



Written Testimony

of

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For the Roundtable Panel Hearing

**“Closing the Wealth Gap:
Empowering Minority-Owned Businesses to Reach Their Full Potential for
Growth and Job Creation”**

before the

Senate Committee on Small Business and Entrepreneurship

Wednesday, September 18, 2013
Russell Senate Office Building Room 428A

This testimony was prepared by Signe-Mary McKernan and Caroline Ratcliffe. The views expressed are those of the authors and should not be attributed to the Urban Institute, its trustees, or its funders.

Chair Landrieu, Ranking Member Risch, and members of the committee, we thank you for the opportunity to testify about closing the racial wealth gap.

When it comes to economic gaps between whites and families of color in the United States, income inequality tells only part of the story. Urban Institute research shows that the racial wealth gap is three times larger than the racial income gap.¹ This distinction is important because wealth is where economic opportunity lies.

Wealth isn't just money in the bank, it's insurance against tough times, tuition to get a better education and a better job, capital to build a small business, savings to retire on, and a springboard into the middle class.

Urban Institute analyses of wealth accumulation over the life cycle show that the racial wealth gap grows sharply with age. When people are in their 30s and 40s, whites have about 3.5 times more wealth than people of color. By the time people reach their early to mid-60s—near their peak wealth-building years—whites have about 7 times the wealth of people of color.

African American and Hispanic families are not on the same wealth-building path as white families. They are less likely to own homes and retirement accounts, so they miss out on these traditionally powerful wealth-building tools. African American and Hispanic families also start out behind. For example, they are five times less likely to receive a large gift or inheritance than a white family.² These are dollars that can be used for important investments, such as higher education, down payment on a home, or to invest in a small business.

Today's skewed federal subsidies exacerbate the disparity in wealth holdings and the racial wealth gap. The federal government spends billions of dollars annually to support wealth-building (via the mortgage interest deduction and preferential tax treatment of retirement savings). Because these subsidies go through the tax code, they primarily benefit high-income families, disproportionately leaving out African Americans and Hispanics who have lower income.

Reforming wealth-building policies so they benefit all families, and helping families enroll in automatic savings vehicles, will help improve wealth inequality and promote saving opportunities for all Americans.

Five specific suggestions to close the racial wealth gap are:

- 1. Make homeownership tax subsidies more progressive**

Homeownership has long been the primary saving mechanism for low- and middle-income families and can be a stepping stone to the middle class. Low-income families generally miss out on homeownership subsidies operating through the tax system. For example, more than 70 percent of the mortgage interest deduction benefits go to the top fifth of taxfilers (by income). Low-income families are further disadvantaged if those subsidies raise housing prices, especially in urban areas where land is scarce. A first-time homebuyers tax credit targeted to low-wealth families and strategies to reduce barriers to homeownership would help reduce the wealth gap.

¹ "Less Than Equal: Racial Disparities in Wealth Accumulation," by Signe-Mary McKernan, Caroline Ratcliffe, Eugene Steuerle, and Sisi Zhang, April 2013, available at <http://www.urban.org/publications/412802.html>.

² "Do Financial Support and Inheritance Contribute to the Racial Wealth Gap?" by Signe-Mary McKernan, Caroline Ratcliffe, Margaret Simms, and Sisi Zhang, September 2012, available at <http://www.urban.org/publications/412644.html>.

2. Promote retirement savings through automatic individual retirement accounts (IRAs) and expand the Saver's Credit

To help the nearly half of U.S. workers who do not have an employer-sponsored savings plan, enact federal legislation to create automatic IRAs and expand the Saver's Credit. Automatic IRAs could particularly help low-wage workers save for retirement, as they are less likely than higher-wage workers to have an employer-sponsored retirement plan. With this program, employers that do not offer a savings plan would use their payroll system to automatically deposit a portion of employees' earnings into an IRA. There is no cost to employers (beyond a small administrative fee, which is usually covered by a credit). Any employee who did not want to participate in the program would have to take steps to opt out. This is an important design feature, as automatic enrollment in 401(k) programs has been found to substantially increase 401(k) participation. Coupling automatic IRAs with an expansion of the Saver's Credit will help boost incentives for low-income families to save for retirement and increase their stock of assets available for retirement security.

