

# **Justice honored: How to pay for Reparations without using taxpayer dollars**

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## **Executive Summary**

In recent years, the case for reparations for the American descendants of slaves has gained increasing public support in San Francisco, in California, in Tulsa, Oklahoma and other locations. However, many supportive government officials have been clearer about society's moral obligation than about the best way to pay for it. During a time of uncertain economic projections, there are many competing societal needs and demands on government revenues. But what if there is a way to pay for reparations without costing the taxpayers any money?

In this paper, a financing mechanism is presented, called "future returns investment," that takes advantage of similar financing strategies used by university endowments, the Social Security Trust Fund, Alaska Permanent Fund, Employee Stock Ownership Plans, wealthy investors and major corporations to pay for ongoing wealth creation out of future earnings realized from current investment and profit growth, over time horizons of 10 to 20 years. By using this financing mechanism, it is possible to provide a substantial level of reparations to the descendants of slaves without using any taxpayer money. Depending on the time horizon, the amount of reparations received per individual could range from half a million to nearly \$2 million.

Future returns investment also could be used to finance other public goods, such as student loan repayment, or nonprofit housing, or to finance public ownership of a utility. This paper provides details about how such a proposal could work.

## **PART I. INTRODUCTION: HOW WEALTH IS GENERATED**

Both the city of San Francisco and the state of California have Reparations Commissions that have recommended that black Americans descended from slaves should be entitled to some kind of compensation. This seems particularly fitting since slavery and post-Civil War Jim Crow laws denied black families an opportunity to accumulate capital and wealth. In the face of the most rapacious acts of white brutality, black Americans were deprived of a century of investing in businesses, real estate, stocks and other investments that would have allowed them to accumulate wealth, and pass it along to subsequent generations over the decades, in pursuit of the American Dream.

But what kind of compensation is appropriate, and how can it be financed? Who should be in the benefits class? The details are elusive. Certainly impacted African-Americans are entitled to some monetary compensation, but how can this be funded during a time when there are so many competing societal needs, and government revenues are struggling to keep up? San Francisco faces a [\\$780 million budget deficit](#) over the next two years.

Consequently, many government officials who support reparations are more clear on society's moral obligation than on the best way to pay for it.

But what if there is a way to pay for reparations without costing the taxpayers any money? Does that sound too good to be true?

Actually, there is a way to do just that. There is a financing vehicle available, a version of which is used by university endowments, the Social Security Trust Fund, Alaska Permanent Fund, Employee Stock Ownership Plans, wealthy investors and major corporations all the time. It is called “*future returns investment*.”

Do you know how major corporations like Apple, GM, Toyota and IBM fund future growth and investment? The popular perception is that they earn profits, and then invest those profits in new inventions and factories which result in more profits. And it is also believed that they raise money for investment through the sale of new common stock.

But that’s actually not how new capital and investment is paid for. Most of the time corporations use their awesome credit power to borrow large amounts of money for new investment. On average, over \$2 trillion of new capital is created annually, most of it through debt financing and retained earnings. Corporations raise only a small amount of new capital through the sale of new common stock, around five percent. Instead, they borrow large amounts of capital, knowing that their new investments will attract more customers and earn more revenue and profits, allowing them to pay off the loans out of *future earnings*.

That mechanism is key: *they pay for new investment out of future earnings, not out of current profits or savings*. Over time, the successful corporations get richer and richer, as do all the investors who bought those companies’ stocks. Since nearly 90 percent of stocks in the United States are owned by the [wealthiest 10 percent](#) of Americans who are rich enough to risk a cash investment in the volatile stock market, this is a winners game that only a handful of people can play. It’s as if, in a strange twist of our economic system, eligibility to acquire new capital is *restricted to those who already own capital*.

And since oftentimes the new investment and increased profits is spurred by the introduction of new technologies, that means only the wealthiest of Americans benefit as investors from innovation and technology. Of course, all Americans benefit as consumers from new technologies introduced into the fields of healthcare, communications, energy efficiency, home economics, transportation and more. But the tiniest fraction of people become investors in those companies, and reap the money-in-the-bank profits from these new innovations.

