



Sub-prime mortgages and segregation

Sub-prime mortgages were supposed to put an end to segregated neighbourhoods by allowing affordable housing to more people. But a new study shows that better access to mortgages leads to more - not less - racial segregation.

With the election of Barack Obama as President of the USA, it is easy to believe that America has entered a post-racial era, where race relations are no longer a source of contention. But a study by INSEAD Professor of Economics, **Amine Ouazad**, reveals that while the government has taken active measures to increase racial integration in the country, market forces often lead to segregation.

In America, race continues to be correlated with class. African-American neighbourhoods tend to be poorer, less safe and far from good schools. Good neighbourhoods, on the other hand, tend to be predominantly white. During the Clinton administration, the government's theory was that offering easier access to mortgages would allow racial minorities to afford houses in better neighbourhoods. Ouazad explains, "There has been a lot of intervention in the mortgage market by the federal government, by sub-prime lenders, by independent mortgage brokers. There was a far-reaching political statement that we are giving hope to people by providing credit. We will have better neighbourhoods and more integrated communities."

In his study, Ouazad wanted to test this theory. He gathered 13 years of data from 1995 to 2007 about housing loans, the location of houses bought by new

home-owners and the racial demographics of schools. During this period, America was at the height of a credit boom as a result of cheaper mortgages. Ouazad's study revealed the surprising result that the policy of increasing credit supply had the opposite of its intended effect: it increased segregation. The question is why? Ouazad says the study provides several clues.

Personal preferences

The first has to do with people's personal preferences. Ouazad's study shows that when people receive a housing loan, they tend to choose to live in less diverse neighbourhoods. This was particularly clear with the Hispanic population. Ouazad explains: "The most important story is the increase in the Hispanic population over the period. We have a doubling of the Hispanic population as a fraction of the US population over the 1990-2000 decade. Hispanic households tended to use credit to move to Hispanic areas or to white areas. They tended to avoid neighbourhoods where there is a large fraction of African Americans." Ouazad makes it very clear that the decision about where to buy a house was not necessarily motivated by race. "It's not about race, per se. It's that Hispanic households may want to move to better neighbourhoods and unfortunately, this is strongly correlated in the US by

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race. African American neighborhoods tend to be the worst neighbourhoods.”

Housing inflation

The second reason for increased segregation has to do with inflation. While some cities in America, such as Austin, Texas, have plenty of space to build houses for new home-owners, other cities, such as San Francisco, California, cannot accommodate new houses. In cities where the supply of housing is constrained by features of the landscape and by land use regulations, housing prices went through the roof during the credit boom. Ouazad says that the inflation of house prices was so steep that it priced out minorities, even when they had loans. “As prices kept going up, it cost more and more to get into a better neighbourhood. Minorities were still excluded, but at a higher price. It affected whites and Hispanics and African Americans differently because as the prices shoot up it is only the high income individuals who can keep the pace of the price increases.”

In America, schools are funded locally by the neighbourhoods in which they are located. The best performing schools tend to be those that are well funded by the taxes of wealthier households. In order for families to get their children into better schools, they need to buy houses in better neighbourhoods. As a result, the increase in segregation of neighbourhoods has led to an increase in segregation in schools as well. Ouazad thinks that this is an unfortunate outcome. “One of the purposes of education is to train citizens and to increase the awareness of races. If you value integration, you really want to integrate school systems.”

Race in America today

The findings of Ouazad’s study have a lot to say about the state of race in America today. Until the 1960s, the US government instituted the so-called Jim Crow Laws that mandated segregation in all public facilities, including schools, buses, restrooms and restaurants. Laws also prevented the sale of certain houses to minorities. The civil rights movement attempted to undo these laws and by 1971, the government had repealed the legal enforcement of segregation. Ouazad believes that in the years after desegregation, “the market was partly a substitute for these laws. The market has played the role of segregating households.” This has been shown in an academic paper by Cutler, Glaeser, and Vigdor (1999).

This points to the power of market forces to effect social changes in society. The market can be much stronger than the federal courts in terms of shaping people’s daily experiences with race. Ouazad urges

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governments to carefully consider the ramifications of interfering with market forces. In this case, the policy makers who attempted to increase the supply of credit did not foresee that this could push prices up. Ouazad asserts, “the market is operating in the background and policies may not be as effective as we think because there is going to be a reaction in the market in house prices and school quality which is capitalised into house prices.”

Since the Obama election, there has been a general sentiment that race is no longer a central factor in people’s thinking and decision making. Ouazad’s research indicates that race still plays a dominant role in society, not primarily through conscious racial biases, but simply because we want to live in better neighbourhoods and we want our children to go to better schools.

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