3. Reauthorize the Assets for Independence program

The Assets for Independence program, established by the Assets for Independence Act (1998), is the largest source of funding for individual development accounts (IDAs) in the United States. IDAs are personal savings accounts targeted at low-income households that encourage them to save for specific investments (e.g., postsecondary educational advancement, a home, or a business) by matching earned income deposits and providing other program supports. Research finds that participating in an IDA program increases the likelihood an individual becomes a homeowner, starts or expands a business, or pursues postsecondary education.³ Further, joint Urban Institute research finds that foreclosure rates for IDA homebuyers were one-half to one-third the rate for other low-income homeowners in the same communities.⁴

4. Increase access to high-quality education for low-wealth families

Wealth disparities are passed from generation to generation. Higher wealth families can buy high-quality education by buying a home in a wealthy school district or sending their children to private schools. Large gifts and inheritances play a further role in perpetuating the racial wealth gap. As mentioned above, African American and Hispanic families are five times less likely to receive a large gift or inheritance than a white family.⁵ These are dollars that can be used for important investments, such as higher education, a home, or a small business. Public policies that subsidize education, for example, could enable families without sources of large gifts to go to college, boosting their earning capacity and, with it, their ability to accumulate wealth.

³ "Final Literature Review: Evaluation Design for the Next Phase Evaluation of the Assets for Independence Program," by Erica H. Zielewski, Caroline Ratcliffe, Signe-Mary McKernan, Lissa Johnson, and Michael Sherraden, May 2009, available at <http://www.urban.org/publications/412439.html>.

⁴ "Weathering the Storm: Have IDAs Helped Low-Income Homebuyers Avoid Foreclosure?" by Ida Racemacher, Kasey Wiedrich, Signe-Mary McKernan, Caroline Ratcliffe, and Megan Gallagher, April 2010, available at <http://www.urban.org/publications/412064.html>.

⁵ "Do Financial Support and Inheritance Contribute to the Racial Wealth Gap?" <http://www.urban.org/publications/412644.html>.

5. Improve access to micro and small business capital for low-wealth groups such as African Americans and Hispanics

Self-employment can patch income shortfalls, improve earnings growth, and diversify a family's wealth base beyond homeownership and retirement assets. But access to capital is more difficult for minorities, who are less likely to receive conventional small business loans or large gifts from family members that could finance small businesses.⁶ Small business loans are important for economic development, but because the definition of a small business is broad—cutoff of 500 employees—the loans are less likely to reach families of color. Microbusinesses are also important for self-sufficiency and wealth building.⁷

For more information:

Attached brief: “Less Than Equal: Racial Disparities in Wealth Accumulation” by Signe-Mary McKernan, Caroline Ratcliffe, Eugene Steuerle, and Sisi Zhang, April 2013, also available at <http://www.urban.org/publications/412802.html>

“The Racial Wealth Gap in America,” a three-minute whiteboard animation video, April 2013, available at <http://www.urban.org/changing-wealth-americans/video/>

“The Changing Wealth of Americans” on the Urban Institute web site, <http://www.urban.org/changing-wealth-americans/>

“Asset Building for Today's Stability and Tomorrow's Security” by Signe-Mary McKernan and Caroline Ratcliffe (<http://www.urban.org/url.cfm?ID=1001374>) and *Asset Building and Low-Income Families*, edited by Signe-Mary McKernan and Michael Sherraden (<http://www.urban.org/books/assetbuilding/index.cfm>)

⁶ “Competitive and Special Competitive Opportunity Gap Analysis of the 7(a) and 504 Programs,” by Kenneth Temkin, Brett Theodos, and Kerstin Gentsch, January 2008, available at <http://www.urban.org/publications/411596.html>.

⁷ “Small Business and Microenterprise as an Opportunity- and Asset-Building Strategy,” by Signe-Mary McKernan and Henry Chen, June 2005, available at <http://www.urban.org/publications/311188.html>.

Less Than Equal: Racial Disparities in Wealth Accumulation

Signe-Mary McKernan, Caroline Ratcliffe, Eugene Steuerle, and Sisi Zhang

When it comes to economic gaps between whites and communities of color in the United States, income inequality tells part of the story. But let's not forget about wealth. Wealth isn't just money in the bank, it's insurance against tough times, tuition to get a better education and a better job, savings to retire on, and a springboard into the middle class. In short, wealth translates into opportunity.

