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"In the course of the Great Recession, already fragile black and Hispanic middle-class households lost huge amounts of wealth, which had often been painstakingly accumulated over many decades."

The Great Recession and the Destruction of Minority Wealth

DOUGLAS S. MASSEY AND JACOB S. RUGH

Social Mobility Today

Third in a series

It seems obvious now, but there was a time when social scientists paid little attention to wealth as a factor in America's system of racial stratification. For many years, researchers focused primarily on black-white differentials in education, employment, and earnings; and in these dimensions progress was clearly being made. From 1963 (just before the passage of major civil rights legislation) to 2001 (just after the economic boom of the 1990s), the ratio of black-to-white median household income rose from 33 percent to 64 percent. Over the same period, the black-white ratio for high school graduates climbed from 51 percent to 89 percent, and the ratio for college graduates rose from 41 percent to 55 percent. Although progress toward racial equality may have been slow and fitful, the gaps were clearly narrowing and advances in education and income seemed to be creating a new black middle class.

In the 1990s, however, two books focused attention on the persistence of huge racial gaps with respect to wealth: Melvin Oliver and Thomas Shapiro's *Black Wealth/White Wealth* (1995) and Dalton Conley's *Being Black, Living in the Red* (1999). Wealth is the total value of assets minus liabilities at any point in time. For African American families in 1963 it was just 5 percent of median wealth for white families; by 2001 the figure had risen to just 16 percent. At that point, median family wealth stood at $166,511 for whites and $26,149 for blacks, yielding a racial wealth gap of more than $140,000. For Hispanics the gap was around $151,000. (All values cited herein pertain to families and are in constant 2016 dollars.)

Wealth distributions are highly skewed, however: the median value (the 50th percentile) understates intergroup differences by taking little account of high values in the upper tail of the distribution. The absolute size of wealth differentials is better captured using the mean value (the average of all elements in the distribution). As of 2001, mean household wealth for whites was $662,337 compared with only $97,930 for blacks, for a wealth gap of $564,407. On average, then, whites were 5.2 times wealthier than blacks but only 1.6 times more affluent as indexed by mean household income. We thus get a very different perspective on class status by focusing on wealth instead of income.

Wealth provides a critical cushion for the shocks and vagaries of life under capitalism, a buffer that the nation's African Americans for the most part lack. Whereas affluent black households are often just a few paychecks away from the street, affluent whites typically have a financial reserve that can sustain them during periods of unemployment and lost income. Owing to their relative lack of wealth, the class status of high-earning blacks is much more fragile than that of high-earning whites. The same can be said of Hispanics. In 2001, mean white wealth was 5.5 times that of Hispanics while mean white income was only 1.4 times greater.

Historically, the accumulation of black wealth was suppressed by discriminatory processes embedded in US society. In the twenty-first century, black wealth is being actively destroyed by means of an entirely new set of discriminatory structures. In order to understand what happened to African Americans during the Great Recession, and why rates of black social mobility lag so far behind those of whites, we first have to recognize this history.

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WEALTH SUPPRESSION

The principal source of wealth for most American households is homeownership, especially for those outside the upper echelons of the income distribution. Any social structure that affects homeownership and home values thus plays an outsized role in determining household wealth. During the twentieth century, the most important structures influencing the ability to accumulate equity through homeownership were racial segregation in housing, racial segmentation in lending, and racial discrimination in employment.

At the turn of the twentieth century, the vast majority of blacks lived in the rural South. Within 70 years, the Great Migration brought about the geographic diversification and urbanization of black America. In 1900, 90 percent of all black Americans lived in the South and just 20 percent in urban areas, but by 1970, after seven decades of mass out-migration, more than half lived outside the South and 81 percent were urbanized. These shifts were accompanied by sharp increases in the residential segregation and spatial isolation of African Americans, especially in industrial cities of the Northeast and Midwest.

The arrival of black migrants in northern cities was initially resisted peacefully by white leaders who sought to negotiate a withdrawal of black interlopers from white spaces, using social pressure and financial incentives. When these methods failed, whites typically resorted to violence. White mobs gathered outside black-occupied homes and unleashed an escalating spiral of attacks. If they went unanswered, these attacks typically culminated in bombings and arson that ultimately forced black residents to leave the neighborhood.

