MARCH 2018

FORCED TO WALK A DANGEROUS LINE

THE CAUSES AND CONSEQUENCES OF DEBT IN BLACK COMMUNITIES

PROSPERITY NOW

FORCED TO WALK A DANGEROUS LINE: THE CAUSES AND CONSEQUENCES OF DEBT IN BLACK COMMUNITIES

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March 2018

ACKNOWLEDGEMENTS

The authors are grateful to the diverse team of people who made this paper possible. Felipe Barroso and Emma Polson analyzed national survey data for the infographics. Nick Canfield, Austin Carrico, Michael Gawlick, Rachel Grant, Spectra Myers, Madelaine Santana, Daniel Woodhams, and the analytics team at the University of Missouri's Institute of Public Policy provided research assistance. Dedrick Asante-Muhammed, Emanuel Nieves, Caroline Ratcliffe, Joshua Sledge, Jeremie Greer, Kasey Wiedrich and Sarah Willis were advisors and reviewers. Sean Luechtefeld and Shehryar Nabi edited the paper. Sandiel Grant designed the layout and graphics.

This report was made possible with the generous support of MetLife Foundation.

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Introduction

Debt has become a fact of modern American life. According to the Federal Reserve Bank of New York, Americans collectively hold $13 trillion in debt,[1] and the median held by individual households is $60,000.[2] For many, this debt is "good debt", which enables homeownership or access to education that unlocks wealth-building opportunities and helps pull families through financial shortfalls.

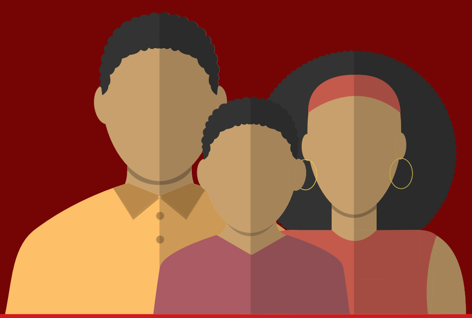
But for millions of others, debt weighs heavily on household balance sheets. Credit leveraged as "good debt" can quickly become difficult to manage. This "troublesome debt" arises as households experience emergencies, unexpected expenses or shortfalls in their cash flow. Having troublesome debt has long-term consequences such as wage garnishment, ongoing indebtedness and restricted access to low-cost, high-quality credit, insurance, jobs, housing and utilities.[3] More than one in four (27%) Black households report they sometimes miss or are late on their debt payments, compared to approximately one in seven (15%) White households.[4]

Social narratives often assume that problems with managing debt are the result of poor choices or individual behavior, but these are not the primary factors driving debt among African American households. For this community, trouble managing debt is a critical symptom of the country's growing racial wealth divide. Black households have substantially lower levels of wealth than White households across all income levels. In 2016, median net worth for White households was $171,000, compared to just $17,600 for Black households.[5] Low- and moderate-income (LMI) Black households (i.e., most Black Americans[6]) have particularly low levels of wealth. Low levels of wealth translates into less protection from the troublesome debt that accompanies a financial emergency, such as a job loss or long-term illness.

With these alarming statistics as our starting point, this paper reviews how the racial wealth divide makes debt particularly burdensome for LMI African American households, as well as how burdensome debt is further exacerbating the divide. We argue that the historical exclusion of Black Americans from wealth-building opportunities prohibit them from reaping strong returns on "good debt," while simultaneously exposing them to troublesome debt at disproportionately higher rates than their White counterparts. This challenge is amplified by ongoing racial bias in the debt relief options available to Black consumers today. Although these findings are troubling, we also argue that there are pathways to mitigate the negative impacts of debt on Black households. Because these pathways require us to re-engineer practices and address policies at all levels of government, this paper also recommends a series of interventions to ensure that debt isn't the death knell for Black household finances.

DEBT DISPARITIES

Though the proportion of Black and White Households with debt are similar, proportionally more Black Household experience difficulties with debt and bill payments. Troublesome debt is a symptom of the racial wealth divide and perpetuates discrepancies in wealth development.