The basic capitalist principle of business finance allows wealthy businesses and investors to borrow money for investment purposes, and then pay off the loans out of future profits. Indeed, the vast majority of wealth in the world is derived from capitalizing on investments which pay for themselves over time out of their own future earnings. Financial wealth accumulates even more wealth, and it does that much faster over time than does wage income, which is how most everyday people earn their living. Economist Thomas Piketty captured this reality in his famous formula  $r > g$  (the rate of return on capital exceeds the economic growth rate), which demonstrated why the small 10 percent elite of wealthy people get richer while the vast 90 percent majority of people tread water or worse.

In addition, to borrow money a condition is attached: to qualify for a loan the borrower must put up some kind of collateral to ensure that the loan will be repaid. Only the wealthy can meet this condition. This is the essence of each and every investment, and ensures that the already-wealthy are the ones who benefit from capital’s ability to pay for new investment and capital accumulation out of future earnings from the new investment.

### **Using future earnings to pay for reparations**

But what if there is a way to deploy this financing mechanism to benefit more than a tiny privileged few, but instead to benefit a greater swath of Americans, such as those deemed eligible for reparations?

Sixty years ago, the lawyer and investment banker Louis Kelso actually thought of a way to do just that. Kelso was the inventor of the Employee Stock Ownership Plan (ESOP). In the 1970s, ESOPs were the rage, with hearings in Congress, a *60 Minutes* interview of Kelso, and thousands of companies establishing stock ownership plans in which capital ownership of the company was diffused to all employees. Today, [14.7 million worker](#) are covered by 6300 ESOPs, almost as many workers as are members of labor unions and twice the number of private sector union members, which distribute a total of \$126.7 billion and hold an estimated [\\$2.1 trillion in value](#), which works out to an average of [\\$129,521 per worker-owner](#). [Walmart](#), Lowe's and Publix Super Markets (and previously United Airlines, Avis, Exxon, Enron and JC Penny) are just a few of the businesses that have adopted ESOPs for their employees.

There is a version of this kind of financing, in which investments to create new wealth are paid for out of future profits, that could be deployed to pay for reparations, or student loans, or nonprofit housing, or to finance public ownership of a utility like PG&E, or any number of public goods, without dipping into the public tax coffers. Here's how that would work.

#### **Future returns investment for the public good – San Francisco case study**

San Francisco would sell tax-exempt, long-term municipal bonds to raise the necessary investment capital. Typically municipal bonds are used to fund infrastructure development or other city needs. But in this case, the proceeds from the sale of these municipal bonds would be used to purchase stocks of large and successful publicly-traded companies. A portion of the funds would be used to purchase stocks that have potential for long-term capital appreciation, and another portion would be used to purchase dividend-paying common stocks.

The stocks and bonds would be held by a nonprofit trust in alliance with the city – think Friends of Reparations, like the current nonprofit [Friends of the Public Library](#). The stock portfolio held by the trust would be managed by a professional investment firm.

This kind of structure is similar to how universities such as Harvard, Yale and Stanford manage and [grow their enormous endowment funds](#). Harvard has a \$53 billion fund – three times larger than San Francisco's entire budget – and it is managed by the Harvard Management Company, which has realized a nearly [34 percent return](#) on investment in recent years, despite a troubled global economy. These university endowment funds have [grown robustly over the years](#) by investing in a diversified portfolio of investments. For example, Harvard's endowment is made up of [more than 13,000 individual funds](#) invested as a single entity.

This trust would be called the Reparations Fund. Beneficiaries of the Fund would be decided based on the appropriate criteria for which descendants of slaves should qualify. Each beneficiary would be granted a certain number of units in the Fund, a form of stock ownership in the diversified portfolio of equity investments. Payouts to the Reparations Fund beneficiaries would be small at first to give the Fund time to grow, but payouts would increase over time as Fund investments appreciate and dividends accumulate.