Policymakers often focus on income and overlook wealth,¹ but consider: the racial wealth gap is three times larger than the racial income gap. Such great wealth disparities help explain why many middle-income blacks and Hispanics haven't seen much improvement in their relative economic status and, in fact, are at greater risk of sliding backwards.

How Have Wealth Inequality and Income Inequality Changed Over Time?

Wealth is not just for the wealthy. The poor can have wealth too—and that wealth can accrue over time or provide collateral for borrowing, giving families a way to move up and out of poverty. A home or a car can offer benefits far beyond their cash value. And even a small amount of savings can help families avoid falling into a vicious cycle of debt when a job loss or financial emergency hits.

Wealth disparities have worsened over the past 30 years (figure 1). High-wealth families (the top 20 percent by net worth) saw their average wealth increase by nearly 120 percent between 1983 and 2010, while middle-wealth

families saw their average wealth go up by only 13 percent. The lowest-wealth families—those in the bottom 20 percent—saw their average wealth fall well below zero, meaning their average debts exceed their assets.

There is extraordinary wealth inequality between the races. In 2010, whites on average had six times the wealth of blacks and Hispanics (figure 2). So for every \$6.00 whites had in wealth, blacks and Hispanics had \$1.00 (or average wealth of \$632,000 versus \$103,000).²

The income gap, by comparison, is much smaller. In 2010, the average income for whites was twice that of blacks and Hispanics (\$89,000 versus \$46,000), meaning that for every \$2.00 whites earned, blacks and Hispanics earned \$1.00.

How have these two measures changed over time? Neither has improved, but while the income gap has stayed roughly the same, the wealth gap has grown. In 1983, the average wealth of whites was roughly five times that of black and Hispanics.

In inflation-adjusted 2010 dollars, as opposed to ratios, the gap is also growing—as would happen in any growing economy if the

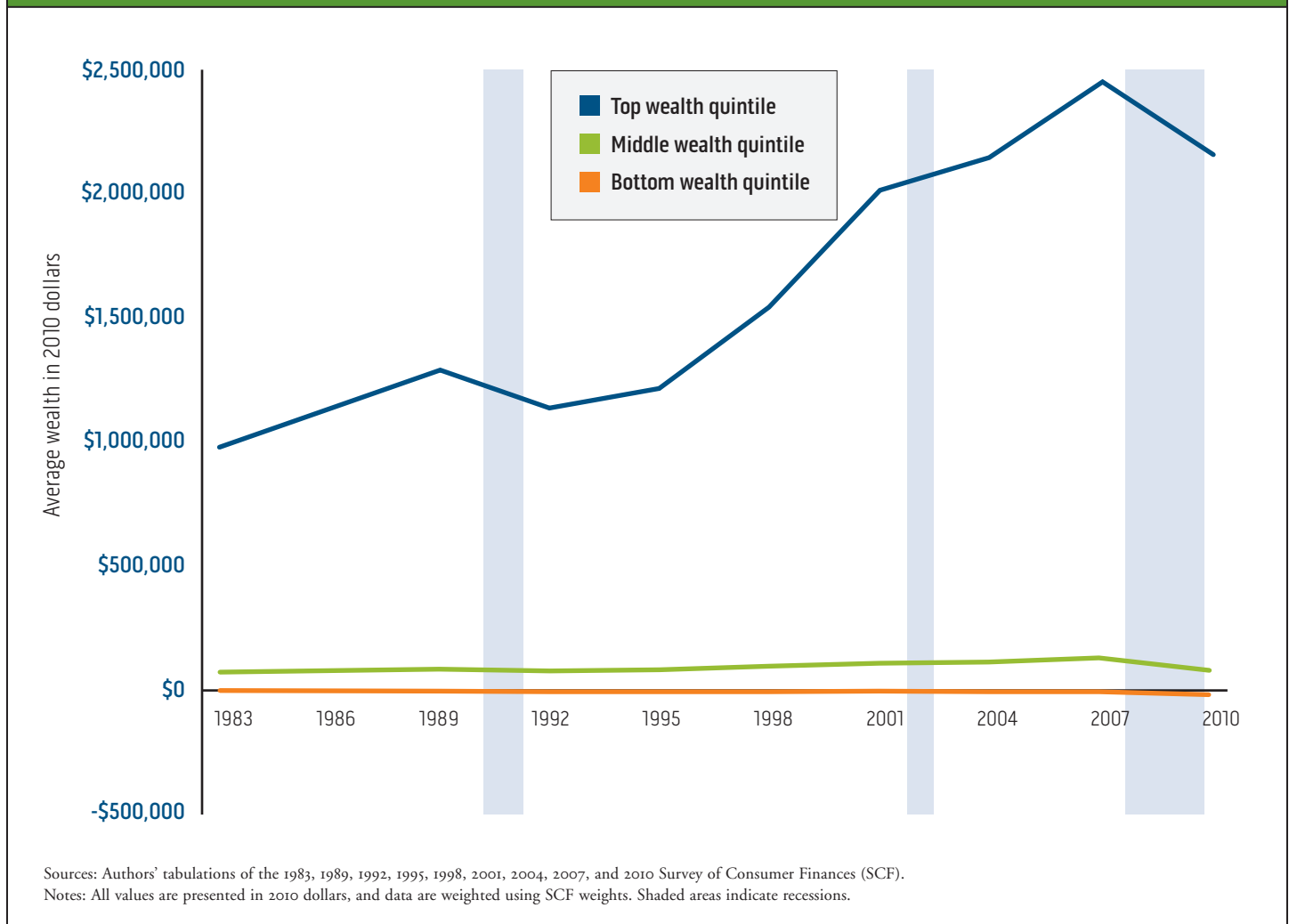
ratios remained constant, much less moved farther apart. The average wealth of white families was \$230,000 higher than the average wealth of black and Hispanic families in 1983 (figure 3). By 2010, the average wealth of white families was over a half-million dollars higher than the average wealth of black and Hispanic families (\$632,000 versus \$98,000 and \$110,000, respectively). If we look at the median family the wealth holdings are lower and the differences are smaller, but the trends are the same.³

