

# The Economics of Race: When Making It to the Middle Is Not Enough

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No project of this kind could be put together without the contribution of a number of people. Consumer Bankruptcy Project I, in 1981, and Consumer Bankruptcy Project II, in 1991, was the work of Professors Teresa A. Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, all of whom have continued their work into Consumer Bankruptcy Project III. In addition, Professors David Himmelstein, Bruce Markell, Michael Schill, Susan Wachter, and Steffie Woolhandler have shared in the design and development of the study. Professors Katherine Porter, John Pottow, and Deborah Thorne served as Project Director at different times, participating in the design of the study, and managing much of the data collection. Cathy Ellis and Ann de Ville provided extraordinary administrative support, and Alexander Warren designed and managed all the coding databases. We are collectively grateful for the contributions of each person.

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### *I. Introduction*

America depends on a strong middle class. Our economy prospers because middle class men and women get up every morning, put in a full day's work, and buy the goods and services that others have to offer. Our society defines itself by the values middle class families pass from generation to generation as they raise their children. Our democracy is rooted in the middle class's unwavering support for the rule of law and its willingness to abide by election outcomes. And the central solution to America's long-standing race problems has been the hope that as more racial minorities make it into the middle class, they will become a vital, engaged, committed part of a more diverse America.

The assumption that participation in the middle class will solve other economic and social problems facing racial minorities is strong. Most academic and popular discussions of economics and race focus exclusively on difficulties facing the chronically poor. The unspoken assumption of much of this work is that those who make it into the middle class economically and socially have made it—and there is no need to worry more about them. But some scholars are questioning that comfortable assumption, as a growing body of work examines how black families are having much greater difficulty accumulating wealth<sup>1</sup> and how tax codes or other seemingly neutral statutes systematically disadvantage black families.<sup>2</sup>

Data from the bankruptcy courts provide another lens into understanding the economic security—or insecurity—of Hispanic and black

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1. See generally DALTON CONLEY, *BEING BLACK, LIVING IN THE RED: RACE, WEALTH AND SOCIAL POLICY IN AMERICA* (Univ. of Cal. Press 1999); MELVIN L. OLIVER & THOMAS M. SHAPIRO, *BLACK WEALTH, WHITE WEALTH* (Routledge 1995); THOMAS M. SHAPIRO, *THE HIDDEN COST OF BEING AFRICAN AMERICAN: HOW WEALTH PERPETUATES INEQUALITY* (Oxford Univ. Press 2004).

2. See generally Dorothy Brown, *Pensions, Risk, and Race*, 61 WASH. & LEE L. REV. 1501 (2004).

families.<sup>3</sup> The bankruptcy courts are a place where middle class families in extraordinary financial distress seek relief. By analyzing data about the circumstances of bankrupt people of different racial groups, it is possible to develop another perspective in understanding the economic vulnerability of different racial groups in America.

The bankruptcy data reveal a disturbing story of Hispanic and black middle classes that are at greater risk for economic collapse than their white counterparts. Bankruptcy is a middle class phenomenon, a place of escape for those who have good jobs, established credit, accumulated assets, and suffered sharp reversals. Hispanic and black families are no exception; those in bankruptcy are disproportionately middle class when measured by education, occupation, and homeownership. Even so, Hispanic families are nearly twice as likely to file for bankruptcy as their white neighbors, and black families are three times more likely to file.

The bankruptcy data expose even greater racial disparities among homeowners—those who have achieved the most tangible sign of participation in the middle class. Hispanic and black homeowners face sharply increased risks of filing for bankruptcy as compared to their white counterparts. The immediate reasons that trigger a bankruptcy filing—job loss, medical problems, and family breakup—are remarkably similar among all three racial groups, which suggests that their financial problems are not isolated to a single, identifiable event but that a more widespread vulnerability of families of color is at work. These data may suggest more pervasive job difficulties and more trouble financing medical care. Perhaps more critically, the data presented here are consistent with other reports that suggest racial minorities are singled out for predatory loans and other subprime credit that drain billions of dollars out of the pockets of these families and push them into financial collapse.

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3. I would be extremely interested in pursuing questions about the comparative economic success of other racial groups in the United States, but the reported national data for other groups is quite sporadic. Moreover, with a sample of just under 2000 families in bankruptcy, the number of people from other racial groups is small enough to undermine reliable statistical comparisons among different population groups. With better government data reporting by racial groups and better funding and a larger database for independent research, such issues could be explored over time.

## II. Background—Bankruptcy and the Middle Class

When my coauthors and I began our first study of the families in bankruptcy back in the early 1980s,<sup>4</sup> we accepted the conventional wisdom that we would encounter lower class America—marginally employed or chronically unemployed people with little education and poor economic prospects.<sup>5</sup> After all, who else would go bankrupt? To be sure, the incomes of the families filing for bankruptcy were low. In 1981, about a quarter of the families were below the poverty line, and half were sandwiched between poverty and median incomes. By 2001, those numbers had dropped even further, with about half below the poverty line and another 40% sandwiched between poverty and median income in the United States.<sup>6</sup> When the households in bankruptcy are segregated by race, the most salient feature is their similarity.<sup>7</sup> Income differences among different groups filing for bankruptcy are modest; at the time of filing, most of the families have quite low incomes.

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4. For a detailed discussion of the research methods of the 1981 Consumer Bankruptcy Project, see TERESA SULLIVAN, ELIZABETH WARREN, & JAY LAWRENCE WESTBROOK, *AS WE FORGIVE OUR DEBTORS: BANKRUPTCY IN AMERICAN AND CONSUMER CREDIT*, app. at 342–54 (1989) [hereinafter SULLIVAN, WARREN, & WESTBROOK, *AS WE FORGIVE OUR DEBTORS*]. For a detailed discussion of the research methods of the 1991 Consumer Bankruptcy Project, see TERESA SULLIVAN, ELIZABETH WARREN, & JAY LAWRENCE WESTBROOK, *THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT*, app. at 263–87 (2000) [hereinafter SULLIVAN, WARREN, & WESTBROOK, *THE FRAGILE MIDDLE CLASS*]. For a detailed discussion of the research methods of the 2001 Consumer Bankruptcy Project, see ELIZABETH WARREN & AMELIA TYAGI, *THE TWO-INCOME TRAP: WHY MIDDLE CLASS MOTHERS AND FATHERS ARE GOING BROKE*, app. at 181–88 (2003).