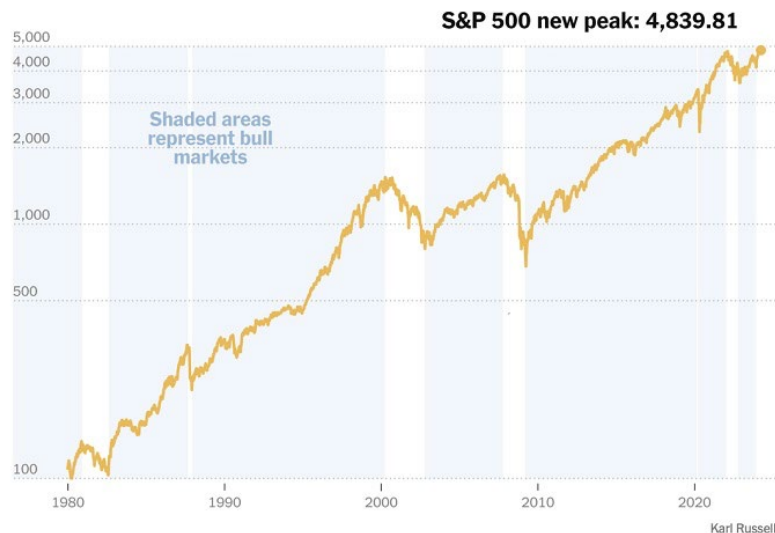
The municipal bond itself also would be paid off over time out of the accrued, tax-exempt wealth of the Reparations Fund. Once a loan has been fully repaid, all future dividends would be taxable. Payouts for beneficiaries would be established as an annual stipend rather than as a lump sum, to ensure that the fund would not shrink and could guarantee continuous accumulated earnings for the fund. Structured this way over a period of 20 years, the payout would be substantial, likely in the millions of dollars per individual.

Payouts over time also make more sense from the viewpoint of the beneficiaries. Handing over a large sum of cash to people who may have no previous experience in investing it could potentially overwhelm them. Managing large sums of money is a knowledge-based skill, and it takes time to acquire that knowledge and skill and to learn how to invest and grow more wealth. It would be wise to include education and training in investment and asset growth management as part of a reparations package. Opportunities for beneficiaries to have a stock and investment portfolio that is managed by a professional investment firm could be integrated into the Reparations program. Having a longer time horizon rather than a lump sum is a prudent way to allow time for such skill building and investment management.

A look at the history of lottery winners raises a red flag that handing a large sum of unrestricted cash to recipients could backfire. According to the National Endowment for Financial Education, [70% of lottery winners](#) go bankrupt within a few years. Examples abound of people who suddenly have more money than they've ever had before, and spend it erratically or get swindled (including by relatives) and generally end up worse than before they had all the money. Payouts over time also responds to concerns raised by many who believe in the moral obligation of reparations, yet are less comfortable over the idea of large cash payments.

### The question of stock market volatility

A natural concern would be that this financing mechanism would tie the fortunes of the Reparations Fund to the stock market, which can be volatile. But [historically speaking](#), over a 5 to 10 year horizon, the stock market nearly always goes up. [Since 1928](#), the U.S. stock market has risen on average nearly 10% per year, and over the past 20 years, the S&P 500 has grown at an annual rate of about 7.5%. The market is up roughly 3 out of every 4 years (see Figure 1).



So volatility is not the problem. The real problem is whether the recipient has the wherewithal to tolerate the risk of the ups and downs, which poor and middle-class people rarely possess. Having a financial cushion to tolerate risk is an advantage that wealthy people enjoy, and is one of the primary reasons why they alone predominantly benefit from the incessant wealth-creating machine of the financial markets. Ironically, those who already own a lot of wealth and capital are the ones who can accept the risk that allows them to benefit the most from the acquisition of new capital.

### **Kelso's "universal capitalism"**

Louis Kelso called this type of financial investment "universal capitalism" -- the idea that *everyone should be able to benefit* from the medium-and long-term growth of the stock market, instead of just a tiny sliver, the 10 percent of wealthiest Americans, who can afford the risk. Kelso, the author of several books including *The New Capitalists* and *Democracy and Economic Power*, believed that everyone should benefit from the most powerful economic growth engine that humans have ever devised – capitalism.

