Remarks by Vice Chairman Roger W. Ferguson, Jr.

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Some Recent Findings regarding the Economic Condition of Minority Americans

I am pleased to be here this morning, and I wish to thank the Coalition of Black Investors (COBI) for inviting me to speak as part of your national convention. I would like to focus my remarks on research that describes the economic status of minority Americans. Many of these remarks will be based on recent research by the federal government, including that of the Council of Economic Advisers and the Federal Reserve. I will also touch on programs across the Federal Reserve System to promote small business access to capital and credit and to help individuals manage better in the financial world.

In taking this approach, I implicitly recognize what the civil rights leaders of the 1960s recognized, which is that many issues that appear to be race-related are actually socioeconomic in character and origin.

Employment and Unemployment
As all of you know, we are fortunate to be experiencing the longest uninterrupted economic expansion in U.S. history. Over the past year our economy created 2-1/4 million private sector jobs, and unemployment is the lowest it has been in more than thirty years. As shown in the most recent Economic Report of the President, prepared by the Council of Economic Advisers, the expansion has benefited all segments of the population, including minority populations. In fact, the unemployment rate for blacks, at 8 percent, is the lowest it has been since minority unemployment statistics have been collected. But despite these gains, blacks still lag in terms of employment opportunities, as their unemployment rate is still nearly twice the national average.

Let me offer a few remarks on the effect of interest-rate increases on minority unemployment. As you know, our principal purpose in conducting monetary policy is to contribute as best we can to fostering the fastest economic growth sustainable over time and the highest possible standard of living for all Americans. History shows that an economy cannot achieve maximum sustainable growth without price stability, which allows businesses and consumers to make economic decisions undistorted by the fear and uncertainty of inflation. And it is price stability that is the Fed's principal contribution to prosperity. When inflation is already relatively low, we aim to keep supply and demand roughly in balance and prevent inflationary pressures from building. Thus, at times when demand is outpacing the economy's capacity to increase supply, policymakers will seek to dampen demand through higher short-term interest rates. Raising rates can involve short-term economic costs, but by taking action early on we can avoid much more severe economic distress later.

Now, monetary policy by its nature is a blunt tool and cannot be calibrated to exempt a particular segment of our economy. Unfortunately, minority employment seems to be more sensitive to cyclical changes in the economy than employment in general. Economists have determined that there are a variety of reasons for the disparity. Educational level, work experience, and proximity to available jobs are among the top reasons for the inequity between minorities and white non-Hispanics in the labor market. So, if we can keep the economy on the maximum sustainable growth path by adjusting monetary policy in a forward-looking manner, then we will avoid a boom-and-bust pattern that would hurt all Americans, especially minorities. That will help create the conditions under which the greatest number of Americans share in the nation's prosperity.

Private Wealth Creation

Just as the current expansion has been beneficial for the creation of employment, so too has it been hospitable for individual wealth creation. The Federal Reserve and the private sector both have an interest in understanding the process of wealth creation. We at the Fed attempt to encourage the stable economic conditions that allow for sustainable job creation and, ultimately, give rise to wealth creation. You as an organization promote saving and investing among African-American consumers and work to increase financial literacy.

Using our 1995 and 1998 Surveys of Consumer Finances as background, Federal Reserve economists are seeking to better understand issues of personal finance. In an acceleration of a trend dating from 1992, both mean and median net worth for U.S. families rose strongly between 1995 and 1998: mean net worth rose 26 percent, and the median rose 18 percent. Both the mean and the median net worth in 1998 were nearly 20 percent higher than in 1989, toward the end of the last expansion.

However, as with unemployment, there were differences across racial lines. Over the 1989-98 period, the growth in the mean and median net worth was greater for white non-Hispanic families than for minority families. Moreover, while the growth rate increased steadily for whites through 1998, the rate for minorities leveled off after 1995. Finally and importantly, by 1998 the median net worth of minority families was still substantially below that of other families -- $16,400 versus $94,900.

Part of this disparity may be attributable to differences in the family holdings of assets, including everything from vehicles to "managed assets." White families are only slightly more likely to hold nonfinancial assets, such as vehicles and equity in businesses and nonresidential properties. However, as I will discuss further, among their nonfinancial holdings, whites are much more likely to hold business equity, whereas minority family holdings tend to be more concentrated in other nonfinancial assets. Differences in holdings of financial assets are even more skewed. Only 81 percent of nonwhite and Hispanic families held financial assets in 1998, an increase over the 77 percent observed in 1995 but still below the 96 percent of white non-Hispanic families owning them.

