Declaration of Independence} para. 2 (U.S. 1776).
\textsuperscript{11} \textit{U.S. Const.} art. I, § 2, cl. 3.
over the working classes through the greater bargaining power that capital has over labor, especially low-skilled workers.\textsuperscript{14} This unequal bargaining power leads to the inequitable distribution of wealth as those with control over capital can extract work from others without just compensation.\textsuperscript{15} As seen in Hale’s work, legal neutrality claims that law has no effect on this wealth distribution.\textsuperscript{16} Instead, law simply protects property rights and freedom of contract.\textsuperscript{17} Under this concept of legal neutrality, other institutions, for example the market, fuel the wealth distribution occasioned by unequal bargaining power.

Hale rejected the claim that legal neutrality has no wealth effects. Rather, Hale pointed out that legal rules lead to particular wealth distribution patterns and that different legal rules create different wealth distribution patterns while still protecting property rights and freedom of contract.\textsuperscript{18} For Hale, the allegedly neutral system of American property and inheritance laws does more than merely protect private property and freedom of contract; these laws also give property owners power over workers to the detriment of most Americans.\textsuperscript{19}

Sixty years after Hale, Stephen J. Rose, in a book and poster depicting the interrelationships of income, wealth, occupation, race, gender, and household type, showed that five percent of the United States population owns sixty percent of the nation’s wealth.\textsuperscript{20} Using an icon representing 160,000 people as its primary unit, the left side of the poster portrayed the American population by income up to $125,000.\textsuperscript{21} Ninety-three percent of the American population earned at or below this $125,000 mark.\textsuperscript{22} Ninety-three percent of the American population is able to fit within the physical frame of the approximately two by three foot poster.\textsuperscript{23}

\begin{itemize}
\item 14. \textit{Id.} at 626-27.
\item 15. \textit{Id.} at 627-28.
\item 16. \textit{Id.} at 626.
\item 17. \textit{Id.}
\item 18. \textit{Id.} at 628. “Bargaining power would be different were it not that the law endows some with rights that are more advantageous than those with which it endows others.” \textit{Id.} at 627-28.
\item 19. \textit{Id.} at 627-28.
\item 21. Rose, \textit{supra} note 20, at 25.
\item 22. \textit{Id.}
\item 23. \textit{Id.}
\end{itemize}
In order to expand the chart at the same 160,000 people per icon scale and include those who earn combined incomes of up to $300,000, the poster must add eight feet in height. Few icons populate this extended chart representing people who earn more than $125,000 annually. In order to reflect the 150,000 households with more than $1 million in yearly income, the poster must grow three stories high.

Although Rose’s poster tells a different story, the American myth perpetuates the idea that anyone can climb those three stories in one lifetime. This belief coexists with public rules and private practices that have tied wealth to race for generations. As a result, non-whites are even less likely to move out of poverty than whites.

The disparate, distributional result that ties race and wealth has been supported throughout American history by government programs. The United States began as a slave nation, and the end of slavery did not break the tie between race and wealth. Most people are aware of the failures of the post-Civil War Reconstruction and the emergence of the Jim Crow system of segregation. Few are as aware of how the liberal New Deal tied race and wealth. The New Deal introduced the notion of an economic safety net into American politics. As such it pulled many Americans from poverty. But the New Deal also excluded agricultural and domestic workers from that economic safety net because those occupations served as a “neutral” proxy for race. After World War II, the government continued to enrich its citizens based on race through the Federal Housing Administration, which made home

24. Id.

25. The Y axis (the vertical line running along the left hand side of the poster) shows income up to $125,000. The X axis shows the U.S. population in increments of 160,000 up to ninety-three percent of the population. Id.

26. Id.


ownership available to working class whites, while excluding black buyers through redlining and other exclusionary practices. These government programs increased white family well-being significantly while systematically excluding blacks, Indians, and others. Yet, because each program based exclusions on seemingly neutral factors, many whites have never understood the role their race played in their rise from poverty to middle class status.

Hale argues that contract law is driven by bargaining power and made up of seemingly class neutral rules that actually shift bargaining power to owners of capital and away from labor. Favoring the wealthy over workers is not the stated justification for these rules. Instead, proponents justify these rules as the most efficient means of supporting an important social goal called freedom of contract. The rules ignore the fact that, without true bargaining power, there can be no freedom of contract. Thus the rich and the poor share in the same freedoms which somehow mysteriously tend to favor the wealthy. The New Deal developed seemingly race-neutral rules that actually shifted wealth away from blacks and towards whites. These rules were not presented as part of an effort to bring the white working class into the middle class while leaving black America in Depression conditions for another forty years. Yet, by restricting benefits to whites either explicitly—as in the federal home mortgage arena—or implicitly—as in Social Security—these government programs helped ensure that government benefits would enforce an income and wealth gap between white Americans and their non-white counterparts. These gaps, first between the wealthy and everyone else (which is enforced by contract law among other legal rules) and between black wealth and white wealth (perpetuated by historical gaps in government benefits), occur in a wide range of assets, including access to education.

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FACIAL NEUTRALITY REINFORCING HIERARCHY IN JUDICIAL DECISION-MAKING

Two judicial decisions announced twenty-five years apart illustrate how equality and neutrality can veil the reinforcement of existing wealth inequities. Rodriguez v. San Antonio School District\(^{30}\) and Hopwood v. Texas\(^{31}\) both concerned the Texas public education system. Rodriguez dealt with elementary and secondary education;\(^{32}\) Hopwood grappled with higher education in the state’s premier law school.\(^{33}\)

Rodriguez challenged the practice of funding local school districts through property taxes.\(^{34}\) In a property tax system, rich school districts are able to raise more funds through taxation than poor districts. Because rich districts include land and buildings with higher property values, these districts are able to raise greater funding while putting less tax burden on each taxpayer within the district. As Douglas Reed explained, “property-rich districts could generate significant revenues for education (at relatively low tax rates), while property-poor districts could produce only very small amounts of revenue (while taxing themselves at comparatively high rates).”\(^{35}\) This uneven and unequal funding scheme led three law professors to argue that state wealth, rather than school district wealth, was a better measure of funding per student.\(^{36}\) The professors urged that “children are classless . . . no child of tender years is capable of meriting more or less than another.”\(^{37}\) The Edgewood School District’s budget, where Mr. Rodriguez’s children attended school, spent only two-thirds as much money per student as compared to the Alamo Heights School District’s per-student expenditures.\(^{38}\) The residents of the Edgewood District were

32. See generally Wong, supra note 1, for further discussion of elementary and secondary education.
34. Rodriguez, 411 U.S. at 4-5.
37. COONS, CLUNE & SUGARMAN, supra note 36, at 419.
predominantly Mexican-American; in contrast, the residents of Alamo Heights were predominantly “Anglo.”39

Although the factual record fully apprised the Supreme Court concerning the wealth and ethnic differences between the Edgewood and Alamo Districts, the majority explicitly rejected a link between the “property-poor districts” and race. Instead the majority declared: “Nor does it now appear that there is any more than a random chance that racial minorities are concentrated in property-poor districts.”40 Citing a Connecticut-based study, the majority also rejected associating economic disadvantage and “property-poor” districts.41 In ruling against the funding challenge, the majority wrote:

In sum, to the extent that the Texas system of school financing results in unequal expenditures between children who happen to reside in different districts, we cannot say that such disparities are the product of a system that is so irrational as to be invidiously discriminatory. . . . The complexity of these problems is demonstrated by the lack of consensus with respect to whether it may be said with any assurance that the poor, the racial minorities, or the children in overburdened core-city school districts would be benefited by abrogation of traditional modes of financing education.42

Thus, in 1973 the Supreme Court let Texas continue to fund its school districts through local property taxes, thereby ensuring that rich school districts would spend more on their elementary and secondary school systems than poor school districts. The Court refused to find any connection between wealth and race or ethnicity, nor did it find a connection between wealth and educational resources.

In 1996, the Fifth Circuit decided Hopwood v. Texas,43 a challenge to the admissions policy at the University of Texas School of Law. Children who attended kindergarten in Texas at the time Rodriguez was decided were twenty-five years old when the Hopwood litigation began. Thus, Texans who were in the applicant pool to attend the University of Texas Law School grew up in an educational system that had allowed vast differentials in their publicly funded education because of Rodriguez. In addition, these

39. Id. at 12.
40. Id. at 57.
41. Id. at 23.
42. Id. at 54-55, 56.
43. 78 F.3d 932 (5th Cir. 1996).
Texan applicants grew up shortly after the University of Texas desegregated, although for the vast majority of its history the University of Texas was a segregated institution. 44

Even though the University of Texas and its law school had ended de jure segregation, enrollment at the University remained predominantly white. 45 During the Hopwood era, the law school embarked on an affirmative action plan meant to address this de facto segregation. 46

In Hopwood, the Fifth Circuit characterized the question before it as whether “in order to increase the enrollment of certain favored classes of minority students, the University of Texas School of Law discriminates in favor of those applicants by giving substantial racial preferences in its admissions program.” 47 The court rejected the University of Texas Law School’s admission policy as unconstitutional because it produced an entering class containing students who did not meet a supposedly neutral and objective standard of merit. 48 The court’s reliance on supposedly neutral tests did not reflect the race and class issues inherent in the Texas public school system.

Both Rodriguez and Hopwood reflect a kind of neutrality. As Anatole France might have said, in Rodriguez the law is equalitarian and neutral when it allows all parents to spend whatever funds they want on their children’s education, so long as they have the money to do so. Further, the law remains neutral when the graduates of under-funded schools are subject to the same tests as graduates of well-funded schools in order to gain admission to the state university’s law school. Each decision reflects a theoretical neutrality that together create a real world differential in access to public education at the primary, secondary, and graduate levels.


46. Hopwood, 78 F.3d at 935-38.

47. Id. at 934.

48. In 1993 resident (Texan) white applicants had a mean grade point average of 3.53 and a law school admissions test score of 164. Mexican Americans averaged 3.27 and 158, respectively; blacks averaged 3.25 and 157. Id. at 937 n.7.
The law acknowledges that a rule allowing only whites to enter the University of Texas is not neutral. But the Fifth Circuit employed the shield of neutrality by demanding that the University of Texas employ an admission policy for local Texas residents that heavily relied on test scores. Many view the use of test scores as neutral, even though the judges received evidence of these tests’ race and class bias. Further, the differences in educational opportunity on the primary and secondary levels meant that there would be different test scores by race even if the tests themselves had no race bias.

From a doctrinal perspective, Rodriguez and Hopwood illustrate Hale’s two observations that (1) neutrality can mask redistributive effects, and (2) different rules could create different wealth effects without harming fairness, freedom of contract, or property ownership. Read together, Rodriguez and Hopwood offer a microcosmic view of children denied educational opportunities under the guise of neutral law.

49. See Sweatt v. Painter, 339 U.S. 629, 634 (1950) (“It may be argued that excluding petitioner from that school is no different from excluding white students from the new law school. This contention overlooks realities.”).

50. Hopwood, 78 F.3d at 962.


52. For further discussion of the race and class implications of Rodriguez, see generally Goodwin Liu, The Parted Paths of School Desegregation and School Finance Litigation, 24 Law & Ineq. 81 (2006), arguing that Keyes v. Sch. Dist. No. 1, 413 U.S. 189 (1973) and Rodriguez together presented the opportunity to fuse school finance litigation and desegregation, though the Court rejected that opportunity. See also Susan H.Bitsensky, We “Had a Dream” in Brown v. Board of Education . . ., 1996 Det. C. L. Rev. 1, 16 (arguing that Rodriguez must be overturned in order for the United States to realize the full promise of Brown); Michael Heisse, Equal Educational Opportunity, Hollow Victories, and the Demise of School Finance Equity Theory: An Empirical Perspective and an Alternative Explanation, 32 Ga. L. Rev. 543, 575 (1998) (discussing how Rodriguez forced proponents of school finance equity at the federal level into state court battles for adequacy); Paula J. Lundberg, State Courts and School Funding: A Fifty-State Analysis, 63 Alb. L. Rev. 1101, 1145 (2000) (arguing that the states which are less urban, have a higher per-capita income, and have greater state constitutional protection have been and will be more likely to reject the Rodriguez holding and invalidate their own funding schemes); Denise C. Morgan, The Less Polite Questions: Race, Place, Poverty and Public Education, 1998 Ann. Surv. Am. L. 267 (arguing that to improve public education contrary to the traditional litigation preceding and including Rodriguez, litigation that is capable of fusing race, poverty, and space must be encouraged).
As the discussion of Rodriguez and Hopwood above illuminates, American legal institutions sometimes create seemingly neutral rules that actually enforce race and wealth roles. For example, access to education is a type of wealth. The Rodriguez and Hopwood decisions each articulate neutral rules that, when combined, distribute public education in skewed ways. Yet, as Hale pointed out, the unequal distribution of wealth is hard to detect. Neutral rules serve to mask unequal wealth distribution and to make the skewed distribution possible.

Until now this Article has looked at a series of rules and government policies that purported to be race and class neutral, such as freedom of contract and law school admissions. This Article now turns to a law that does not purport to represent class neutrality: the federal tax code. There are a number of reasons to consider tax laws as statutes with both race and wealth effects. The first and most obvious reason that the United States tax system might have both race and wealth effects is that the system clearly implicates both income and wealth distribution. At its most basic level, the gift and estate tax laws explicitly tax large estates as they pass from generation to generation, and the income tax uses progressive rates as income rises. A second reason for expecting to see differences based on race and wealth in the United States taxing statutes is that both the income gap between blacks and whites and the wealth gap are dramatic in this country. Because both the income and wealth gaps are so extreme by race, effects of the intersection of race and wealth might appear more readily in a statute that deals directly with income and wealth.

The observations contained in the paragraphs above argue that the American tax system is both race-neutral as written and race-and wealth-sensitive as structured. In fact, as one would expect, it turns out that the United States tax system has a series of rules that result in blacks and whites at the same income level, education level, marital status, number of children, and region of residence paying very different amounts of federal income tax, with blacks

53. For more on education as a form of wealth, see generally Wong, supra note 1, and Mitchell & Mitchell, supra note 1.
54. Hale, supra note 13, at 628.
55. Rose, supra note 20; see also Beverly Moran & William Whitford, A Black Critique of the Internal Revenue Code, 1996 Wis. L. Rev. 751, 770.
56. See generally Moran & Whitford, supra note 55.
paying more. This differential by race is achieved through a number of mechanisms. One way that the distribution is achieved is through the technical rules and how those rules interact with how people live. Another way the distribution is achieved is through the silence that allows the rules to play out differently by race without any movement toward reform. A third factor that helps maintain wealth distribution by race is the shaping of public opinion so that Americans accept rules that favor the wealthy as neutral rules that favor us all.

Technically, the distribution of tax benefits to whites and away from blacks is achieved through a series of credits, exclusions, and deductions that all work so that the greatest benefits go to people who fit a white profile and the lowest benefits go to people who fit other profiles. A quick example of this phenomenon is apparent in the bundle of benefits that apply to home ownership.

A vast gap in home ownership exists between whites and blacks. The gap in home ownership is a direct result of a wide range of government policies from the creation of the Republic to date. Thus, it can hardly be argued that home ownership is a voluntary act or that black people have purposefully eschewed home ownership. Instead, black people are now, and have been, consistently shut out of the home ownership market by a series of laws, rules, and private policies.

The Internal Revenue Code gives tremendous benefits to home ownership. The cost of financing a home is completely deductible for most Americans. Property taxes that support local schools are also deductible. If the house goes up in value, the owners can draw money out of the house through borrowing, not pay any tax on the receipt of the borrowed funds, and deduct the payment of mortgage interest. When the owner sells the home, the gain realized from any increased value or equity is usually received completely tax-free.