How Does the Racial Wealth Gap Change Over the Life Cycle?

The racial wealth gap grows sharply with age. Early in wealth-building years (when adults are in their 30s), white families have 3.5 to 4 times the wealth of families of color. Over the life cycle these initial racial differences grow in both absolute and relative terms.

Whites on average are on a higher accumulation curve than blacks or Hispanics. Whites age 32–40 in 1983 had an average family wealth of \$184,000 (figure 4). In 2010, near their peak wealth-building years of age 59–67, average white family wealth had shot

Figure 1. Wealth Inequality among U.S. Families Is Increasing



up to \$1.1 million. In contrast, blacks age 32–40 in 1983 saw their average family wealth rise more slowly, from \$54,000 to \$161,000 by 2010. Meanwhile, average family wealth for Hispanics increased from \$46,000 in 1983 to \$226,000 in 2010. In other words, whites in this cohort started with about three and a half times more wealth than blacks in their 30s but had seven times more wealth in their 60s. Compared with Hispanics, whites started with four times more wealth in their 30s but had nearly five times more wealth three decades later.⁴

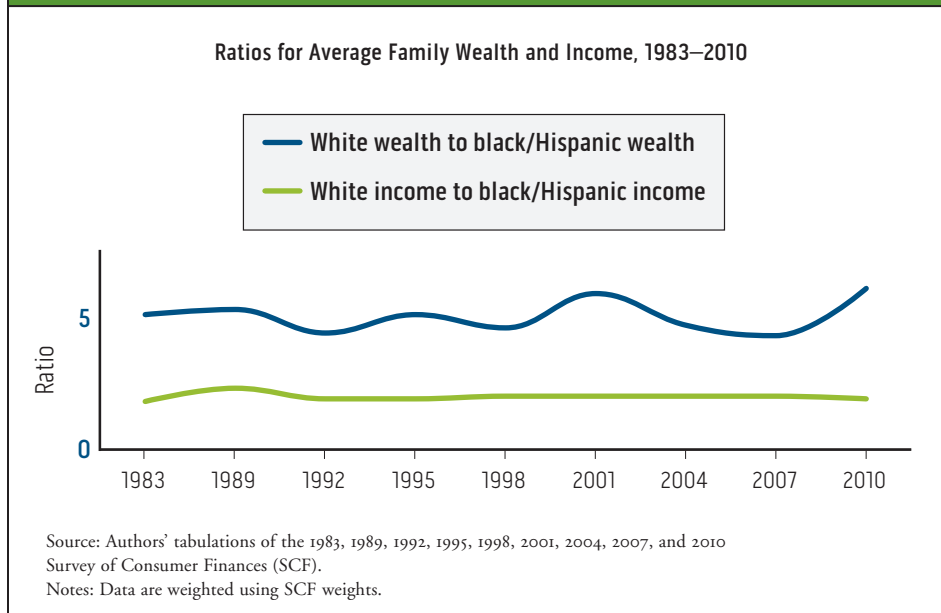
Blacks especially, but also Hispanics, are not on the same compound growth path. Particularly important, these families of color are less likely to own homes and have retirement accounts than whites, so they miss out on the automatic behavioral component of these traditionally powerful wealth-building vehicles. In 2010, fewer than half of black and Hispanic families owned homes, while three-quarters of white families did.