27% OF BLACK HOUSEHOLDS HAVE BEEN **LATE** WITH DEBT PAYMENTS	**15%** OF WHITE HOUSEHOLDS HAVE BEEN **LATE** WITH DEBT PAYMENTS
60% FIND IT **SOMEWHAT** OR **VERY DIFFICULT** TO COVER BILLS	**48%** FIND IT **SOMEWHAT** OR **VERY DIFFICULT** TO COVER BILLS
40% REPORT **GOOD** OR **VERY GOOD** CREDITS	**65%** REPORT **GOOD** OR **VERY GOOD** CREDITS
77% OF BLACK HOUSEHOLDS HAVE **DEBT**	**78%** OF WHITE HOUSEHOLDS HAVE **DEBT**
MEDIAN DEBT **$30,800**	MEDIAN DEBT **$73,800**
MEDIAN NET WORTH **$17,600**	MEDIAN NET WORTH **$171,000**

SOURCES | 2016 Survey of Consumer Finance; 2015 National Financial Capability Study; 2017 U.S. Department of Commerce

Troublesome Debt and the Racial Wealth Divide: A Mutually Reinforcing Cycle

Troublesome debt and the racial wealth divide are mutually reinforcing one another. To break the cycle, we must address both the drivers of troublesome debt and the drivers of racial wealth inequality more broadly. This section outlines some of the ways debt is widening the racial wealth divide, as well as how the racial wealth divide is supercharging Black consumers' exposure to troublesome debt.

Historical Discrimination from Wealth-Building Opportunities

Debt among low- and moderate-income Black households is rooted in historical racism manifested through inequitable institutional policy and pervasive market forces. Historical discrimination in employment, homeownership and servicemember benefits have limited Black Americans' opportunities to become financially stable, achieve prosperity and accrue wealth that can be handed down to future generations.

DISPARATE EMPLOYMENT & WAGE ADVANCEMENT

A solid income from a stable job is an important element in building financial stability and wealth. The historical exclusion of Black workers from America's formal economy has barred their access to wealth-building jobs. Labor force discrimination is reflected in consistent lags in employment and wages between Black and White workers. With fewer employment opportunities and lower incomes, workplace discrimination has been one of the biggest drivers of the racial wealth divide.

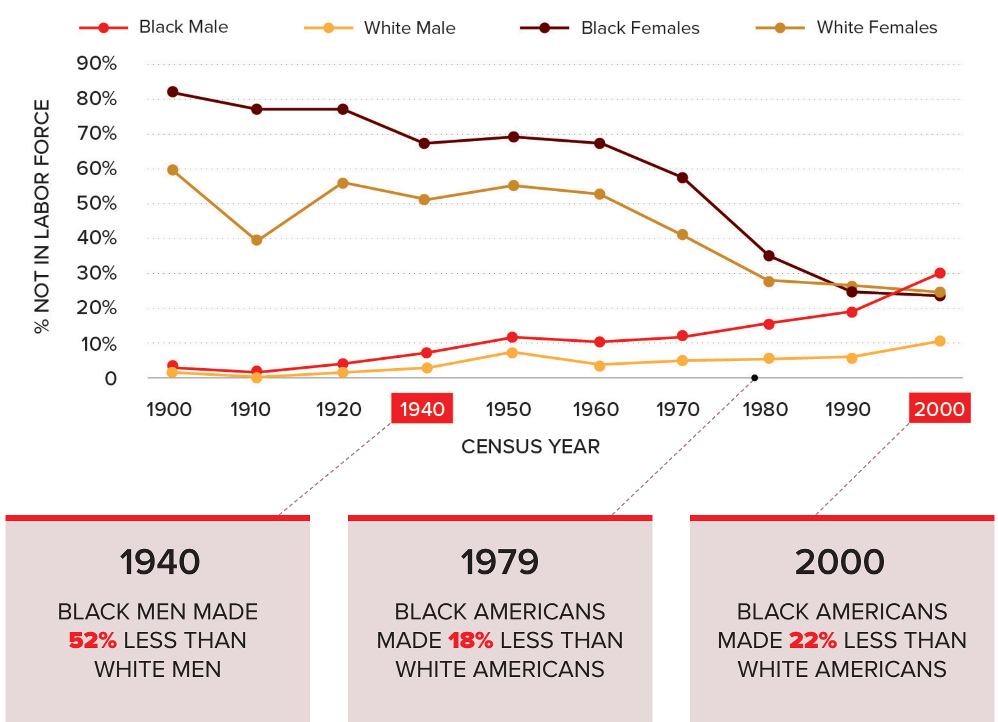
At the start of the 20th century, Black male workers engaged in the formal labor force at nearly the same rate as their White male counterparts.[7] This started to shift during the Great Depression, when employers began hiring White workers over Black workers and, in some cases, firing Black workers to replace them with White workers.[8] Black male workers' alienation from the formal labor economy continued in the decades following World War II, even though official rates of Black unemployment declined.

