THE SAMUEL DUBOIS COOK CENTER ON SOCIAL EQUITY

Hank & Billye Suber Aaron Young Scholars Summer Research Institute

3rd Year Cohort

Research Papers

Summer 2019

From Morsels to Crumbs: What's Left for Black America in the Wake of The Great Recession

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Abstract

The Great Recession resulted in the largest net decrease in Black wealth. This paper contends that the circumstances that permitted the decrease arose when regulations on the banking industry were repealed. Research indicates that financial institutions in the U.S. are biased against African Americans and intentionally participate in predatory practices that target them, these practices are amplified by their deregulation strategies. Based on an examination of the literature, a full reinstatement of policies that historically provided stability to the U.S. economy as a whole, are particularly beneficial to African Americans who are more susceptible to the effects of economic downturns.

Introduction

The economic downturn that occurred between 2007 and 2009, dubbed "The Great Recession," resulted in an increase in unemployment, decreased spending, losses in both retirement and home equity (Hurd 22). Whites lost 11.6% of their wealth, however because housing accounts for 92% of Black wealth, when the housing market crashed during The Great Recession, it resulted in an unprecedented decrease in Black wealth holdings amounting to a loss of 18.9% (Tippett et al. 4; Burd-Sharps and Rasch 1, 12).

To combat this decrease in wealth, an Act was created in 2010 entitled The Dodd-Frank policy designed to stimulate economic recovery following the downturn. This act had a positive impact on white homeowners who began to show immediate signs of recovery resulting in a zero net loss in median household wealth between 2009-2011 (Burd-Sharps and Rasch 10). However, the Dodd-Frank Act has had no impact on the recovery of Black wealth.

While whites recovered their losses in wealth, Black wealth continued to decline, even in the midst of federal policies enacted to remediate the effects of The Great Recession. This decline in wealth was not only related to home-equity, but it also impacted non-home-equity wealth as well (Burd-Sharps and Rasch 10). One in five African Americans own other assets including money invested in mutual funds, checking and retirement accounts, and business equity, all of which declined after The Great Recession (Tippett et al. 3). The Federal Government is at the core of the deterioration of Black wealth, impeding its recovery, by refusing to design policies that positively affect African American wealth.

Thesis Statement

- The deregulation of banks led to the Great Recession which resulted in the largest net decrease in Black wealth holdings. Tightening regulations on the banking industry will reduce the possibility of economic downturn, which disproportionately impacts African American households.

Research Questions

This papers' guiding research questions are as follows:

- How did the deregulation of banks impact Black household wealth during and after the 2007- 2009 recession?
- If policies are put into place to regulate banks, how might these policies positively impact wealth acquisition for African Americans?

Terminology

The following terms are integral to understanding this paper: wealth is defined as the sum total value of one's assets subtracted from their debts. Recession is defined as a period of temporary economic decline during which trade and industrial activity are reduced (Oxford). Homeownership, in the context of this paper, refers to the status of owning a home. This paper discusses homeownership because it accounts for 92% of African Americans wealth (Tippett et al. 4). Equity refers to the value of a home subtracted from the balance left on its mortgage. Subprime loan refers to a type of loan whose interest rates start low but quickly accrue interest over time. Consolidation, in the context of this paper, refers to the combining of multiple financial institutions into a single entity. For the purposes of this paper, Latino and non-white Hispanic are to be understood as synonymous and are used interchangeably.

Methodology

This paper refers to secondary source materials to establish a causal relationship between the deregulation of banks and The Great Recession.

Literature in the field includes research published by The American Civil Liberties Union (ACLU), The Center for Responsible Lending (CRL), and academic journals including the Wake

Forest Journal of Business and Intellectual Law. The ACLU is a national nonprofit that interacts with the U.S. courts to litigate civil rights cases, analyzed the impact of The Great Recession on the racial wealth gap. The CRL is a nonprofit research and policy group that focuses on lending discrimination, their study analyzed the impact of The Great Recession along racial lines. The Wake Forest Journal of Business and Intellectual Law traced the History of the Glass-Steagall Act and its interpretation. This paper utilizes articles from the aforementioned journals to inform the research about the adverse impact(s) economic downturns have on the African American community.

Because there are gaps in the literature, a causal relationship between the deregulation of banks and The Great Recession has not been established.

Limitations

Limitations in this paper can be found in the included policy proposals which do not address bias within the banking industry. Instead, the policy proposals in this paper address the consequences of the deregulation of banks. In short, this paper does not focus on bias within the banking industry, rather it focuses on deregulation as a means of amplifying preexisting biases.