To avoid unseemly acts of violence and wanton property destruction, city councils sought to segregate the races legally by enacting municipal ordinances to set aside separate residential areas for black and white residents. Introduced first in Baltimore in 1910, such ordinances spread rapidly from city to city until 1917, when the US Supreme Court declared them unconstitutional—not because they violated the constitutional rights of black home seekers but because they infringed on the rights of white property owners.

Black migration to the nation's industrializing cities surged with the onset of World War I in 1914, which shut down immigration from Europe and created nationwide labor shortages. The migration accelerated further after 1917 when the United States entered the war and the military draft pulled white workers out of factories. Black workers responded by moving in droves to take advantage of the job vacancies.

As black workers and their families arrived in northern cities, they initially settled in existing black and racially mixed neighborhoods. Soon these neighborhoods filled up and black settlers spilled over into adjacent white districts. In response to these incursions, waves of communal violence swept through urban America after 1917, culminating in the great Chicago Riot of 1919. Over the course of six days, roving gangs of white vigilantes attacked any black person they encountered on the "white" side of the residential color line. The uprising was finally quelled by imposition of martial law, but not before it resulted in 38 deaths and 500 injuries. More than 1,000 black families were driven from their homes.

In the wake of the mayhem, the Chicago Real Estate Board took action to institutionalize racial discrimination in housing markets and thus avoid the needless destruction of saleable properties. Deed restrictions prohibiting rental or sale to African Americans already existed but were seen as inefficient because they could be applied only on a property-by-property basis. To expand the scale of racial exclusion, Chicago realtors invented a new device known as the restrictive covenant—a contract among white property owners committing them collectively not to rent or sell housing to African Americans. Once a majority of property owners in a covered area had signed, the covenant became legally binding and violators could be sued in court to force compliance.

In 1927, the Board went further by creating a model covenant that could be used by realtors throughout the nation. Four years earlier, the National Association of Real Estate Boards had written a new code of ethics for brokers, stating that "a realtor should never be instrumental in introducing into a neighborhood . . . members of any race or nationality . . . whose presence will clearly be detrimental to property values in that neighborhood." With these tools in place, racial discrimination was embedded in the structural organization of housing markets throughout the United States, driving levels of black segregation to unprecedented heights.

INSTITUTIONALIZED SEGREGATION

With the onset of the Great Depression in 1929 and the advent of Franklin D. Roosevelt's New Deal in the 1930s, the federal government became more

centrally involved in the US political economy. In the process, it institutionalized racial segregation in the public as well as the private sphere, most forcefully through the workings of three federal agencies: the Home Owners' Loan Corporation, which was created in 1933 to shield homeowners from foreclosure; the Federal Housing Administration (FHA), established in 1934 to make homeownership more widely available; and the Veterans Administration (VA), which implemented the GI Bill of Rights, enacted in 1944 to support the reintegration of war veterans into civilian life.

All three agencies created lending programs that insured private mortgages for up to 90 percent of a loan's value, as long as the issuing bank conformed to certain federally mandated criteria, such as small down payments and long amortization periods. The government also stated that the loans could only be used for the purchase of new single-family homes built on large lots with wide setbacks, thereby channeling home investment away from city centers where room for new construction was limited and the housing stock was dominated by row houses, apartment buildings, and multipurpose structures.

In addition, federal rules required an evaluation of the creditworthiness of borrowers, one that took into account their purported effect on the stability of neighborhoods. Adopting practices already established in the real estate industry, the government prohibited loans to "inharmonious racial or nationality groups." This prohibition was sporadically applied to other groups, but always to blacks. The FHA underwriting manual stated that "if a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes." To this end, the FHA insisted on the use of racially restrictive covenants, a policy that also applied to VA loans.

Both lending programs required neighborhoods to be assessed. For this purpose they relied on "residential security maps" developed by the Home Owners' Loan Corporation. These maps color-coded urban neighborhoods according to their stability and suitability for federally insured loans. Green indicated full eligibility, yellow signaled caution, and red meant ineligibility. Invariably, black neighborhoods were coded red. In this way, federal policy institutionalized the practice of "redlining" throughout the nation, channeling home investment away from cities and from all black neighborhoods for decades to come.

