COMMUNITY CONSUMER DEFENSE LEAGUE
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THE ALLIANCE TO CLOSE THE RACIAL WEALTH GAP

POLICY BRIEF

HOW FEDERAL POLICY WORSENED THE RACIAL WEALTH GAP

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It has frequently been noted that U.S. white families have far greater wealth than Black, Indigenous and Latino families, as well as families in certain Asian American and Pacific Islander communities. This leaves these families less able to bounce back from an unexpected expense or job loss, or to pass generational wealth along to their children. Too often forgotten, however, is the long history of federal legislation and regulatory policy that directly contributed to this racial wealth gap.

Entire books have been written on aspects of this subject (see, for example, "The Color of Law" by Richard Rothstein). This paper briefly summarizes key 20th and 21st century federal policies that have worsened racial wealth and income disparities.

As of the fourth quarter of 2022, on average, for every dollar of wealth a white family had, Black families had about 25 cents and Latino families had about 24 cents. While data needed to paint a full picture of Asian American and Pacific Islander communities is lacking, certain AAPI communities have significantly higher rates of poverty and lower rates of homeownership than whites.

Five major areas of federal policy have directly helped to create or worsen the current racial wealth gap:

I. ***Redlining came from Great Depression housing policies.*** As part of President Franklin Roosevelt's efforts to alleviate the Great Depression of the 1930s, the *Federal Home Loan Bank Act*, the *Home Owners Loan Corporation* and the *Federal Housing Administration* together helped to create America's great white middle class, the envy of the world. They also fostered a massive racial homeownership gap still in existence today by legally denying home mortgages to people of color through redlining.

II. ***Savings and loan crisis of 1985-89.*** Loose regulation failed to protect marginalized communities, and the legislative fix for the resulting disaster, the *Financial Recovery and Enforcement Act of 1989* (FIRREA), further damaged communities of color,[i] virtually wiping out the small but growing number of savings and loans owned by people of color.[ii]

III. ***Financial deregulation and the Great Recession of 2008.*** Together, these erased years, and in some cases decades, of wealth accumulation in communities of color.[iii] From 2007 to 2013, middle-income Black families lost nearly half their household wealth, while middle income Latino families lost more than half – and both groups had recovered just a small percentage of those losses by 2016.[iv]

IV. ***21st century failures of federal regulatory agencies to adequately protect consumers.*** Repeated instances of predatory and discriminatory banking practices have disproportionately harmed consumers of color and have too often been met with just a slap on the wrist.

V. ***Current Federal Reserve policies.*** The Fed has moved aggressively to combat inflation with policies that inevitably increase unemployment and instability in communities of color.

The continuing impact of these five actions threaten America's future. People of color will soon be a majority of the U.S. population, and continued racial wealth and homeownership gaps will cripple our economy. Below is a more detailed explanation of the policies listed above and their impact.

REDLINING WAS CREATED BY FEDERAL DECREE

Decades after redlining was banned, the damage it did to communities of color lingers.[v] Redlining played a huge role in creating the continuing racial homeownership and wealth gaps.

Formal redlining began with the first federal banking legislation and programs designed to address the effects of the Great Depression, beginning with the Federal Home Loan Act in 1932, followed by creation of the Home Owners Loan Corporation in 1933 and The Federal Housing Administration in 1934.

HOLC is often cited as the originator of mortgage redlining, creating maps that designated communities of color as undesirable for lending. The racist attitudes and language found in the appraisal sheets and Residential Security Maps created by the HOLC effectively gave federal support to existing racial bias in society at large.[vi]

These federal efforts largely created our large white middle class but were intentionally withheld from communities of color, resulting in a lower quality of life by virtually every social measurement – education, health, social mobility, wealth and mortality.

Homeownership has proven to be both the doorway and gatekeeper to success and wealth creation, subsidized by federal, state, and local governments: Owners receive mortgage interest deductions and shelter capital gains from taxes upon the sale of primary residence.

Homeownership also has non-economic benefits. It provides security and self-esteem, creates a sense of belonging, builds neighborhoods, and increases voting and civic participation.

Decades of racial and ethnic homeownership disparities have not improved, and remain the major contributor to the ongoing racial wealth gap:

Homeownership rates by race:[vii]

- White: 73.4%
- Latinos: 50.6%
- African American: 44.3%
- Asian American: 63.1%
- Pacific Islander: 45.6%
- Native American: 56.7% [viii]

THE S&L CRISIS AND RESULTING LEGISLATION[ix] WIPED OUT POC-OWNED LENDERS

The 1980s savings and loan crisis was the greatest financial calamity to hit the U.S. economy since the Great Depression, wiping out a third of the 3,234 savings and loan associations and virtually all of the Black- and Latino-owned S&Ls.