Synthesis of Findings

My argument originates from one policy, The Glass Steagall Act of 1933, and how its repeal in 1999 led to The Great Recession. The first section of this paper will discuss the history of the Glass Steagall Act and how it's strict regulation on banks helped to stabilize the U.S. economy. The second section of the paper will explain the logic of banks and the practices that they employed leading up to The Great Recession. The third section of this paper will discuss The Great Recession and its disparate impacts across racial groups through the lens of housing in the areas of foreclosure and loan origination. Additionally, the second section will also discuss the lasting impact(s) of The Great Recession on the racial wealth gap. The final section of this paper will discuss policy solutions that aim to prevent future economic downturns of a similar magnitude to The Great Recession. The conclusion will endorse policy solutions that mitigate the possibility of banks to implore practices that jeopardize the economic stability of the U.S. and the global economy.

The Glass Steagall Act

While rife with deep racial wealth inequality, in the United States, homeownership has historically been touted as a driver of upward economic mobility. Following the Great Depression, President Franklin Delano Roosevelt's New Deal programs solidified homeownership as a method of acquiring wealth for white households through subsidization by the federal government (Baradaran 6). Without the support of the federal government at this critical point in U.S. history, the then-emerging white middle class would not exist. However, the same institutions that were responsible for lifting whites out of poverty did not extend the same privileges to the entire American populace (Baradaran 6). The federal government's refusal to subsidize housing for African Americans was accompanied by pernicious discriminatory lending policies to include: redlining, the race-based outright refusal of loans to individuals; and giving loans to African American homeowners with significantly higher interest rates when compared to their white counterparts (Baradaran 6).

Following the deleterious economic downturn of the 1930s, countless policies reigning in the big banks that caused the stock market to crash in years prior were established, one of which was the Glass-Steagall Act. The Glass Steagall Act of 1933 “included provisions that were designed to stabilize the U.S. financial system by separating commercial banks from the capital markets and by prohibiting nonbanks from accepting deposits” (Wilmarth 443). In doing so, the Glass-Steagall Act “helped to maintain the stability of the banking industry and capital markets” from WWII through the 1970s (Wilmarth 445). However, the approval of limited exceptions to Glass-Steagall’s structural prohibitions during the 1980s opened the door to further deregulation.

Prior to its repeal in 1999, The Glass Steagall Act was then undermined in two critical ways (Mahon). First, “banks received permission to convert their consumer and commercial loans into asset-backed securities through the process of securitization” e.g. banks were allowed to pool and turn home and auto loans into stock options (Wilmarth 446). Second, “banks gained authority to become dealers in over-the-counter derivatives” enabling the unsupervised exchange of debt in capital markets (Wilmarth). Additionally, nonbank financial institutions were allowed to fund their operations by substituting assets e.g. government bonds for deposits (Wilmarth 445). The final phase of the push for deregulation by the big banks allowed them to expand both their operations interstate and “the scope of the federal ‘safety net’ for banks to cover ‘the entire financial services industry’ effectively using the public’s tax dollars to subsidize risky financial transactions subsequently transferring the brunt of the responsibility to the public (Wilmarth 448). While the Glass-Steagall act was effectively nullified prior to its repeal the “loopholes and exemptions rested on highly contestable legal interpretations and could have been reversed by either regulators or the courts” (Wilmarth 542). In short, the protections for consumers that were offered by the Glass Steagall Act could have been maintained, however because of poor legal oversight, the protections were ignored by lawmakers (Mahon).

Catalyst for The Great Recession

When Glass-Steagall protections for consumers were rolled back, the scope of the activities banks could engage in was expanded. For individual agents in the economy, this meant that banks could sell pieces of their (subprime) mortgages- which accrued interest at an accelerated rate- to other banks (Solman Paul and Adam Tooze). The banks were interested in procuring subprime mortgages because they believed that the subprime mortgages would be assets- as they appreciate in value over time because the interest paid on the loan increased over time. In short, banks were interested in giving consumers poor quality loans because they were speculated to be very profitable (Solman, Paul and Adam Tooze). This problem was amplified by the ability of non banks, like car dealerships and retail shops, to issue credit that was based on assets with inflated values (Wilmarth 445). For instance, car dealerships gained the ability to issue credit to prospective owners to purchase vehicles. The credit that was then issued, was backed by debt that was bought from bigger banks by the dealership. The debt that was used to back the credit issued by the car dealership could originate from a subprime loan or a government bond.