57. Id. at 754-55.
58. Id. at 754.
59. Id. at 753-54.
60. Id. at 752.
61. The home mortgage interest deduction presents one example of this phenomenon. See id. at 754; see also Beverly Moran, Setting an Agenda for the Study of Tax and Black Culture, 21 U. Ark. Little Rock L. Rev. 779, 783 (1999); William C. Whitford, Remarkable, 76 N.C. L. Rev. 1639, 1645 (1998).
63. See generally Collins & Margo, supra note 1; Kirkland & Peters, supra note 1.
64. See generally Collins & Margo, supra note 1.
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The combination of the tremendous tax benefits for home ownership and the private practices and policies that kept blacks from that home ownership shows how the intersection of a neutral law with a race-charged situation compounds race effects. The intersection of the law and the reality of how people live allows the race-neutral law to change wealth outcomes by race.

As E.P. Thompson might tell us, the intersection of race and wealth in the United States tax laws is best achieved if the law is supported by public opinion. For example, support for such concepts as freedom of property and freedom of contract helps mask how the law serves to create wealth based on bargaining power. In the case of tax legislation, manipulation of public opinion and societal ignorance of racial hierarchy both contribute to attitudes that veil recognition of the tax law’s role in maintaining wealth disparities.

One illustration of how public relations can manipulate public opinion for political ends in federal tax legislation is provided by Marjorie Kornhauser. Her article presents an early example of the still-current political phenomenon of small, well-financed groups influencing tax legislation through lobbying, the media, and rhetorical appeals to the “common man.” Kornhauser shows Americans reacting completely outside their class interests when dealing with tax policy.

Kornhauser’s work concerns the repeal of certain public reporting requirements that made information on wealthy taxpayers’ income accessible to the general public. Kornhauser opines that the average American had nothing to lose from the public reporting requirement. In contrast, wealthy Americans felt vulnerable in the face of public revelations of their holdings. Even though they represented a numeric minority, the campaign the wealthy mounted against the disclosure rules gained wide popular support. The wealthy were able to construct a story that resonated

65. CASHIN, supra note 29, at 3-38.
68. Id. at 58.
69. Id.
70. Id.
71. Id.
72. Id. at 58-59.
with average Americans who came to identify with those wealthy taxpayers but were actually harmed by the provision.\footnote{Id.}

Contemporary debates over the estate tax present a more current example of the same crossover identification phenomenon. The estate tax is nothing if not a tax that directly targets upper class families seeking to make intergenerational wealth transfers. Yet, even when commentators assured the public that only one percent of the population would ever confront the gift and estate tax, a mass abolition movement arose against the so-called “death” tax.\footnote{The estate tax currently affects less than 1 percent of families, and it is the most progressive tax in the country because its impact is almost entirely on the nation’s richest families . . . . At the moment, the government imposes a tax of about 46 percent on estates worth more than $2 million, or more than $4 million in the case of couples. Edmund L. Andrews, \textit{G.O.P. Fails in Attempt to Repeal Estate Tax}, \textit{N.Y. Times}, June 9, 2005, at C1.}

What Professor Kornhauser’s work illustrates and what the public outcry against the “death tax” reflects is how the great American cultural urge toward neutrality and equality masks, as Hale and France both suggested, a tremendous class-based privilege. The cultural concern for equality and neutrality serves as both a strength and weakness. In its best light, the culture fosters empathy with those less fortunate and a willingness to sacrifice for the greater good. At its worst, it supports a type of silence that prevents Americans from seeing, and therefore discussing, ways to actually achieve that neutrality and equality. This silencing dynamic is evident in legal education.

\section*{LEGAL EDUCATION: TRAINING GROUND FOR CONTINUED SILENCE}

Wealth disparities and race both play marginal roles in the law school curriculum.\footnote{bell hooks describes class in America as the subject the culture does not address. “Nowadays it is fashionable to talk about race or gender; the uncool subject is class.” \textit{bell hooks, Where We Stand: Class Matters} vii (2000) (grieving that greed sets “the standard for how we live and interact in everyday life”). Her comment is reminiscent of Patricia J. Williams’s description of race as the elephant in the room that gets tiptoed around, also not discussed. \textit{Patricia J. Williams, The Alchemy of Race and Rights} 49 (1991). Although both wealth and race tend to be ignored in law school classrooms, several good casebooks are available on these subjects, including \textit{Derrick Bell, Race, Racism and American Law} (5th ed. 2004); \textit{Emma C. Jordan & Angela P. Harris, Economic Justice: Race, Gender, Identity and Economics} (2005); and \textit{Juan Perea, Richard Delgado, Angela P. Harris & Stephanie M. Wildman, Race and Races: Cases and Resources for a Diverse America} (2d ed. 2007).} Although all first year law students study sub-
jects that raise wealth and race issues, legal educators rarely teach those subjects in ways that raise those concerns. Instead, legal pedagogy adopts a mode of “perspectivelessness,” reinforcing the ideal that legal discourse is objective and analytical. Perspectivelessness supports the myth of legal neutrality. Although legal scholars like Hale have been very explicit about the role of wealth in American law, and critical race theory has been equally explicit about the role race plays in American legal institutions, both topics remain relegated to boutique seminar courses. Students can, and often do, study law for three years without ever considering either wealth or race as legitimate topics of study.

The omission of race and wealth disparities from the core law school curriculum reinforces its invisibility in other parts of the profession, thereby supporting the kinds of judicial decisions and statutes discussed in the preceding sections. As E.P. Thompson observed, “class is something which in fact happens.” When class just “happens” in the law school classroom without any study or comment, legal educators train the next generation of lawyers to ignore these fundamental issues of fairness and their implications for democracy.

A student writing exercise provides one example of the absence of basic knowledge about wealth disparity within the context of legal education. Upon finishing a unit on work and care giving, which included readings on the United States’ economy and how it is managed to ensure unemployment, law students taking a Social Justice Law class spent three minutes on a free write exercise, answering the question: “What is class?” Several essays discussed physical classroom space. Other students wrote about “class” as

77. See, e.g., Cass R. Sunstein, Why Does the Constitution Lack Social and Economic Guarantees?, 56 SYRACUSE L. REV. 1, 20 (2005) (supporting the idea that the Nixon appointments to the Supreme Court removed the potential for a progressive understanding of wealth distribution); see also Hale, supra note 13, at 626.
79. E.P. THOMPSON, THE MAKING OF THE ENGLISH WORKING CLASS 9 (1964); see also Martha R. Mahoney, Class and Status in American Law: Race, Interest, and the Anti-Transformation Cases, 76 S. CAL. L. REV. 799, 805 (2003) (arguing that “when law ignores class while claiming to protect white workers, it gives authority to the claim that whites are harmed by the advent of people of color”).
conduct, in the sense of classy, or snobby, or being embarrassed by a lack of “classiness.” Thus, even in the context of readings and discussions of wealth disparities, these students’ initial reaction to the term “class” was to envision meanings disconnected from wealth. When asked whether they spoke much about class and wealth disparities in law school, the students answered “No.”

The silence on wealth and class in the law school classroom is not limited to one school or one classroom.\textsuperscript{81} Indeed, that silence is so pervasive that it impacts student career choices, and reduces the number of law students who aspire to work for social justice. Several studies of legal education note that students enter law school with a desire to work in the public interest.\textsuperscript{82} Yet by the time these same students graduate, they have changed their vision of success toward a corporate practice devoid of social justice issues.\textsuperscript{83}

Class implicates relationships and power so that, while social stratification statistics give a snapshot of one aspect of class or wealth, these statistics fail to convey the ways people experience class, how they identify themselves and others, or how power structures become replicated.\textsuperscript{84} Wealth’s invisibility in legal education is part of how class “happens.” When class just “happens,” the failure to pay attention replicates and reinforces existing structures.\textsuperscript{85} The replication and reinforcement of these existing structures influences the development of law, legal theory, and the next generation of legal professionals.

\textsuperscript{81} Margaret Montoya illustrates another example of missed learning opportunities for the whole class, because prevailing assumptions in the classroom prevented the recognition of wealth disparities. See Margaret E. Montoya, Mascaras, Trenzas, y Grenas: Un/Masking the Self While Un/Braiding Latina Stories and Legal Discourse, 17 HARV. WOMEN’S L.J. 185, 192 (1994).

\textsuperscript{82} See Robert Granfield, Making Elite Lawyers: Visions of Law at Harvard and Beyond 3 (1992) (describing students’ changing view of career goals); Robert Stover, Making It and Breaking It: The Fate of Public Interest Commitment During Law School 13 (1989) (reporting that one-third of beginning first-year law students said they hoped to work in public interest jobs and one-sixth of graduating third years expressed the same hopes; the number of students who expressed commitment to public interest jobs dropped by half during law school).

\textsuperscript{83} See Stover, supra note 82, at 13. Note, however, that corporate law practice need not be disconnected from social justice work. Bob Egelko, 14 S.F. Law Firms Pledge Free Work for Poor Clients: Judicial Nudge Prompts Commitment, S.F. CHRON., Dec. 15, 2000, at A26 (describing the successful effort of Chief Judge Marilyn Hall Patel, U.S. District Court in San Francisco, and Chief Justice Ronald George, California Supreme Court, with the Bar Association of San Francisco to encourage law firms to commit a percentage of attorney time to pro bono work).

\textsuperscript{84} See Mahoney, supra note 79, at 805.

\textsuperscript{85} Id.
Income and wealth inequalities exist for many reasons; law is only one of those reasons. Yet, as this Article shows, law is not a trivial reason. In many ways legal rules, especially those rules that claim to support equality and neutrality, can mask the means for supporting wealth and power differentials of all sorts. Legal education disserves the very people who need to understand both how law supports and undercuts equality and neutrality. Legal education ignores the issues of race, class, and inequality through the silence on these issues that permeates many classrooms. As a result, future leaders lack the training that they need to even imagine how law supports or undercuts true equality, much less how to address those issues in any serious way.

**ACCESS TO LAWYERS AND THE LEGAL SYSTEM: A FORM OF WEALTH**

This Article offers different definitions of wealth. Some view income as a proxy for wealth. The discussion of the racial roles assigned by the Constitution makes race a type of political wealth, defining who has a say in forming the elected government. The discussion of *Rodriguez* and *Hopwood* addressed education as a form of wealth. The racial allocation of government benefits in the discussion of the federal tax laws illustrates how tax laws are structured. These tax laws create wealth transfers from blacks with less wealth to whites with more wealth, and the public financing of housing does the same by reducing blacks’ access to the funds needed to purchase housing and other types of wealth.

Access to lawyers and the legal system is another form of wealth. A typical view of the provision of legal services would see legal services as a value-free commodity that is governed by the market. But as Hale pointed out, legal rules have tremendous impact on the protection of property rights, the creation of bargaining power, and the determination of wealth distribution.86 Just as legal rules act to concentrate other types of wealth, such as education, housing, and tax benefits, legal resources are yet another type of wealth that remains unevenly distributed by class and race. Reginald Heber Smith decried the notion of “one law for the rich and another for the poor.”87 Indeed, Smith viewed freedom and equal access to justice as inextricably intertwined.88

86. See Hale, supra note 13, at 628.
87. Reginald Heber Smith, Justice and the Poor 3 (1919).
88. Id.
Like Smith, President Jimmy Carter charged that legal resources are inappropriately apportioned. President Carter complained that "ninety percent of lawyers serve only ten percent of the population."\textsuperscript{89} In a recent study by the National Legal Aid and Defenders Association, researchers found that in California alone there was roughly one legal aid attorney for every 10,000 economically disadvantaged Californians.\textsuperscript{90} Equal justice under law is a disregarded ideal when access to lawyers is so skewed.\textsuperscript{91}

The availability of lawyers to bring social justice cases on behalf of individuals and communities affects both the nature of cases that are brought into court and the legal rules that prevail. Cruz Reynoso provides an example of the importance of lawyers for the protection and creation of wealth with his description of a New Mexico program established to increase the number of Native American lawyers.\textsuperscript{92} “Soon we started seeing cases coming out of Arizona . . . in which Native American tribes sued to receive water that they were entitled to under treaties. Rights mean nothing if nobody enforces them.”\textsuperscript{93} Access to lawyers empowered the Indian community and allowed it to achieve rights that were previously not enforced because of a lack of legal resources.\textsuperscript{94} But Indians are not the only poor people who are in need of legal services. In New Jersey, it is estimated that less than one percent of all tenants have lawyers to help them in landlord-tenant court.\textsuperscript{95}

\textsuperscript{89} GRANFIELD, \textit{supra} note 82, at 4 (1992).
\textsuperscript{90} See Deborah L. Rhode, \textit{Access to Justice}, 69 FORDHAM L. REV. 1785, 1786 (2001); Jose Padilla, Surviving 40 Years of Poverty Law Practice: Salvaging Justice, Address at Santa Clara University Law School (Oct. 16, 2006).
\textsuperscript{91} A study released by Legal Services of New Jersey on October 13, 2006 finds that over the past year nearly 120,000 low-income New Jersey residents attempted to receive free legal assistance, but were turned away due to a lack of resources. Legal services providers are worried that the data underrepresent the problem because many low-income people do not attempt to receive legal services when they need them. The report, “People Without Lawyers: New Jersey’s Civil Legal Justice Gap Continues,” also found that ninety-nine percent of defendants in landlord-tenant eviction cases at state courts were not represented by a lawyer. Kate Conscarelli, Poor Jerseyans Have Limited Access to Legal Aid, Study Finds, THE STAR LEDGER, Oct. 13, 2006.
\textsuperscript{92} Cruz Reynoso, \textit{Educational Equity}, 36 UCLA L. REV. 107, 111 (1988).
\textsuperscript{93} \textit{Id.} Lawyers are not, however, a panacea for the ailments of disempowered communities. Marc Galanter, in a classic article, explains how the legal system is stacked against the “have-nots” in society. \textit{See generally} Marc Galanter, \textit{Why the “Haves” Come out Ahead: Speculations on the Limits of Legal Change}, 9 LAW & SOC’Y REV. 95 (1974).
\textsuperscript{94} \textit{See} Ralph W. Johnson, \textit{Indian Tribes and the Legal System}, 72 WASH. L. REV. 1021, 1031 (1997) (noting that as “tribes have gained greater access to legal counsel, courts have increased their focus on Indian issues”).
\textsuperscript{95} See Conscarelli, \textit{supra} note 91.
How different would landlord-tenant relationships in New Jersey, or in any other state, look if the parties approached the court with equal access to legal resources?

The United States spends only $300 million on legal services to serve over forty million poor citizens. By contrast, “[a] single law firm, which represents maybe a hundred or so corporate clients, earned . . . [one billion dollars].” The total profits of a half dozen law firms exceed the total federal, state, and local expenditures for legal representation for the poor.

CONCLUSION

Louis Brandeis once warned that: “We can have democracy; in this country; or we can have great wealth concentrated in the hands of a few, but we can’t have both.” In the United States, race and wealth are so intertwined that the wealthy few are also almost invariably white. If Brandeis is correct, and democracy cannot exist alongside concentrated wealth, then perhaps wealth concentrated by race presents an even greater threat than wealth that is concentrated through more random means.

Most disciplines seem to believe that law plays a role in creating and maintaining wealth and race disparities. This Article shows that from the origins of the nation when the United States Constitution explicitly established racial roles to the present, government policy often directed wealth from Indians and blacks towards whites. This Article discussed one ironic aspect of legal method that helps legal institutions and doctrines play their role in maintaining race and wealth hierarchy—the aspiration to equality and neutrality. The examples of seemingly neutral rules having race and wealth effects included Texas public education as sustained by Rodriguez and Hopwood; the color-blind federal tax laws; the law school classroom and its replication of silence on matters of class; and access to justice as measured by the availability of lawyers’ services.