Owing to the privations of the Great Depression and the exigencies of World War II, these provisions had little effect on the spatial organization of urban areas through the 1930s and 1940s. From 1950 to 1970, however, they undergirded a massively racialized reorganization of urban geography: whites took advantage of federal subsidies to flee central cities for cheaper and newer homes in booming suburbs as masses of southern blacks entered the cities to occupy the homes and neighborhoods they left behind. Since the racially changing cities were cut off from mortgage lending and other investments by public policy and private practice, the vacated homes were purchased mainly by white entrepreneurs, who then leased or "sold" them to blacks on usurious terms.

Rather than being offered standard mortgages, black home buyers were forced into exploitive land installment contracts and rent-to-own schemes. Such agreements required them to make inflated monthly payments over time in expectation of receiving title to the home when the contract ended. In the interim, the seller held title to the property and could evict buyers for missed or incomplete payments. Since the earnings of African Americans remained tenuous due to rampant labor-market discrimination during the 1950s and 1960s, missed payments were hardly unusual. Not only was such discrimination perfectly legal, it also was supported by New Deal legislation that permitted segregated unions with separate labor contracts for blacks and whites.

Black neighborhoods were explicitly targeted for predatory lending.

Even those African Americans fortunate enough to complete a contract successfully had little chance of building substantial home equity. Due to institutionalized discrimination in the real estate and banking industries, once a neighborhood began to turn black it was redlined and cut off from future investment, leading to sagging demand, lagging property values, and a deteriorating housing stock. With access to home equity blocked, black families found it extremely difficult to build wealth through most of the twentieth century.

In essence, the structural organization of lending and housing markets in the postwar era mechanically produced low rates of black homeownership and low values for the few homes that

African Americans did manage to acquire. At the end of the 1980s, the rate of homeownership for blacks was only 42 percent and the mean home value was just $131,000, whereas for whites the respective figures were 68 percent and $215,000. In light of these data, it is unsurprising that average black wealth in 1989 constituted just 18 percent of average white wealth, even though the average black household income by then had risen to 62 percent of the average white income.

Financial targeting

Although a series of civil rights laws was enacted between 1964 and 1977 to end legal segregation and ban open discrimination in markets, new structures of racial exploitation quickly arose to take their place. A regime of mass incarceration put a growing percentage of black men behind bars. Criminal records reduced employment rates and earnings, exacerbating the suppression of black income and savings. At the same time, a wholesale restructuring of mortgage lending not only suppressed black wealth but actively served to destroy it. However, while the transformation of mortgage lending in the 1930s and 1940s was led by the government, during the 1980s and 1990s it was led by the private sector.

The trigger for this transformation was the invention and spread of derivative investments known as collateralized debt obligations, and in particular mortgage-backed securities. Before the 1980s, most mortgages were directly issued by consumer banks to individual borrowers. After the 1980s the mortgage industry moved from direct to indirect lending, working through independent brokers that originated mortgages and then sold them to investment banks for repackaging into securities. The new financial instruments were created by bundling multiple mortgages together to generate an aggregate stream of mortgage payments, which was then used to underwrite bonds. This process is called securitization.

Before the advent of mortgage-backed securities, the number of mortgages that could be issued at any time was limited by the quantity of deposits that banks had on hand to lend. Now, the potential number of mortgages was limited only by what the market for these securities could bear. During the 1990s and early 2000s, that market seemed limitless. Although government-sponsored enterprises such as Fannie Mae and Freddie Mac also issued these securities, the boom was led by private entities, which dominated the market.

In order to diversify risks, mortgages of varying quality were organized into different "tranches," with the highest-quality loans being placed in the top tranches and lower-quality loans in the bottom tranches. This practice created a strong demand for risky subprime mortgages in order to create balanced risk portfolios. Subprime loans carried higher interest rates to compensate lenders for the greater risk they were presumably incurring. These loans were also more profitable for intermediaries whose remuneration depended on the gap between the prevailing interest rate and that paid by borrowers, known as the yield spread.

Once a portfolio of mortgages was constructed to back a saleable security, the soundness of the bonds was assessed by a small number of credit-rating agencies. They had an incentive to give bonds a high rating, since they were paid fees by the firms that wished to sell them. Over time the demand for mortgage-backed securities grew to a point where risky, low-quality loans comprised an ever-larger share of the tranches, and rating agencies came under increasing pressure to overlook this fact. Both they and the financial firms had a strong interest in branding the bonds as "investment-grade," a designation required by pension funds and many institutional investors.