Given the potential for wealth creation from financial assets, this discrepancy is noticeable. In this period of admittedly robust growth in stock prices, the median value of stock holdings among those having any stock holdings rose strongly--from $15,400 in 1995 to $25,000 in 1998, a 62.3 percent increase, but nonwhites and Hispanics tend to be disproportionately underrepresented in stock ownership. More than half of white non-Hispanic families held some form of stock in 1998, but only 30 percent of minority families did. Put another way, the relatively smaller number of minority families that own financial assets tend to make more conservative choices regarding their portfolios, favoring fixed-income securities over stock ownership in any form. They therefore have not participated fully in the wealth creation that comes from equity investments and that has been such an important part of this unprecedented expansion.

The Role of Small Businesses in our Economy

I know that COBI is also concerned with business ownership by minorities. The Federal Reserve is interested as well in small businesses and their access to credit. In part, our ongoing interest in the availability of credit to small businesses and its effects on economic growth stems from the significant role that small firms play in our dynamic economy. By some estimates, there are upwards of twenty-three million small businesses in the United States accounting for more than 99 percent of all firms. Although a great number of these firms involve individuals who are self-employed or who have only a few employees, small businesses employ, collectively, more than half of the private sector workforce. These firms also generate nearly half the sales revenues of all U.S. firms.

The current expansion has provided a favorable climate for small businesses generally and for minority-owned firms in particular. In 1996 alone, nearly a million new firms began operation. Moreover, in recent years, the number of minority-owned firms has been growing at a rate of three to four times that of other small businesses, though minority-owned firms still constitute only a small proportion of all small businesses. As of 1997, about 10 percent of all small businesses with employees were minority-owned: about 2 percent were black-owned, 4.5 percent were Asian-owned, and 4 percent were Hispanic-owned.

Research and Access to Capital and Credit

Given the importance of small businesses to our economy, and their heavy reliance on credit to facilitate growth, the Federal Reserve has taken a leading role in efforts to improve the understanding of factors that bear on the availability of funds to support business activity. In 1999, the Federal Reserve sponsored a major research conference on business access to capital and credit that provided many insights on similarities and differences in the characteristics of white-owned and minority-owned firms and of male-owned and female-owned firms. For example, firms owned by blacks tend to be smaller (whether measured by assets or by employees), newer, and more likely to be located in an urban area than their nonminority counterparts. Black-owned businesses also tend to be owned by a person with fewer years of business experience and to have poorer credit histories, but they are also more likely to be owned by a person having at least some college education. Finally, black-owned businesses are more likely to be a sole proprietorship and in the services industry. Differences between other minority-owned firms and white-owned firms tend to be less pronounced, though they have been found.

Clearly, many factors are considered in credit decisions. Smaller businesses with limited equity capital, fewer assets to pledge as collateral, uncertain earnings streams, and high failure rates can reasonably be expected, on the whole, to experience greater difficulties in obtaining credit than larger firms experience. The personal creditworthiness of the business owner in sole proprietorships or small partnerships, as well as in small corporations, is also an important consideration. Creditor evaluations of risk, based on these and other legitimate economic factors, properly play a central role in credit decisions.

Aside from these differences along financial and nonfinancial dimensions, the research also showed that minority and women-owned firms differ from white and male-owned firms in some of their credit market experiences. All the papers concluded that black-owned firms were generally more likely to be turned down for credit. However, when examined more closely, these general patterns are seen to mask more complex relationships. For example, differences in turndown rates are less pronounced in urban markets, which accounted for the vast majority of firms in the study, than in rural areas. And when small retail establishments are considered separately, denial rates for black-owned firms and for white-owned firms are similar. Clearly, additional research will be required to more fully understand these complexities.

Determining whether and to what extent discrimination may help explain differences in the credit market experiences of small businesses owned by individuals from different demographic groups is difficult. Discrimination, if it exists in any creditor's decision, is disturbing. The moral and legal objections to discrimination are obvious. In addition, constraints on access to credit due to discrimination carry real costs and serious economic consequences. Such constraints inhibit economic opportunities by limiting the ability of victims to purchase homes, expand businesses, and accumulate wealth. At its heart, discrimination in granting credit artificially restricts the flow of capital. It means that viable economic activity goes unfunded and markets that should work do not.

The Federal Reserve's 1993 National Survey of Small Business Finances has been an extremely useful tool for better understanding the role that discrimination may play in affecting small business credit markets. This survey collected detailed information on the financial and other characteristics of a nationally representative sample of small businesses. To help us gain a better understanding of the nature and needs of minority-owned firms, the survey oversampled the firms owned by various minority groups. The survey was the basis for much of the documentation of differences in credit market experiences obtained through our conference last year, and it continues to provide clues regarding the reasons for these differences. However, these data alone cannot identify discrimination because they do not include all the unique factors involved in each credit-granting decision.