Instead, the way the US economy is structured, only a handful of people pocket the vast amounts of generated wealth, while only the crumbs trickle down into everyone else's pockets via wages (which have been stagnant for decades) and government redistribution. But as income tax rates on corporations and high net worth individuals have declined precipitously in recent decades, there is a lot less to redistribute.

By allowing everyday people – such as those eligible for reparations – to benefit from the astounding ability of amassed wealth to pay for new investment and capital accumulation out of future earnings, we can better ensure that the benefits of investment, economic growth and technological innovation will be more broadly distributed and "universal."

This type of financing innovation is similar to how the Alaska Permanent Fund and the Social Security Trust Fund work. The Alaska Permanent Fund – also originally initiated by Kelso – harnesses the return on investment in Alaska's oil wealth to provide an annual stipend to every Alaskan resident. The Social Security Trust Fund uses as its chief source of investment the revenue from the payroll contributions of every American worker, which it then invests in US Treasury bonds. Over time the value of the Social Security Trust Fund grows larger than the sum of workers' contributions. When workers eventually retire, they reap a dividend paid for out of their own contributions combined with the future earnings from the investment activities of the Social Security Trust Fund.

For both the Social Security Trust Fund and the Alaska Permanent Fund, each participant is essentially a shareholder in those respective Funds. One difference with the Reparations Fund however, is that, unlike with Social Security where the funds for investing come from workers' wages, in this case the initial investment funds will come from a municipal bond, relying on San Francisco's AAA bond rating to pay low interest rates amortized over decades.

In fact, historically various presidential administrations used "*future returns investment*" to capitalize important infrastructure projects. President Franklin Roosevelt utilized the Reconstruction Finance Corporation (RFC) to finance manufacturing and development. For liquidity it issued bonds, most of which were bought by the federal government. The RFC then made loans to local governments and productive small businesses at below-market rates. Cities issued "revenue bonds" and repaid them and the RFC loans with the revenues generated by the works funded by the loans. Using such funding mechanisms, the RFC was able to lend or invest over \$40 billion

from 1932 to 1957, funding the New Deal and World War II and eventually returning a net profit to the federal government of \$690 million. Similarly Secretary of the Treasurer Alexander Hamilton's "American System" created a national development bank that issued credit to the government and private interests for manufacturing, infrastructure improvements and other economic development. Infrastructure and productivity flourished during that period.

These kinds of innovative financing mechanisms have long existed in multiple forms in the real world. The power of "*future returns investing*" can be used to make up for the destruction of slave descendants' lives and property, which further deprived them of a century of investing in real estate, homes, businesses, stocks and other investments that would have allowed them to accumulate wealth that could have been passed along to their children and grandchildren. A well-designed Reparations Fund would provide a new stream of wealth which then could be invested by the beneficiaries across the generations.

In short, universal capitalism applied as a financing tool for reparations would allow reparations recipients to become stakeholders in the economy in a way that was never before possible. Why not let those who have been robbed through the sin of slavery – the worst form of robber baron capitalism – benefit from a positive financial structure to become the new owners of capital?

Without using any taxpayer funds, not only would this finance the long-overdue reparations, but it would help encourage a large group of people who today possess little capital to feel like they have a stake in the nation's future. It would make poor people not only less poor, but turn them into owners in prosperous companies, and for the first time in US history into true stakeholders in the economic system. And by doing this in San Francisco, that would increase and broaden the tax base of the City once participants start receiving dividend distributions from the Fund.

## **PART II. HOW MUCH REPARATIONS PAYMENTS PER INDIVIDUAL?**

The investment strategy of the Reparations Fund would be to use a mix of investments that balance the amount of long-term capital appreciation with investments that pay out some dividends as soon as possible. This would allow beneficiaries to have several options, since there will likely be different classes of beneficiaries, i.e. some younger, others more elderly, some needing as much current income as possible, others preferring a greater amount of capital appreciation over time.