How Did the Great Recession Affect Wealth, and Who Lost the Most?

While the Great Recession didn't cause the wealth disparities between whites and minorities, it did exacerbate them. The 2007–09 recession brought about sharp declines in the wealth of white, black, and Hispanic families alike, but Hispanics experienced the largest decline. Lower home values account for much of Hispanics' wealth loss, while retirement accounts are where blacks were hit hardest.

Between 2007 and 2010, Hispanic families saw their wealth cut by over 40 percent,

Figure 2. The Racial Wealth Gap Is Three Times Greater Than the Racial Income Gap



and black families saw their wealth fall by 31 percent (figure 5). By comparison, the wealth of white families fell by 11 percent.

Like a lot of young families, many Hispanic families bought homes just before the recession. Because they started with higher debt-to-asset values, the sharp decline in housing prices meant an even sharper cut in Hispanics' wealth.⁵ As a result, they were also more likely to end up underwater or with negative home equity. Between 2007 and 2010, Hispanics saw their home equity cut in half, compared with about a quarter for black and white families.

In contrast, black families lost the most in retirement assets, while white families experienced a slight increase. On average, blacks saw their retirement assets fall by 35 percent during the Great Recession, compared with a smaller (but still substantial) decline of 18 percent for Hispanic families. This finding is