5. For a first look at class issues related to income and occupation of the debtors in bankruptcy, see SULLIVAN, WARREN, & WESTBROOK, *AS WE FORGIVE OUR DEBTORS*, *supra* note 4, at 84–107. For a more detailed discussion of the presumptions of class status among bankrupt debtors and various approaches to pin down class, see SULLIVAN, WARREN, & WESTBROOK, *THE FRAGILE MIDDLE CLASS*, *supra* note 4, at 27–74. For more differentiated data about the class status of families in bankruptcy in 2001, see generally Elizabeth Warren, *Financial Collapse and Class Status: Who Goes Bankrupt*, 41 OSGOODE HALL L.J. 115 (2003).

6. Teresa Sullivan, Elizabeth Warren, & Jay Lawrence Westbrook, *Bankruptcy Stigma: Twenty Years of Evidence About How America Is Changing* (Working Paper, 2004) (on file with the Washington and Lee Law Review).

7. The difference between black and Hispanic families is not statistically significantly different, nor is the difference between Hispanic and white families. The difference between white and black families is significant at  $p > .05$ .

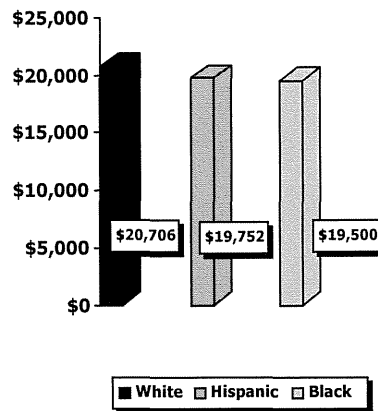


Figure 1: Median Income, by Race, 2001

Source: 2001 Consumer Bankruptcy Project

But class is more than a paycheck. Among the households filing for bankruptcy, about two out of every three have experienced an income interruption within two years before filing.<sup>8</sup> While that may mean that income in the year of the bankruptcy filing is at or near the poverty level, many of these families have been solidly middle class.<sup>9</sup> A laid-off computer programmer or a teacher who loses a job to district-wide cutbacks may be thrown into financial chaos, but she is not tossed out of the middle class the day the pink slip arrives. She remains solidly middle class, even as her income plummets and even if she ends up in bankruptcy. Moreover, the families who are most likely to be in a position to take advantage of bankruptcy are those who have built up credit over time, who have some assets worth protecting and some debts that have gotten out of control—conditions that describe the middle class more accurately than the chronically poor.

When the focus shifts from current annual income to enduring qualities such as education, occupation, and homeownership, the picture of families filing for bankruptcy is overwhelmingly middle class. More than 90% of those who filed for bankruptcy either attended college, had a job in the upper 80% of all occupations in the United States, or had bought a home.<sup>10</sup> Two-thirds of the families met two or more criteria, and almost 30% met all three.<sup>11</sup>

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8. Warren, *supra* note 5, at 127.

9. See *id.* at 144 (finding that 91.8% of those filing had at least one criterion identifying them as middle class).

10. *Id.* at 142–44.

11. *Id.* at 144.

Once again, the overall picture of families in bankruptcy matches the picture for different racial subgroups. When the same three criteria are united—attendance at college, good job, and homeownership—whites, Hispanics, and blacks filing for bankruptcy are statistically indistinguishable.<sup>12</sup> That is, about 91% to 93% of bankrupt white families, Hispanic families, and black families were solidly middle class.<sup>13</sup>

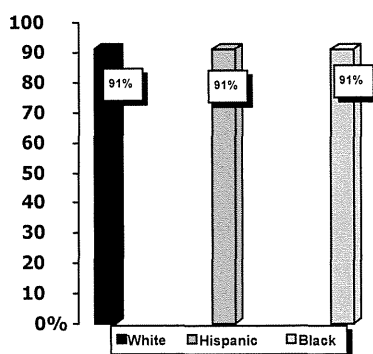


Figure 2: Indicia of Middle Class—Education, Jobs and Homeownership, by Race  
Source: 2001 Consumer Bankruptcy Project

12. The criteria used for the three racial subgroups was the same as for the undifferentiated bankruptcy sample: any attendance at college, any current or past purchase of a home, and any occupational prestige score in the upper 80% of all such scores. The aggregated report on occupation is based on occupational prestige scores for the whole population; the racially segregated reports are based on occupational prestige scores for each race. The aggregated cutoff is a score of thirty-one. Cutoff for the eightieth percentile for white workers is thirty-two, for black workers is twenty-nine, and for Hispanic workers is twenty-seven. For more discussion of occupational prestige scores and to see some examples of the scores, see *id.* at 131–35, and the General Social Survey 1972–2000 Cumulative Codebook, at <http://www.icpsr.umich.edu/GSS> (last visited Oct. 26, 2004) (on file with the Washington and Lee Law Review).

For a more detailed description of occupational prestige scores and their use, see Robert W. Hodge, *Occupational Prestige in the United States, 1925–1963*, 70 AM. J. OF SOC. 286, 286–302 (1964). For those unfamiliar with occupational prestige scores, it is possible to glean some understanding of the enterprise by scanning through the long lists of codes developed by the National Organization for Research at the University of Chicago. Food counter workers are near the bottom at fifteen, along with construction workers and peddlers at seventeen, maids at eighteen and produce packers at nineteen. In the middle range, a retail sales clerk is twenty-nine, a cashier is thirty-one, an air traffic controller is forty-three, and a billing clerk is forty-five. Near the top of the ladder, architects and aeronautical engineers are at seventy-one, outstripped by lawyers at seventy-six, college professors at seventy-eight, and physicians at eighty-four.

13. See Warren, *supra* note 5, at 144 (finding 91.8% of the bankruptcy sample to be middle class). Differences among the three groups are not statistically significant.

While the majority of these families were solidly middle class, the economic difficulties they faced were truly staggering. In 2001, the median family owed credit cards and other nonmortgage debts that equaled 15.6 months of its total income.<sup>14</sup> In other words, in addition to paying for rent or mortgage, utilities, food, health insurance, gas, car insurance, clothing, medical care, life insurance, furniture, and hundreds of other expenses, these families would have to find a way to set aside more than a year's worth of income to pay off past debts. And if they could not manage to pay off the debts, the interest alone was running at about a third of every paycheck. These families were in such a hole that dead flat broke looked like a huge improvement.

