# Remarks by Vice Chairman Roger W. Ferguson, Jr.

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## Economic Progress and Small Business

I am pleased to join you today. I would like to focus first on the economic status of minority Americans, including some information from the Federal Reserve's most recent Survey of Consumer Finances. I will then turn to the role of small businesses in our economy, drawing on our research on small business finances and our efforts to promote small business access to capital and credit.

**Labor Market Developments**
During the 1990s, we were fortunate to have experienced the longest uninterrupted economic expansion in U.S. history. By late 2000, the unemployment rate was the lowest it had been in more than thirty years. The expansion benefited all segments of the population, including minority groups. In fact, the unemployment rate for blacks dropped to less than 7-1/2 percent in late 2000; it had not been lower than 9 percent since statistics on the minority labor force were first collected in 1972. But despite the improvement, blacks still lagged, with an unemployment rate that was nearly twice the national average.

Over the past year and a half, as all of you know, we have experienced a business cycle downturn that has been followed, more recently, by a very slow recovery in the labor market. As a result, we have retraced some of the gains recorded during the 1990s. The overall unemployment rate has moved back up to 5-3/4 percent in recent months, and the jobless rate for blacks has hovered just below 10 percent.

The fact that the business cycle has had broad effects on the labor market outcomes--both on the upside and on the downside--highlights the limited scope for monetary policy to be calibrated to target or to exempt a particular segment of our economy from cyclical changes in economic activity. Over the course of the business cycle, in both good times and bad, minority unemployment rates tend to run significantly higher than the national average. Economists have determined that a variety of factors contribute to that persistent disparity, including educational levels, work experience, and proximity to available jobs. Nonetheless, the particularly troubling longer-run trend of declining labor force activity of black men remains subject to considerable debate.

Monetary policy alone cannot address the underlying structural causes of differences in economic outcomes for various groups, but it can contribute to an environment in which progress toward equality is more likely to be made. Adjusting monetary policy in a forward-looking manner to attain the maximum sustainable growth path for the aggregate economy and stable prices will help foster conditions under which the greatest number of Americans--including minorities--share in the nation's prosperity. The Federal Open Market Committee's accommodative policy over the past 22 months has been aimed at supporting aggregate

demand to lay the groundwork for a return to a sustainable rate of economic expansion. And, last week's decision to ease further was aimed at increasing the chances that the economic recovery would stay on track and not be derailed by the recent soft spot.

**Private Wealth Creation**

Just as the long expansion of the 1990s brought marked reductions in unemployment, it also supported individual wealth creation. Because the creation of wealth is an important benefit of policies that encourage stable economic conditions and sustainable job creation, my colleagues and I at the Fed take an active interest in understanding the process of wealth creation. The Board's Surveys of Consumer Finances, which are conducted every three years, help us understand issues of personal finance.

With the information for 2001 tabulated so far, our survey shows that U.S. families saw sizable gains in both their mean and their median net worth over the past decade: Median real net worth rose 40 percent, and mean net worth rose 72 percent, between 1992 and 2001. Roughly half those gains occurred between 1992 and 1998, and half occurred in just three years, from 1998 to 2001. Between 1992 and 1998, although the level of net worth for minority families remained well below that of other families, their median real net worth was rising at roughly the same pace, 20 percent, as nonminority families. However, between 1998 and 2001, inequality in family net worth increased significantly: Median real net worth changed little for minority families while it increased an additional 17 percent for nonminority families. As a result, the striking difference in the level of wealth between minority and other families widened further: In 2001, the median net worth was $17,100 for minority families versus $120,900 for non-Hispanic white families. I note, for this audience, that the story for African Americans alone is somewhat more positive: Median wealth did increase about 13 percent between 1998 and 2001, but the median level of net worth in 2001 was still only $19,000.

A substantial part of the wealth gap is associated simply with differences in family ownership of assets. In 2001, about 22 percent of minority families had no type of nonfinancial asset--such as a residence, a vehicle, or a business; almost 18 percent had no type of financial asset--such as a checking or savings account, stocks, bonds, or other such assets. For other families, the comparable figures were well below 10 percent. Obviously, with their more limited asset ownership, minorities had less opportunity to benefit from the substantial appreciation of assets, such as houses and corporate equities, that occurred over the 1990s.