Let's assume that San Francisco wants to offer reparations to approximately 1000 individuals who qualify according to the established criteria, with a targeted reparations amount per individual beneficiary of \$500,000 to \$1 million.

To supercharge the Reparations Fund, let's assume that San Francisco offers a municipal bond worth \$1 billion,<sup>1</sup> with the money raised being invested in a diversified portfolio of stocks. And let's assume that the Reparations Fund was invested in a S&P 500 index fund, which over the past 20 years has appreciated 7.5 percent per year on average (note that this is a conservative estimate of the investment appreciation potential – other indexes such as the NASDAQ and Russell 2000 have annually appreciated 18.9 percent and 19.2 percent on average, respectively).

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<sup>1</sup> This amount is well within San Francisco's bond capacity. According to the [San Francisco Controller's office](#), The City has a maximum limit on the amount of outstanding general obligation bonds of \$9.86 billion. Of that ceiling, San Francisco has only \$2.63 billion in outstanding general obligation bonds, and an additional \$1.50 billion in bonds that are authorized but unissued. Thus San Francisco's debt level is less than half of its maximum ceiling.

With those assumptions built into our reparations model, below are projections for four case scenarios showing the amount of benefits that could be paid to all 1000 beneficiaries, and over different time horizons. Each of the cases assumes that the beneficiary's account (the "Account") earns the S&P 500's 7.5 percent compound return on the Reparations Fund's investments.

**Case #1 – Municipal bond with a 10 yr term, paying an annual dividend to beneficiaries:**

***Assumptions:***

The municipal bonds are interest-only and have a **term of 10 years**

The invested funds in the S&P 500 earn on average a **7.5% compound annual return**

These bonds pay an interest rate to the municipal bond investors of **2.6%**, the current rate being paid on 10-year tax-exempt AAA municipal bonds

These bonds pay *an annual dividend to the beneficiary of 2.4%* of the initial \$1 million benefit to each beneficiary, which amounts to **\$2000 per month, \$24,000 per year.**

***Results:***

*At the end of 10 years, and after the Fund's bond investors have been paid off, an additional amount would be payable to each beneficiary of \$350,000.*

Each individual beneficiary would have **received \$240,000 in dividend payments** during the 10-year term of the Fund, followed by **another \$350,000** at the end of 10 years. The total amount realized by each individual beneficiary from dividends and stock appreciation would be **\$590,000.**

**Note: no taxpayer money would be used to fund this reparations payment or to pay off the municipal bond.**

**Case #2 – Municipal bond with a 10 year term, no annual dividend to beneficiaries:**

***Assumptions:***

The municipal bonds are interest-only and have a **term of 10 years**

The invested funds in the S&P 500 earn on average a **7.5% compound annual return**

These bonds pay an interest rate to the municipal bond investors of **2.6%**, the current rate being paid on 10-year tax-exempt AAA municipal bonds.

*Difference compared to Case #1: No annual dividends are paid to Fund beneficiaries for the first 10 years.*

***Results:***

*At the end of 10 years, and after the Fund's investments bond investors have been paid off, the amount that would be payable to each individual beneficiary would be \$696,000.*

**Note: no taxpayer money would be used to fund this reparations payment or to pay off the municipal bond.**

**Case #3 -- Municipal bond with a 20 yr term, paying an annual dividend to beneficiaries:**

***Assumptions:***

The municipal bonds are interest only and have a **term of 20 years**

The invested funds in the S&P 500 earn on average a **7.5% compound annual return**

These bonds pay an interest rate to the municipal bond investors of **3.3%**, the current rate being paid on 20 year tax-exempt AAA municipal bonds

These bonds pay an *annual dividend to each individual beneficiary of 2.4%*, starting after the fifth year of the Fund, or **\$2000 per month, \$24,000 per year for 15 years.**



**Results:**

At the end of 20 years, after the Fund's bond investors are paid off, the *amount that would be paid to each individual beneficiary would be \$1,191,000*

The beneficiary would have **received \$360,000 in dividend payments** during the 15-year payment period of the Fund, followed by **another \$1,191,000** at the end of 20 years. The total amount realized by the beneficiary from dividends and stock appreciation would be **\$1,551,000**.