Once again, dividing the families by race produces much the same result. Median debt-to-income ratios for all debts (including mortgage debts) and for nonmortgage debts are similar for all three groups. Differences favor Hispanic and black filers, both of whom have somewhat more favorable (lower) debt-to-income ratios at the time they file for bankruptcy than whites.<sup>15</sup>

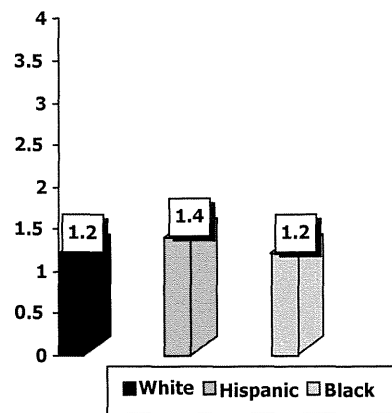


Figure 3: Median Nonmortgage Debt-to-Income Ratios, by Race

Source: 2001 Consumer Bankruptcy Project

14. 2001 Consumer Bankruptcy Project (data on file with the author).

15. The differences on nonmortgage debt-to-income ratios between blacks and Hispanics are not significant, but differences between whites and blacks and Hispanics as a group are significant at  $p > .01$ . Total debt-to-income ratios (including all mortgage debt) were 3.3, 3.1, and 2.8 for white, black, and Hispanic households. The white-black difference was significant, but the other combinations were not significantly different. The fact that 3.3 and 3.1 were significantly different but that 3.3 and 2.8 were not serves as a reminder that statistical significance can turn on both the size of the difference and the size of the sample group. There are fewer Hispanics in the bankruptcy sample, making statistical significance somewhat more difficult to achieve.

Determining the reasons that families file for bankruptcy is always challenging. The debtors themselves, however, have their own explanations for what caused their filings, identifying some of the triggers that helped push them into bankruptcy. Job problems head the list—layoffs, cut backs, salary cuts, failed businesses, and the like account for about two-thirds of the filings.<sup>16</sup> Medical problems are next on the list, accounting for about half of all filings.<sup>17</sup> Family breakups—divorce or death of a spouse—account for about one in five of the filings.<sup>18</sup>

Again, the patterns are similar across different racial groups. For whites, Hispanics, and blacks in bankruptcy, job difficulties are the leading cause for their filings. The financial fallout from medical problems is more prominent among white filers, but for all three groups, roughly half of all families identify medical problems as a reason for filing. Divorce and family breakup account for a steady 20% of the filings of all three groups. These three reasons—job difficulties, medical problems, and divorce—played a role in nine out of ten filings. The remaining bankruptcies were triggered by a mixture of reasons: some people were called up to overseas military duty, someone was hurt trying to foil a robbery, and some said they just spent more than they earned.

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16. Families citing a job problem or failure of a small business as a reason for filing, identifying a loss of income for two weeks or longer because of a job problem, or listing themselves as unemployed and looking for work constituted 68.3% of all filings. 2001 Consumer Bankruptcy Project, *supra* note 14.

17. Families citing medical problems as a reason for filing, listing unpaid medical debts in excess of \$1000, or identifying a loss of income for two weeks or longer because of medical problems account for 51.0% of all filings. *Id.*

18. Families citing divorce or family breakup as a reason for their bankruptcy filing comprised 17.9% of all filings. The number rises to 23.7% when including the death of a family member. *Id.*



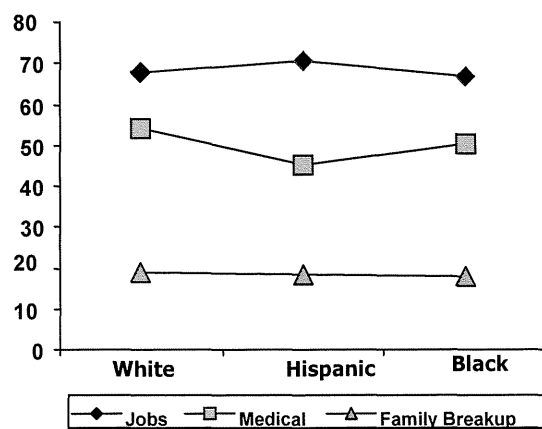


Figure 4: Reasons for Filing Bankruptcy, by Race  
Source: 2001 Consumer Bankruptcy Project

The overall picture is one of middle class families in trouble—white, Hispanic, and black alike. Those filing for bankruptcy reflect an increasingly volatile job market as outsourcing and downsizing become watchwords across the country. They also represent part of the growing wave of families who live without adequate insurance—either to pay medical bills or to cover their incomes when they lose time from work. And they are part of the divorced nation, struggling to support two households when their combined incomes barely keep one household afloat.

These difficulties also suggest deeper fractures in the economic stability of the middle class, difficulties that go beyond the specific reasons for filing and that cut across races. Increasing the family's costs of educating children from preschool through college has left families strapped, and the race to buy a home in a school district with decent public schools has caused millions of families to strap themselves to huge mortgages.<sup>19</sup> Hospitals that send patients home quicker and sicker and changing demographics have resulted in far more families caring for ill and elderly family members than a generation ago. By many measures, a growing number of those in the middle class can no longer afford to be middle class.

19. For a more detailed discussion of the economic burden on middle class families imposed by the educational system, see WARREN & TYAGI, *supra* note 4, at 32–40.

### III. A More Vulnerable Middle Class

White, Hispanic, and black families come to bankruptcy trying to cope with similar problems. But they do not come to bankruptcy in the same numbers. When bankruptcy-filing data are adjusted for the relative size of each group,<sup>20</sup> it becomes clear that the risk of bankruptcy is not shared equally among different racial groups. Hispanic families are nearly twice as likely to file for bankruptcy as their non-Hispanic white counterparts, and black families more than three times more likely to file than white families.

