Financial institutions in disadvantaged areas: a comparative analysis of policies encouraging financial inclusion in Britain and the United States

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Abstract. The paper compares British and US government policy initiatives to combat financial exclusion and promote community reinvestment. Financial exclusion, a general term applied to those who lack financial products, is concentrated in a small number of deprived urban areas in larger cities that are also starved of private sector investment. British policies, though they have drawn on US experience, predominantly treat exclusion as an individual problem and pay insufficient attention to the wider interconnections between people and place that underlie financial exclusion. These are more prominent in the Community Reinvestment Act (CRA) that has led to significant improvements in financial inclusion and community investment in the USA. The CRA is underpinned by a more compartmentalised and locally embedded system of financial regulation. Consolidation in the banking sector and the growth of competition between banks and other financial institutions in an increasingly integrated US financial sector threaten this. British policies seek to provide ‘joined-up’ solutions to financial exclusion in a manner that is more in tune with an integrated financial sector where a small number of large banks compete on a level playing field with other financial institutions. The paper highlights the difficulties that these policies face in enlisting the cooperation of financial institutions.

The growth of policy interest in finance exclusion
Changes in regulation and competition have combined with advances in information technology to change the economics of the financial sector, intensifying pressures for rationalisation and financial exclusion. Financial exclusion, a generic term applied to those who lack financial products (Kempson and Whitley, 1999), is connected to wider increases in income inequality and demographic trends, such as the growth in single parents and the fact that people are living to an older age (Kempson et al, 2000). Such exclusion is concentrated in a small number of deprived urban areas in larger cities, though there are pockets in urban and rural areas in all regions. The closure of bank branches in such areas and the impact of this on the access of local communities to financial services has become a major issue in the last few years. This is paralleled by a wider concern that the poorest urban and rural locations are becoming ‘no-go’ areas for private sector investment and that such communities are heavily dependent on philanthropy and public money for urban regeneration (Mayo et al, 1998).

In Britain policy initiatives aimed at improving access to financial services are at the heart of New Labour’s attempts to provide integrated solutions to social exclusion and promote renewal in deprived neighbourhoods (HM Treasury, 1999a). The British government has drawn on US experience (Hogarth and O’Donnell, 1999) to develop its policy solutions. The influence of US policy reflects the strong tradition of community reinvestment in the USA, and the way US-inflected ideas are fostered by the ‘fast policy’ transfer of ‘off the shelf’ solutions based on US experience. According to Peck and Tickell such, “mechanisms of international and interlocal policy transfer — which take place along channels that have been created, structured and lubricated by technocratic elites, think tanks, opinion-formers, consultants, and policy networks — have been rapidly
established as one of the principal modes of policy development in strategically critical fields” (Peck and Tickell, 2002, page 398).

Britain, where New Labour’s Third Way borrowed extensively from the Democratic Party under Clinton, has been particularly susceptible to such policy adaptation. The influence of US policies towards the financial sector on Britain also has a longer history. According to Moran (1991), in the 1980s the USA was the epicentre of a so-called ‘financial services revolution’ in which financial regulation and market practices in Britain and elsewhere were rewritten, modelled on the more competitive US financial sector, and its functionally and institutionally specialised regulatory structure.

As part of its attempts to promote financial inclusion, Britain has sought to develop simpler and cheaper financial products more suited to the needs of those on moderate incomes, drawing especially on US experience of basic bank accounts. The introduction by the British government of electronic payment of benefits, drawing on a similar scheme in the USA, represents both a threat and an opportunity. On the one hand, it could potentially undermine the income of many post offices, frequently used by the most financially vulnerable to obtain social security benefit. However, if well handled, it presents an opportunity to ensure that those currently outside the financial system have better access. The government is also encouraging the growth of community development financial institutions that are popular vehicles for the development of financial services and investment in deprived areas in the USA.

It is too early to evaluate fully the effectiveness of the British initiatives (Jones, 2003). However, a comparison of these policies with the approach towards community reinvestment in the USA suggests British policy does not deal very well with the cross-cutting character of financial exclusion, which is a product both of people and of place. It focuses on financial exclusion as an individual or household problem, and has been less active in addressing the wider role of financial institutions in investment in local communities. US policy towards financial inclusion, enshrined most notably in the Community Reinvestment Act (CRA), has a more explicit spatial and community perspective (12 USC section 2901 et seq). This has led both academics and community groups to advocate the introduction of the CRA in Britain. An assessment of the operation of the CRA in the USA suggests it is not a panacea for financial exclusion. It relies for its justification and effectiveness on the regulatory compartmentalisation of the financial sector in the USA and on the separation of banks from other financial services. This is being undermined by the deepening integration of the financial sector. Arguably the British approach to combating financial exclusion, emphasising partnership and joining-up separate initiatives, is more in tune with the complex character of financial exclusion, wider changes in the financial sector and associated reforms of financial regulation and supervision. However, the British experience also highlights the difficulties that such policy faces in enlisting the cooperation of financial institutions.