In this context, black borrowers in black neighborhoods were no longer prospects to be avoided; they had become attractive targets for exploitation. After decades of economic exclusion, African Americans were perceived as financially unsophisticated, gullible, and easy marks for peddlers of deceptive financial products. In addition, civil rights advances and the economic boom of the 1990s had increased the rate of black homeownership from 42 percent in 1990 to 49 percent in 2005. Black migration from the rural South ceased around 1970, leaving black households in cities to age in place, and by the early twenty-first century many had come to own their homes outright, creating a significant cache of wealth.

Owing to black residential segregation, of course, this tempting pool of housing wealth was concentrated in specific neighborhoods, making the marketing of exploitive lending products easy and efficient. Black neighborhoods were explicitly targeted by mortgage brokers, retail banks, and other financial organizations for "predatory lending." The predation entailed steering low-income borrowers into home loans they could not really afford, and selling affluent borrowers, who otherwise qualified for prime loans, on more costly and

risky subprime loans. These lending products not only carried higher yield spreads; they had other exploitive features such as adjustable interest rates (to ensure that if market rates rose the yield spread would be maintained) and prepayment penalties to discourage early repayment and preserve the cash flows backing the securities.

By the mid-1990s, up to 35 percent of those receiving subprime loans were actually eligible for prime loans; near the height of the housing boom in 2006, that share had risen to more than 60 percent. African Americans were conspicuously overrepresented among the recipients of these loan products and were more likely to be using them to extract equity rather than purchase a new home. The targeting of black neighborhoods for predatory lending came to be known as "reverse redlining." It became the characteristic mechanism for extracting wealth from black communities in the early twenty-first century.

Black neighborhoods were blanketed with billboards and posters offering to turn their homes into ready cash. Black zip codes were saturated with bulk mail offering loans with no down payments and low teaser rates. Telephone exchanges linked to black neighborhoods (the first three digits after the area code) were deluged with recorded and personal calls offering to help customers "build wealth." Black business owners were paid to turn client lists over to mortgage brokers, and black clergy were induced to vouch for their lending services in return for contributions.

Federal policy institutionalized the practice of "redlining" throughout the nation.

As a result of this racialized targeting, the degree of black segregation in 2000 emerged as the strongest single predictor of the number and rate of home foreclosures across metropolitan areas between 2006 and 2008. Its effect was twice that of the next closest predictors (the jobless rate and average credit rating). Although some assert that attempts to boost minority homeownership under the Community Reinvestment Act (CRA) helped to increase the risk of foreclosure, the share of loans made by CRA-covered lenders had no effect in predicting the number or rate of foreclosures.

Bias in Baltimore

Baltimore is among the nation's most segregated metropolitan areas, with a long history of discrimination. We conducted a detailed analysis of mortgages sold to blacks and whites in Baltimore from 2000 to 2008, which confirmed the predatory nature of the lending to blacks and quantified the costs to the city's black community. Black borrowers were systematically steered into higher-cost loans, with monthly payments that were 5.3 percent higher than those of similarly qualified whites after taking into account a host of background characteristics. As a result, the average black homeowner spent $550 more per year in mortgage payments, which would accumulate to more than $16,000 if the loan went to term.

Black borrowers were also 50 percent more likely to be channeled into high-risk loans. Because of their higher costs and risks, they were 70 percent more likely to end up in foreclosure. As of 2008, 215 black borrowers in the city had already forfeited $2.4 million in wealth through completed foreclosures.

With two colleagues, we conducted a content analysis of a random sample of depositions filed in four lawsuits alleging discrimination against US financial institutions, including those directly involved in lending to Baltimore's black community. A total of some 220 sworn depositions were analyzed and classified independently by two investigators, and 76 percent were judged to provide clear evidence of targeted discrimination against black borrowers and/or black neighborhoods, as the following quotations indicate:

> [The firm] discriminated against minority loan applicants by not offering them their better or newer products which had lower fixed interest rates and fees.
>
> Elderly African American customers were thought to be particularly vulnerable and were frequently targeted for subprime loans with high interest rates.
>
> It was the practice . . . where I worked to target African Americans for subprime loans. It was generally assumed that African American customers were less sophisticated and intelligent and could be manipulated more easily into a subprime loan with expensive terms than white customers.