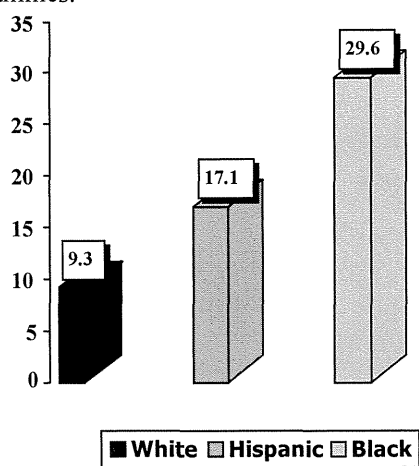


Figure 5: Bankruptcy Filings per Thousand Households, by Race, 2001

Source: 2001 Consumer Bankruptcy Project

It is worth pausing to enjoy the impact of this information. Those who file for bankruptcy are overwhelmingly middle class—regardless of race. But those who are Hispanic or black are far more likely to file bankruptcy. If the families had been poor, then the racial differences would tell us about the impact of poverty. But the people filing for bankruptcy have gone to college, found good jobs, and bought homes, which means that the bankruptcy

20. Four of the five cities in which the sampled bankruptcy courts sit—Chicago, Dallas, Nashville, and Philadelphia—have disproportionately large black populations relative to the United States population as a whole. By contrast, blacks are slightly under-represented in Los Angeles relative to the United States population. For all discussions of filing rates per thousand of the population, the data were adjusted to reflect the percentage of blacks in the United States population as a whole. Because the Census Bureau did not report similar metropolitan data for Hispanic families, it was not possible to make the same adjustment for Hispanic families. Data about Hispanic families are reported on a statewide basis, but these reports include multiple judicial districts, which cannot be used for the same localized adjustment.

filing data tell a tale about an American middle class in which financial risks are disproportionately borne by different subgroups.

These data reveal a deeply vulnerable middle class in which blacks who have gone to school and worked like their white counterparts are nonetheless more than three times more likely to find themselves in bankruptcy. The Hispanic middle class stands somewhere in the middle—nearly twice as likely as their non-Hispanic white counterparts to file for bankruptcy, but nearly half as likely as their non-Hispanic black counterparts.

The data also suggest that problems that drive families into bankruptcy—jobs, medical, and family breakups—are hitting some racial groups harder than others. The data show that among the filers, whites, Hispanics, and blacks are all likely to be in bankruptcy because of jobs losses in about the same proportions. But dividing the data by their proportions in the population demonstrates that Hispanics are filing for bankruptcy because of job problems about twice as often as non-Hispanic whites, and blacks are filing for job reasons at about three times the rate of their white counterparts. The same is true for medical problems and family breakups. Similar problems seem to drive families of all racial groups into bankruptcy, but those problems trigger far more bankruptcies among Hispanic and black families than among white families. The data strongly support the inference that economic stress related to race is not concentrated solely among the chronically poor. Instead, middle class families of color are under substantial pressure—pressure that is pushing substantial numbers into bankruptcy every year.

#### *IV. The Racial Divide in Homeownership*

For most middle class Americans, both social and economic life center around the home. Homes shape patterns of living: children do or do not share bedrooms, bathrooms are private or communal, and families establish gathering places to eat, to pay bills, or to do homework—all depending on their homes. Home location also determines to which schools the children will be assigned, whether there will be sidewalks for learning to ride a bike, and who will be the close-by neighbors. Over time, homes become repositories of the families' collective memories, serving as a silent reminder of the children who grew up and the adults who aged in these rooms.

The financial piece of homeownership runs just as deep. For most Americans, homes are the single biggest asset they own.<sup>21</sup> In 2001, more than two-thirds of all households—67.7%—were homeowners, and the average value of the house they owned was \$122,000.<sup>22</sup> By comparison, only 52.2% of all families had even a single dollar in a retirement account, and half of all families with retirement accounts had less than \$29,000.<sup>23</sup> Stock ownership was even less widespread, with only 21.3% of families owning any stock, and median holdings were a modest \$20,000.<sup>24</sup>

Homes may be Americans' biggest financial asset, but different racial groups have not become homeowners at the same rates. Among non-Hispanic white families, homeownership rates in 2001 were at 74.3%, while Hispanic and black families' homeownership rates trailed at 47.3% and 47.7% respectively.<sup>25</sup> In other words, white families were about 57% more likely to own a home than their black counterparts.

The homes owned by white families are also likely to be more valuable than the homes owned by other racial groups. The median value of holdings for white homeowners was \$130,000 in 2001, while the median value of holdings for nonwhite or Hispanic households was \$92,000.<sup>26</sup> This means that white homeowners are not only more likely to own homes, but the homes they own are on average about 41.3% more valuable than those of their nonwhite or Hispanic counterparts.

It may be harder for Hispanic and black families to purchase houses, and their homes may be somewhat more modest, but once they buy their homes they would seem to have crossed over the great divide from their friends and families who rent. Regardless of race and the specific value of the home, nearly all homeowners had applied for mortgages and gone through the sometimes-challenging process of purchasing a home.

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21. Ana M. Aizcorbe et al., *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances*, 89 FED. RES. BULL. 1, 19 (2003) (presenting a table listing the proportion of families owning homes and the value of residential homes).

22. *Id.*

23. *See id.* at 12–13 (listing the percentage of families holding selected assets and the median value of those holdings).

24. *See id.* (noting stock ownership and the value of stock holdings among American families).

25. U.S. CENSUS BUREAU, HOUSING VACANCIES AND HOMEOWNERSHIP ANNUAL STATISTICS: 2002, tbl. 20, at <http://www.census.gov/hhes/www/housing/hvs/annual02/ann20ind.html> (last visited Oct. 5, 2004) (on file with the Washington and Lee Law Review).

26. Aizcorbe et al., *supra* note 21, at 19.

Homeowners of every race would seem to have safely found their place somewhere in the middle class America.

The bankruptcy data belie this optimistic assumption. Bankruptcy filings are far more likely among Hispanic and black homeowners than among white homeowners. Filing rates among white homeowners are about 6.1 per thousand. Hispanic homeowners are nearly three times more likely to file for bankruptcy, filing at a rate of about 16.4 per thousand. Black homeowners are at even greater risk. About 31.7 per thousand black homeowners file for bankruptcy in a single year—a rate that is more than five times that of white homeowners.