Financial exclusion and disadvantaged areas
Academic research makes a powerful case for government intervention to combat financial exclusion. There is no precise figure for those people financially excluded (Comptroller of the Currency, 1997; OFT, 1999), and access to and exclusion from financial services are measured in a number of ways. However, in an increasingly cashless society, life is difficult without access to a bank (or building society) account. For those on modest incomes and with limited savings, the risk of becoming overdrawn and incurring high charges is a powerful disincentive to operating such an account (Caskey, 2002; Hogarth and O’Donnell, 1999). Consumers without bank accounts may have to pay to have their wages cashed, and they may pay more for services such as gas and electricity. Those without bank accounts lose access to the wide range of services
where the bank account acts as a gateway. Access to short-term credit is an important part of managing on a very restricted budget. However, people without a financial history, with inadequate savings, or problems in their credit record, can find it difficult if not impossible to obtain credit from mainstream lenders (Caskey, 2002). Vulnerable consumers are likely to lack household contents insurance and be less able to replace things lost. Risk assessment has become increasingly sophisticated, and those who live in areas of high crime (who tend to be those who are vulnerable) have to pay higher premiums even though they need insurance most. Developments in technology and the growth of Internet and telephone banking have increased the range of distribution channels for financial services, and in principle could bring benefits for the vulnerable, but such groups currently have low access to such technology.

The Office of Fair Trading (OFT, 1999) estimates the number of people in Britain without bank and building society current or savings accounts as 6–9% of individuals (2.5–3.5 million people), but as many as 14% of households have no current account. Access to such financial services is as bad in the USA as in Britain. The 1998 Survey of Consumer Finances indicates 10% of all families were without a transaction account (cheque or savings account). Interestingly, there was a decline in the percentage of families without deposit accounts between 1995 and 1998. However, those without access to transactional banking in the USA are more likely to have to rely on high-cost alternative providers such as cheque-cashing outlets or payday lenders (Kempson et al., 2000).

Using data from the Family Resources Survey (which does not include home contents insurance), Kempson and Whyley (1999) estimate that around 1.5 million households in Britain (7%) have no mainstream financial products. A further group of households, approximately 4 million strong (19% of households) make limited use of financial services (that is, use one or two services). Comparative analysis of British and US evidence shows there is no single explanation for households being on the margins of financial service access (Kempson et al., 2000). Those never engaged tend to be the young who have not yet developed a financial relationship or the old who are part of the cash generation. Those characterised by low or no use of financial services are poor, and the household tends to be in rented accommodation and headed by someone in receipt of state benefits. They are single people and couples who do not have a secure job, and ethnic groups for whom language, culture, and religion may be barriers (Kennickell et al., 2000). Relatively few people are denied access by financial institutions, exclusion occurs on the grounds of price, products that are inappropriate to peoples’ needs, and the fact that no one is trying to sell them products (Caskey, 2002). A lack of financial literacy leads some to self-exclusion, while mistrust of financial institutions or positive choice encourages others to use alternatives to mainstream sources of finance (Ford and Rowlingson, 1996). However, exclusion is a dynamic process with a substantial minority of households moving in and out of using financial services as their circumstances change (Kempson and Whyley, 1999).

British research shows the use of financial services also depends on where people live. Access to financial services is lowest in Scotland (13% of households have no financial products), the North, Greater London, and the North West (9% of households have no financial products). It is highest in the South East where only 3% of households have no financial products. Differences are more marked at the local level. Almost half of those with no financial products (47%) live in one of the fifty most deprived districts and boroughs in England and Wales. Households living in these fifty deprived local authorities are at least six times more likely to have no financial products than those living in the sixty-five authorities with the least deprived populations (Kempson and Whley, 1999). However, statistical analysis appears to suggest that
geography is not the primary determinant of the individual take-up of financial products. Only a small number of people say they do not have a bank account because there is no branch nearby (Hogarth and O’Donnell, 1999; OFT, 1999). Alternative delivery mechanisms, such as partnerships between supermarkets and banks, and cashback facilities at shops contribute to reducing the geographical aspects of individual exclusion (Kelly, 2001a; 2001b). In a study of the implications of branch closure in Britain Kempson and Jones (2000) found that, despite the recent wave of branch closures, 75% of households and firms were still within half a mile of a branch, though the numbers were lower in rural areas (32% and 27%, respectively). In a large-scale survey of the 15% of the population most distant from a branch (that is, more than 1 mile from a branch in urban areas and 4 miles from a branch in rural areas) only one in ten people said they found access to a branch difficult. A minority of firms, who used branches frequently, said they found it difficult to reach their branch (11%). In total it was estimated only 1.5% of the total population had some difficulties. Those most likely to experience problems were the self-employed who worked from home and small retailers, as well as the elderly and those with disabilities.