Figure 3. The Racial Wealth Gap Is Not Improving

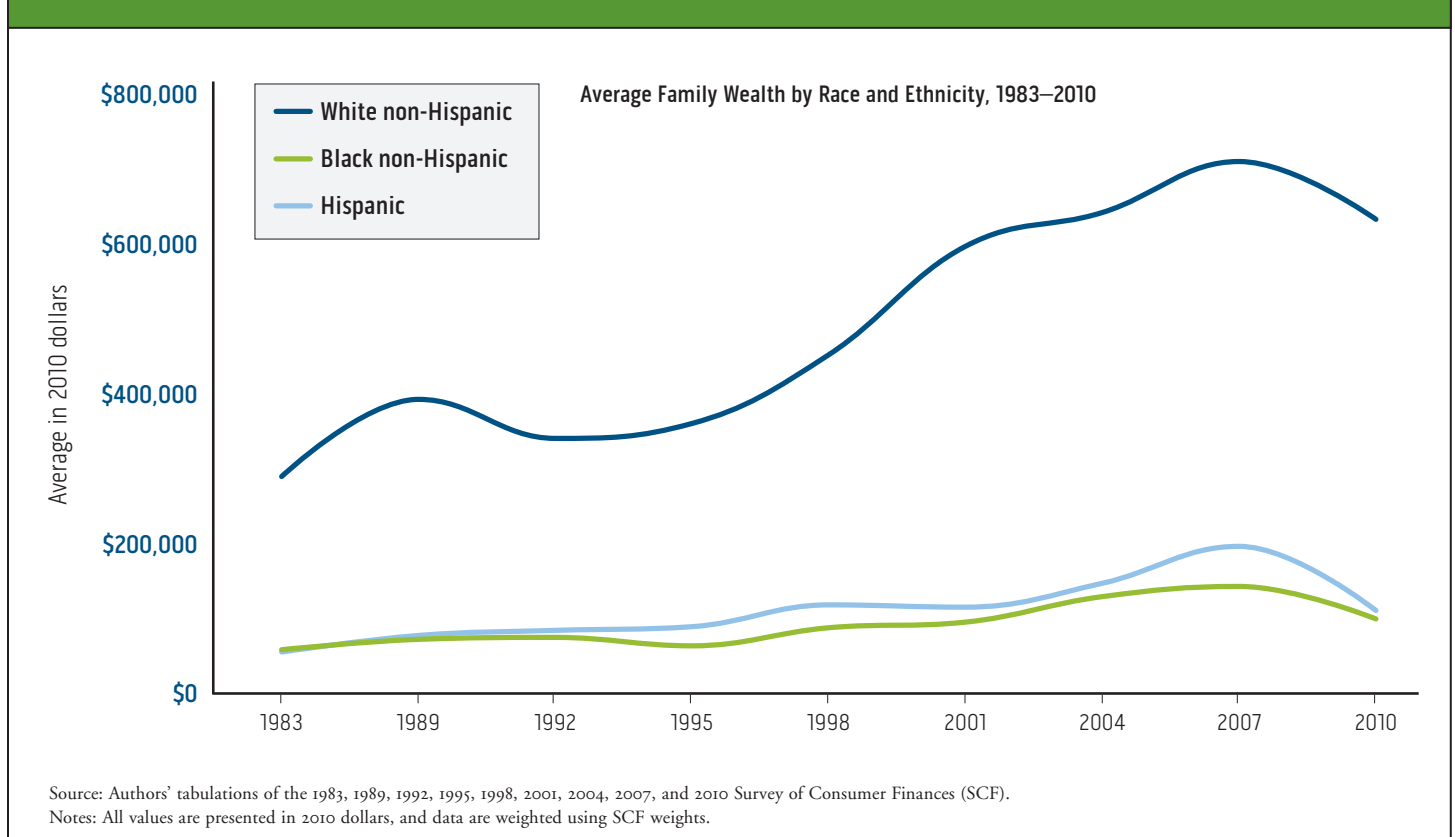
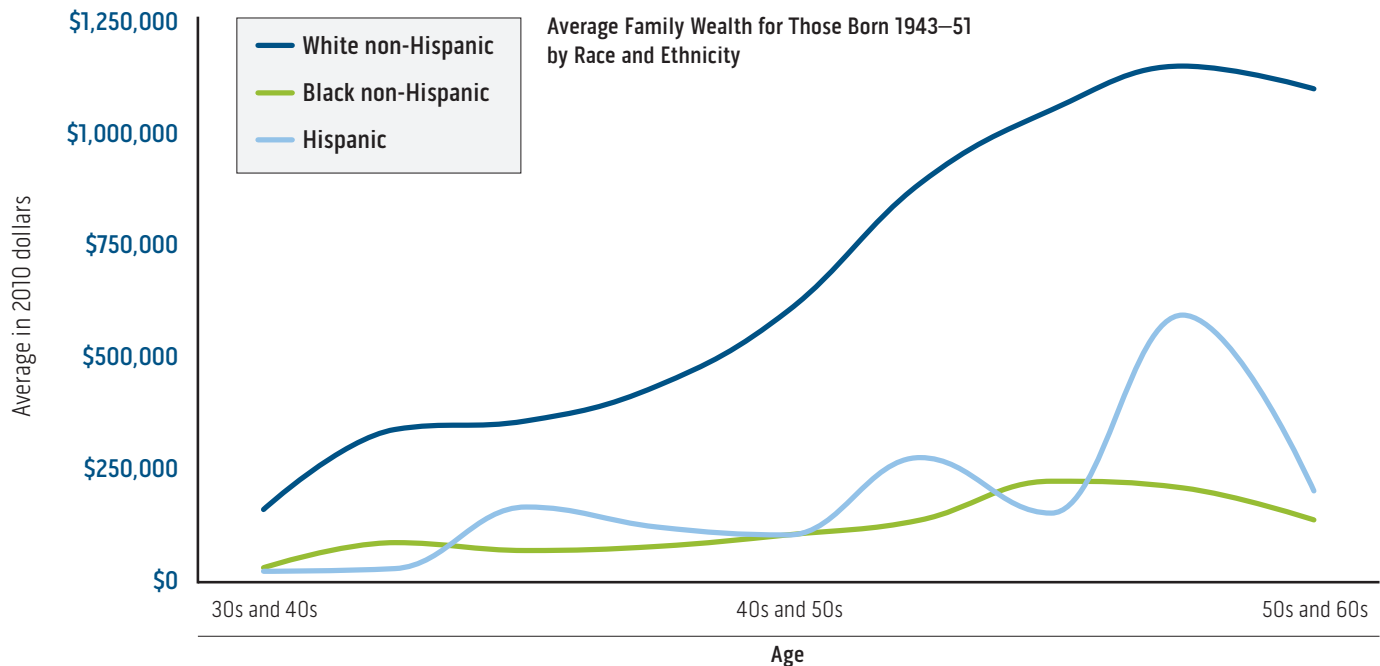