Vulnerable Hispanics

Although black borrowers and neighborhoods were the first to be targeted for predatory lending, as the housing boom continued Hispanics were increasingly victimized as well, especially in suburban areas of the "sand states" of Arizona,

California, Florida, and Nevada. The longstanding black-white divide in housing meant that Hispanics living in and around historically black areas also became victims of subprime lending. Many historically black areas—South Los Angeles, North Las Vegas, Chicago's South Suburbs, Central Orlando, South Mountain in Phoenix, the South Bronx—were predominantly Latino by 2008.

Hispanics were also vulnerable because they had a younger age structure (yielding a higher rate of household formation) and more young children (creating a demand for newer suburban housing). They were socially connected to other immigrants in the United States who were themselves in housing distress and unable to help. Many had relatives abroad who depended on remittances, placing a greater strain on household income.

Many Hispanic households also contained one or more undocumented workers. Rising deportations during the Bush and Obama administrations accelerated foreclosures by removing these key sources of household income needed to keep up with mortgage payments. Between 2004 and 2013, some 23 percent of Latino homeowners had lost their homes to foreclosure, compared with 19 percent of blacks, 11 percent of Asians, and 9 percent of non-Hispanic whites.

THE HARDEST HIT

The end result of this predatory lending to blacks and Hispanics was a pronounced boom and bust cycle for wealth. From 1983 to 2007, the wealth of both groups rose as home prices inflated and the risks of predatory lending were obscured. Mean black family wealth rose from $67,000 to $95,000 between 1983 and 1998. After a brief pause, black wealth then increased very markedly, peaking at $156,000 in 2007 on the eve of the Great Recession. But owing to the excessive costs and risks imposed on blacks because of predatory lending, and a lack of non-housing investments, when the housing bubble burst their apparent gains in wealth evaporated. Black wealth fell to a nadir of $102,000 in 2013, marginally above where it had been in 2001. Although black wealth recovered somewhat by 2016, it still remained below the level achieved back in 2007.

The ups and downs of Hispanic wealth were even more extreme. Hispanic families in 1983 had only $63,000 in mean net wealth in 1983, some $4,000 below that of blacks. By 1998, however, the figure had risen to $129,000, about $34,000 above mean black wealth. After declining to $120,000 in 2001 in the wake of the dot-com recession, it rocketed to $216,000 in 2007 before plummeting to $111,000 in 2013. As with blacks, Hispanic wealth recovered somewhat by 2016, but remained well below its earlier peak.

As of 2016, mean white wealth was 6.6 times that of blacks and 4.8 times that of Hispanics. In contrast, average white household income was only 1.5 and 1.3 times greater than that of blacks and Hispanics. From 1983 to 2016, the absolute size of the average wealth gap for blacks rose from $257,000 to $780,0000, while that for Hispanics grew from $261,000 to $728,000, as both groups fell further behind whites.

In the course of the Great Recession, already fragile black and Hispanic middle-class households lost huge amounts of wealth, which had often been painstakingly accumulated over many decades. As a consequence, both groups now have diminished resources as they face a political context that is increasingly hostile to civil rights guarantees in principle and civil rights enforcement in practice. Wall Street's interest in mortgage-backed securities is reviving and financiers are moving to create new collateralized debt obligations from car loans, payday advances, credit-card debt, student loans, and other financial products often sold on exploitive terms. Residential segregation and the predatory lending it facilitates thus remain at the core of America's system of racial stratification, and there is little hope of protection from Donald Trump's administration.

Although Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 in an effort to curtail the excesses that brought on the Great Recession, its provisions are now being rolled back under Trump. Organizations such as the Center for Responsible Lending and the National Fair Housing Alliance combat predatory lending and discriminatory real estate practices, but the reach and resources of these nonprofits do not match the financial industry's. Moreover, they are getting less help from federal authorities than ever. Emblematic of the current climate is Housing and Urban Development Secretary Ben Carson's decision to remove language from his department's mission statement referring to "inclusive communities" that are "free from discrimination." ■

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