97. Id.
98. Id.
This Article also reflects different definitions of wealth. Human beings held as slaves provided a form of wealth to their owners.\textsuperscript{100} Access to education develops human capital and is another form of unevenly distributed wealth in this nation.\textsuperscript{101} Similarly, access to legal services is denied to the poorest Americans. Home ownership, the bedrock of wealth for the American middle class, is very skewed by race as a result of long-term public and private policies. Thus, while other disciplines have a more focused definition of wealth, the legal landscape invites a more encompassing view.

Richard Delgado has urged those in the legal academy to learn from other disciplines in their effort to promote social change.\textsuperscript{102} He noted, for example, that post-colonial literature, searching for ways to oppose imperial forces in Africa, Asia, and Latin America, developed chronologically parallel to the civil rights tradition in the United States, but “without much interchange between the two.”\textsuperscript{103} Law and legal institutions need assistance from other disciplines to reveal the inconsistencies contained in the legal system and ultimately to hold that system accountable.

\textsuperscript{100} See Anthony Paul Farley, \textit{Accumulation}, 11 \textit{Mich. J. Race} \& L. 51, 54 (2005) (urging that the rule of law supports the primal scene of accumulation).
\textsuperscript{101} See generally Mitchell \& Mitchell, \textit{supra} note 1; Wong, \textit{supra} note 1.
\textsuperscript{103} \textit{Id.} at 19.
Wealth Redistribution and the Income Tax

BEVERLY MORAN*

INTRODUCTION

This section of the *Howard Law Journal* is devoted to the question of wealth redistribution. The section on wealth redistribution contains five views of the United States tax system. This article asks how the tax system can stand against increasing income and wealth inequality.

Part I of this article presents evidence of the increasing trend towards inequality in both income and wealth that has occurred since the Reagan administration (1981-1989). Part II discusses whether social welfare payments lighten this otherwise growing income and wealth inequality. Part II also discusses the view, expressed by Adam Smith (the father of capitalism), that social welfare programs are created and maintained in order to protect social inequality rather than to redistribute wealth.

In Parts III and IV, the article discusses two ways the present federal tax system is meant to redistribute wealth: progressive rates and the Earned Income Tax Credit. These two Parts conclude that progressive rates essentially deliver greater public relations than true wealth redistribution and that the Earned Income Tax Credit is an inappropriate way of providing cash assistance to the working poor.

In Parts V and VI, the article discusses a wealth tax as an alternative wealth redistribution device. Part V discusses the general redistribution influences of a wealth tax given the large gaps in wealth within the United States and the constitutional issues with a federal wealth tax. Part VI looks at a wealth tax through the lens of black reparations.

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* Professor of Law, Vanderbilt University Law School; A.B., Vassar College; J.D., University of Pennsylvania; LL.M., New York University. Thanks to Alice Bullock, Janet Hirt, Leon Trakman, and the *Howard Law Journal.*
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The article then concludes with the observation that the present federal income tax has lost whatever redistributive properties it once had and that a wealth tax would deliver more wealth redistribution than the present progressive income tax.

I. THE TREND TOWARD INEQUALITY

The phrase "wealth redistribution" tends to evoke images that contradict reality. Rather than unwashed hordes tearing at Marie Antoinette's silk gown, the expression "wealth redistribution" more accurately describes a flow of assets up from the poor to the rich.

Evidence abounds for viewing wealth redistribution as welfare for the rich. The Troubled Asset Relief Program is only the most recent confirmation of the phenomenon.\(^1\) As taxes from truck drivers and teachers went to bail out American International Group (A.I.G.) and Goldman Sachs, twenty-five hedge fund managers received more in combined annual salary than the gross domestic product of Costa Rica, Iceland, Jordan, or Uruguay.\(^2\)

Upward wealth distribution is ubiquitous. The great transfer of wealth through colonialism and slavery from Africa and Asia to Europe shapes today's world,\(^3\) as do the massive land transfers from Native Americans to various European powers and then to the United States from the fifteenth century onward.\(^4\)

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Since the Reagan administration, upward wealth distribution has accelerated in the United States resulting in increasing inequality of both income and wealth. The growth of inequality since the 1980s is particularly shocking because, from the turn of the century and until the Reagan administration, the United States and Western Europe experienced small but stable declines in wealth and income inequality. Now, three decades after the Reagan Revolution, the United States enjoys both growing poverty and a shrinking middle class.

The concept of upward wealth distribution does not come from Karl Marx. Rather, the observation that “the rich get richer” comes from Adam Smith, also known as “the father of capitalism”: “Whenever there is great property, there is great inequality. For one very rich man, there must be at least five hundred poor, and the affluence of the few supposes the indigence of the many.” Yet, despite forces that trend toward income and wealth concentration, Part II discusses government counter-forces to upward distribution.

II. AGAINST INCREASING INEQUALITY: COUNTERFORCES TO DISTRIBUTION UP

Smith observed that great wealth creates great inequality. Smith also asserted that government actively protects the rich from the poor, thereby supporting income and wealth inequities:


7. See Jacob S. Hacker, The Risky Outlook for Middle-Class America, in Ending Poverty in America: How to Restore the American Dream 66-76 (John Edwards, Marion Crain, & Arne L. Kalleberg eds., 2007); Elizabeth Warren, The Vanishing Middle Class, in Ending Poverty in America: How to Restore the American Dream, supra, at 38-52. For a discussion on Reaganomics, see The American Economic History Reader, supra note 3, at 476-500.

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The affluence of the rich excites the indignation of the poor, who are often both driven by want, and prompted by envy, to invade his possessions. It is only under the shelter of the civil magistrate that the owner of that valuable property, which is acquired by the labour of many years, or perhaps of many successive generations, can sleep a single night in security. He is at all times surrounded by unknown enemies, whom, though he never provoked, he can never appease, and from whose injustice he can be protected only by the powerful arm of the civil magistrate continually held up to chastise it.\textsuperscript{9}

A counter to the idea of government as an instrument of upward distribution is the idea of government as a downward redistributor through benefits like public schools and welfare. Again, Smith suggests a different intent behind these programs. While some see public benefits as downward redistributions, Smith understands these same public benefits as ensuring an upward concentration of wealth. Along with the civil magistrate, Smith identifies welfare and public education as ways that government protects the wealthy against the poor:

The state . . . derives no inconsiderable advantage from . . . instruction [of the working classes]. The more they are instructed the less liable they are to the delusions of enthusiasm and superstition, which, among ignorant nations, frequently occasion the most dreadful disorders. An instructed and intelligent people, besides, are always more decent and orderly than an ignorant and stupid one. They feel themselves, each individually, more respectable and more likely to obtain the respect of their lawful superiors, and they are therefore more disposed to respect those superiors.\textsuperscript{10}

In this quote, Smith demonstrates his understanding of how public benefits enforce wealth and income inequities upward. Yet even if we accept Smith's proposition that public benefits do not redistribute wealth downward, there are other aspects of government that seem directly dedicated to downward redistribution—in particular, the federal income tax system and its progressive rates.

III. DOWNWARD WEALTH REDISTRIBUTION: THE FEDERAL INCOME TAX SYSTEM AND ITS PROGRESSIVE RATES

From its inception to date, the federal income tax has contained

\textsuperscript{9} Id.
\textsuperscript{10} Id. at WN V.i.f.61.
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progressive rates;\textsuperscript{11} yet there is no common agreement on their purpose.\textsuperscript{12} One widely criticized justification for progressive rates is their

\textsuperscript{11} Progressive rates occur when those who earn more pay a higher marginal rate of tax. For example: a rate of 10\% on the first $100 and 25\% on the next $100 produces a total tax of $35 on $200 for a marginal rate of 17.5\%. With respect to the federal income tax on individuals, the 1954 Code delineated a progressive tax with twenty-four income brackets applying to tax rates ranging from 20\% to 91\%. I.R.C. § 1(a) (1954).

\textsuperscript{12} See Walter Blum & Harry Kalven, The Uneasy Case for Progressive Taxation (1953); see also Marjorie E. Kornhauser, The Morality of Money: American Attitudes To-

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<thead>
<tr>
<th>If the taxable income is:</th>
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<tr>
<td>Not over $2,000</td>
<td>20% of the taxable income</td>
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<td>$690,000, plus 99% of excess over $85,000</td>
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<td>$1,410,000, plus 99% of excess over $150,000</td>
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<td>Over $160,000 but not over $170,000</td>
<td>$1,500,000, plus 99% of excess over $160,000</td>
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<td>Over $170,000 but not over $180,000</td>
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<td>Over $190,000 but not over $200,000</td>
<td>$1,770,000, plus 99% of excess over $190,000</td>
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<tr>
<td>Over $200,000</td>
<td>$1,860,000, plus 99% of excess over $200,000</td>
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After adjusting the 1954 income bracket thresholds for inflation, 2006 income tax rates are shown to be generally much lower than they were in 1954, with the general exception of those earning between $30,650 and $45,113 in constant 2006 U.S. dollars, whose statutory tax rates are only slightly lower than in 1954. In the graph below, the top line represents marginal income tax rates during the year 1954, and the bottom line represents such rates during 2006.

![Graph showing income tax rates comparison between 1954 and 2006](image-url)


12. See Walter Blum & Harry Kalven, The Uneasy Case for Progressive Taxation (1953); see also Marjorie E. Kornhauser, The Morality of Money: American Attitudes To-

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contribution to downward wealth redistribution. For its critics, progressive rates provide unnecessary downward redistribution in an already economically open society where individual work, rather than government intervention, is meant to reduce inequalities. But are progressive rates effective wealth redistributors; i.e. do the federal income tax’s progressive rates redistribute wealth downward?

On paper, progressive rates can appear dramatic. At times, the highest marginal rate has risen to 90% of taxable income. Working solely from the statute as written, progressive rates seem ideal for downward wealth redistribution; but the dramatic appearance of rates on paper are just part of the story.

Progressive rates are applied to ordinary income, including income from wages, but a lower rate applies to income from the sale of capital assets, such as stocks, bonds, and real estate. Progressive rates are more public than real because as income and wealth rises, sources of taxable income shift from wages to capital gains. This shift in the source of income moves most wealthy people out of the high progressive rates on ordinary income and into the lower tax rates on capital gains. The result is that, as income rises, tax rates actually fall.

Ironically, the only time that rates on capital gains equaled the rates for other types of income was during the Reagan administration. In all other eras, the federal income tax system reduced rates


14. See Blum & Kalven, supra note 12.


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for capital gains.\(^{20}\) Even the extreme rates of the Eisenhower Administration (1953-1961) did not necessarily redistribute income because of the countervailing influence of the significantly reduced capital gains rates.\(^{21}\)

Further, even if federal income tax rates are progressive, progressivity in the federal income tax is counterbalanced by regressive state and federal taxes.\(^{22}\) Thus, although the federal income tax’s progressive rates might appear to redistribute wealth downward, the capital gains rate and other tax benefits reserved to capital such as the deferral of tax on appreciation until realization, combined throughout the twentieth century to make progressive marginal rates more imagined than real. In the twenty-first century, the still extant Bush administration (2001-2009) tax cuts have even more dramatically changed the incidence of progressivity.

In the present economy, increased inequality combined with the Bush administration’s tax cuts for the wealthy have turned progressive rates on their head. The shift is so significant that Warren Buffett publicly challenged a crowd of 400 billionaires to reveal if any one paid a higher marginal tax rate than his own cleaning lady.\(^{23}\) Buffet reported

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<td>Not over $2,300</td>
<td>No tax</td>
</tr>
<tr>
<td>Over $2,300 but not over $3,400</td>
<td>11% of the excess over $2,300</td>
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<tr>
<td>Over $3,400 but not over $4,400</td>
<td>$121, plus 12% of the excess over $3,400</td>
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<tr>
<td>Over $4,400 but not over $10,500</td>
<td>$535, plus 15% of the excess over $6,500</td>
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<tr>
<td>Over $8,500 but not over $10,800</td>
<td>$835, plus 16% of the excess over $8,500</td>
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<tr>
<td>Over $10,800 but not over $12,900</td>
<td>$1,205, plus 18% of the excess over $10,800</td>
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<tr>
<td>Over $12,900 but not over $15,000</td>
<td>$1,581, plus 20% of the excess over $12,900</td>
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<tr>
<td>Over $15,000 but not over $18,200</td>
<td>$2,001, plus 23% of the excess over $15,000</td>
</tr>
<tr>
<td>Over $18,200 but not over $23,500</td>
<td>$2,737, plus 26% of the excess over $18,200</td>
</tr>
<tr>
<td>Over $23,500 but not over $28,800</td>
<td>$4,115, plus 30% of the excess over $23,500</td>
</tr>
<tr>
<td>Over $28,800 but not over $34,100</td>
<td>$7,507, plus 38% of the excess over $34,100</td>
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<tr>
<td>Over $34,100 but not over $41,500</td>
<td>$10,319, plus 42% of the excess over $41,500</td>
</tr>
<tr>
<td>Over $41,500 but not over $55,300</td>
<td>$16,115, plus 42% of the excess over $55,300</td>
</tr>
<tr>
<td>Over $55,300 but not over $81,800</td>
<td>$28,835, plus 50% of the excess over $81,800</td>
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his own marginal rate as a little over 17% while his receptionist and cleaning lady each topped out at a 30% marginal rate.\(^{24}\)

At least for the time being, the statutory progressive tax rates in the federal income tax are not achieving wealth redistribution down; but does redistribution lie somewhere else in the Internal Revenue Code? Perhaps the answer lies with the Earned Income Tax Credit.

IV. WEALTH REDISTRIBUTION DOWN? THE FEDERAL INCOME TAX SYSTEM AND THE EARNED INCOME TAX CREDIT

When George McGovern ran for president, he was widely mocked for the “negative income tax” he proposed in order to distribute cash to the working poor.\(^{25}\) Yet, twenty years later, McGovern’s acolyte, President Bill Clinton, reintroduced the negative income tax through the renamed Earned Income Tax Credit.\(^{26}\)

When President Clinton (1993-2001) entered office he was faced with tremendous pressure to adopt “workfare,”\(^{27}\) a program first introduced in Wisconsin that tied welfare payments to work.\(^{28}\)

\(^{24}\) See Matthew Miller, Me and My Secretary, FORBES, Nov. 26, 2007, at 42-44, available at http://members.forbes.com/2007/1126/042b; see also Warren Buffett’s Tax Rate Is Lower than His Secretary’s (Tom Brokaw interviews Warren Buffett), http://www.youtube.com/watch?v=UtSb-2LoCs or http://www.youtube.com/watch?v=3z_Ur0KljHc.


\(^{26}\) I.R.C. § 32 provides that a taxpayer’s Earned Income Tax Credit will equal a specified percentage of the taxpayer’s earned income up to a maximum dollar amount. The earned income tax credit (EITC) was introduced under President Gerald Ford, and increased under Presidents Carter, Reagan, and Bush. Under President Clinton through the Omnibus Reconciliation Act of 1993, the maximum EITC payment increased over $1000 to $2,528. In 1995, this went up to $3,110, and in 1996 the maximum EITC one could receive increased to $3,556. Also introduced in 1994 was an EITC payment for a single person with no dependents. See Jennifer Bird-Pollan, Who’s Afraid of Redistribution? An Analysis of the Earned Income Tax Credit, 74 MO. L. REV. 251 (2009), available at http://law.missouri.edu/lawreview/docs/74-2/Bird-Pollan.pdf (providing a brief history of the EITC and working through the mechanics of the credit); Jonathan Barry Forman, Earned Income Credit, in ENCYCLOPEDIA OF TAXATION AND TAX POLICY 99 (1999), available at http://www.taxpolicycenter.org/UploadedPDF/1000524.pdf. For a discussion of the earned income tax credit as a part of welfare reform, see JOEL F. HANDLER & YEHEZKEL HASSENFIELD, BLAME WELFARE: IGNORE POVERTY AND INEQUALITY (2007).