As with labor force participation, Black wages in the formal economy generally lagged behind those of White workers.[9] While the gap in wages closed significantly in the late 1960s and mid-1970s, there have been ebbs and flows ever since. Racial wage disparities widened in the 1980s, retracted in the 1990s and widened again in the early 2000s. The dampening effect on Black wages is widely attributed to the loss of public employment over the last generation. In the post-civil rights period, the public sector was Black America's largest employer and the most effective vehicle for Black mobility.[10] Black federal, state and municipal employees received greater work protections, better benefits and higher earnings than those in the private sector or who were self-employed. A larger share of Black public employees tended to be in the managerial and professional classes, as compared to those working in the private sector. Unfortunately, as public spending declined in the 1980s, so did Black employment in the public sector.[11]

Wage and employment discrimination remain pervasive today—especially among males.[12] As of 2000, Black males were twice as likely as their White counterparts to fall outside the regular labor force.[13] To be sure, Black men continued working, but did so increasingly in the "informal economy"—in occupations that pay wages in cash and offer few or no benefits, such as home and auto repair, hairstyling, driving unlicensed taxis, selling untaxed cigarettes and alcohol, or providing in-home health care.[14] In 2010, economists Kenneth Couch and Robert Fairlie affirmed that when business cycles weaken, Black workers are the "first fired."[15]

Employment Discrimination, 1900-2000

Labor Force Nonparticipation, Persons over Eighteen Years



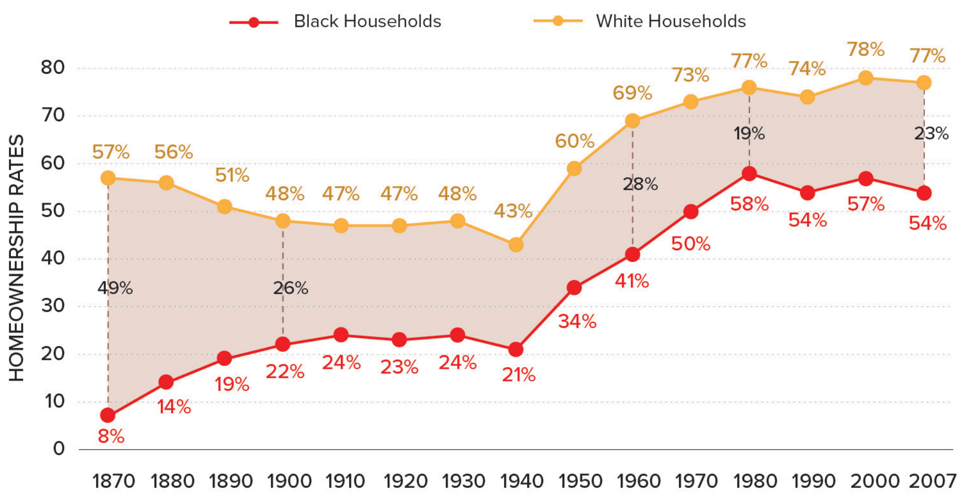
SOURCES | Michael B. Katz, *Why Don't American Cities Burn*; Sources: Amitab Chandra *Labor-Market Dropouts and the Racial Wage Gap: 1940-1990*; Valerie Wilson and William M. Rodgers, III, "*Black-White Wage Gaps Expand with Rising Wage Inequality*".