Such evidence would seem to support a policy that plays down the significance of space and place. However, treating financial exclusion solely as an individual or household problem neglects the interlocking nature of financial exclusion where many of the factors associated with exclusion are intimately tied up with the dynamics of the local economy, and the ways in which local labour and housing markets work to segregate the disadvantaged spatially. Since the early work of Harvey (1973), geographers have been well aware of the power of money to shape place. Market psychology and informational asymmetries tend to restrict the flow of capital to older, low-income, inner-city neighbourhoods, even where profitable returns are available on investment. These processes may manifest themselves as ‘finance gaps’ whereby individuals and enterprises in disadvantaged areas with less money to start with find it difficult to gain access to credit and financial services more generally (Mayo and Mullineux, 1999). However, they reflect deeper seated processes.

Changes in regulation and competition in the financial sector, although they have increased access for the majority, have promoted rationalisation and financial exclusion in deprived areas (Leighton and Thrift, 1997). Here financial exclusion, in turn, reinforces patterns of social disadvantage including poor housing, low income, and inadequate services in disadvantaged neighbourhoods. For example, the reduction of the bank branch network in poorer areas, brought about by the entry of new institutions into the market using electronic forms of delivery of financial services and the drive of existing operators to reduce costs, creates difficulties for retail businesses handling cash in those areas and results in customers going elsewhere for their retail banking taking their spending power with them. People go out of the local area to shop, because they are also going out of the area to bank (Mayo et al, 1998). A reduction in retailing demand in areas deserted by financial institutions, in turn, reduces retail presence and property values and ultimately new investment by financial institutions, and the local area without a branch can enter a downward spiral of urban degeneration and decline. Ultimately, the rationalisation of branches in financial institutions may contribute to “cross-cutting and systematic marginalisation” (Speak and Graham, 1999, page 1999) of communities. Restructuring in the financial sector can combine with similar trends of withdrawal from the same communities by private services such as energy, telecommunications, and food retailing. These trends in combination threaten “to undermine severely the degree to which marginalised urban neighbourhoods can hope to achieve any meaningful degree of ... inclusion in ... wider metropolitan life” (Speak and Graham, 1998, page 1998). Thus, “A financial system which once facilitated
wealth building for households and communities now exacerbates initial discrepancies in income and wealth … resulting in financial dynamics that lead to growth in one area but cause decline in another” (Dymski and Veitch, 1996, page 1234). The operation of these interconnected processes suggests the need for integrated policies towards financial exclusion, and raises questions about whether policies that focus on financial exclusion as an individual or household problem can be fully effective.

Government policy towards financial exclusion in Britain
A joined-up approach to financial and social inclusion
New Labour has signed up to the government ‘modernisation’ agenda popularised by Osborne and Gaebler (1992), and policies to combat financial exclusion are presented as a ‘joined-up’ approach to promoting neighbourhood renewal and wider social inclusion (Johnson, 2000; Kelly, 2002). The government believes that the classic functional separation of central government spending departments is inadequate to deal with the complex nature of exclusion (Ling, 2002). This difficulty, so it is argued, has been further compounded by the civil service reforms of the 1980s and 1990s that introduced agencies, internal markets, privatisation, and market testing and compulsory competitive tendering (Cabinet Office, 1999). Although these increased the focus of government on delivering services, they also made policy coordination more difficult.

The Cabinet Office has assessed the skills, budgeting arrangements, and leadership styles needed for joint working, and established the Social Exclusion Unit to facilitate joined-up working (Policy and Innovation Unit, 2000a; 2000b; 2000c)(1). The Treasury’s cross-cutting Public Service Agreements with individual government departments have also promoted joining-up. Though attention has focused on the work of the Cabinet Office Policy Action Team (PAT 14) (HM Treasury, 1999a) as marking a defining moment in the development of government policy on financial exclusion, in fact, a number of reports came together at about the same time to clarify government thinking. PAT 14 argued that too many people were excluded from the financial system, and financial products needed to be more tailored to the needs of low-income borrowers. The OFT (1999) highlighted that more wealthy and sophisticated consumers of financial products were in effect subsidised by those taxpayers who paid for the regulatory costs of the financial sector but had limited access to financial services. The Policy and Innovation Unit (2000c) argued the Post Office (PO) could form part of the policy solution to financial exclusion. It was trusted by the financially vulnerable in receipt of benefits from its widely distributed and easily accessible branch network. The Treasury Task Force (HM Treasury, 1999b) on credit unions also argued they offered a means of extending affordable financial services to those on modest incomes. The Social Investment Task Force (2000), reported to the Chancellor on ways of using community development financial institutions (CDFIs) to improve investment in the poorest areas. This work was consistent with the Cabinet Office Policy Action Team’s report on Enterprise and Social Exclusion (PAT 3). It argued for additional financial assistance for the Small Business Service to encourage enterprise and business growth in disadvantaged areas (HM Treasury, 1999c).