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dent Clinton built the idea of work driving welfare reform into a bipartisan consensus to provide cash assistance to working families through the Earned Income Tax Credit.\textsuperscript{29} The Earned Income Tax Credit is now the largest cash assistance program for the able bodied in the United States.\textsuperscript{30}

As a wealth redistribution device, the Earned Income Tax Credit's main advantage over traditional welfare was its status as hidden cash assistance. So long as it remained buried in the tax code, the Earned Income Tax Credit avoided political controversy.\textsuperscript{31} Stanley Surrey described this phenomenon many years earlier in his pioneering work on the tax expenditure budget.\textsuperscript{32} Surrey understood that politicians use the federal income tax as a way of hiding programs that they believe cannot stand the light of public scrutiny.\textsuperscript{33}

Tellingly, Surrey's primary examples of tax-driven hidden government expenditures all achieved upward wealth distribution. For example, Surrey often employed the home mortgage interest deduction in his work; he explained that the deduction subsidizes home ownership for the wealthy at many times the rate that it subsidizes the poor.\textsuperscript{34} Surrey's point was that Representatives and Senators could never publicly cast votes for direct government expenditures that subsidize millionaires while doing little for working people. But these same Congressmen could vote for complicated tax regimes that accomplished the same wealth concentrating purpose without challenge because the complicated tax code allows benefits to the wealthy to hide in plain sight.\textsuperscript{35}

The Earned Income Tax Credit enjoyed the cover of tax complication until the heat of the last presidential election. In response to then-candidate Obama's claim that he would reduce taxes for 95\% of Americans, Republicans and conservatives caught hold of the Earned

\textsuperscript{29} See Handler & Hasenfeld, supra note 26, at 81-89.
\textsuperscript{30} See id. at 81.
\textsuperscript{31} See id.
\textsuperscript{33} See id.
\textsuperscript{34} See Stanley S. Surrey, Pathways to Tax Reform: The Concept of Tax Expenditure 134-36 (1973); see also Brian H. Jenn, The Case for Tax Credits, 61 Tax L. 549, 556-57 (2008) (using the example of the mortgage interest deduction to two taxpayers with equal mortgage interest expense but different tax rates to show the deductions are inequitable).
\textsuperscript{35} See Surrey, supra note 34.
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Income Tax Credit to retort that Obama’s promise was false on its face because a large portion of the population was already exempt from federal income taxation.\textsuperscript{36}

Perhaps purposefully misunderstanding that even those working people who pay no federal income tax still pay high rates on other state and federal taxes, the Republican party reviled the Earned Income Tax Credit as proof that the poor pay no taxes at all. As a result of the controversy, one great benefit of the Earned Income Tax Credit is lost: its ability to provide cash assistance to the working poor without being tagged as welfare. Instead of a politically neutral way of getting cash to the working poor, what is left of the Earned Income Tax Credit is an exposed and extremely complicated redistribution mechanism that costs too much for the government and the recipient.\textsuperscript{37}

Americans often share stories of their fear of the Internal Revenue Service, yet the United States places its most vulnerable citizens into the tax system in order to obtain their basic necessities. People working low paying jobs, with little time off, those who might have health issues, and who certainly have children, are asked to comply with complicated tax rules in order to obtain the benefits of the Earned Income Tax Credit.\textsuperscript{38} Furthermore, the burden of complying with the earned income tax credit falls most heavily on minorities and women because they make up the largest segment of the working poor.\textsuperscript{39} As a wealth redistribution device, the Earned Income Tax Credit is a failure.


\textsuperscript{38} See Barbara Ehrenreich, \textit{Nickel and Dimed: On (Not) Getting By in America} (2001).

Wealth Redistribution and the Income Tax

But what other possibilities exist in the federal tax system? Can the federal tax system play a role in downward wealth distribution outside of the Earned Income Tax Credit?

V. DOWNWARD WEALTH REDISTRIBUTION: POSSIBILITIES FOR A WEALTH TAX

The federal tax system focuses on income rather than wealth.40 The federal government's failure to tax wealth helps increase both income and wealth inequalities because, in the United States, wealth is more unevenly distributed than income.41 To the extent that wealth is protected from tax, the federal government helps support upward wealth concentration.

In the United States, wealth has race, ethnic, and gender effects. For example, in 2002, the median net worth of non-Hispanic white households was $87,056; for households with a black householder, the median net worth was $5,446; for households with an Asian or Pacific Islander householder, the median net worth was $59,292; and for households with an Hispanic householder, the median net worth was $7,950.42 Also in 2002, female householders had a median net worth of $20,217, which was 19.8 percent of the married-couple median. Male householders had a median net worth of $23,700 or 23.2 percent of the married couple median.43 The wealth gaps between groups in the United States are much greater than other gaps between blacks and whites, or males and females, including gaps in education and income.44 A tax on wealth, rather than income, might help decrease wealth and income inequality by addressing wealth as a foundational part of inequality.45

41. See WOLFF, supra note 5; OLIVER & SHAPIRO, supra note 5.
44. See, e.g., WOLFF, supra note 5; Moran, supra note 40.
45. See, e.g., WOLFF, supra note 5; Moran, supra note 40.
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The primary legal roadblock to a federal wealth tax is a constitutional restriction on direct taxes without apportionment that prohibits a wealth tax absent constitutional amendment. The constitutional prohibition on direct taxes is not, however, an insurmountable barrier to a wealth tax. The same constitutional provision was amended in 1913 in order to permit the modern American income tax. One hundred years later, Article 1 § 2 could be amended again in order to permit a federal wealth tax.

The restriction on wealth taxes is achieved by Article 1 § 2 of the Constitution, which requires that direct taxes be apportioned by population. The restriction on direct taxes reflects the eighteenth century American political need to accommodate southern slaveholders.

In the eighteenth century United States, most wealth was held in land or slaves—both easy targets for tax. The wealthiest Americans—those with the largest acreage and slave holdings—resided in states with the lowest white male populations. Their low white male populations, especially in relation to acreage, put these wealthy southern planter states at a numerical disadvantage in the House of Representatives when compared to states with larger white male populations and smaller per capita white male land holdings.

A tax on land and slaves—the most significant forms of eighteenth century American wealth—would have shifted the burden of government away from the highly populated small states of the northeast and toward the slaveholding south with its low white male population. At least two adjustments were placed in the United States Constitution in order to reaffirm southern power in the face of demographic reality:

(1) A modification that counted each slave as three-fifths of a person for purposes of allocating Representatives. This rule increased

46. See U.S. Const. art. 1, § 2 (“Representatives and direct taxes shall be apportioned among the several states which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons.”); Moran, supra note 40.

47. See U.S. Const. amend. XVI (“The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.”).

48. Id.

49. See Moran, supra note 40.

50. See id.; see also The American Economic History Reader: Documents and Readings, supra note 3.
the number of Representatives from the southern states thereby giving the South more political power for its white male minority. (2) A second constitutional modification prohibiting direct taxes without apportionment effectively made both a federal wealth and a federal income tax unconstitutional.\textsuperscript{51} This second modification ensured that the federal government could only tax land and slaves on sale, when a transfer tax would avoid the constitutional prohibition against direct taxes without apportionment.\textsuperscript{52}

VI. CAN A WEALTH TAX CONTRIBUTE TO REPARATIONS?

Given the racial history of Article 1 § 2 as a means of concentrating power in southern slaveholding elites and the continuing race effects of wealth distribution within the United States, a wealth tax as one way to achieve wealth redistribution fits at least three tax policy concerns:

(1) Because so much of the population has little or no wealth, a wealth tax would exempt a large part of the population from filing, thereby saving the government and the taxpayers a great deal of economic and social cost.\textsuperscript{53}

(2) Because wealth and income are so closely associated, a wealth tax would target those most able to pay and most likely to occupy the smallest and most protected part of the population.

(3) Because if we are to believe Adam Smith and other tax benefit theorists, a wealth tax most clearly ties government benefits to the tax, which is a primary goal of taxation.\textsuperscript{54}

In addition, a wealth tax could address some lingering race issues in the United States, for example, the question of reparations for slavery.

In the United States, even very mild attempts to make up for slavery can provoke terrifying threats.\textsuperscript{55} Although the United States

\textsuperscript{51} See generally Robin L. Einhorn, American Taxation, American Slavery (2006).
\textsuperscript{52} See Moran, supra note 40.
\textsuperscript{53} See Graetz, supra note 37 (noting high cost of up to 100 million unnecessary tax returns); Wolff, supra note 5 (discussing how many people would be exempt from a wealth tax).
\textsuperscript{54} See Smith, supra note 8, at WN V.1.b.2, WN V.i.f .61; Moran, supra note 40.
\textsuperscript{55} See, e.g., E. Gordon Gee, Carpetbaggers and Conflagration: Vanderbilt University Makes New Enemies of Old Friends, in UNIVERSITY PRESIDENTS AS MORAL LEADERS (David G. Brown ed., 2006) (describing death threats received by the Chancellor and his cabinet as a result of an attempt to change the name of a dormitory from "Confederate Memorial Hall" to "Memorial Hall").
has sometimes acknowledged responsibility and provided redress,\(^{56}\) when the subject is American slavery, the topic of reparations raises serious disagreement.\(^{57}\)


\(^{57}\) For discussions of objections to the modern black reparations movement, see, for example, Robert K. Fullwider, The Case for Reparations, and Stephen Kirchner, The Case Against Reparations, both in Reparations for Slavery: A Reader, 141-50, 151-62 (Ronald P. Salzberger & Mary C. Turck eds., 2004); Juan Williams, Enough: The Phony Leaders, Dead-End Movements, and Culture of Failure that Are Undermining Black America—and What We Can Do About It 67-85 (2006) (listing several objections to the black reparations movement, including that the movement is not serious in either a political or a cultural sense); Alfred L. Brophy, Reconsidering Reparations, 81 Ind. L.J. 811, 814-18 (2006) (criticizing Eric A. Posner & Adrian Vermeule, Reparations for Slavery and Other Historical Injustices, 103 Colum. L. Rev. 689, 747 (2003) for using a too narrowly drawn definition of reparations). See generally Roy L. Brooks, supra note 56, at 180-206 (listing objections to black reparations, including African involvement with the slave trade, the universal acceptance of slavery during the nineteenth century, that reparations unfairly penalize white Americans whose families immigrated after the Civil War, the absence of slaves to compensate because all the slaves are dead, that reparations is just an even more illegitimate form of affirmative action, that white soldiers paid reparations for the entire nation by their deaths in the Civil War, that slavery gave present day black Americans the opportunity to live in a prosperous country, that class based reparations are more universal and fair, that blacks need to contribute to racial reconciliation, that there is so much mixed blood in the United States that everyone would be entitled to reparations, and that the amount of reparations is impossible to calculate); Alfred L. Brophy, Reparations Pro & Con 76 (2005) (listing objections to reparations in addition to those listed by Brooks, including: only a small minority of whites ever owned slaves, black reparations are based on race and not injury, blacks owe a greater debt to the United States than the country owes to blacks, reparations are just disguised separatism); Louis Kaplow & Steven Shavell, Fairness Versus Welfare, 114 Harv. L. Rev. 967 (2001); Eric A. Posner & Adrian Vermeule, Reparations for Slavery and Other Historical Injustices, 103 Colum. L. Rev. 689, 747 (2003) (criticizing current writings on reparations as based on large-scale abstractions about justice and injustice).
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There is no doubt that slavery betrayed American political ideals by denying millions of people the ability to obtain wealth and confer that wealth to future generations. These restrictions on the ability to accumulate and pass on wealth did not end with slavery. Instead, a series of government programs reinforced the wealth disparities between those citizens that arrived by migration and those who arrived in chains. In addition to the other government programs that helped


58. For a discussion of the impact on modern law of the creation of people as property, see, for example, Patricia Williams, Fetal Fictions: An Exploration of Property Archetypes in Racial and Gendered Contexts, 42 Fla. L. Rev. 81, 88 (1990). See generally Patricia J. Williams, On Being the Object of Property, 14 Signs J. WOMEN CULTURE & Soc’y 5 (1988).

59. In the context of social security, see Marc Linder, Farm Workers and the Fair Labor Standards Act: Racial Discrimination in the New Deal, 65 Tex. L. Rev. 1335, 1337-38 (1987) (noting that legislative history of the Social Security Act shows that blacks were deliberately excluded from benefits under the domestic and farm worker provisions, and that even blacks that were eligible for Social Security assistance received significantly lower benefits than whites). See also Mei Zhu Lu et al., The Color of Wealth: The Story Behind the U.S. Racial Wealth Divide 73-130 (2006) (discussing the historical events that have led to black wealth inequities, including slavery, blacks’ inaccessibility to New Deal programs; and other state-sponsored discrimination in the areas of employment and housing); Mary Poole, The Segregated Origins of Social Security: African Americans and the Welfare State 174-87 (2006).

For a discussion of the role of the federal government in denying black Americans access to wealth in housing, see, for example, Massey & Denton, supra note 4. See generally William J. Collins & Robert A. Margo, Racial Differences in Wealth: A Brief Historical Overview, and Elizabeth, Kirkland & Sheila L. Peters, Location, Location, Location: Residential Segregation and Wealth Disparity, both in RACE AND WEALTH DISPARITIES: A MULTIDISCIPLINARY DISCOURSE, 11-22; 23-40 (Beverly L. Moran ed., 2008).

For racist policies in education meant to perpetuate a black underclass, see, for example, Reavis Mitchell & Roland Mitchell, History and Education: Mining the Gap: Historically Black Colleges as Centers of Excellence for Engaging Disparities in Race and Wealth, in RACE AND WEALTH DISPARITIES IN THE UNITED STATES: A MULTIDISCIPLINARY DISCOURSE, 82-109 (Beverly L. Moran ed., 2008).

For general discussions of the wealth gap between blacks and whites in the United States, see, for example, Dalton Conley, Being Black Living in the Red: Race, Wealth & Social Policy in America 55-81 (1999); Chuck Collins, Betsy Leondar-Wright, & Holly Sklar, Shifting Fortunes: The Perils of the Growing American Wealth Gap (1999); Oliver & Shapiro, supra note 5, at 100-10; Francine D. Blau & John W. Graham, Black White Differences in Wealth and Asset Composition, 105 Q.J. Econ. 221, 337 (1990) (noting the large differences in wealth acquisition that cannot be explained by income, education, region, or marriage).
maintain the wealth gap that began with slavery, we can add our decision to tax income instead of wealth.

Our federal tax laws continue to exacerbate the wrong started in slavery in a number of ways:

- First, by confiscating a portion of the earnings that could otherwise go towards accumulating wealth, the federal tax laws make it harder for each generation to make up for past lost opportunities.
- Second, government programs that created wealth for whites added to the black/white wealth gap.\textsuperscript{60}
- Third, by treating income from wealth much more favorably than earned income, the current income tax system has skewed the progressive rates.\textsuperscript{61}

Thus, the federal income tax both shelters wealth for the already rich and attacks the means of obtaining wealth for those without. At least some of the objections to reparations and the flaws in our federal tax system are answered with a wealth tax.

A wealth tax eliminates the special benefits that the Internal Revenue Code now confers on property and its owners.\textsuperscript{62} Thus, the great gap in wealth between blacks and whites (and males and females) no longer acts through the tax system as a way of protecting white wealth to the detriment of blacks or male wealth to the detriment of females. Instead, a wealth tax places the tax burden directly where Smith would recommend; that is, on the greatest beneficiary of government largesse: the property owner.