INEQUITABLE HOMEOWNERSHIP OPPORTUNITIES

Homeownership is the single most important determinant of a household's net worth. As savings rates have steadily declined in recent decades, U.S. households increasingly tap the equity in their homes to make ends meet.[16] Unfortunately, Black Americans have borne the brunt of state-sanctioned discrimination in housing and mortgage lending practices since the middle of the 19th century. Relatively few Black households have been able to leverage homeownership as an asset that protects a household from financial fluctuations and enables upward economic mobility.

As a first-order problem, relatively few Blacks Americans own homes compared to Whites Americans. In 1870, the Black owner-occupancy rate stood at just eight percent, compared to 56% for White owner-occupants.[17] Because this data was collected in the first Census to consider African Americans as free persons, the 49-point homeownership gap was not surprising. By 1910, the homeownership gap narrowed to 26 points, as Black owner-occupancy rates rose from eight percent to 24%. Unfortunately, the homeownership gap between White and Black households stubbornly persists and is only one point smaller today than it was over a century ago.[18] While Black homeownership expanded after World War II, those gains were outpaced by gains in White homeownership.[19] "Redlining," the collusion between government officials and lenders to deny mortgage loans for people of color in particular neighborhoods, was one of the major reasons for the persisting gap.[20]

Homeownership Gaps, 1870-2007



SOURCE | Collins and Margo, Race and Home Ownership from the Civil War to the Present

Even for Black households that purchased a home, discriminatory policies limited home values. Redlining not only hindered Black homeownership, it also kept Black homeowners out of neighborhoods with high home values. To further limit the value of Black homes, state and local tax assessors routinely over-assessed and under-appraised Black-owned properties.[21] Both practices actively stripped equity from Black-owned homes, further depressing the value of housing as an asset for Black families. Today, Black-owned homes are worth less than half as much at the median ($94,400) as those of White homeowners ($215,800).[22]

THE DISPROPORTIONATE BENEFITS OF THE GI BILL

The GI Bill is one of the greatest wealth-building opportunities in recent generations. Passed into law in 1944, the GI Bill provides veterans with low-cost loans for home mortgages or business ownership, as well as tuition assistance for postsecondary education. Although the GI Bill does not contain any discriminatory language or provisions, its actual implementation in the early years was delegated to the states with little federal oversight. As a result, Black servicemembers faced discrimination from racially biased administrators and lenders who refused to authorize or lend to them.[23] An often-cited example of this discrimination came from Mississippi, where just two of 3,229 loans made under the GI Bill in 1947 were made to Black servicemembers. [24] Denying the benefits of the GI Bill to Black veterans prevented them and their families from receiving the support they needed to attain the financial security afforded to White veterans. In other words, the GI Bill fostered a lasting boost in White wealth while doing very little to help African Americans achieve long-term economic mobility.

Unequal Returns on "Good Debt"

Credit products assumed to facilitate entry into the middle class—those considered "good debt"—can wind up making consumers' financial situations worse. This is especially true for Black consumers. An earlier section of this paper highlights how Black-owned homes tend to be under-appraised or over-assessed, or restricted to neighborhoods with low housing values. In turn, Black homeowners are deprived of the opportunity to build wealth through home equity.