Figure 4. The Racial Wealth Gap Grows with Age



Source: Authors' tabulations of the 1983, 1989, 1992, 1995, 1998, 2001, 2004, 2007, and 2010 Survey of Consumer Finances (SCF).
Notes: All values are presented in 2010 dollars, and data are weighted using SCF weights.

consistent with research that suggests lower-income families are more likely to withdraw money from retirement savings after a job loss or other adverse event. The high rates of unemployment and other financial needs that took hold with the Great Recession appear to have led to larger declines in retirement savings for black families.

The stock market has essentially recovered since the recession. So, those families able to hold onto their retirement saving over longer periods (such as those who remain employed or have other assets to which they can turn) come out much better than those who sell when markets are low.

How Do We Fix This?

Families of color were disproportionately affected by the recession. However, the fact

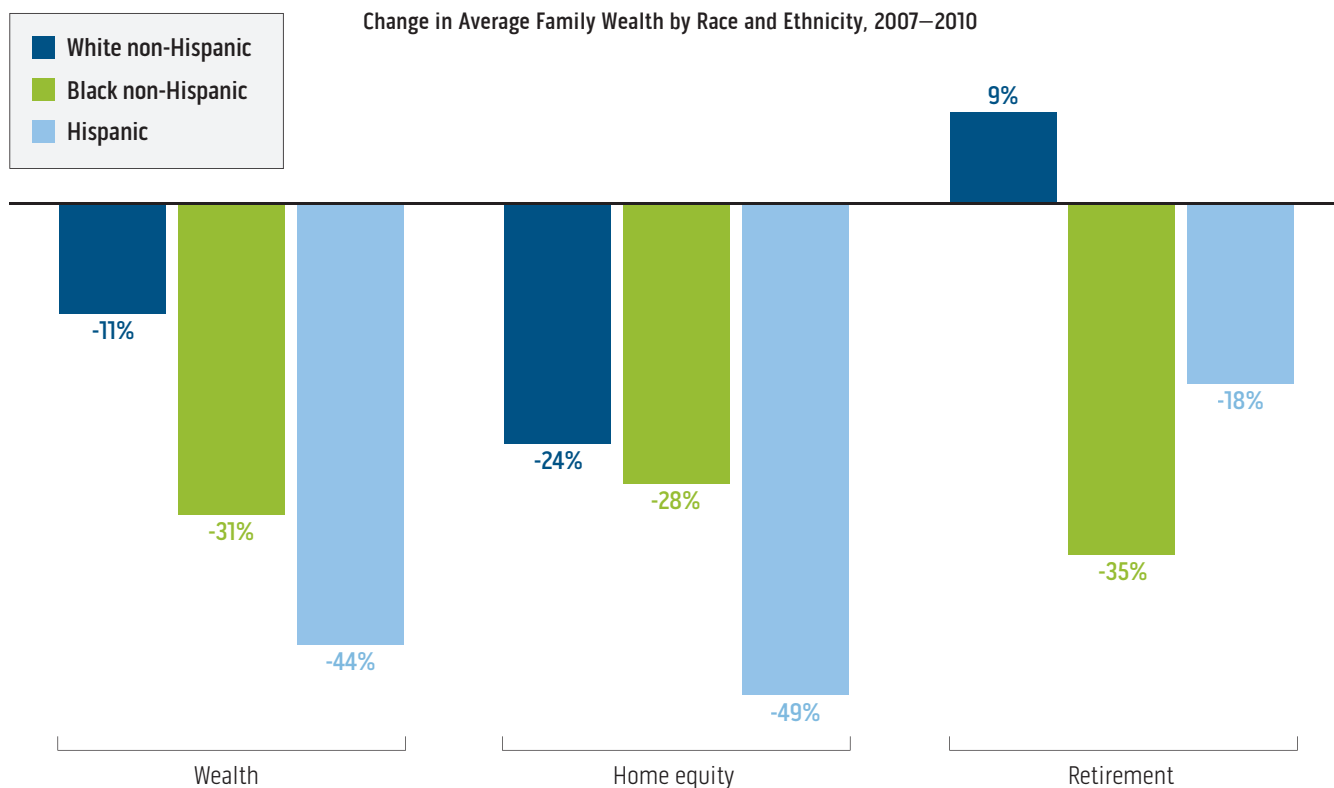
that they were not on good wealth-building paths before this financial crisis calls into question whether a whole range of policies (from tax to safety net) have actually been helping minorities get ahead in the modern economy. More fundamentally, it raises the question of whether social welfare policies pay too little attention to wealth building and mobility relative to consumption and income.