Next, any exemption for the lowest amounts of wealth within a wealth tax would excise a large portion of the black population from taxation. As a result, the exemption would provide a period for blacks to build up their wealth base after centuries of restrictions on black wealth accumulation.\textsuperscript{63}

\textsuperscript{60} See sources cited supra notes 57 and 59.

\textsuperscript{61} Such rules as deferring the unrealized gains in wealth, often allowing those unrealized gains to completely escape tax through the date of death basis rules of I.R.C. \textsuperscript{64} § 1014, and taxing the income flowing from wealth at less than half the maximum rates for earned income, I.R.C. § 1(h), have all led Warren Buffet (reportedly the third richest man on earth) to ask why he pays a lower tax rate than his secretary. See Martin J. McMahon, Jr., \textit{The Matthew Effect and Federal Taxation}, 45 B.C. L. Rev. 993 (2004); 105 Tax Notes 1383 (2004); Beverly L. Moran & William Whitford, \textit{A Black Critique of the Internal Revenue Code}, 1996 Wis. L. Rev. 751-820 (1996) (discussing ways that the benefits for wealth create greater tax liabilities for black taxpayers); Tom Bawden, \textit{Buffet Blasts System that Lets Him Pay Less than His Secretary}, Times of London, June 26, 2007, at 1.

\textsuperscript{62} See, e.g., Moran & Whitford, supra note 61.

\textsuperscript{63} For general information about the growing gap between the rich and the poor in the United States based on income, see, for example, \textit{Congressional Budget Office, Historical Analysis of the U.S. Tax System}, 1996.
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Although government was a main force in stripping blacks of their wealth for the past four centuries, government was (and is) ironically also the cause of black wealth. For example, the Civil War Amendments and the Civil Rights Laws are real sources of black wealth.64 Without those government actions, blacks would have less wealth than they do today, no matter how disproportionate that wealth is in contrast to their white counterparts. With a wealth tax, blacks pay the tax that is most closely associated with the benefits that government conferred on them while also receiving the lower tax bills that come from the recognition that lower wealth rates are a result of government action against them.

CONCLUSION

The last thirty years have seen increasing wealth and income inequality. At the same time, the last eight years of tax reform have eroded the federal income tax system's ability to stand against inequality through progressive rates. The one weapon left in the tax system's arsenal for promoting wealth redistribution is the Earned Income Tax Credit. Although it is now the largest cash assistance pro-

gram for the working poor in the United States, the Earned Income Tax Credit is not well suited to assisting people in need. Middle and upper income people find the tax system difficult to deal with, despite access to professional help. Yet, the United States asks people most at risk and with the least access to professional advice to navigate the tax system in order to obtain basic subsistence.

A more efficient way to use the tax system as a wealth redistribution device is to tax wealth directly. The largest inequity in the United States is wealth, not income or education. Wealth is also one of the most salient predictors of future success. Tellingly, wealth is also highly predicted by race and gender. The association of wealth and race is not accidental. Rather, it is the result of a long string of government policies, many of which were explicitly based on race. Even the present constitutional restrictions on the federal government’s ability to tax wealth have their origin in the desire to protect slavery and the southern plantation class.

Given the increasing inequality of income and wealth within the United States; the present inability of the federal income tax system to effectively stand against increasing inequality; the importance of wealth to well being; and the past race history and present race effects of much of the United States increasing income and wealth inequality, a wealth tax is a more efficient means of wealth redistribution within the tax system. A wealth tax has several advantages over our present system including: (1) fewer tax returns, because such a large portion of the United States population has no wealth and would be exempt from filing; (2) a closer association of taxes paid with benefits received because such a large portion of the cost of government goes towards the protection of wealth; and (3) a wealth tax would target those with the greatest ability to pay, primarily because income is so tied to wealth.

Finally, because American history shows that wealth is so tied to race, a wealth tax would have an interesting reparations effect. Those who were once treated as property would receive the necessary breathing room to develop wealth and fulfill the American dream.
IDEAS

How the U.S. Tax Code Privileges White Families

Tax policies have preserved the racial inequality that has long defined America.

MARCH 23, 2021

Dorothy A. Brown
Tax-law professor at Emory University

Soon after I got my master’s degree in tax law from NYU in 1984, I started preparing my parents’ tax returns. They filed jointly, and what always stuck out to me was how comparable their incomes were. My mother worked as a nurse at an assisted-living facility, and my father was a plumber with the New York City Housing Authority.
Some years, my father’s overtime would put him on top by a few hundred dollars; other years, my mother outearned him.

What I saw every year was what researchers call the “marriage penalty”: My parents, like many other married Black couples trying to pay for a mortgage, save for their children’s future, and afford health care, were paying higher taxes under the joint return than they would have had they remained single and filed separately. What I sensed then—and what 25 years of academic research have revealed to me in greater detail since—was that changes to the U.S. tax code typically benefit white taxpayers, while putting Black taxpayers at a further disadvantage, even when Black and white Americans have made the same life choices. Subsidies for homeownership benefit white homeowners more than Black homeowners. Tax breaks for workers benefit white workers more than Black workers. And tax reform has always been a fight over which white Americans get tax cuts, with Black Americans paying the price, as I document in my book *The Whiteness of Wealth: How the Tax System Impoverishes Black Americans—And How We Can Fix It.*

The U.S. tax code can seem like a neutral, or at least equally punishing, system. But that misses how it has privileged white people—particularly white married couples—and preserved the racial inequality that has long defined America. Take the joint return, for instance, a policy that was designed to give a tax break to married (heterosexual) couples in which only the husband worked in the paid labor market. That setup favored white couples, whose familial structure was most likely to fit its mold. And it came at the expense of Black married couples, including my parents.

*Read: Why Black families struggle to build wealth*

That inequality flows from the joint tax return’s origins, a story that begins with an affluent couple named Henry and Charlotte Seaborn, members of the Seattle Yacht Club, who married in 1902. Henry was the vice president of a shipbuilding corporation, Skinner & Eddy, and Charlotte was a stay-at-home spouse. At the time, there was no such thing as “married filing jointly” in the way we understand it today. Each taxpayer filed his or her own return only if they had income greater than the exemption amount, which meant that Henry would file a return, but not Charlotte. By 1927, almost 98 percent of Americans paid no income tax, because their income did not exceed the exemption. The revenues needed to fund the government did not require any additional taxpayer dollars. Prior to World War II, our progressive tax system placed a target on Henry’s back.

But Henry had the wealth to do something about it, and in 1927, he and his lawyers figured out a workaround. Henry Seaborn’s taxable income for the year was $38,500 (well over $500,000 in today’s dollars), and his team came up with an idea: If he could treat half of his income as Charlotte’s, he could save $703.01 ($10,000 in
today’s dollars) in taxes. Why? Because the progressive tax system taxes income at higher rates as income increases. In other words, the rate that applies to my first dollar of taxable income is lower than the rate that applies to my last. If, however, each spouse were taxed on half of Henry’s income, the rate applicable to the half now characterized as Charlotte’s would be significantly less than if it were part of Henry’s total.

Washington was a community-property state, which meant that, legally, Charlotte had a right to half of Henry’s income. So they each filed individual tax returns, with Charlotte claiming her “half” of Henry’s income on hers. The IRS disapproved and said that Henry should have been taxed on all of the income, and therefore he owed the additional taxes.

Henry paid up, but then he went to court to fight. He won at the district-court level, but the IRS appealed. His case went all the way to the Supreme Court, where the Seaborns won. Their win, however, followed the loss by a different white taxpayer who tried to transfer half his income to his stay-at-home spouse by contract—not because of community-property law—and the Supreme Court ruled against him. That taxpayer loss, coupled with the Seaborns’ victory, meant that now the tax liability for married couples would turn on whether they lived in a community-property state.

That disparity ultimately led to Congress enacting the joint return in 1948, which allowed all married couples like the Seaborns—with a husband who works in the paid labor market and a wife who stays at home—to pay less in taxes, regardless of where they lived: a marriage bonus. The joint return gave tax breaks to single-wage-earner couples, but nothing to households where both spouses worked. So what? Weren’t we in a world where only the highest-earning Americans paid taxes? But WWII had changed everything.

Funding the war required tax revenue—lots of it—and from 1940 to 1945, income-tax rolls increased from 7 million to 42 million Americans because the exemption amount was lowered and more people now owed taxes. That number now included many Black Americans, and Black wives have always been likelier to work in the paid labor market than white wives. The reasons are varied, but one of the most significant is that Black men are subject to labor-market racial discrimination, which makes their income lower than that of white men and their labor-force participation less stable because of higher unemployment rates. Also, research suggests that Black married couples at all income levels are more egalitarian when it comes to sharing power than their white peers. While white married couples such as the Seaborns were getting a tax cut with the advent of the joint return, most Black married couples were not.

Everything comes down to who has a say. In 1948, only two Black Americans were voting members of Congress, and the law of the land was “separate but equal.” Black
Americans were paying taxes for government benefits that excluded them. Over time, those white people who did not benefit from the joint return figured out new ways to shape the system to their needs. Consider, for example, the situation of single white men. These men didn’t like how the joint return gave their married co-workers tax breaks that they didn’t have access to. They called it the “single’s penalty,” and they lobbied Congress. In 1969, they received a different rate structure that decreased the marriage bonus in order to decrease the single’s penalty. This meant that the taxes of married couples increased, but the hike was not the worst part. The worst came for the couples in which husbands and wives earned roughly equal amounts of income. Those couples’ tax bills would go up, and now—as along with marriage bonuses—they had marriage penalties. And marriage-penalty couples happened to be disproportionately Black. In order for single white men to pay less in taxes, married Black couples such as my parents would have to pay more. They would pay more for decades, until my father’s death in 1994.

Read: American wealth is broken

Over time, as more and more white wives entered the labor market, more married white couples also paid the marriage penalty. My research, based on 1990 Census Bureau data, shows that although most married white couples got a marriage bonus, the married white couples who were most likely to pay the marriage penalty were in households earning $60,000 to $90,000 a year. This marginally changed following the 2001 and 2003 Bush tax cuts, which provided some marriage-penalty relief. Based on 2010 Census Bureau data, I found that for households with income totaling $50,000 to $200,000, a greater percentage of married white couples are paying higher taxes than getting a tax break. A Treasury report predicted that for 2016, while 51 percent of married couples would get a marriage bonus, 40 percent would pay a penalty.

That set the stage for the 2017 Trump tax cuts. Suddenly, marriage-penalty relief was part of the agenda, without explanation in the legislative history other than rote statements such as “Married couples will no longer be penalized just for their choice to be married.” The Trump tax cuts temporarily eliminated the marriage penalty for nearly everyone. That was accomplished by a change to the rate structure that doubled the bracket for a single taxpayer, to account for the possibility of two equal earners. Those rate-structure changes ignored households at the low end that were eligible for the earned-income tax credit, and those at the high end. Households at the low end continue to face marriage penalties, but the same is not true for high-end married couples. Why? Because, as I found in my research, most of those high-income white married couples are in marriage bonus households, whereas their Black peers are more likely to be in marriage penalty households, even at high income levels. With the Trump tax cuts, the marriage penalty applicable to high-income white households has been largely theoretical—but it remains the reality for their Black peers.
For the unequal effects of marriage in the tax code, at least, the solution is easy: Return to our progressive beginnings and allow only individual tax returns. The decision on whether to get married should never have been allowed to affect anyone’s tax bill. Canada has had an individual-filing-based system for more than 100 years. Justice requires the married Henrys of the world to pay the same as the single Henrys. Racial justice requires that married couples like my parents don’t face a marriage penalty, and that they don’t get left behind when tax cuts come.

**DOROTHY A. BROWN**, a tax-law professor at Emory University, is the author of *The Whiteness of Wealth: How the Tax System Impoverishes Black Americans—And How We Can Fix It.*
Sabrina Conyers, partner at Nelson Mullins Riley & Scarborough, Charlotte, North Carolina

Sabrina Conyers is a partnership and corporate tax attorney with more than 15 years of experience providing domestic and international tax planning, general corporate, corporate governance, private equity, and real estate finance planning and advisory services to clients. She has served as lead counsel, negotiator, and facilitator for transactions ranging in value up to $2 billion. Her clients include corporations, investment banks, private equity funds, and private companies (including partnerships, S Corporations and real estate developers). Ms. Conyers represents clients in structuring, negotiating, and documenting the tax consequences of their partnerships and joint ventures, mergers and acquisitions (M&A), real estate and REIT transactions, domestic and cross-border financings and other corporate combinations and reorganizations. Ms. Conyers advises clients on transactions involving limited partnerships, limited liability companies, joint ventures, and other strategic alliances.

Beverly Moran, Professor Emerita of Law, Vanderbilt Law School

Beverly Moran’s work focuses on federal income taxation, including individuals, partnerships, tax-exempt organizations and corporate. In addition to her work on the Internal Revenue Code, Professor Moran’s interdisciplinary and multidisciplinary work encompasses empirical legal studies ("Coitus and Consequences"), international and comparative tax law ("Taxation" in The Oxford Handbook of Legal Studies), Islamic law ("Islamic Law and Elder Care in the Central Asian Edgen System"), labor law ("The Right to Religious Accommodation in Pension Plans"), law and development ("Local Government Tax Incentives for Economic Development"), legal education ("Revisiting the Work We Know So Little About: Race, Wealth, Privilege, and Social Justice"), legal philosophy ("Capitalism and the Tax System: A Search for Social Justice"), and politics ("United States’ Trade Policy and the Exportation of United States’ Culture"). Over the course of her career, she has won a number of teaching awards and grants, including a Fulbright award and grants from the Annie E. Casey Foundation, the Rockefeller Foundation, International Rotary and the Ford Foundation. While on Vanderbilt’s law faculty, she has served on the executive committee of the Association of American Law Schools, the board of governors of the Society of American Law Teachers and as a committee member of the American Bar Association Initiative on the Middle East and North Africa. She is a former director of Vanderbilt’s LL.M. and Social Justice programs, and was the first director of the Vanderbilt University
Center for the Americas. She spent 2008-09 at the Massachusetts Institute of Technology as an American Council on Education Fellow. Before joining Vanderbilt’s law faculty, Professor Moran taught at the University of Wisconsin Law School, where she directed the Center on Law and Africa. She began her academic career on the faculty of the University of Cincinnati College of Law. She has also been a visiting professor at the University of Colorado, the University of Asmara in Eritrea, the University of Kentucky, Michigan State University, People’s University in Beijing, the Peking University in Beijing, and the University of Giessen in Germany.