Nonetheless, increases in ownership are an important factor in explaining the gains in net worth that we did see for minorities over the past decade. Two items stand out as particularly important: transaction accounts and personal residences. Transaction accounts--including checking and savings accounts--are the most basic type of financial asset. Without such holdings, families are unlikely to acquire the sophistication to move further into the financial system. Over the period from 1992 to 2001, the share of minority families with such accounts rose from 64 percent to 78 percent.

No doubt, a large part of the differences in asset holdings between minorities and other families may be attributed to differences in income. By the definitions used in our survey, the median income of minority families in 2001 was only 57 percent that of other families. However, earlier work by our staff suggests that, even after controlling for such factors as income and formal education, minorities are still less likely to hold even a basic checking account. This finding suggests that fostering equal opportunity and supporting financial

literacy campaigns may help minorities move into the financial mainstream.

I do not have time today to cover the full range of detailed findings on asset and debt holdings from our 2001 Survey of Consumer Finances. Clearly, the survey is an important source of information on how changes in financial markets, innovations in lending, and other factors affect the financial situation of families. Our staff is preparing an article for publication in the *Federal Reserve Bulletin* early next year, which will provide a fuller review of the results.

**Changes in Home Ownership**
The other important contributor to the rise in wealth among minorities has been the rise in home ownership. Indeed, for many households, the largest and most important asset is the home they own. Home ownership is one of the cornerstones of wealth building and is generally associated with a range of socially desirable outcomes, including good schools, less crime, and neighborhood stability. For these and other reasons, increasing the rate of home ownership has been a long-standing national priority.

Over the past decade or so, strong gains in employment, relatively low interest rates, and modest price inflation have spurred home buying across all segments of our society. In addition to favorable general economic conditions, home ownership has benefited from the introduction of new information processing technologies, including credit scoring, that have reduced the costs of obtaining a mortgage and from the introduction of a host of new, more affordable mortgage products.

Strong private and public support for home ownership has helped to push the national homeownership rate to 67.8 percent in the third quarter of 2002. While rates for all groups have risen over the past decade, minority households have experienced the largest gains in home ownership. For blacks and Hispanics, homeownership rates averaged 47.5 and 48 percent, respectively, over the past year, up from rates of around 43 percent and 40 percent, respectively, a decade earlier. These trends in minority home ownership are quite positive, but more work remains to further close the substantial gap between minorities and non-Hispanic whites, whose homeownership rate is above 70 percent.

**The Role of Small Businesses in our Economy**
Business ownership has been another area of economic progress for minorities. The Federal Reserve has an ongoing interest in small businesses and their access to credit, which stems, in part, from the significant role that small businesses play in our dynamic economy. By some estimates, we have upwards of twenty-five 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 no employees, small businesses, collectively, employ more than half the private-sector workforce and generate about three-fourths of net new jobs each year. These firms also generate more than half the sales revenues of all U.S. firms. In addition, research has consistently found that small businesses contribute vitally to the economies of urban and rural communities.

The expansion of the last decade provided a favorable climate for small businesses generally and for minority-owned firms in particular. The year 2000 alone saw the creation of more than 600,000 new firms with employees in the United States. Moreover, in recent years, the number of minority-owned firms has been expanding at a rate more than four times that of U.S. businesses overall. Nonetheless, minority-owned firms still constitute only a small proportion of all small businesses. As of 1998, about 15 percent of all small businesses were minority-owned: about 4 percent each were black-owned and Asian-owned, and 6 percent

were Hispanic-owned.

**Small Business 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 small business activity. Our most recent report to the Congress in September on the availability of credit to small businesses provides an extensive review of developments in recent years. In the report, we noted that business-financing flows to both large and small borrowers, after having been strong in the late 1990s, have since moderated along with the pace of economic activity. Debt growth appears to have held up better at small firms than it has at large firms, and small businesses did not report material difficulties in obtaining credit during the recent downturn. From 1997 to 2002, the demand for credit by small businesses tracked the pattern of debt growth. Equity financing of small businesses showed a similar pattern: It surged in the late 1990s but then slowed after 2000 when stock prices began to decline and venture capital funding became less available.

An important input into our analysis of small businesses is the Board's Survey of Small Business Finances, which is conducted every five years; the most recent was in 1998. These surveys collect 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 over-samples firms owned by various minority groups.

These data have been extremely useful for our understanding of the role that discrimination may play in affecting small business credit markets. Research based on data from the surveys has 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, sales, or employment), newer, and more likely to be located in an urban area than their nonminority counterparts. Black-owned businesses also tend to be owned by younger individuals with fewer years of experience and poorer credit histories. Finally, black-owned businesses are more likely to be sole proprietorships and in the services industry. Other differences between other minority-owned firms and white-owned firms have been identified, but they tend to be less pronounced.