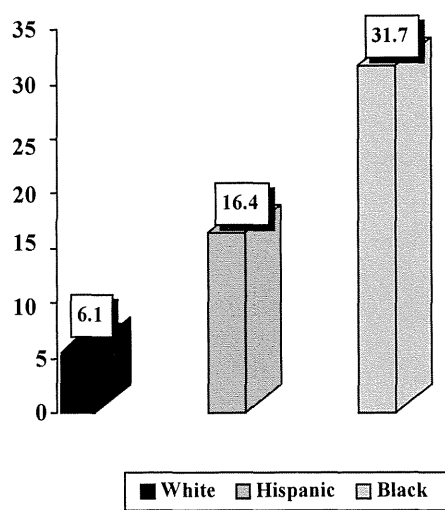


Figure 6: Bankruptcy Filings Per Thousand Homeowners, by Race, 2001  
Source: 2001 Consumer Bankruptcy Project

This means that the differences among whites, Hispanics, and blacks filing for bankruptcy is magnified, not diminished, among those who have acquired that key symbol of middle class stability—the house. Another way to understand these data is to note that when everyone who did not try to save for a home, did not have a good enough job to help them qualify for a mortgage, did not pass the credit screens, or did not show the initiative to get out and buy a house is eliminated from the sample, the differences among racial groups in financial collapse is accentuated.

*V. Homeowners and Nonhomeowners—A Second Racial Divide*

In the United States, there is a great economic divide between homeowners and renters. The other side of the data showing that most Americans have their wealth tied up in their homes is that most renters have far lower total net worth than their home-owning counterparts. The differences are not confined only to homes. Renters have fewer assets of every kind—stocks, bonds, retirement accounts, cars, personal property, small businesses, and so on.<sup>27</sup> Of course, homeowners also carry home mortgages, which pinch into their total net worth. Even so, when it is all added up—all the assets and all the debts—homeowners come out way ahead of renters. Total median net worth in the United States for homeowners in 2001 was \$171,700, compared for median net worth for renters of \$4800.<sup>28</sup>

This financial data would suggest that as a group, homeowners should be less likely to file for bankruptcy than their renter counterparts. They should be more secure, have more resources to call on when they encounter financial difficulties, and be more likely to withstand a financial blow without filing for bankruptcy. The bankruptcy data confirm that point. At a time when 67.7% of the general population owned homes, only about 52.9% of the families in bankruptcy were homeowners,<sup>29</sup> making the overall bankruptcy-filing rate for homeowners below that of the national average.

But the disaggregated data tell a very different story. While homeowners are overall less likely to file for bankruptcy, that story is shaped by the experience of white homeowners. White renters are about three times more likely to file for bankruptcy than white homeowners.

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27. See *id.* at 12, 19 (listing the average values of various assets for homeowners and renters).

28. *Id.* at 7.

29. Consumer Bankruptcy Project 2001, *supra* note 14. About 52.9% of the families filing for bankruptcy in 2001 were homeowners at the time they filed. Another 5.8% reported that they had already lost their homes. Warren, *supra* note 5, at 140.

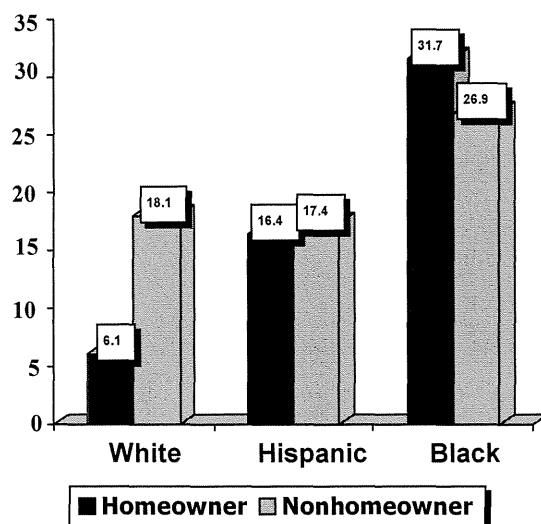


Figure 7: Bankruptcy Filings per Thousand Homeowner/Nonhomeowner, by Race, 2001

Source: 2001 Consumer Bankruptcy Project

For Hispanic families, the greater economic security of homeownership disappears. Both homeowners and renters file for bankruptcy at roughly equal rates. Among Hispanics, filing rates hover at 16.4 per thousand for homeowners and 17.4 per thousand for nonhomeowners. Despite their ability to pass an earlier credit screen and their planning, Hispanic homeowners find themselves in bankruptcy as often as renters. Black families show exactly the opposite effect. Instead of homeownership carrying greater security as it does with whites, these homeowners are collectively more at risk for a declaration of bankruptcy than are renters. The filing rate for black homeowners is 37.1 per thousand, a 17.8% increase in the filing rate over the filing rate for black renters.

The race-homeownership interaction reveals a disturbing twist. White and Hispanic renters are likely to go bankrupt at about the same rates, and black homeowners are only modestly more likely to file. It is the difference among homeowners that drives much of the racial twist that appears in bankruptcy. The disaggregated data reveal a disturbing trend for Hispanic and black families: As they work to make it into the middle class, as they stretch and struggle to buy their homes, they are not building up wealth and security at the same rate as their white counterparts. For Hispanics and for blacks, the data show that making it to the middle class is not enough to make them economically more stable.

*VI. No Wealth Accumulation: The Effects of Predatory Lending*

There may be a number of reasons why Hispanic and black families' homeownership fails to translate into greater economic security. There could be differences in the homes they buy, or they may face different resale markets that do not produce adequate assets when they are forced to sell. But there is growing evidence that certain homeowner groups are targeted in ways that might make them more—not less—vulnerable to financial collapse.

During the 1980s, as regulatory control over interest rates collapsed,<sup>30</sup> a new industry was born: the "subprime" mortgage lender. Subprime lenders specialize in issuing high-interest mortgages to families with spotty credit that are unlikely to qualify for traditional, low-cost "prime" mortgages. In the early days of deregulation, subprime mortgage lending was nonexistent. But by the mid-1990s, banking giants such as Citibank and Chase Manhattan expanded substantially because of profits from their credit card lending and were looking for new markets to tap.<sup>31</sup> They applied the same principles to home mortgage lending that profited their credit card divisions so handsomely: charge high interest rates and pour substantial resources into selling their product widely. Even if default rates climbed, the increased number of outstanding loans at rates well in excess of the cost of funds would pump up profits.

The relative cost of a subprime mortgage is truly staggering. For example, in 2001, when standard mortgage loans were in the 6.5% range, Citibank's *average* mortgage rate (which included both subprime and traditional mortgages) was 15.6%.<sup>32</sup> To put that in perspective, a family buying a \$175,000 home with a subprime loan at 15.6% would pay *an extra \$420,000* during the 30-year life of the mortgage—that is, over and above the payments due on a prime mortgage. Had the family gotten a traditional

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30. For a detailed discussion of this change over time, see, for example, Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1271–79 (2002) (describing the mortgage market of the 1970s and the subsequent deregulation).