I can assure you that the Federal Reserve will remain vigilant for any indications that illegal discrimination is part of credit decisions. We, of course, continue to examine banks to measure and ensure their compliance with the Equal Credit Opportunity Act. And we will continue to sponsor research that bears on issues of credit availability and constraints, including those involving potential illegal discrimination.

Information and Educational Programs

Besides collecting and analyzing data on small businesses and consumers, the Federal Reserve has also supported programs to encourage community development in low- and moderate-income areas. Through our Community Affairs programs at each of the twelve Federal Reserve Banks, we conduct ongoing outreach and educational activities and give hands-on technical assistance to help banks, their customers, and communities understand and address community credit needs, including those of small businesses. This is no small commitment. The Federal Reserve Board and the twelve Reserve Banks combined devote more than 100 full-time staff members to help institutions understand and participate in community development.

To give you an idea of the kinds of activities we engage in, the twelve Federal Reserve Banks over the past three years have sponsored educational conferences, seminars, and workshops focusing on credit and investment issues attended by more than 35,000 people. Some of this activity involves issues related to affordable housing and community development, but over the past few years, our Community Affairs activities have increasingly focused on small business and economic development.

Each of the Reserve Banks develops programs responsive to local needs. The Federal Reserve Bank of Boston sponsored a major conference entitled "Making It in the

Mainstream," which reviewed partnerships between minority enterprises and major corporations as a strategy for inner-city business development and job creation. The Federal Reserve Bank of Richmond, in conjunction with the National Association of Women Business Owners, conducted a series of six conferences entitled "Access to Capital: Start to Finish," which focused on the financing needs of and resources for women-owned businesses.

As an adjunct to their educational programs, the Reserve Banks provide direct technical assistance to bankers, businesses, and community development organizations to help them identify and address capital and credit issues. Many of our Reserve Banks have helped bankers create multibank community development corporations (CDCs) and other consortium lending intermediaries, which focus on equity and debt financing for small and disadvantaged businesses. They also help banks deal with regulatory requirements that often must be addressed before investing in CDCs, Small Business Investment Companies, or multibank loan consortiums. The Federal Reserve Bank of Atlanta, for example, worked with the Florida Black Business Investment Board and assisted banks interested in investing in regional black business investment corporations, which provide equity and loans to black-owned businesses in that state. In a related effort this past year, the Federal Reserve Bank of Chicago began the initial phases of its "Small Business Credit Access Initiative," which will identify and address barriers to equity and debt capital for small enterprises in the Chicago metropolitan area, especially those businesses located in predominately minority and low-income communities.

As another example, the Federal Reserve Bank of Cleveland has joined forces with the Small Business Administration and the Greater Cleveland Growth Association's Council of Smaller Enterprises (COSE) to fund and coordinate a communitywide effort to improve capital access for small businesses in northeast Ohio.

The Fed is also strongly supportive of efforts across the nation to increase financial literacy. We are actively involved with the National Partners for Financial Empowerment (NPFE). This nonpartisan coalition, launched by Treasury Secretary Lawrence Summers in April 2000, is a public-private partnership that seeks to promote the development of personal financial skills. Many Americans at all income levels do not understand the basics of personal finance and how to make their money work for them as efficiently as possible. Some are easy targets for abuses or make poor choices in the use of credit. Many low- and moderate-income families lack access to financial services. Families of all income levels need financial education to improve their financial future, but families at the lowest income levels face special challenges. Personal debt and bankruptcy rates are high, and saving is at its lowest level in seventy years. The inability of many households to budget, save, and invest, prevents them from laying the foundation for a secure financial future.

To raise public awareness of the critical importance of financial literacy and to reinforce the many creative and energetic efforts in financial literacy already underway, NPFE is engaging in a major campaign that will reach across the nation with the help of leaders from the public and private sectors. Working with the NPFE, the Federal Reserve will seek to educate people on how to make informed choices for common financial transactions, including home mortgages, consumer credit, and basic banking services.

Conclusion

Let me conclude by emphasizing that the Federal Reserve employs many tools that help us understand credit markets and address credit and capital availability issues confronting consumers and small businesses. Through effective monetary policy, our goal is to help maintain price stability and sustain conditions for growth that provide continuing opportunities for families and small businesses to flourish. Sustainable growth also helps many of our citizens to enter the job market, obtaining important skills that can be life-transforming. By creating conditions conducive to maximum sustainable growth, the Federal Reserve can best do its part to make sure that all Americans have the chance to assure their financial well-being. Through our supervision of banks, we continue to monitor financial institutions' compliance with laws requiring them to offer credit fairly and impartially. And we will continue to sponsor research on consumer finance and small business credit markets and to promote financial literacy. Through these efforts we, like you, are working to ensure that our current economic gain enables the construction of a solid platform for enhanced job opportunity, business growth, and wealth creation for all Americans.

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