Loren Ponds, partner at Miller & Chevalier Chartered

Loren Ponds centers her practice on providing strategic counsel to clients on legislative, regulatory, and other tax policy issues, as well as advising on technical tax matters related to transfer pricing and other international tax topics. She advises clients on the impacts of tax policy, such as the implementation of the Tax Cuts and Jobs Act of 2017 (TCJA), and issues related to technical corrections, administrative guidance, and legislative amendments to various provisions. In addition, Ms. Ponds advises clients on Advance Pricing Agreements, mutual agreement procedure (MAP) negotiations, and international tax controversy matters before the Internal Revenue Service (IRS), intangible property transactions, and other transfer pricing and international tax issues. Prior to joining Miller & Chevalier, Ms. Ponds served as Majority Tax Counsel to the U.S. House of Representatives Committee on Ways and Means, where she developed, analyzed, and refined the international tax provisions of the TCJA. Previously, Ms. Ponds served in Ernst & Young LLP’s National Tax Department with a focus on transfer pricing and other international tax issues, where she counseled multinational companies on tax planning projects, including intellectual property planning, supply chain optimization, and restructurings. Fluent in French and German, Ms. Ponds worked abroad as Ernst & Young’s Global Transfer Pricing Operations Manager in Düsseldorf, Germany. Ms. Ponds was also a German Chancellor Fellow of the Alexander von Humboldt Foundation at the Universität Hamburg-International Tax Institute in Germany, as well as a Trainee at the Organization for Economic Cooperation & Development in Paris, France.
Session 8: Perspectives of Minority Business Entrepreneurs
8:05 - 8:45 p.m. EDT

Discussion Leader: Shoba Sivaprasad Wadhia, Associate Dean for Diversity, Equity and Inclusion, Samuel Weiss Faculty Scholar and Clinical Professor of Law, and Director of the Center for Immigrants’ Rights Clinic, Penn State Law in University Park

Presenters: Francisco R. Angones, Partner at Angones McClure & Garcia and former President of the Florida Bar Association; Dr. Chitra Dorai, Founder and CEO of Amicus Brain Innovations, Inc.; Marcia J. Griffin, Co-founder and CEO of HomeFree USA; and James M. Griffin, Co-founder and COO of HomeFree USA

Event Co-Chairs:

Samuel C. Thompson Jr.
Professor and Arthur Weiss Distinguished Faculty Scholar at Penn State Law

Sabrina Conyers
Partner at Nelson Mullins Riley & Scarborough

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Francisco R. Angones, partner at Angones McClure & Garcia and former president of the Florida Bar Association

Francisco R. Angones, past President of The Florida Bar, handles personal injury, medical malpractice, products liability and other insurance defense cases in addition to commercial litigation. He was born in Havana, Cuba in 1950 and is fully bilingual. Mr. Angones received his undergraduate and law degrees from the University of Miami and has an AV rating from Martindale-Hubbell®. Admitted to the Florida Bar in 1976, Mr. Angones is also admitted to the Trial Bar of the United States District Court for the Southern District of Florida, the United States Court of Appeals for the 5th and 11th Circuits and the United States Supreme Court. Long active in professional and civic organizations, Mr. Angones was the youngest attorney ever to assume the presidency of the Cuban-American Bar Association and the first Hispanic to be elected President of the Dade County Bar Association. He has been a member of the House of Delegates of the American Bar Association. He has served as Chairman of the Board of Victoria Hospital, and on the Metro-Dade Community Relations Board. Mr. Angones is a member of the Dade and Broward County Bar Associations, the American Bar Association, the Cuban-American Bar Association, the Defense Research Institute, the Spellman-Hoeveler American Inn of Court, the American Board of Trial Advocates and the International Association of Defense Counsel. Mr. Angones is a Supreme Court Certified Mediator.

Shoba Sivaprasad Wadhia, Associate Dean for Diversity, Equity and Inclusion, Samuel Weiss Faculty Scholar and Clinical Professor of Law, and Director of the Center for Immigrants' Rights Clinic, Penn State Law in University Park

Shoba Sivaprasad Wadhia is Associate Dean for Diversity, Equity, and Inclusion; the Samuel Weiss Faculty Scholar; and Clinical Professor of Law at Penn State Law in University Park. Her research focuses on the role of prosecutorial discretion in immigration law and the intersections of race,
national security and immigration. She has published more than thirty law review articles, book chapters and essays on immigration law. Her work has been published in Duke Law Journal, Emory Law Journal, Texas Law Review, Washington and Lee Law Review, Harvard Latino Law Review, Administrative Law Review, and Columbia Journal of Race and Law. Wadhia has published two books with New York University Press: Beyond Deportation: The Role of Prosecutorial Discretion in Immigration Cases (2015) and Banned: Immigration Enforcement in the Time of Trump (2019). Wadhia is the author of Immigration and Nationality Law: Problems and Solutions, with Steve Yale-Loehr and Lenni Benson, published by Carolina Academic Press in 2019. Wadhia is the inaugural Editor-In-Chief of the American Immigration Lawyers Association (AILA) Law Journal, a partnership between AILA and Fastcase. In 2019, she served as the Enlund Scholar In Residence at DePaul University School of Law. Her scholarship has been cited in numerous law journals and by federal appellate court judges, including Judge Richard Posner (article on deferred action), Judge Paul J. Watford (article on the role of discretion in speed deportation), and Judge Kim McLane Wardlaw (“See generally” citation to book Beyond Deportation). In 2019, Wadhia testified before Congress on the historical role of prosecutorial discretion and deferred action in immigration cases. She regularly authors opinion pieces on a range of immigration topics, and has published such pieces in the Los Angeles Times, Philadelphia Inquirer, The Hill, blog for the U.S. Supreme Court (SCOTUS Blog), blog of the Harvard Law Review, American Constitution Society, American Immigration Council, Yale Journal on Regulation’s Notice & Comment, and Immigration Law Professors Blog. She has also served as an expert witness, lead author or co-counsel in connection with Deferred Action for Childhood Arrivals (DACA), the asylum ban, the travel ban, and prosecutorial discretion more generally. At Penn State Law, Professor Wadhia teaches doctrinal courses in immigration and asylum and refugee law. She is also the founder/director of the Center for Immigrants’ Rights Clinic (CIRC), where she supervises students in three areas: 1) community outreach; 2) legal support in individual immigration cases; and 3) policy work for institutional clients. CIRC has earned a national reputation for its high-quality work product and impact in the community. 2018 marked the 10-year anniversary of CIRC. CIRC was honored with the Excellence in Legal Advocacy Award in 2017 by the American-Arab Anti-Discrimination Committee and named legal organization of the year in 2019 by the Pennsylvania Immigration Resource Center. Wadhia has received many local and national awards for her scholarship, teaching, and service, including Pro Bono Attorney of the Year by the American-Arab Anti-Discrimination Committee in 2003, leadership awards by the Department of Homeland Security’s Office of Civil Rights and Civil Liberties and Office of the Inspector General in 2008, 2017 Honoree by the National Immigration Project, Arnold Addison Award for Town and Gown Relations by the Borough of State College in 2019, and the 2019 Elmer Friend Excellence in Teaching Award by the American Immigration Lawyers Association. In 2020, Wadhia won the university-wide Rosemary Schraer Mentoring Award and was named a Fastcase 50 Awardee, which honors 50 of "the law’s smartest, most courageous innovators, techies, visionaries, & leaders.” Prior to joining Penn State, Professor Wadhia was deputy director for legal affairs at the National Immigration Forum in Washington, D.C. She has also been an associate with Maggio Kattar, P.C. in Washington, D.C., where she handled asylum, deportation, family, and employment-based immigration benefits matters.
James (Jim) M. Griffin  
Jim's career spans more than 45 years in mortgage banking with a focus on affordable housing and direct experience in mortgage lending, management of specialized loan programs, inner city real estate development, housing consulting, and the provision of transitional housing and support for homeless families. He has worked across the U.S. and abroad serving as a financial advisor and public housing policy consultant to HUD, U.S.A.I.D., World Bank, and numerous city, state and foreign governments.

Marcia J. Griffin  
Marcia Griffin is on a mission to strengthen people, elevate partners, and enhance communities across America. As founder and president of HomeFree-USA, Marcia has helped thousands to achieve and retain the dream of homeownership and greater wealth. HomeFree-USA enjoys a remarkable 0% foreclosure rate among families that have participated in the organization’s pre- and post-purchase guidance programs. Serving as a bridge between financial institutions and the community, Marcia addresses the needs of homebuyers and homeowners with targeted education, distinctive marketing strategies and lender. A recognized homeownership expert and frequent featured guest speaker, she is a member of the Freddie Mac Affordable Housing Advisory Committee, she leads the Fannie Mae Affordable Housing Advisory Committee, the Ocwen Financial Community Advisory Council, America’s Homeowner Alliance, Wells Fargo Housing Foundation Steering Committee and the Affordable Housing Advisory Councils of the Federal Home Loan Bank of Atlanta, and the Mortgage Bankers Association. Marcia is a tireless advocate for nonprofit homeownership organizations. Under her leadership, her organization funds and strengthens the capacity of 53 other nonprofits that represent the interests of 4.5 million diverse families across the country.
Francisco R. Angones, partner at Angones McClure & Garcia and former president of the Florida Bar Association

Francisco R. Angones, past President of The Florida Bar, handles personal injury, medical malpractice, products liability and other insurance defense cases in addition to commercial litigation. He was born in Havana, Cuba in 1950 and is fully bilingual. Mr. Angones received his undergraduate and law degrees from the University of Miami and has an AV rating from Martindale-Hubbell®. Admitted to the Florida Bar in 1976, Mr. Angones is also admitted to the Trial Bar of the United States District Court for the Southern District of Florida, the United States Court of Appeals for the 5th and 11th Circuits and the United States Supreme Court. Long active in professional and civic organizations, Mr. Angones was the youngest attorney ever to assume the presidency of the Cuban-American Bar Association and the first Hispanic to be elected President of the Dade County Bar Association. He has been a member of the House of Delegates of the American Bar Association. He has served as Chairman of the Board of Victoria Hospital, and on the Metro-Dade Community Relations Board. Mr. Angones is a member of the Dade and Broward County Bar Associations, the American Bar Association, the Cuban-American Bar Association, the Defense Research Institute, the Spellman-Hoeveler American Inn of Court, the American Board of Trial Advocates and the International Association of Defense Counsel. Mr. Angones is a Supreme Court Certified Mediator.
Glenn Carrington, Dean, Norfolk State Business School

Glenn Carrington Since 2017 Dean Carrington has been leading the way to prepare business students for the real business world and entrepreneurship—through school administration strategy and management, aggressive fundraising efforts, advocacy among business partners and with personal passion. Prior to Norfolk State, he spent more than three decades with leading professional accounting firms, serving Fortune 500 clients with a focus on corporate tax accounting and financial transactions. Early in his career, he served in the IRS Chief Counsel's office, beginning as an attorney-advisor in the Treasury Department’s Honors Program. He is recognized for his hard work, teaming and fostering of mutual respect and appreciation among all of the professionals, business executives, faculty and students with whom he has worked.

Sabrina Conyers, partner at Nelson Mullins Riley & Scarborough, Charlotte, North Carolina

Sabrina Conyers is a partnership and corporate tax attorney with more than 15 years of experience providing domestic and international tax planning, general corporate, corporate governance, private equity, and real estate finance planning and advisory services to clients. She has served as lead counsel, negotiator, and facilitator for transactions ranging in value up to $2 billion. Her clients include corporations, investment banks, private equity funds, and private companies (including partnerships, S Corporations and real estate developers). Ms. Conyers represents clients in structuring, negotiating, and documenting the tax consequences of their partnerships and joint ventures, mergers and acquisitions (M&A), real estate and REIT transactions, domestic and cross-border financings and other corporate combinations and reorganizations. Ms. Conyers advises clients on transactions involving limited partnerships, limited liability companies, joint ventures, and other strategic alliances.
Dr. Chitra Dorai, Founder and CEO of Amicus Brain Innovations, Inc.

Dr. Chitra Dorai is a globally renowned AI Scientist and Thought Leader, focused on bringing the power of AI to tackle some of the most important societal problems at the intersection of healthcare and financial services. Dr. Dorai, known as a ‘Force for Good’ prioritizes advancing artificial intelligence (AI) research and practice with accountability, responsibility, and transparency for the benefit of humanity. Dr. Dorai was at IBM as an IBM Fellow (first woman of Indian origin to receive this recognition worldwide) and her last role was Global CTO for cognitive services in IBM’s Global Business Services unit. During her tenure at IBM (in TJ Watson Research Center, GTS, and GBS), Dr. Dorai was a recipient of IBM’s highest honor in 2011 – the Gerstner Award for Client Excellence; she was recognized as an IBM Distinguished Engineer in 2012 and was appointed by the IBM CEO as an IBM Fellow, the company’s preeminent technical honor in 2015. Her ground-breaking work from 2009 until 2015 on customer-focused analytics and AI solutions in mortgage servicing saved thousands of struggling homeowners facing foreclosure with the right homeownership retention programs and alternative workout options during one of the most challenging times in the history of the U.S. housing market. In 2016, she was profiled as a ‘Societal Innovator at the IBM HQ. In 2018, she received ‘The Visionary’ award from the National Association of Women in Real Estate Business. Dr. Dorai graduated from IIT Madras with an undergraduate degree in Electrical Engineering and received her Ph.D. in Computer Science at Michigan State University with the Distinguished Academic Achievement award. She is the co-inventor of 48 patents and has received multiple high-value patent awards, having been recognized as a Master Inventor thrice at IBM. She has co-authored 100+ technical papers at IEEE and ACM conferences and journals, edited a book, and received five best paper awards at international conferences. She is frequently interviewed or cited in the press, news, blogs, and videos on a wide variety of topics. With her passion for nurturing global talent in STEM, she serves on the Advisory Boards of multiple organizations that focus on increasing diversity and inclusion in the workplace. Following twodecades of a highly decorated career at IBM, Dr. Dorai is currently focused on making AI knowledge accessible to everyone and bringing AI-based innovations to the greying globe.
Ollen Douglass, Managing Director at Motley Fool Ventures

Ollen Douglass  Prior to joining the Fund, Ollen was CFO of The Motley Fool Holdings, Inc. for 14 years. During that time, he was responsible for the overall financial health of The Fool and helped guide the company through periods of major growth, contraction, and market volatility. Ollen’s oversight duties included The Fool’s finance and accounting groups as well as legal, benefits, sales, business development, real estate, business intelligence, international and asset management. His financing experience spans the full spectrum from bank financing to venture financing. During Ollen’s management of the pilot program, Motley Venture Partners, he and the team compiled a portfolio of private companies that will be contributed to the Fund. Today, Ollen serves on the board of Eyrus, InHerSight, and Young Artists of America. He has been a recipient of the Motley Fool Founders’ award and Favorite Fool award. He was twice nominated for Greater Washington CFO of the Year and is a member of the 2019 class of Greater Washington Minority Business Leaders. Prior to joining The Fool, Ollen worked in mortgage banking, focusing on mortgage servicing, fair lending and risk management. He was also an auditor for KPMG and is a CPA (inactive). Ollen graduated from the University of Baltimore with a bachelor’s degree in accounting and lives in the Washington area with his wife and three sons.
Robert W. Fairlie

I am a Professor of Economics at the University of California, Santa Cruz and a member of the National Bureau of Economic Research (NBER). My research interests include entrepreneurship, education, information technology, racial and gender inequality, labor economics, and immigration. Publications from my research have appeared in journals such as the American Economic Review, Economic Journal, AEJ: Applied, AEJ: Policy, ReSTAT, JOLE, JAMA: Surgery, Nature: SoE, Management Science, JPAM and MIT Press (book). I received a Ph.D. and M.A. from Northwestern University and B.A. with honors from Stanford University. I have held visiting positions at Stanford University, Yale University, UC Berkeley, and Australian National University. I have received funding for my research from the National Science Foundation as well as numerous government agencies and foundations, and have testified to the U.S. Senate, U.S. House of Representatives, U.S. Department of Treasury, and the California State Assembly, and received a joint resolution from the California State Assembly. I am regularly interviewed by the media (e.g. NY Times, WSJ, Washington Post, NPR, PBS, CNN, CBS, NBC) to comment on economic, small business, inequality and policy issues.
Kay Gordon, partner at Nelson Mullins, New York City

Kay Gordon counsels clients on hedge fund, funds-of-fund, private equity fund, real estate fund, venture funds, and compliance-related matters involving registered advisers and broker-dealers. She also advises clients on a broad range of securities and regulatory matters as well as a variety of financial instruments and transactions, including managed accounts, credit facilities, joint ventures, and derivative instruments. She works closely with strategic, institutional, and seed investors and also represents clients in investigations by the SEC and other regulators. Ms. Gordon is a frequent speaker and author. She is a chartered financial analyst (CFA) and currently serves on an advisory board of a large hedge fund.