31. There are several companies affiliated under the "Citigroup" logo. For ease of identification, all of the companies are referred to by this organization's best-known moniker—Citibank. Similarly, "Chase" is the name for J.P. Morgan Chase & Co. and its affiliates. For a list of the largest subprime lenders active in the United States, see U.S. Department of Housing and Urban Development (HUD), *HUD Subprime and Manufactured Home Lender List*, data set (2001), at <http://www.huduser.org/datasets/manu.html> (last updated July 1, 2004) (on file with the Washington and Lee Law Review).

32. See generally Lew Sichelman, *Community Group Claims CitiFinancial Still Predatory*, ORIGINATION NEWS, Dec. 21, 2001, at 25, 2001 WL 14830866 (reporting on new claims of Citibank predatory practices after settlements with state and federal regulators).



mortgage instead, it would have been able to put two children through college, purchase half a dozen new cars, and put aside money for retirement.

Citibank and other subprime lenders typically defend their business practices by arguing that they are helping more families own their own homes.<sup>33</sup> But this defense is little more than a public relations distraction. In the overwhelming majority of cases, subprime lenders prey on families that *already* own their own homes, rather than expanding access to new homeowners. Fully 80% of subprime mortgages involve refinancing loans for families that already own their homes.<sup>34</sup> For these families, subprime lending does nothing more than increase each family's housing costs, taking resources away from other investments, and increasing the chances that the family will lose its home if anything goes wrong.

Subprime lending has an even more pernicious effect. It ensnares people who, in a regulated market, would have had access to lower cost mortgages. The lenders' own data show that many of the families that end up in the subprime market are middle class families that would typically qualify for a traditional mortgage. At Citibank, for example, researchers have concluded that at least 40% of those who were sold ruinous subprime mortgages would have qualified for prime-rate loans.<sup>35</sup> Fannie Mae puts the number even higher across the industry with its research showing that 50% of the families that ended up with a subprime loan would have qualified for a prime mortgage.<sup>36</sup>

Subprime mortgages have garnered a substantial share of the mortgage refinancing market. A study by the Department of Housing and Urban Development in 2000 revealed that *one in nine* middle-income families (and one in fourteen upper-income families) who refinanced a home mortgage ended up with a high-fee, high-interest subprime mortgage.<sup>37</sup> For many of

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33. See National Home Equity Mortgage Association, *Join NHEMA*, at <http://www.nhema.org/join.asp> (last visited Oct. 5, 2004) (offering information on the benefits of membership in NHEMA) (on file with the Washington and Lee Law Review).

34. See HUD, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (2000), at <http://www.hud.gov/library/bookshelf18/pressrel/subprime.html> (last visited Oct. 26, 2004) (stating that 80% of subprime loans are home refinancing loans) (on file with the Washington and Lee Law Review).

35. See Sichelman, *supra* note 32, at 25 (reporting that NTIC claimed nearly 40% of Citibank customers were eligible for lower rates than they carried).

36. James H. Carr & Lopa Kolluri, *Predatory Lending: An Overview*, in FINANCIAL SERVICES IN DISTRESSED COMMUNITIES: ISSUES AND ANSWERS 37 (Fannie Mae Found. 2001) (on file with the Washington and Lee Law Review).

37. See HUD, *supra* note 34 (noting that subprime loans accounted for 11% of all loans in moderate-income neighborhoods and 7% of all loans in upper-income neighborhoods). To be sure, subprime lenders have focused more of their efforts among poorer homeowners; 26% of low-income homeowners end up with predatory refinancing, more than twice the rate of

these families, there is no trade-off between access to credit and the cost of credit. They simply paid more than their counterparts who had prime mortgages.

Why would middle class families take on high-interest mortgages if they could qualify for better deals? For many, the answer is they did not know they could do any better. Many unsuspecting families are steered to an overpriced mortgage by a broker or some other middleman who represents himself as acting in the borrower's best interests but who is actually taking big fees and commissions from subprime lenders.<sup>38</sup> In some neighborhoods these brokers go door-to-door, acting as "bird dogs" for lenders by looking for unsuspecting homeowners who might be tempted by the promise of extra cash. Other families get broadsided by extra fees and hidden costs that they do not become aware of until it is too late to go to another lender. One industry expert describes the phenomenon: "Mrs. Jones negotiates an 8% loan and the paperwork comes in at 10%. And the loan officer or the broker says, 'Don't worry, I'll take care of that, just sign here.'"<sup>39</sup>

The connection between predatory mortgage lending and race is unmistakable: Predatory lenders target black and Hispanic homeowners. They are, of course, glad to take a subprime mortgage from anyone, but they redouble their efforts to saddle families they see as vulnerable with burdensome mortgages, and that includes black and Hispanic families. In 2002, Citibank's subprime lending subsidiary was prosecuted for deceptive marketing practices, and the company paid \$240 million to settle the case—at the time, the largest settlement of its kind.<sup>40</sup> A former loan officer testified about how she marketed the mortgages: "If someone appeared uneducated, inarticulate, was a minority, or was particularly old or young, I would try to include all the [additional costs] CitiFinancial offered."<sup>41</sup> In other words,

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moderate-income families. *Id.*

38. Howell E. Jackson & Jeremy Berry, *Kickback or Compensation: The Case of Yield Spread Premiums 11* (2003) (unpublished manuscript, available at [http://www.law.harvard.edu/faculty/hjackson/pdfs/january\\_draft.pdf](http://www.law.harvard.edu/faculty/hjackson/pdfs/january_draft.pdf)) (on file with the Washington and Lee Law Review).

39. Dennis Hevesi, *A Wider Loan Pool Draws More Sharks*, N.Y. TIMES, Mar. 24, 2002, § 11, at 1.

40. The charges alleged that Citibank's consumer finance unit employed deceptive practices to sell home loan insurance. To settle the case, Citibank agreed to pay \$240 million, the largest settlement to date of a Federal Trade Commission consumer protection case. See Pham-Duy Nguyen, *Citigroup \$240 Mln Lending Unit Settlement Approved*, BLOOMBERG NEWS, Nov. 15, 2002, LEXIS, Bloomberg News File (reporting the preliminary settlement).