Savings and loans were originally developed in the 1880s by community groups to fill a home loan need banks were neglecting. These groups pooled their funds and lent them to individual members to purchase their homes, and repaid loans were reinvested in other home loans. Access to federal deposit insurance following the Great Depression allowed these local efforts to evolve into a large savings and loan Industry. By 1980 there were thousands of S&Ls, sometimes called thrifts, focused primarily on providing home mortgages.

Leaders in communities of color saw an opportunity to provide the small business and home mortgage loans banks were not providing and began to build their own local S&Ls. By 1980 there were estimated to be over 100 Black and 50 + Latino S&Ls across the nation.

Federal deregulation intended to help S&Ls compete with larger banks allowed them to engage in more speculative and risky ventures. Weak regulatory oversight allowed flagrant mismanagement and outright fraud to go undetected for years, culminating in the collapse of over 1,000 institutions and a $124 billion taxpayer bailout.[x]

Regulatory agencies simply failed to protect consumers, especially the most vulnerable communities.[xi] Involved in the fraud and subsequent cover-ups were prominent individuals, including regulators, politicians, financial executives and five U.S. senators.[xii]

Congress' effort to prevent a repeat crisis was called the 1989 *Financial Institutions Reform, Recovery and Enforcement Act* (FIRREA) which imposed new capital requirements that many S&Ls and most POC-owned S&Ls could not meet.

The crisis affected all communities. But it disproportionately affected communities of color, who already suffered a homeownership and wealth gap.

THE GREAT RECESSION: REGULATORY FAILURE WORSENED THE RACIAL WEALTH GAP

The Great Recession directly resulted from the regulatory failure to recognize the huge national housing bubble that U.S. banks and mortgage corporations built via deceptive and predatory practices. It especially affected millions of moderate and lower-income homeowners and buyers across the nation and disproportionately affected communities of color, wiping out huge amounts of wealth.[xiii]

Loose regulation allowed mortgage corporations and banks to market predatory mortgages and aggressively sell them to vulnerable families, often people of color or immigrants -- mortgages "*that would eventually create financial hardship for them, as they ended up building debt rather than wealth*." [xiv] They then packaged them as securities and sold them to investors, who failed to do proper due diligence.

Deceptive practices flourished in the early- and mid-2000s. Bankers and mortgage brokers wrote loans for homes they knew the buyers couldn't afford, illegally inflating buyers' income on loan applications, and setting up trick loans with huge, unaffordable future balloon payments hidden in the fine print. This led to a wave of mortgage defaults and a crisis that resulted in millions of disproportionately Black, Latino, and Southeast Asian families losing their homes, down payments, and payment investments.[xv]

Taxpayers – including those low- and moderate-income families who were victims of predatory mortgages -- ended up helping to bail out the banks. The bailed-out banks quickly recovered and enjoyed new profits that provided bankers with raises and bonuses.[xvi]

And the government, facing a glut of thousands of foreclosed homes, sold them in bulk at huge discounts to rich investors who in turn rented many of them at high rents to the foreclosed families.

FEDERAL AGENCIES HAVE FAILED TO PROTECT FAMILIES FROM DISCRIMINATORY BANKS

Wells Fargo, City National, Silicon Valley, First Republic, and Comerica Bank are notorious examples of illegal, often discriminatory, actions and regulatory failure. When their violations became highly publicized, regulators could no longer ignore them and were compelled to investigate. The guilty banks, unfortunately, received some of the most lenient regulatory punishments available, leaving their victims without sufficient reparations to cope with the devastating consequences of these violations.

Wells Fargo, for example, has a 20-year history of malfeasance and over that period racked up over $20 billion in regulatory fines. That may sound like a lot, but it's roughly one year's net profit.[xvii] Overall, the Consumer Financial Protection Bureau and other regulators have largely allowed it to continue business as usual. Wells Fargo's track record includes:

- Creating false accounts for customers without their knowledge to extract millions in illegal fees.[xviii]

- Predatory auto loans in which 25,000 customers' vehicles were repossessed for failure to pay auto insurance assigned without their knowledge.[xix]
- Mortgage discrimination, with 53% of African American applicants denied loans compared to just 25% of white applicants. [xx]
- Illegally denying Native Americans check cashing privileges [xxi]

City National, headquartered in Los Angeles, is among the 50 largest banks in the United States. Los Angeles has a Black population of 9%, a Latino population of 49.1%, and an Asian population of 15.6%.[xxii] "City National only opened one branch in a majority-Black and Hispanic neighborhood in the past 20 years, despite having opened or acquired 11 branches during that time period." [xxiii]

City National Bank was found "legally liable" for mortgage discrimination, but no managers were personally punished. The bank was slapped on the wrist with a fine of $31 million.