James M. Griffin, Co-founder and COO of HomeFree USA

James (Jim) M. Griffin Jim's career spans more than 45 years in mortgage banking with a focus on affordable housing and direct experience in mortgage lending, management of specialized loan programs, inner city real estate development, housing consulting, and the provision of transitional housing and support for homeless families. He has worked across the U.S. and abroad serving as a financial advisor and public housing policy consultant to HUD, U.S.A.I.D., World Bank, and numerous city, state and foreign governments.
Marcia Griffin is on a mission to strengthen people, elevate partners, and enhance communities across America. As founder and president of HomeFree-USA, Marcia has helped thousands to achieve and retain the dream of homeownership and greater wealth. HomeFree-USA enjoys a remarkable 0% foreclosure rate among families that have participated in the organization’s pre- and post-purchase guidance programs. Serving as a bridge between financial institutions and the community, Marcia addresses the needs of homebuyers and homeowners with targeted education, distinctive marketing strategies and lender. A recognized homeownership expert and frequent featured guest speaker, she is a member of the Freddie Mac Affordable Housing Advisory Committee, she leads the Fannie Mae Affordable Housing Advisory Committee, the Ocwen Financial Community Advisory Council, America’s Homeowner Alliance, Wells Fargo Housing Foundation Steering Committee and the Affordable Housing Advisory Councils of the Federal Home Loan Bank of Atlanta, and the Mortgage Bankers Association. Marcia is a tireless advocate for nonprofit homeownership organizations. Under her leadership, her organization funds and strengthens the capacity of 53 other nonprofits that represent the interests of 4.5 million diverse families across the country.

Bernel Hall Over the past 20 years, Bernel Hall has executed over $5 billion in real estate investment, lending, and disposition transactions for multifamily, retail, office, and hotel properties in 36 states throughout the US. A former investment banker, public housing executive, and real estate finance professor, Mr. Hall is an expert in large, multi-faceted public-private real estate transactions. As CEO of Halltown Real Estate Advisors, Mr. Hall served as real estate investment advisor to some of the largest housing authorities in the country. As part of his tenure with the Atlanta Housing Authority (“AHA”), Mr. Hall established an $100 million co-investment vehicle between AHA, HUD, and the Atlanta Economic
Development Authority (“Invest Atlanta”). During his tenure with the New York City Housing Authority (“NYCHA”), Mr. Hall oversaw the execution of over $1.5 billion in real estate disposition, development, and joint venture transactions. Previously, Mr. Hall worked in Goldman Sachs’ Urban Investment Group where he was responsible for sourcing and evaluating urban-based multifamily, retail, and mixed-use real estate private equity investments. Prior to his work at Goldman Sachs, Mr. Hall executed $785 million in real estate acquisitions, loans, and joint ventures transactions for UBS Investment Bank. Mr. Hall began his career with Bank of America in the Firm’s Construction Lending and Real Estate Investment Banking Groups. Mr. Hall taught Real Estate Portfolio Management and Financial Modeling at NYU’s Schack Real Estate Institute and has also served as a guest lecturer for the New Jersey Redevelopment Authority. Mr. Hall is a licensed Uniform Investment Advisor (Series 65) and possesses a Bachelor of Science from North Carolina State University and a M.B.A. from the Harvard Business School.

Barry W. Ickes, Professor of Economics and Head, Department of Economics, Penn State

Barry W. Ickes  I am Head of the Department of Economics at the Pennsylvania State University. I am also Professor of Economics and Director of the Center for Research on International Financial and Energy Security, and a Founder of The New Economic School in Moscow. Formerly, I was a Non-Resident Senior Fellow at the Brookings Institution. I am the past Chair of the Board of Directors of the National Council for Eurasian and East European Research. I was the President of the Association for Comparative Economic Studies during 2004.
Beverly Moran's work focuses on federal income taxation, including individuals, partnerships, tax-exempt organizations and corporate. In addition to her work on the Internal Revenue Code, Professor Moran’s interdisciplinary and multidisciplinary work encompasses empirical legal studies ("Coitus and Consequences"), international and comparative tax law ("Taxation" in The Oxford Handbook of Legal Studies), Islamic law ("Islamic Law and Elder Care in the Central Asian Edgen System"), labor law ("The Right to Religious Accommodation in Pension Plans"), law and development ("Local Government Tax Incentives for Economic Development"), legal education ("Revisiting the Work We Know So Little About: Race, Wealth, Privilege, and Social Justice"), legal philosophy ("Capitalism and the Tax System: A Search for Social Justice"), and politics ("United States’ Trade Policy and the Exportation of United States’ Culture"). Over the course of her career, she has won a number of teaching awards and grants, including a Fulbright award and grants from the Annie E. Casey Foundation, the Rockefeller Foundation, International Rotary and the Ford Foundation. While on Vanderbilt’s law faculty, she has served on the executive committee of the Association of American Law Schools, the board of governors of the Society of American Law Teachers and as a committee member of the American Bar Association Initiative on the Middle East and North Africa. She is a former director of Vanderbilt’s LL.M. and Social Justice programs, and was the first director of the Vanderbilt University Center for the Americas. She spent 2008-09 at the Massachusetts Institute of Technology as an American Council on Education Fellow. Before joining Vanderbilt's law faculty, Professor Moran taught at the University of Wisconsin Law School, where she directed the Center on Law and Africa. She began her academic career on the faculty of the University of Cincinnati College of Law. She has also been a visiting professor at the University of Colorado, the University of Asmara in Eritrea, the University of Kentucky, Michigan State University, People's University in Beijing, the Peking University in Beijing, and the University of Giessen in Germany.
Robert Mundheim is Of Counsel in the Capital Markets practice. He focuses on corporate governance issues and has counseled special committees in the buy-outs of HCA, Aramark and Bright Horizons. He also chaired the Special Committee in the buy-out of Quadra Realty Trust. He advised the Review Committee of the JPMorgan Chase Board of Directors in connection with its review of the issues arising out of the London Whale matter, as well as the independent members of the Board of Directors of Wells Fargo in connection with sales practice issues. He is also the Ombudsman for KGS-Alpha Capital Markets LP and Amherst Pierpont Securities LLC. He was formerly Executive Vice President and General Counsel of Salomon Inc. and later Senior Executive Vice President and General Counsel of Salomon Smith Barney Holdings Inc. Prior to joining Salomon Inc. in September 1992, Robert was Co-Chairman of the New York law firm of Fried, Frank, Harris, Shriver & Jacobson and University Professor of Law and Finance at the University of Pennsylvania Law School, where he had taught since 1965. He served as Dean of that institution for seven and a half years (1982-1989). He presently serves as the Professor of Corporate Law & Finance at the University of Arizona James E. Rogers College of Law.
Sabastian V. Niles is a Partner at Wachtell, Lipton, Rosen & Katz where he focuses on rapid response shareholder and stakeholder activism and preparedness, takeover defense and corporate governance; risk oversight, including as to ESG, cybersecurity and crisis situations; U.S. and cross-border mergers, acquisitions, buyouts, investments, divestitures and strategic partnerships; and other corporate and securities law matters and special situation. Sabastian advises worldwide and across industries, including technology, financial institutions, media, energy and natural resources, healthcare and pharmaceuticals, construction and manufacturing, real estate/REITs and consumer goods and retail. He has counseled boards of directors and management teams on self-assessments, engagement with institutional investors and proxy advisory firms and navigating activist situations involving Barry Rosenstein/JANA Partners, Bill Ackman/Pershing Square, Carl Icahn, Daniel Loeb/Third Point, David Einhorn/Greenlight Capital, Glenn Welling/Engaged Capital, Jeff Smith/Starboard Value, Jeffrey Ubben/ValueAct, Jonathan Litt/Land & Buildings, Keith Meister/Corvex, Mick McGuire/Marcat, Nelson Peltz/Trian, Scott Ferguson/Sachem Head, Paul Singer/Elliott Management, Relational Investors and Tom Sandell/Sandell Asset Management, among many others. In addition to serving as Consulting Editor for the New York Stock Exchange’s Corporate Governance Guide, Sabastian writes frequently on corporate law matters and has been a featured speaker at corporate strategy and investor forums. His speaking engagements have addressed topics such as Shareholder Activism; The New Paradigm of Corporate Governance; Hostile Takeovers; Strategic Transactions and Governance; M&A Trends; Board-Shareholder Engagement; Confidentiality Agreements in M&A Transactions; Negotiating Strategic Alliances with U.S. Companies; Current Issues in Technology M&A; Corporate Governance: Ethics, Transparency and Accountability; and Developments in Cross-Border Deals. Sabastian received his juris doctorate from Harvard Law School, where he co-founded the Harvard Association of Law and Business (and continues to serve on the Advisory Board) and won the U.S. National ABA Negotiation Championship representing the Harvard Program on Negotiation. He received B.S., B.A. and B.S. degrees in Finance, Economics and Decision & Information Sciences, respectively, from the University of Maryland, where he won two National Championships and four Regional Championships in intercollegiate mock trial.
Gina D. Nisbeth is a Director in the Structured Lending and Investments Group. She began her career with Citi 16 years ago on the Short Term sales and trading desk. Gina traded the municipal Tender Option Bond portfolio to money market funds for 10 years, growing that program to the largest in the industry. She transitioned into Citi Community Capital, Citi’s community development lending and investing group, in 2009 and she is now responsible for the management of Citi’s New Markets Tax Credit program including transaction origination and structuring as well as portfolio management. Ms. Nisbeth also serves as the President of the firm’s Community Development Entity, named the Citi NMTC Corporation. Gina graduated from Rutgers College with a B.A. in Political Science and as an Eagleton Institute of Politics Undergraduate Fellow. She later received an MBA from The Fox School of Business at Temple University with a concentration in Finance. Gina holds a Series 7 and 63 licenses from FINRA.

Hari M. Osofsky is Dean of Penn State Law and the Penn State School of International Affairs and Distinguished Professor of Law, Professor of International Affairs, and Professor of Geography. As dean, she is deeply committed to collaboratively building legal and international affairs education for a changing society, and is leading initiatives in mentoring, technology, and interdisciplinary and international partnerships. She has been recognized for her technology leadership by the American Bar Association’s Legal Technology Resource Center as one of the 2019 Women of Legal-Tech. She also has been very involved nationally in supporting more women and people of color to consider law school and university leadership. Dean Osofsky’s over 50 publications focus on improving governance and
addressing injustice in energy and climate change regulation. Her scholarship includes books with Cambridge University Press on climate change litigation, textbooks on both energy and climate change law, and articles in leading law and geography journals. Dean Osofsky’s Emory Law Journal article, Energy Partisanship, was awarded the 2018 Morrison Prize, which recognizes the most impactful sustainability-related legal academic article published in North America during the previous year. Dean Osofsky has collaborated extensively with business, government, and nonprofit leaders to make bipartisan progress on these issues through her leadership roles and teaching. Her professional leadership roles have included, among others, serving as President of the Association for Law, Property, and Society; chair of the American Association of Law School’s Section on Property; and a member of the Executive Council of the American Society of International Law and the International Law Association’s Committee on the Legal Principles of Climate Change. She also is a member of the Board of Governors of the Society of American Law Teachers and the editorial board of Climate Law. Her leadership and mentorship work was recognized by the Association for Law, Property, and Society’s 2016 Distinguished Service Award and the University of Minnesota 2015 Sara Evans Faculty Woman Scholar/Leader Award. Dean Osofsky received a Ph.D. in geography from the University of Oregon and a J.D. from Yale Law School. Prior to joining the Pennsylvania State University, Dean Osofsky served on the faculties of University of Minnesota Law School, Washington and Lee University School of Law, the University of Oregon School of Law, and Whittier Law School.

Ayana Parsons, Senior Partner, Board and CEO Inclusion at Korn Ferry and Co-Founder, Fearless Fund

As a core member of Korn Ferry’s Global Consumer Practice, Ayana leads Chief Marketing Officer, President, CEO and Board searches at consumer- and customer-centric organizations of all sizes. Ayana’s international experience, coupled with her cross-industry background and passion for people, gives her a unique vantage point from which to solve her clients’ most pressing recruitment and succession planning challenges. Prior to joining Korn Ferry, Ayana was with another global consulting firm where she placed C-Suite executives at several of the world’s leading companies and led numerous succession planning and talent pipelining engagements for her clients. Before embarking on her career in executive talent and leadership, Ayana served as the Global Head of Retail, Consumer Goods and Lifestyle Industries at the World Economic Forum where she led the preeminent global discussions in Davos, Switzerland on all topics related to her respective industries. With nearly 20 years of experience as both a practitioner and consultant, Ayana leverages her expertise in international business, executive search, top team effectiveness, succession planning, diversity & inclusion, marketing and general management to deliver differentiated value to her clients. A seasoned industry executive, Ayana’s earlier career
spanned sales, marketing and general management roles at several of the world’s most admired companies including Philips, Pfizer, Kimberly-Clark and Procter & Gamble. Ayana attended Oral Roberts University on a division I basketball scholarship, completing her studies at Florida A&M University where she holds a master’s degree in business administration. Ayana is based in Atlanta, where she is actively involved in the local community. In her free time, Ayana enjoys working out, attending sporting events, traveling and spending quality time with her husband and two young daughters.