41. Paul Beckett, *Citigroup's 'Subprime' Reforms Questioned*, WALL ST. J., July 18, 2002, at C1.

lending agents routinely steered "minority" families to higher cost loans whenever they thought there was a chance they could get away with it.

Such steering hits minority homeowners with particular force. Several researchers have shown that minority families are far more likely than white families to get stuck with subprime mortgages, even when the data are controlled for income and credit rating.<sup>42</sup> According to one study, black borrowers are 440% more likely than white borrowers to end up with a subprime rather than a prime mortgage.<sup>43</sup> In fact, residents in high-income, predominantly black neighborhoods are actually *more* likely to get a subprime mortgage than residents in low-income white neighborhoods—more than twice as likely.<sup>44</sup>

In many cases, these lenders want more than families' money; they also want to take people's homes. Banks have been caught deliberately issuing mortgages to families that could not afford them, with the ultimate aim of foreclosing on these homes. This practice is so common it has its own name in the industry: "Loan to Own."<sup>45</sup> These lenders have found that foreclosing can be more profitable than just simply collecting a mortgage payment every month because the property can then be resold for more than the outstanding loan amount.<sup>46</sup> The lender rakes in fees at closing and receives high monthly

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42. For a thorough discussion of discrimination in mortgage lending, see generally STEPHEN ROSS & JOHN YINGER, *THE COLOR OF CREDIT: MORTGAGE DISCRIMINATION, RESEARCH METHODOLOGY, AND FAIR-LENDING ENFORCEMENT* (MIT Press 2002).

43. See ASSOC. OF CMTY. ORG. FOR REFORM NOW, *SEPARATE AND UNEQUAL: PREDATORY LENDING IN AMERICA* 10 (ACORN 2002), available at [http://www.acorn.org/fileadmin/Community\\_Reinvestment/Reports/S\\_and\\_E\\_2004/separate\\_and\\_unequal\\_2004.pdf](http://www.acorn.org/fileadmin/Community_Reinvestment/Reports/S_and_E_2004/separate_and_unequal_2004.pdf) (stating that black homeowners were 4.4 times more likely than white homeowners to receive a subprime loan) (on file with the Washington and Lee Law Review); see also Randall M. Scheessele, *HF-009 1998 HMDA Highlights*, at 3–4 (1999), at <http://www.huduser.org/publications/hsgfin/workpapr9.html> (last updated Mar. 18, 2003) (discussing differences between blacks and whites in home purchase loans) (on file with the Washington and Lee Law Review).

44. See HUD, *supra* note 34 (reporting that 39% of homeowners in black upper-income neighborhoods have subprime refinancing but only 18% of homeowners in white lower-income neighborhoods have subprime refinancing).

45. Congress recently considered legislation specifically targeting "loan to own" practices as an amendment to the current Truth in Lending laws. See Consumer Mortgage Protection Act of 2000, H.R. 4213, 106th Cong. (2000) (expanding substantive protections for vulnerable consumers from abusive lending practices); *Illinois Association of Mortgage Brokers Backs Important Consumer Protection Legislation*, PR NEWswire, Apr. 17, 2000, LEXIS, PR News File (stating that the Consumer Mortgage Protection Act of 2000 intends to expand protections to consumers with bad credit or a limited credit history).

46. Margot Saunders, director of the National Consumer Law Center, explained in testimony before Congress:

Based on equity, a lender is in an advantageous situation: either the borrower pays the loan back with high interest or foreclosure on the home permits a recovery from

payments for a few years, waits for the family to fall behind, and then sweeps in to take the property. The lender wins in every possible way—high profits if the family manages to make all its payments and even higher profits if the family does not.

There are other signs that homeownership does not represent the same wealth accumulation for black and Hispanic families as for their white counterparts. Among white homeowners, median mortgages were about 56.9% of the median value of their homes.<sup>47</sup> Nonwhite and Hispanic families carried larger median mortgages relative to the value of their homes—66.3%.<sup>48</sup> This suggests that across the board, whether they have been ensnared by predatory lenders or not, nonwhite and Hispanic homeowners are taking on more mortgage debt relative to the value of their homes. This mortgage debt leaves them with less equity in their homes and relatively larger debts that must be paid even during times of financial reversals.

For decades, blacks and Hispanics have been concerned about access to credit—a very real fear that being cut off from mortgage money would mean they could never build up wealth through homeownership the way white families could. Moreover, there was a growing body of evidence that even though it was illegal, overt discrimination and "redlining"—the practice by which mortgage lenders refused to lend in certain neighborhoods—was crippling housing markets in minority neighborhoods and denying low- and moderate-income families the chance to build wealth through homeownership. The new solution was to "democratize credit"—make credit available to anyone and everyone, no matter how poor.<sup>49</sup> The prediction was for a more perfect world in which home ownership rates would go up, a sluggish

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the property directly. In fact, when foreclosure occurs and the borrower's property is sold to the lender for less than fair market value (as it generally is), the lender can resell the property after foreclosure and realize the homeowner's equity. These anticipated windfalls encourage some lenders to make loans designed to result in foreclosure.

*Real Estate Settlement Act Truth in Lending Act*, 105th Cong. (1998) (testimony of Margot Saunders, Managing Attorney National Consumer Law Center), 1998 WL 18089596.

47. See Aizcorbe et al., *supra* note 21, at 19, 22–23 (presenting tables listing the median values of residential homes and the median values of mortgages segregated by race). The percentages were calculated by dividing the median value of the mortgage by the median value of the home.

48. *Id.*

49. Progressive reformers actually made the first major campaign to democratize credit in the early twentieth century. LENDOL CALDER, *FINANCING THE AMERICAN DREAM* 124–55 (Princeton Univ. Press 1999) (describing the evolution of credit at the turn of the twentieth century).

economy would begin to boom, and cities would blossom—all thanks to the free flow of credit.

This concern over discrimination stirred much of the support for loosening lending restrictions in the mortgage lending industry. Deregulation was not a right-wing conspiracy; it was actually supported by most Democrats as well.<sup>50</sup> Many liberals got behind the move for traditionally liberal reasons: They wanted to defend lower-income families. They had been persuaded that the risks posed by overaggressive lenders might not be as dangerous as once was thought. A deregulated lending market could even prove to be a critical tool to help low-income and disadvantaged groups improve their lot. After all, working-class families needed credit to start businesses, to build homes, and to send their kids to college—objectives that upper-income families had long had plenty of opportunities to do.