**Note: no taxpayer money would be used to fund this reparations payment or to pay off the municipal bond.**

**Case #4 -- Municipal bond with a 20 year term, no annual dividend to beneficiaries:**

***Assumptions:***

The municipal bonds are interest only and have a **term of 20 years**

The invested funds in the S&P 500 earn on average a **7.5% compound annual return**

These bonds pay an interest rate to the municipal bond investors of **3.3%** (\$33,000), the current rate being paid on 20-year tax-exempt AAA municipal bonds

No annual dividends are paid to Fund beneficiaries.

**Results:**

*At the end of 20 years, and after the Fund's bond investors are paid off, the amount that would be paid to each individual beneficiary would be \$1,789,000*

**Note: no taxpayer money would be used to fund this reparations payment or to pay off the municipal bond.**

As one can see from these different case scenarios, the amount and timeline for payments to beneficiaries depend on whether they receive more money over a shorter time horizon or a longer one (immediate dividend payments vs. payments after investment appreciation and bond term maturation), and whether the investment appreciation horizon is over 10 years or 20 years.

Following full investment appreciation, the Accounts could be distributed either in a lump sum or in installments, such as 10 year certain annuities. Another option might be to distribute via a combination of distribution strategies, such as 25 percent in a lump sum amount and the rest in a 10 year certain annuity.

It would be possible to allow individual beneficiaries to select which case scenario fits best with their own situation, since there will likely be different classes of beneficiaries. Some will be elderly and would want more of the money upfront; others will be younger and may be more attracted to receiving more money over a longer time horizon to benefit from greater capital appreciation. Payouts to the Fund beneficiaries would be small at first, but would increase in later years when dividends have accumulated and Fund investments have appreciated. There is also the possibility that stock market performance results in higher and/or quicker returns, and so payouts could be larger in certain years, and could mature faster than predicted.

**Future returns investment – state of California case study**

A similar reparations plan could be designed for the state of California. Instead of using municipal bonds as the initial source of investment funds, state bonds would be used. And because state bonds



enjoy lower-cost tax benefits than municipal or other types of bonds, a California-based program of future returns investment could potentially pay beneficiaries more quickly, with greater levels of benefits, than the model presented above for San Francisco. The calculations in the previous section are based on bonds issued by a local municipality such as San Francisco, where the bonds typically pay an interest rate of 2.6%. But if the bonds were issued by the State of California, the interest rate would be more in the range of 3.3% for a 10 year bond, which could potentially allow greater levels of benefits and faster payout, or coverage for a larger group of beneficiaries.

It is also important to note that these case scenarios are based on an assumption of 1000 beneficiaries. If the number of beneficiaries were to be higher or lower, that also would affect the level of benefits and the speed of the payout. So defining the criteria for *who* would be a beneficiary is a crucial detail.

These case scenarios are examples that illustrate how a substantial amount of reparations can be paid to the descendants of slaves by paying for them through the power of “future returns investment,” instead of dipping into the public coffers – that is, supercharging a Reparations Fund out of the future profits from a diversified portfolio of stock investments. *This investment vehicle offers a way to act on both the moral and financial obligation that the public at-large and public officials have committed to fulfilling without dipping into the public treasury.* It also would increase and broaden the tax base of San Francisco, or any other jurisdiction that embarks on this path, once participants start receiving distributions from the Reparations Fund.

This financing vehicle of future returns investment also could be deployed to pay for other public goods, such as student loans, nonprofit housing, or to finance public ownership of a utility like PG&E without dipping into the public treasury.

Doing so for reparations would take a giant step toward revitalizing black ownership in the economy to its original dream during the immediate post-Civil War period, before it was snuffed out by the murderous plundering of Jim Crow, the KKK, the White League, lynchings, the burnings of black businesses and churches in places like Tulsa, Oklahoma, and the shocking catalogue of racist predations that stole the wealth and labor from the very people whose backs quite literally built this country.