Dana Peterson, Chief Economist at The Conference Board

**Dana Peterson** is the Chief Economist & Center Leader of Economy, Strategy & Finance at The Conference Board. Peterson joins The Conference Board from Citi, where for many years she served as a North America Economist and later as a Global Economist. Her wealth of experience extends to the public sector, having also worked at the Federal Reserve Board in Washington, D.C. Dana’s wide-ranging economics portfolio includes analyzing global economic themes having direct financial market implications, including monetary policy; fiscal and trade policy; debt; taxation; ESG; and demographics. Her work also examined myriad US themes leveraging granular data. In addition, Dana conducted multi-asset research and wrote publications with other Citi research teams – both US and global – including strategists covering rates, equities, credit, foreign exchange, commodities, political analysis, and asset allocation. Peterson’s research has been featured by US and international news outlets, both in print and broadcast. Publications and networks include CNBC, FOX Business, Bloomberg, Thomson-Reuters, the Financial Times, and the Wall Street Journal. She is the 1st Vice Chair of the New York Association for Business Economics (NYABE), and a member of NABE, and NBEIC. She received an undergraduate degree in Economics from Wesleyan University and a Master of Science degree in Economics from the University of Wisconsin-Madison.
Loren Ponds centers her practice on providing strategic counsel to clients on legislative, regulatory, and other tax policy issues, as well as advising on technical tax matters related to transfer pricing and other international tax topics. She advises clients on the impacts of tax policy, such as the implementation of the Tax Cuts and Jobs Act of 2017 (TCJA), and issues related to technical corrections, administrative guidance, and legislative amendments to various provisions. In addition, Ms. Ponds advises clients on Advance Pricing Agreements, mutual agreement procedure (MAP) negotiations, and international tax controversy matters before the Internal Revenue Service (IRS), intangible property transactions, and other transfer pricing and international tax issues. Prior to joining Miller & Chevalier, Ms. Ponds served as Majority Tax Counsel to the U.S. House of Representatives Committee on Ways and Means, where she developed, analyzed, and refined the international tax provisions of the TCJA. Previously, Ms. Ponds served in Ernst & Young LLP’s National Tax Department with a focus on transfer pricing and other international tax issues, where she counseled multinational companies on tax planning projects, including intellectual property planning, supply chain optimization, and restructurings. Fluent in French and German, Ms. Ponds worked abroad as Ernst & Young’s Global Transfer Pricing Operations Manager in Düsseldorf, Germany. Ms. Ponds was also a German Chancellor Fellow of the Alexander von Humboldt Foundation at the Universität Hamburg-International Tax Institute in Germany, as well as a Trainee at the Organization for Economic Cooperation & Development in Paris, France.
Professor Tom Sharbaugh brings more than 35 years of practice experience to the classroom. Before joining Penn State Law, Tom was the firm-wide managing partner of operations at the Morgan Lewis & Bockius LLP law firm, based in the firm’s Philadelphia office. In this position, which he held for 15 years, Tom was responsible for the day-to-day operations of the global law firm with more than 3,100 personnel. As a partner in the firm’s Business & Finance Practice Group, he represented a wide variety of clients in transactional and corporate matters, including private equity funds in M&A and investment transactions. He has a particular interest in start-up and early stage businesses and their funding. He has written a number of articles and delivered many presentations on the legal issues confronting small businesses and the securities laws applicable to capital raising through unregistered offerings. From 1982 to 1988 he was a partner of Saul Ewing LLP, where he represented middle market companies in general corporate matters. Tom also serves in several volunteer roles for a number of educational and non-profit institutions. At Penn State, he is the chair of the Annual Giving Advisory Council, the chair of the President’s Club, and a member of the Campaign Executive Committee for the current capital campaign, A Greater Penn State. Tom is also a member of the Board of Trustees of the Penn Medicine Health System in Philadelphia, the Chair of the Board of Managers of Pennsylvania Hospital in Philadelphia, and a member of the Board of Directors of the Mount Nittany Conservancy.
Ethan Smith is a co-founder and Managing Partner of Starfield & Smith. He focuses his practice in commercial law, with an emphasis on government guaranteed lending, conventional commercial lending and real estate law. Designated closing counsel for several Certified Development Companies Represents lenders in SBA licensing, compliance, regulatory enforcement, and guaranty purchase matters. Represents lenders before the US Small Business Administration. Active writer and speaker on government guaranteed lending issues nationwide. Ethan has prepared loan documents and performs compliance reviews for loan files for hundreds of SBA 7(a), 504, conventional, and USDA B&I commercial loans. He has also closed numerous other conventional commercial financing transactions and complex commercial transactions.
Mark Storslee is an Assistant Professor at Penn State Law. His research focuses on the First Amendment freedoms of religion and speech, and topics in constitutional law generally. He has published in the University of Chicago Law Review, the University of Pennsylvania Law Review, The Review of Politics, and Political Theology among other journals. He is also a co-editor of Comparative Religious Ethics: Critical Concepts in Religious Studies (Routledge, 2014). Mark holds a law degree from Stanford Law School and a PhD in Religious Studies from the University of Virginia. After law school, he clerked for Judge Diarmuid O’Scannlain on the U.S. Court of Appeals for the Ninth Circuit and served as executive director of the Constitutional Law Center at Stanford Law School. In 2020, Storslee was awarded the Harold Berman Award for Excellence in Scholarship by the Law and Religion Section of the Association of American Law Schools.
Leo Strine, Jr. of counsel, Wachtell Lipton, and former Chief Justice on Delaware Supreme Court

Leo E. Strine, Jr., is Of Counsel in the Corporate Department at Wachtell, Lipton, Rosen & Katz. Prior to joining the firm, he was the Chief Justice of the Delaware Supreme Court from early 2014 through late 2019. Before becoming the Chief Justice, he had served on the Delaware Court of Chancery as Chancellor since June 22, 2011, and as a Vice Chancellor since November 9, 1998. In his judicial positions, Mr. Strine wrote hundreds of opinions in the areas of corporate law, contract law, trusts and estates, criminal law, administrative law, and constitutional law. Notably, he authored the lead decision in the Delaware Supreme Court case holding that Delaware’s death penalty statute was unconstitutional because it did not require the key findings necessary to impose a death sentence to be made by a unanimous jury. Mr. Strine holds long-standing teaching positions at Harvard and University of Pennsylvania, where he has and continues to teach diverse classes in corporate law addressing, among other topics, mergers and acquisitions, the role of independent directors, valuation, and corporate law theories. He is a member of the American Law Institute, and currently serves as an advisor on the project to create a restatement of corporate law. Mr. Strine also serves as the Michael L. Wachter Distinguished Fellow in Law and Policy at the University of Pennsylvania Carey Law School, the Ira M. Millstein Distinguished Senior Fellow at the Ira M. Millstein Center for Global Markets and Corporate Ownership at Columbia Law School and a Senior Fellow of the Harvard Program on Corporate Governance. From 2006 to 2019, Mr. Strine served as the special judicial consultant to the ABA’s Committee on Corporate Laws. He also was the special judicial consultant to the ABA’s Committee on Mergers & Acquisitions from 2014 to 2019. Mr. Strine speaks and writes frequently on the subjects of corporate and public law, and particularly the impact of business on society, and his articles have been published in The University of Chicago Law Review, Columbia Law Review, Cornell Law Review, Duke Law Journal, Harvard Law Review, University of Pennsylvania Law Review, and Stanford Law Review, among others. On several occasions, his articles were selected as among the Best Corporate and Securities Articles of the year, based on the choices of law professors. Before becoming a judge in 1998, Strine served as Counsel and Policy Director to Governor Thomas R. Carper, and had also worked as a corporate litigator at Skadden, Arps, Slate, Meagher & Flom from 1990 to 1992. He was law clerk to Judge Walter K. Stapleton of the U.S. Court of Appeals for the Third Circuit and Chief Judge John F. Gerry of the U.S. District Court for the District of New Jersey. Mr. Strine graduated magna cum laude from the University of Pennsylvania Law School in 1988, and was a member of the Order of the Coif. In 1985, he received his Bachelor’s Degree summa cum laude from the University of Delaware and was a member of Phi Beta Kappa and a Truman Scholar. In 2000, Governor Carper awarded Mr. Strine the Order of the First State. In 2002, President David Roselle of the University of Delaware presented him with the University’s Presidential Citation for Outstanding Achievement. In 2006, he was selected as a Henry Crown Fellow at the Aspen Institute. In 2019, he was awarded an honorary degree from Washington College in Chestertown, Maryland.
Samuel C. Thompson Jr., Professor, Penn State Law in University Park

Samuel C. Thompson, Jr. directs Penn State’s Center for the Study of Mergers and Acquisitions. He is also a Professor of Law and the Arthur Weiss Distinguished Faculty Scholar. He teaches mergers and acquisitions, focusing on corporate, securities, tax, accounting, and antitrust aspects of these very complex transactions. He also periodically teaches basic federal income tax, international tax, and corporate tax. In addition, beginning with the Spring semester 2021, he is teaching a course entitled: The Lawyer’s Role in Helping Close the Minority-White Gap in Business Ownership. Because of the importance of the topic, the University is permitting the course materials and recordings of the sessions to be available at no cost over the Internet, and the materials and recordings can be accessed here: https://pennstatelaw.psu.edu/minority-business-development-course. Professor Thompson has served in two governmental tax policy positions. First, for a year in the 1970s he was an Attorney-Advisor in the U.S. Treasury’s Tax Legislative Counsel’s Office. Second, for a little over a year in the 1990s he was the tax policy advisor, on behalf of the U.S. Treasury Department’s Tax Assistance Office, to the South African Ministry of Finance in Pretoria, South Africa. In that role, he assisted with the revision of South Africa’s income tax system. He has served as (1) a consultant on merger and acquisition issues to the Federal Trade Commission, (2) a professor in residence at the European Commission’s Antitrust Merger Taskforce in Brussels, and (3) an Attorney Fellow in the Office of Mergers and Acquisitions of the Securities and Exchange Commission. He has presented tax policy testimony before the U.S. House of Representatives, the U.S. Treasury, and the IRS. Professor Thompson has been a full professor at the University of Virginia School of Law and the UCLA School of Law, and he was the dean of the University of Miami School of Law. He also served as the Jacquin D. Bierman Visiting Professor of Taxation at the Yale Law School. He was formerly the partner in charge of the Tax Division of Schiff Hardin, a Chicago based law firm. Professor Thompson is the author of over twenty books, including the following two treatises which are published by the Practicing Law Institute: (1) a two volume treatise entitled Business Taxation Deskbook, and (2) a five volume treatise entitled Mergers, Acquisitions, and Tender Offers. He is also the author of more than seventy-five articles on corporate and international tax, and on corporate, antitrust, and securities issues relating to mergers and acquisitions. He has a (1) B.S. from West Chester University in Pennsylvania, where he was on the varsity football team, (2) an M.A. in
Business and Applied Economics from the Graduate School at the University of Pennsylvania, (3) a J.D. from the University of Pennsylvania’s Law School, and (4) an LL.M. in taxation from the NYU School of Law. From 1966 to 1969 he served in the USMC rising to the rank of captain and receiving the Navy Commendation Medal with Combat V for service in Vietnam.

Shoba Sivaprasad Wadhia, Associate Dean for Diversity, Equity and Inclusion, Samuel Weiss Faculty Scholar and Clinical Professor of Law, and Director of the Center for Immigrants' Rights Clinic, Penn State Law in University Park

Shoba Sivaprasad Wadhia is Associate Dean for Diversity, Equity, and Inclusion; the Samuel Weiss Faculty Scholar; and Clinical Professor of Law at Penn State Law in University Park. Her research focuses on the role of prosecutorial discretion in immigration law and the intersections of race, national security and immigration. She has published more than thirty law review articles, book chapters and essays on immigration law. Her work has been published in Duke Law Journal, Emory Law Journal, Texas Law Review, Washington and Lee Law Review, Harvard Latino Law Review, Administrative Law Review, and Columbia Journal of Race and Law. Wadhia has published two books with New York University Press: Beyond Deportation: The Role of Prosecutorial Discretion in Immigration Cases (2015) and Banned: Immigration Enforcement in the Time of Trump (2019). Wadhia is the author of Immigration and Nationality Law: Problems and Solutions, with Steve Yale-Loehr and Lenni Benson, published by Carolina Academic Press in 2019. Wadhia is the inaugural Editor-In-Chief of the American Immigration Lawyers Association (AILA) Law Journal, a partnership between AILA and Fastcase. In 2019, she served as the Enlund Scholar In Residence at DePaul University School of Law. Her scholarship has been cited in numerous law journals and by federal appellate court judges, including Judge Richard Posner (article on deferred action), Judge Paul J. Watford (article on the role of discretion in speed deportation), and Judge Kim McLane Wardlaw (“See generally” citation to book Beyond Deportation). In 2019, Wadhia testified before Congress on the historical role of prosecutorial discretion and deferred action in immigration cases. She regularly authors opinion pieces on a range of immigration topics, and has published such pieces in the Los Angeles Times, Philadelphia Inquirer, The Hill, blog for the U.S. Supreme Court (SCOTUS Blog), blog of the Harvard Law Review, American Constitution Society, American Immigration Council, Yale Journal on Regulation’s Notice & Comment, and Immigration Law Professors Blog. She has also served as an expert witness, lead author or co-counsel in connection with Deferred Action for Childhood Arrivals (DACA), the asylum ban, the travel ban, and prosecutorial discretion more generally. At Penn State Law, Professor Wadhia teaches doctrinal courses in immigration and asylum and refugee law. She
is also the founder/director of the Center for Immigrants’ Rights Clinic (CIRC), where she supervises students in three areas: 1) community outreach; 2) legal support in individual immigration cases; and 3) policy work for institutional clients. CIRC has earned a national reputation for its high-quality work product and impact in the community. 2018 marked the 10-year anniversary of CIRC. CIRC was honored with the Excellence in Legal Advocacy Award in 2017 by the American-Arab Anti-Discrimination Committee and named legal organization of the year in 2019 by the Pennsylvania Immigration Resource Center. Wadhia has received many local and national awards for her scholarship, teaching, and service, including Pro Bono Attorney of the Year by the American-Arab Anti-Discrimination Committee in 2003, leadership awards by the Department of Homeland Security’s Office of Civil Rights and Civil Liberties and Office of the Inspector General in 2008, 2017 Honoree by the National Immigration Project, Arnold Addison Award for Town and Gown Relations by the Borough of State College in 2019, and the 2019 Elmer Friend Excellence in Teaching Award by the American Immigration Lawyers Association. In 2020, Wadhia won the university-wide Rosemary Schraer Mentoring Award and was named a Fastcase 50 Awardee, which honors 50 of "the law’s smartest, most courageous innovators, techies, visionaries, & leaders." Prior to joining Penn State, Professor Wadhia was deputy director for legal affairs at the National Immigration Forum in Washington, D.C. She has also been an associate with Maggio Kattar, P.C. in Washington, D.C., where she handled asylum, deportation, family, and employment-based immigration benefits matters.

Charles Whiteman, Dean, Smeal College of Business, Penn State

Charles Whiteman  The Dean of the Penn State Smeal College of Business oversees all aspects of one of the largest business schools in the nation. Smeal offers highly ranked programs to more than 5,000 students at all levels; supports the research activities of faculty members in six academic departments; is home to a network of leading research centers in business; and features an alumni network of more than 95,000 Smeal graduates around the world.

Whiteman, who has more than 32 years of experience in higher education and business, assumed the
leadership position at Smeal in July 2012. Prior to joining Penn State, he was senior associate dean for the Tippie College of Business at the University of Iowa, where he was responsible for undergraduate and graduate degree programs; faculty and staff recruitment; promotion and tenure; budgetary operations; college facilities; technology operations; and strategic planning for the business school.

During a career that began as an instructor at Iowa in 1980, Whiteman advanced through the faculty ranks to become a chaired professor and served in a variety of administrative roles including chair of the Department of Economics, director of the Institute for Economic Research, and interim dean.

Whiteman holds a Ph.D. in economics from the University of Minnesota and a bachelor's degree in economics from the University of Kansas. He has conducted research that has been supported by a number of grants from the National Science Foundation, published dozens of academic papers, written two books, and served as associate editor of several economics journals. He has also advised the state of Iowa's Department of Management on economic issues and served as a visiting scholar at the Federal Reserve Banks of Kansas City, Atlanta, Cleveland, and Minneapolis.
THE LAWYER’S ROLE IN HELPING CLOSE THE MINORITY-WHITE GAP IN BUSINESS OWNERSHIP [“MINORITY BUSINESS DEVELOPMENT”]

THANKS TO THE FOLLOWING LAWYERS AND OTHER PROFESSIONALS WHO WERE DISCUSSION LEADERS FOR OTHER SESSIONS OF THE COURSE:

- SABRINA CONYERS, PARTNER, NELSON MULLINS, CHARLOTTE, N.C.: INTRODUCTION TO BUSINESS PLANNING AND CHOICE OF BUSINESS ENTITY
- Srinivas M. Raju, Partner, Richards, Layton & Finger, P.A., Wilmington, Del.: LLC Law and the Incorporation Process
- Eric Solomon, Partner, Steptoe & Johnson LLP, Washington D.C., Tax Considerations in the Choice of Entity
- Sabrina Conyers, Partner, Nelson Mullins, Charlotte, N.C., Executive Compensation Issues
- Chris L. Bollinger, Partner, Schiff Hardin LLP, Chicago, Ill., Intellectual Property Protection—a Primer
- Sabrina Conyers, Partner, Nelson Mullins, Charlotte, N.C., and Aaron Fyke, PE, Founder and Managing Partner, Thin Line Capital, Los Angeles, Capital Raising and Overview of Venture Capital
- Sebastian V. Niles, Partner, Wachtell, Lipton, Rosen & Katz, NYC, and Antonia Hyman, Associate, Wachtell, Lipton, Rosen & Katz, NYC, Venture Capital Financing and Documenting the Transaction
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