Because Hispanics and blacks are disproportionately low income, their wealth building is strongly affected by policies aimed at low-income families. Right now, safety net policies emphasize consumption: the Supplemental Nutrition Assistance Program and Temporary Assistance for Needy Families, for example, try to ensure that families have enough food to eat and other basic necessities. Many safety net programs even discourage

saving: families can become ineligible if they have a few thousand dollars in savings. Wealth-building policies, on the other hand, are delivered as tax subsidies for homeownership and retirement. Since families of color are less likely to be able to use these subsidies, they benefit little or not at all.

Most families save by paying off mortgages through homeownership and accumulating wealth in compounding retirement accounts. The automatic component of these assets—a monthly mortgage payment, regular deposits from earnings to savings—facilitate wealth building. Both methods are threatened by some disturbing current trends. The Great Recession led many low-income individuals to fear homeownership even when it became much cheaper on net than renting. Meanwhile mortgage credit has tightened—and

Figure 5. Hispanics Lost the Most Wealth during the Great Recession, While Blacks Fared Worse than Whites



Source: Authors' tabulations of the 2007 and 2010 Survey of Consumer Finances (SCF).
 Notes: Data are weighted using SCF weights.

might be further tightened with higher down payment rates—making credit most available in a bubble market and least in a bust market. For low-income families, especially families of color, this can exacerbate wealth inequality. Retirement savings, meanwhile, are threatened as a result of reduced employer contributions to pension plans and early employee withdrawals.

A common misconception is that poor or even low-income families cannot save. Research and evidence from savings programs shows they can. When we examined families

living below the poverty level, we found that over a decade more than 40 percent were able to increase their net worth and save enough to escape asset poverty—in other words, they had enough assets to live at the poverty level for three months without income (about \$3,000 for an individual and \$6,000 for a family of four).

The federal government spends hundreds of billions of dollars each year to support long-term asset development. But these asset-building subsidies primarily benefit high-income families, while low-income families

receive next to nothing. Reforming policies like the mortgage interest tax deduction so it benefits all families, and helping families enroll in automatic savings vehicles, will help improve wealth inequality and promote saving opportunities for all Americans. ■

Notes

1. Wealth is measured as total assets minus total liabilities/debt. Assets are the sum of financial assets (such as bank accounts, stocks, bonds, and 401ks/IRAs) and nonfinancial tangible assets (such as homes and real estate, businesses, and vehicles). Liabilities include both unsecured debt (such as credit card balances) and secured debt (such as mortgages and vehicle loans).
2. At the median the racial disparity is greater: whites have eight times the wealth of black and Hispanic families.
3. The median wealth of white families was \$80,000 higher than the median wealth of black and Hispanic families in 1983 (\$91,000 versus \$11,000 and \$10,000, respectively). By 2010, the median wealth of white families was over \$100,000 higher than the median wealth of black and Hispanic families (\$124,000 versus \$16,000 and \$15,000, respectively).
4. Population changes stemming from immigration could account for some of the wealth changes for Hispanics over time.
5. For example, if two households have homes worth \$100,000, and one owes \$70,000 on the mortgage and the other owes \$0, a 30 percent fall in home values implies a 100 percent drop in wealth for the first but only a 30 percent drop for the second.

For more information:
www.urban.org/changing-wealth-americans/

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