Clearly, many factors are considered in credit decisions. Smaller businesses, which tend to have less equity capital available, fewer assets to pledge as collateral, greater variation in earnings streams, and higher failure rates, may be expected, on the whole, to experience greater scrutiny in the process of obtaining credit than larger businesses 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, research has also shown that many minority- and women-owned firms differ from white- and male-owned firms in some of their credit market experiences. In general, studies have concluded that black-owned firms are generally more likely to be turned down for credit. However, when examined more closely, the general pattern has been found to mask more complex relationships. For example, differences in denial rates are less pronounced in urban markets,

which account for a vast majority of firms in the study, than in rural areas. And when small retail firms are considered separately, denial rates for black-owned firms and for white-owned firms are similar. Clearly, additional research is needed to fully understand these complexities. Indeed, these data alone cannot identify discrimination because they do not include all the unique factors involved in each credit-granting decision.

Whether discrimination helps to explain the various credit market experiences of small businesses owned by individuals from different demographic groups--and, if it does, to what extent--is difficult to determine. Discrimination in any creditor's decision is disturbing, and the moral and legal objections to it 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 that markets that should work do not.

I can assure you that the Federal Reserve will remain vigilant for any indications of illegal discrimination in 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 on credit availability and constraints, including 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 and to promote small business development. 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 financial institutions, their customers, and communities understand and address community credit needs. This is no small commitment. The Federal Reserve Board and the Reserve Banks 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 Federal Reserve Banks over the past three years have sponsored educational conferences, seminars, and workshops focusing on emerging community development issues, which more than 45,000 people have attended. Some issues addressed have been related to affordable housing, but recently our activities have focused increasingly on issues related to small business, economic development, and financial literacy. Each Reserve Bank develops programs that are tailored to local needs. For example, the Federal Reserve Bank of Atlanta worked with staff at Georgia State University to research growth patterns of minority-owned businesses. The New York Bank, in partnership with the University of Buffalo, held a conference that explored economic challenges faced by inner-city communities and effective strategies for business development. A recent conference at the Dallas Bank examined the role of technology in community development, discussed financial services in distressed communities, and considered ways of delivering financial services to those without bank accounts.

In 2001, the System's Community Affairs Offices held their second biennial research conference, featuring studies on the delivery of financial services to lower-income populations and small businesses. Topics included the Community Reinvestment Act,

predatory lending, credit scoring, wealth creation, and alternative financial services. The published proceedings are available on the Board's web site. The 2003 conference will be an opportunity for researchers to explore subjects such as evaluating the role of social and private capital in fostering economic development and measuring the success of programs designed to support business development and economic well-being.

Besides these programs, 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.

As I noted earlier, many Americans do not understand the basics of personal finance and lack the sophistication to fully exploit the range of available financial services. Some are easy targets for abuses or make poor choices in the use of credit. The inability of many households to effectively budget, save, and invest is a barrier to their securing their financial future. The Fed is actively supporting efforts across the nation to increase financial literacy. In fact, we offer programs to our own workforce on financial matters. Our Community Affairs and Public Information Offices have recently embarked on a national initiative to highlight the importance of financial literacy and heighten the visibility of economic education programs. Here, for example, staff members of the Pittsburgh Branch of the Cleveland Bank are working with officials of the Pittsburgh Community Reinvestment Group to host a December workshop on preventing predatory lending. This event will offer credit counselors additional information on the use of credit reports and detailed instructions on how to read loan documents, enabling them to serve as more highly trained resources for their constituents.

**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. Our goal is, through effective monetary policy, to help maintain price stability and to create conditions for sustainable economic growth, which will provide continued opportunities for families and small businesses to flourish. In an environment of sustainable economic growth and stable prices, a rising proportion of our citizens will be able to enter the job market and obtain important skills that can be life-transforming. By creating conditions conducive to maximum sustainable growth, the Federal Reserve can best do its part to improve the chances that all Americans have to ensure their financial well-being. Through our supervision of banks, we monitor financial institutions' compliance with laws requiring them to offer credit fairly and impartially. We will continue to collect information and conduct research on consumer finances and on small business credit markets. Finally, we will continue to promote financial literacy. Through all these efforts, we are working to ensure enhanced job opportunity, business expansion, and wealth creation for all Americans.

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