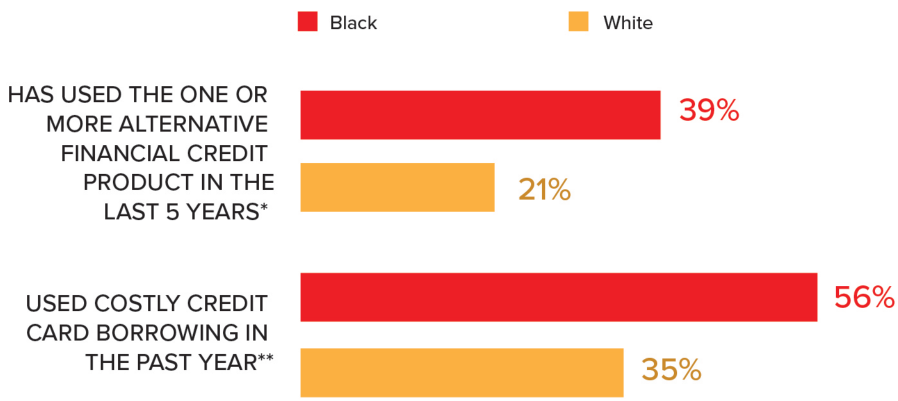
Student loan debt is another example of an area where "good debt" fails to yield equitable returns. Student loan debt has consistently been higher for Black households since at least the late 1980s, when Black students and other vulnerable populations started entering college in unprecedented numbers.[25] Today, 38% of Black adults have student loan debt, compared to only 22% of White adults.[26] This disparate impact has been especially felt by Black women graduates—the only category of student borrowers who owes more than they earn a year after receiving a degree.[27] The disproportionate number of Black students relying on loans and the relatively higher amounts they borrow translates into challenges with saving, compromised credit scores due to high debt-to-income ratios and delays in homeownership and the opportunity to build equity.[28] With fewer returns on the "good debt" that can be leveraged by White consumers, it's no surprise young Black Americans consistently report greater economic insecurity than their White counterparts.[29]

Unfortunately, the challenges African Americans face when it comes to student loan debt don't stop there. Recent reports illustrate how families of color do not reap the same benefits as Whites in higher education.[30] In 2014, a typical Black family whose head of household has a college degree had only $37,600 in wealth while a similar White family had $181,220.[31] While some argue that this stems from poor choices made by individuals and communities, the facts tell a different story: even when college educated, African Americans' ability to climb the economic ladder and avoid troublesome debt is often hindered by the fact that education doesn't afford the same return on investment for all students.[32]

The Devastating Impact of Troublesome Debt

Historical discrimination and insufficient returns on "good debt" set the context for why so many Black households end up in troublesome debt. Building upon that history are today's economic challenges and disparate burdens placed on lower-income Black households. The current economy shifts substantial financial risk onto households, making it especially hard for those with low- and moderate-incomes to get ahead. Because most African American households are relegated to the lower income and asset quintiles, they disproportionately experience the devastating consequences of costly credit and debt (i.e., with credit cards, sub-prime credit, criminal justice debt and collections actions) compared to their White counterparts.

Disparate Exposure to Costly Credit



SOURCE | 2015 National Financial Capability Study

**Includes non-bank borrowing methods such as pawn shops, short-term payday loans, rent-to-own stores and auto-title loans*

***Includes experiences that are likely to generate sizeable interest or fees such as paying only minimum payment, carrying a balance or taking a cash advance.*

THE "GHETTO TAX" AND A PLASTIC SAFETY NET

Poorer consumers (who are disproportionately Black) are typically compelled to spend larger portions of their salaries on food and other necessities compared to wealthier consumers.[33] In recent years, research has documented how "poverty penalty" trends—those illustrating the high costs associated with being poor—have only gotten worse, eating into the disposable income of working- and middle-class African Americans. For example, a 2006 Brookings Institution study noted that a "ghetto tax" is often levied surreptitiously on Americans living in poorer neighborhoods for auto insurance, car loans, banking services and appliances.[34] The nature of the problem is essentially a "racial flat tax"—even though prices for goods and services may rise equally for all consumers, working- and middle-class African Americans are hit the hardest because those increases represent a larger proportion of Black households' already-low income and wealth.

For households with access to credit cards, debt becomes the way to pay for basic living expenses.[35] Deemed the "plastic safety net" by Demos, its 2012 National Survey on Credit Card Debt of Low-and Middle-Income Households revealed that 40% of low- and moderate-income respondents used credit cards to pay for basic living expenses like rent, mortgage payments, groceries, utilities or insurance. While African American and White respondents reported using credit cards in these ways at similar levels of spending, African American respondents were more likely to experience the negative effects of doing so. They experienced higher rates of calls from collections agencies, settlement agreements with credit card companies, repossession of vehicles and eviction from homes.[36]

THE RISE OF TOXIC CREDIT

Beginning in the 1970s, a growing movement to increase access to credit for historically disfranchised populations emerged.[37] At approximately the same time, a multi-decade counter-movement began to minimize government oversight of the financial sector.[38] This toxic alchemy—the expansion of credit on one hand and the erosion of consumer protections on the other—has been a recipe for intergenerational predation and abuse. Many of the products considered predatory or high-cost credit today were established at the time, from subprime mortgage lending and payday loans to overdraft fees and other profit-generating streams for the banking and financial industries.