<u>The Great Recession</u>

In 2007, at the onset of The Great Recession, the housing market crashed. African American and non-white Hispanic homeowners were disproportionately affected because the rate at which they were given sub-prime loans was significantly higher- nearly two times- than their white counterparts (Carr et al. 5). Therefore, it is no surprise that when the housing market crashed, the combined rate at which African American and non-white Hispanic homeowners were foreclosed upon was approximately four times that of their white counterparts (Bocian et al. 7). Banks themselves argued that the rate at which African American and Hispanic borrowers were given subprime loans was due to a lack of financial literacy within those communities (Steil et al.). However, this omits that those communities which predominantly contain low-income borrowers had limited options in the first place. These limited options arose because banks were allowed to consolidate as a result of the removal of Glass-Steagall restrictions.

The solicitation of the terms of the subprime loans given to African Americans were invariably duplicitous. Banks would target zip codes with high concentrations of African Americans to meet the demand for debt from other industries (Steil et al.). Subprime loans for homes acquired by African Americans would be based upon inflated home values that were the direct result of conspiration between lenders, appraisers, and attorneys (Massey et al.). In short, the terms of the subprime loans that African Americans received were worse than their white counterparts.

The demand for debt by nonbank financial institutions, e.g. car dealerships, was the result of the removal of Glass-Steagall restrictions. nonbank financial institutions began to issue credit backed by subprime loans. These were the same loans that were systematically given to African American and Hispanic communities. When African Americans defaulted on the bad loans that were given to them, excluding household equity, this resulted in an unprecedented decrease in Black household wealth excluding home-equity of 40% (Burd-Sharps, Rasch 11). Moreover, including home equity, this resulted in a net decrease of nearly 20% (Burd-Sharps and Rasch 12). In both cases, African American wealth losses exceeded those of their white counterparts by nearly double.

Two years after the official end of The Great Recession in 2009, white homeowners' wealth returned to pre-recession levels. However, the wealth of other racial groups lagged behind in recovery. For every white dollar recovered, Asians recovered 89 cents, Hispanics recovered 12 cents, and African Americans recovered 7 cents (Tippett et al. 17). In the absence of banking regulatory policy, by 2031, median African American wealth will be $98,000 lower than it would have been without The Great Recession (Burd-Sharps and Rasch 3).

Policy Solutions

Researchers have explored several ways to proceed forward in the wake of The Great Recession. Some solutions entail a "restoration of Glass-Steagall-Style structural reforms" that reduce the pervasiveness of "nonbanks from offering deposit substitutes" and "[re]establish a strict separation between FDIC-insured banks and the capital markets" (Wilmarth 548). Additional solutions call for creating credit options for low-income borrowers and removing the incentives set by the secondary mortgage markets to give prospective homeowners subprime loans (Burd-Sharps and Rasch 25-26). The intended outcome of these policy proposals is to restructure the financial sector to “maintain the stability of the banking industry and capital markets” into the future (Wilmarth 445).

The reinstatement of the Glass-Steagall act will both create credit options for low-income borrowers and prevent the incentives created by the secondary mortgage market which creates pressure on banks to predate upon the African American community. The reinstatement of the Glass Steagall Act will undue the consolidation of banks, which creates limited options for predominantly low income, African American borrowers. The reversal of the consolidation of banks will also cease the public’s subsidization of inherently risky financial transactions. Additionally, a full reinstatement will prevent nonbanks from issuing credit that is backed by debt acquired by big banks. Creating credit options for these low-income, predominantly African American borrowers will provide an alternative avenue to acquiring wealth through homeownership.

While these policies will create credit options for low income borrowers, they do not address the ability of financial institutions to discriminate against African American borrowers by giving them higher interest rates relative to their white counterparts. Overall, as a result of these policies, African Americans will have greater access to credit which will allow them to acquire wealth through homeownership. However, even with greater access to homeownership, credit for African American borrowers still come at a premium relative to their white counterparts.

Conclusion

While The Great Recession caused widespread damage to the U.S. economy, African Americans during and after the downturn felt and continue to feel its impact more intimately than their white counterparts. If comprehensive bank reforms are not implemented, approximately one decade from now African American wealth will be $98,000 lower than it would've been without The Great Recession (Burd-Sharps and Rasch 3). Researchers have proposed ways to restore and secure economic stability for the U.S. economy, the most radical of which entails the “restoration of Glass-Steagall style reforms” (Wilmarth 548). However, only a full restoration of the Glass-Steagall act will yield the same stability that existed from WWII to 1970. A full restoration of the Glass-Steagall Act will create credit options for low-income borrowers by undoing the consolidation of banks, remove incentives created by nonbanks for financial institutions to predate upon the African American community, and cease the public’s subsidization of private sector profiteering. Future research will reflect the dynastic qualities of the new economic era in the context of the ‘inheritance economy’.

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