The recent collapse of Silicon Valley Bank and First Republic Bank represents a different sort of regulatory failure. In spite of numerous agency warnings of serious problems, both banks were allowed to continue business as usual until their public collapse. Banking regulators allowed CEO Gregory Becker of Silicon Valley Bank to continue to be a member of the board of directors of the Federal Reserve Bank of San Francisco.[xxiv] Notably, "Less than 2 weeks before Silicon Valley's bank public failure, the CEO sold over $3.5 million in company stock."[xxv]

Comerica Bank's violations enabled a foreign company to unlawfully withdraw funds from the bank accounts of lower-income customers. In direct contravention of Treasury Department rules, Comerica hired a vendor from Pakistan to handle data and oversee fraud disputes for 4.5 million highly vulnerable customers, including those receiving Social Security, disability, and American Indian payments.[xxvi]

Regulatory failures negatively impacted these banks' community investment promises, promises made in exchange for community support for proposed mergers and acquisitions. These commitments are valuable assets for communities that need investment and must be protected.

THE FEDERAL RESERVE'S FIGHT AGAINST INFLATION HARMS COMMUNITIES OF COLOR

The Federal Reserve, which exerts great power over the economy, is attempting to cut inflation to 2% annually via interest rate increases that it anticipates will increase the national unemployment rate to about 4.6%.[xxvii] Unemployment for Blacks and Latinos is typically far higher than the rate for whites – as much as double[xxviii] – and will rise accordingly.

High interest rates create a disproportionate negative economic impact on communities of color. The majority of businesses of color – important sources of employment for their own communities -- are smaller and highly sensitive to interest rates. Higher mortgage rates disproportionately inhibit homeownership opportunities for less-wealthy communities already far below the homeownership rate of white families.

Current inflation stems from several sources which may not be impacted by interest rates, including the pandemic, the supply chain crisis, and the Ukraine war. Although time is mitigating the impacts of both the pandemic and the supply problem, the Federal Reserve continues to utilize an outdated theory to fight inflation.

The economic theory on which the Fed bases its approach can be traced back to the Phillips Curve, an 1861 demand/supply theory that basically states that economic growth through increased employment creates demand for goods, and increases inflation.[xxix] Therefore, inflation can be curbed through higher unemployment that inhibits consumer spending. The application of this theory to the inflation that emerged with the pandemic is disputed by many top economists,[xxx] as well as other experts like former Secretary of the Treasury Robert Reich.[xxxi]

The Fed's strategy of fighting inflation through high interest rates also ignores mounting evidence that major corporations have taken advantage of the situation to raise prices purely to boost profits and reward shareholders[xxxii] – something that interest rates are unlikely to influence.

Community Consumer Defense League have proposed alternative policies to make the Fed more responsive to the needs of communities of color to build intergenerational wealth, including the following commitments:

1. At the absolute minimum, institute a policy of disaggregating all unemployment projections by race and reporting that data as top-line findings, especially related to activities driven by the Fed that may induce increases in the national unemployment rate.
2. Ensure that the senior staff at the Federal Reserve reflects the diversity of all Americans, especially those communities who are most likely to experience economic pain related to inflation and the efforts to tame inflation.
3. Make a strategic commitment to exploring alternative methods endorsed by leading economists to control inflation that do not disproportionately harm formerly redlined communities as well as low-and moderate income Americans.

FACING THE RACIAL WEALTH GAP

The debilitating effect the racial wealth gap has on the century-old racial divisions plaguing our country gets too little attention. Today, according to a recent Federal Reserve study, the racial wealth gap is actually increasing: "White households hold 86.8% of overall wealth. … [Home o]wnership rates among White households have remained considerably higher than for minorities." [xxxiii]

No program can be an instant silver bullet that eradicates racism, builds trust between Americans, and protects democracy. But a concentrated effort can begin to make a difference. A partial solution could be a national homeownership program that substantially increases homeownership, enabling all moderate and some lower-income families to have an opportunity to buy a home and build intergenerational wealth.

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