Prevailing evidence suggests that Black Americans are targets for sub-prime mortgage loans.[39] A recent study by economists Patrick Bayer, Fernando Ferreira and Stephen Ross found that even after controlling for general risk considerations, such as credit score, loan-to-value ratio, subordinate liens and debt-to-income ratios, Black borrowers are 105% more likely to be given a high-cost mortgage than White borrowers.[40] They noted that, "High-risk [sub-prime] lenders are not only more likely to provide high cost loans overall, but are especially likely to do so for African American and Hispanic borrowers."[41]

Additionally, subprime lending happens in large part through alternative financial products such as payday loans. Usage of alternative financial services is positively correlated with income volatility.[42] Major fluctuations in income, expenses or both is the result of an economy with unstable labor market earnings and insufficient funding for public assistance programs, and can exacerbate high or rising costs of basic living expenses such as food, health care, housing and transportation.[43] Households that experience income and expense volatility often have gaps in their household budgets, making them more susceptible to taking out high-interest loans, forgoing basic necessities and increased emotional stress. While families of all races experience this volatility, Black households are more likely than White households to struggle financially after financial shocks.[44] In turn, Black households are also disproportionately more likely to utilize forms of subprime credit options, such as payday lenders, rent-to-own outlets and pawn shops.[45]

THE GROWTH OF CRIMINAL JUSTICE DEBT

Governments have been a hidden force in exacerbating debt burdens in recent decades through the criminal justice system. Since the 1970s, local governments have turned to nontax sources, like public fines and fees, to increase revenue.[46] This included adding fines for mundane violations like parking tickets, expired vehicle registrations or violations of open container laws, as well as fees imposed on incarcerated people for their "use" of the criminal justice system, such as the costs of incarceration, probation and court proceedings.[47] When citizens fail to pay these fines and fees, governments put these debts into collections. In 2015, an estimated 10 million people owed over $50 billion in criminal justice debt.[48]

These revenue-based fees and fines disproportionately affect working-class and poor Black Americans. A sample of local governments in nine thousand cities demonstrated that fines and fees contribute to the revenue for roughly 86% of cities and are higher in locales with larger Black populations.[49] Cities that have larger Black populations generate $12-$19 more in revenue from fees and fines per person, compared to those with smaller shares of Black citizens.[50] By contrast, municipalities that are overwhelmingly White and non-Hispanic "do not exhibit as much excessive fining." The best-known recent example of the fining of Black America is in Ferguson, Missouri, whose majority Black population (69%) is overseen by a White majority in positions of political power and criminal justice leadership. During the Great Recession, the city manager pressured courts and the police department to increase the cost and collection of fines and fees to close the municipal budget gap created by declining sales and property tax receipts.[51]

THE DISCRIMINATORY CONSEQUENCES OF COLLECTIONS

Beyond experiencing more trouble within specific credit and debt categories, Black Americans are also more exposed to collections actions.[52] Recently, the Consumer Financial Protection Bureau reported that 44% of non-White respondents were contacted about debt in collections, compared to 29% of White respondents.[53] Besides collections calls—which can range from a minor nuisance to intense harassment, court-ordered judgements related to collections are disproportionately levied on Black consumers. Investigative journalists from ProPublica found that court judgments on debt collections cases in St. Louis, Chicago and Newark were twice as high in majority-Black neighborhoods as in majority-White neighborhoods.[54] These discriminatory actions result in more African Americans dealing with the consequences of collections actions, including the additional costs of court expenses, judgement payments and wage garnishments, not to mention economic and psychological stress.

A Challenge Exacerbated by Biased Debt Relief Options

Adding a final layer of complexity to why troublesome debt is more prevalent among African American households is a system of biased debt relief options. The remainder of this section explores evidence of racial bias in fraudulent debt relief schemes and the bankruptcy system—further perpetuating the cycles of debt and wealth inequality.