The original intent of the credit democratization movement was for credit to help a greater number of families become more financially independent. Credit was not supposed to be an end in itself. But it seems that the original intent has been forgotten. Consider, for example, the motto of one prominent advocacy group: "Access to credit and capital is a basic civil right."<sup>51</sup> But a subprime mortgage industry has turned that into a right to pay two or three times more for a home than the market rate. The dream of democratization of credit considered credit a vehicle to expand home ownership, to launch businesses, and ultimately to help build wealth in poor neighborhoods. The point was not to bombard families with high-cost loans that prevent families from accumulating wealth.

The data presented here suggest that Hispanic and black homeowners—those most likely to be the targets of predatory lending—are also the most likely homeowners to find their way to the bankruptcy courts. The same signs of distress are evident outside the bankruptcy courts. When we analyzed unpublished data from the Department of Housing and Urban Development, we found that among families who had purchased a home with an FHA-backed

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50. The initial Depository Institutions and Monetary Control Act, which allowed banks to pay higher interest to depositors and preempted state usury laws, passed the House on Sept. 11, 1979, by a vote of 367 to 39, and passed the Senate on November 1, 1979, by a vote of 76 to 9. Thomas, Legislative Information on the Internet, *Bill Summary and Status for the 96th Congress: H.R. 4986*, at <http://thomas.loc.gov/cgi-bin/bdquery/D?d108:1:/temp/~bdEZ6J:@@L&summ2=m&/bss/d108query.html> (last visited Oct. 5, 2004) (on file with the Washington and Lee Law Review).

51. See NATIONAL COMMUNITY REINVESTMENT COALITION, WHO WE ARE, at <http://www.ncrc.org/whoweare/index.php> (last visited Nov. 9, 2004) (stating the organization's primary mission is "to increase the flow of private capital into traditionally underserved communities") (on file with Washington and Lee Law Review).

mortgage, blacks were twice as likely as white homeowners to lose their home in foreclosure.<sup>52</sup>

Minority rights groups are well aware of the dangers of the predatory lending industry. There is, however, an important question of how high economic issues should rank in their list of priorities. When Senator Trent Lott seemingly expressed his nostalgia for a segregated America, minority groups around the country barraged the talk shows and newspapers, and Senator Lott was ultimately stripped of his powerful position as Majority Leader of the Senate. Similarly, when Texaco executives were accused of using racial slurs to refer to blacks, the company was boycotted, sued for millions of dollars, and forced to adopt new practices to ensure that its black employees had better opportunities.<sup>53</sup> But when a Citibank official said in sworn affidavits that she regularly added extra fees to a home mortgage "[i]f someone . . . was a minority,"<sup>54</sup> there was little response. Citibank quietly agreed to a cash settlement with the FTC, and there were no press releases from the NAACP, no extended discussions on Hispanic radio stations, no interviews on the evening news, and no calls for Citibank's highly visible CEO Sandy Weill to resign.

The data from the bankruptcy courts support the inference that subprime lending robs middle class Hispanic and black families of their financial security. Unlike white homeowners who build up equity and make themselves more financially secure, a disproportionate number of nonwhite homeowners are collapsing financially.

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52. See WARREN & TYAGI, *supra* note 4, at 159 (presenting data showing that blacks are twice as likely as white homeowners to lose their homes to foreclosure).

53. In 1996, a Texaco employee revealed secret tape recordings he made of Texaco executives disparaging black employees and discussing the shredding of documents pertaining to a discrimination case. After this release, civil rights leaders called for a boycott against the company, a number of customers cut up their Texaco credit cards, and some investors sold their Texaco stock. Within two weeks of the disclosure, Texaco agreed to pay \$140 million to settle the case. The outrage over these tapes prompted the company to adopt new policies to promote equality and erase discrimination within its organization. See, e.g., Adam Bryant, *How Much Has Texaco Changed?*, N.Y. TIMES, Nov. 2, 1997, § 3, at 1 (reporting the changes made by Texaco); Tim Whitmire, *Tapes Don't Stick in Court: Ex-Texaco Executives Walk*, CHI. SUN-TIMES, May 13, 1998, at 3 (describing the reaction to the released tapes), available at LEXIS, Chicago Sun-Times File.

54. Beckett, *supra* note 41, at C1.

*VII. Conclusion*

The bankruptcy data reveal a disturbing picture of the vulnerability of middle class Hispanic and black families. The data confirm that bankruptcy provides refuge for middle class families of all races when they have fallen on hard times. When measured by enduring criteria such as education, occupations, and homeownership, the families in bankruptcy—white, Hispanic, or black—are drawn from the ranks of the solidly middle class. And the reasons that trigger their filings are also remarkably similar. Regardless of race, families file for bankruptcy primarily in the wake of job loss, medical problems, and family breakups.

But the differences among racial groups tell of very different vulnerabilities for the Hispanic and black middle class. Hispanics are nearly twice as likely to file for bankruptcy as their white counterparts, and blacks are more than three times more likely to end up in bankruptcy. Two-thirds of every group cites a job loss, but it is clear that Hispanic and blacks are far more likely to head to the bankruptcy courts to deal with job losses than their white counterparts. The same is true for medical problems and family breakups. Whether these families have more job, medical, and family trouble or whether they are already weaker financially and that financial instability makes them more vulnerable when job, medical, or family problems occur is not clear from these data. It is possible, of course, that both are at work. In any case, these data reinforce the view that middle class Hispanic and blacks are far more vulnerable to the financial difficulties facing every family.

The story takes on an even more alarming note when homeowners and nonhomeowners are compared by racial groups. Among whites, the bankruptcy data reveal the relative economic security of homeowners compared with their renting counterparts. Among Hispanics and blacks, however, homeowners are more vulnerable—more vulnerable than white homeowners but also more vulnerable than Hispanic or black nonhomeowners. These data raise a concern that the deliberate targeting of nonwhite homeowners for predatory mortgages has left a weakened middle class.

America's greatest hope is for a growing middle class, a middle class that is racially diverse, prosperous, and accessible. But the data from the bankruptcy courts sounds a warning. The economic security that comes with arrival in the middle class is divided by race, leaving Hispanic and black families at far more risk than their white counterparts.