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“How Black Small Businesses Can Hinder Closing the Income and Wealth Gaps”

Details concerning the Black-White income and wealth gaps are well known. It is understood that the average (median) Black-White household income gap is about 37 percent.¹ At the same time, the Federal Reserve Board’s 2019 *Survey of Consumer Finances* indicates that White households possessed \$188,200 in median net worth, while Black households possessed \$24,100 in median net worth.² In this case, we are comparing the center of the income and wealth distributions. What may be of greater importance is to consider the inequality between the top and bottom of the distribution—irrespective of race. But we digress.

Too many scholars, politicians, and commentators to mention have inferred that Black Americans might close the Black-White income and wealth gaps by accelerating our formation and operation of small businesses. We concur that certain aspects of certain Black small businesses may contribute to closing the gaps, but that there are at least four reasons why Black small businesses can hinder closing the gaps.

First, the mean “net income less deficits” of nonfarm sole proprietorships “with and without net income” as reported by the US Department of Treasury, Internal Revenue Service, Statistics of Income Division (SOI) for 2018 (the most recent year for which data are available) was only \$12,852, which is considerably lower than median Black household income reported in footnote 1.³ This mean net income value is for Black and White proprietorships and it is consistent with the historical trend. Therefore, it does not seem possible that, on average, Black small businesses can contribute in a large way to reducing the income gap—unless all newly formed Black small businesses perform at the upper end of the proprietorship net income distribution.

¹ The percentage is for 2019, where the US Department of Commerce, Bureau of the Census reports in “Income and Poverty in the US, 2019” (Table A-1 Income Summary Measures by Selected Characteristics, 2018 and 2019, column F, rows 18 and 20) that Black median household income was \$45,438, while it was \$72,204 for Whites; <https://www.census.gov/library/publications/2020/demo/p60-270.html> (Retrieved on 06/22/21).

² The net worth values are from the Federal Reserve Board’s Fed Notes and a publication titled, “Disparities in Wealth by Race and Ethnicity in the 2019 *Survey of Consumer Finances*,” <https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm> (Retrieved 06/22/21).

³ See SOI Tax Stats – Nonfarm Sole Proprietorship Statistics, “Business Receipts, Selected Deductions, Payroll, and Net Income” for tax year 2018 (EXCEL file named 18sp01br.xls), row 1, columns B and I; <https://www.irs.gov/statistics/soi-tax-stats-nonfarm-sole-proprietorship-statistics> (Retrieved 06/22/21).

It is well known that proprietorships misreport (under-report) their net income by about 50 percent.⁴ If Black proprietors act accordingly, then it is possible that the unreported net income might be used to invest in financial and nonfinancial assets that can one day contribute to closing the Black-White wealth gap. However, we recognize that White proprietors are also misreporting their net incomes.

Second, the foregoing discussion focused on owners of Black small businesses. An important question to ask is: “Can employees of Black small businesses help close the gaps?” The answer is: “Probably not” because, like other small businesses, Black small businesses are likely to compensate their employees with poverty-level (minimum) wages.⁵ These poverty-level wages are far below the Black median household income and can do little to close the income gap.

Keep in mind that the poverty-level wages of Black small business employees position them to become recipients of a variety of social benefits, grants, and subsidies.⁶ Of course, these government payouts do not appear out of thin air; rather they result, in part, from tax revenue. This means that taxes are generally higher than they would be if these employees were paid a “living wage,” and did not receive government support. The increased level of taxes means reduced disposable income with which to create wealth—a factor hindering closing of the wealth gap.

Third, like other small businesses, Black small businesses make efforts to reduce their operating costs. For example, small businesses do not hire their own security force, but call upon local police when a security incident arises. Again, these services do not appear out of thin air, but are made available through the expenditure of tax revenue. In this case, taxes are higher than they would be if public police services were not required by small businesses. These higher taxes contribute to a reduction in disposable income and hinder wealth creation.

Fourth, many municipalities use a variety of methods to generate revenue to meet the cost of new, and to repair existing, infrastructure that facilitates small business operations. However, two important sources of revenue for this purpose are: (1) Borrowing through bond issuance (the bonds are paid ultimately with tax revenue); and (2) taxes. Therefore, small businesses’ infrastructure requirements can serve as an important reason for higher taxes. Again, these higher taxes result in reduced disposable income, which hinders wealth generation.

In summary, while Black small businesses (nonfarm sole proprietorships) may generate income for their owners and employees, on average, that income is generally insufficient to reduce dramatically the Black-White income and wealth gaps. Also, the poverty-level income of many

⁴ See SOI report “Federal Tax Compliance Research: Tax Gap Estimates for 2011-2013”, Table 5 on page 20; <https://www.irs.gov/pub/irs-pdf/p1415.pdf> (Retrieved on 06/22/21).

⁵ A 2013 Employment Policy Institute report, “Who Really Employs Minimum Wage Workers,” indicates that over 50 percent of workers receiving the minimum wage are small business employees; <https://epionline.org/oped/who-really-employs-minimum-wage-workers/> (Retrieved 06/22/21).

⁶ By convention, social benefits are extended to individuals; grants are generally extended to other levels of government; and subsidies are generally extended to market enterprises. In this case, our reference to grants and subsidies is to transfers reaching individuals through government and public nonmarket institutions, respectively.

Black small business employees positions them to become the recipients of a range of publicly derived benefits, which motivates higher taxes, lowers disposable income, and reduces the ability to produce wealth for Americans in general. Admittedly, even more benefits and even higher taxes might be required if Black businesses did not hire these workers. On the other hand, potential Black small business worker might be motivated to qualify for, and find, living-wage-paying positions elsewhere if these small businesses did not exist. Finally, small businesses do not generally absorb the full extent of their social costs (i.e., the cost of police services and infrastructure). This practice results in taxes being higher than they would be otherwise, and those taxes reduce disposable income and hinder wealth building for us all.

In lieu of Black small businesses, we recommend the formation of cooperative and corporative type arrangements that Black entrepreneurs can employ to engage favorably in the marketplace to produce income earning and wealth building opportunities that can actually help close the income and wealth gaps.

This essay has implications for how Black Americans should seek to organize our economy when we form our own nation; and how nations in general should view the role of small businesses in their plans for economic development broadly.

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