FRAUDULENT SCHEMES

In a 2011 survey, the Federal Trade Commission found that African Americans are more than three times as likely as White Americans to experience debt-related fraud (4.4% compared to 1.3%).[55] This includes frauds that promise credit repair, debt relief, mortgage relief and advance fee loans. These schemes prey on consumers' sense of financial responsibility and self-sufficiency, which are common narratives expressed by low- and moderate-income households, [56] and cost consumers money that otherwise could have been used to manage debt or other expenses.

COSTLIER BANKRUPTCIES

Even systems of relief designed to alleviate debt are costlier for indebted Black consumers compared to their White counterparts. Rather than giving cash-strapped Black households a fresh start, punitive bankruptcy legislation passed in 2005 makes it more difficult to file under Chapter 7 bankruptcy protection. Chapter 7 bankruptcies wipe out consumers' debt after a certain amount of time, making it less costly than Chapter 13 bankruptcies. Chapter 13 bankruptcies have higher long-term creditor payments and court and attorney fees. Unfortunately, according to legal scholars Jean Braucher, Dov Cohen and Robert Lawless, Black filers are twice as likely as White filers with a similar financial profile to be shunted by their attorneys into Chapter 13 bankruptcies. [57]

Pathways to Support African Americans with Troublesome Debt

Troublesome debt as experienced by Black households is rooted in a long history of wealth inequality. Its interrelatedness with other economic and social inequities in today's economy makes it complex to address. Fortunately, there are potential pathways to mitigate tthe negative impacts of debt on Black households, particularly those with low to moderate incomes: highly targeted, community-based programs; near-term policy actions by state and local governments; and long-term federal policy changes.

Targeted Community-Based Programs

As a first step to help those currently struggling to manage debt, trusted community-based organizations that are already established in low- and moderate-income Black communities should design programs with people's unique debt management needs and preferences in mind.

Currently, there are several products and services available that could be helpful, but there are gaps in their application for managing debt or their availability within Black communities that prevent them from being effective. For example, financial coaching has been found to have some positive effects on credit and debt outcomes, but take-up and retention are low, and it is unclear how different models of coaching attend to different facets of debt management.[58] Safe and affordable debt consolidation loans could also help individuals escape some of their costlier debt, but whether there are lenders available to fill the need remains to be seen. Finally, opportunities to lessen the burden on those struggling to manage debt have yet to be systematically explored and considered. More inquiry into community-based programs to offer immediate support and the piloting of new approaches would be welcome developments.

Near-Term State and Local Government Actions

State and local governments can act to help counter some of the factors perpetuating troublesome debt in their communities. For example, locales could establish Offices of Financial Empowerment (i.e. New York City and San Francisco) to support community financial education and capability building on issues of credit and debt management.[59] State and local governments could also change their fine and fee structures so that they are not disproportionately burdensome on the most economically vulnerable households,[60] and take part in the Federal Trade Commission's efforts to combat fraud in African American communities.[61]

Long-Term Federal Policy Changes

Finally, the most critical, but likely most meaningful, changes that need to happen are at the federal policy level. Federal reforms that protect families against wealth-stripping practices, provide more income opportunities for historically disadvantaged populations and create access to lifelong wealth-building opportunities are needed.[62] For example, the Earned Income Tax Credit (EITC) could be structured to incentivize savings among lower-income families by including a rainy-day savings option as proposed in the bi-partisan Refund to Rainy Day Savings Act.[63] Government agencies can also do more to integrate financial capability services in areas that serve lower-income populations by offering workforce, housing and community health programs.[64] These policy ideas have long been championed by anti-poverty, fair labor and wealth-building advocates, but as the negative impacts of policy inaction become more and more apparent, we see an opportunity to renew the call for change.

Conclusion

Disparities with troublesome debt is both a symptom and perpetuator of racial wealth inequity. Its roots in historical and ongoing economic discrimination makes it hard to fix. Addressing the challenges facing Black consumers will require targeted action at the community, state and federal levels. With focused attention, innovative solutions and political will, there is hope that together, we can stem the tide of mutually reinforcing debt and wealth inequality.

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