A collaborative partnership
Policy on financial exclusion ties in with the government’s desire to combine a focus on competition and enterprise, more common in the USA, with a stronger concern for

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(1) The Social Exclusion Unit’s remit covers only England, but similar initiatives are underway in Wales and Scotland. In Scotland, as part of its Social Inclusion Strategy, the Local Anti-Poverty Strategy Team has conducted a similar analysis to PAT 14 and made broadly similar recommendations (Kempson et al, 2000).
social justice. The emphasis is on partnership between central government and the private and voluntary sectors to develop a multifaceted approach towards financial exclusion (Johnson, 2000; Kelly, 2001b). The Financial Services Authority (FSA) has been given a specific objective to promote public understanding of the financial system, increase financial literacy and improve the financial advice available to consumers. Regulation by the FSA has moved to a ‘risk-based’ approach rather than extensive documentation of the sales process, with the intention that it should be lighter touch and thereby reduce the cost of compliance. An important element of the government’s approach has been to counter the high degree of complexity and opacity in retail savings markets, because, “highly complex products, sold with often equally complex advice, will inevitably exclude consumers below a certain level of income because of the fixed costs of the advice process” (Sandler, 2002, page 23).

Improved product regulation, including voluntary benchmarking, has sought to provide an inbuilt means of consumer protection and so minimise the cost of expensive face-to-face advice. The price capping of such products with a 1% per annum charging regime has sought to exert a further downward pressure on the cost of advice.

The government has promoted insurance with rent schemes with the Association of British Insurers and the Housing Corporation. In these schemes the local authority, or social housing landlord, negotiates property insurance collectively on behalf of tenants with insurance companies or brokers, and incorporates insurance premiums with the rent for the property. This reduces the cost of premiums, and demystifies and eases the process of payment. It helps to avoid the problem whereby those in areas of high crime, and most in need of insurance, are least able to obtain it. Drawing on US research and experience (Comptroller of the Currency, 2000; Kempson et al, 2000), particular attention has been devoted to developing a basic bank account suited to the needs of those on modest incomes (Sinclair, 2001). It is estimated by the British Bankers’ Association (BBA, 2002) that 5.5 million basic bank accounts had been established by twelve banks and building societies. The accounts provide access to a debit card, automatic cash dispensers, and money transmission services, without any danger of going overdrawn. However, not all of these accounts have been established as a result of government policy, nor have they necessarily been taken up by those previously excluded. There is concern that banks do not publicise these accounts (FSA, 2002), and this mirrors experience in the USA (Kempson et al, 2000).

The Universal Bank (UB) is also a significant component of the government’s policy. As originally conceived by the Policy and Innovation Unit (2000c) this was a social bank providing financial services to those on low and modest incomes. In 1999 the Department of Social Security announced, following an earlier initiative in the USA (Comptroller of the Currency, 1997; Hogarth and O’Donnell, 1999), that it would pay benefits directly into claimants’ bank accounts via automatic credit transfer (over the period 2003–05). This threatened the viability of the PO network that obtained approximately one third of its income from the department for the payment of cash benefits to recipients. However, the automation of benefits could also allow an extension of the range of financial services provided by the PO. It was necessary for those on benefits to have a bank account of sorts for their electronic payment, such people would not see the PO as a traditional bank, and it could therefore be used to attract the ‘unbanked’ into the financial system. The PO network would extend the availability of accounts to locations without bank branches, because 94% (85% in rural areas) of the UK population live within one mile of a PO (Policy and Innovation Unit, 2000c).

In the process of tortuous negotiations between the banks, the PO and government, the UB concept was revised to the provision of Universal Banking Services (UBS). The result looks more like an extension of the long-standing arrangement of the PO to
provide a facility to cash personal cheques and make deposits for account holders of other banks. Under the UBS the basic bank accounts of the various banks will be provided through the PO network. A basic card account will also be established by the PO, supported by £180 million of investment over five years from the banks. Those benefit recipients who do not wish to open a basic bank account can use the card account to receive the electronic payment of their benefits and as a stepping stone to the basic and other bank accounts provided by financial institutions through the PO (Halliday, 2002).

There are good grounds for scepticism that such an account will bring the unbanked into the banking system, and this concern is mirrored by critics of the US experience (Stegman, 1999). The banks are concerned about the overlap between their basic bank account and the UBS concept (Treasury Select Committee, 1999a; 1999b). The Treasury Select Committee (1999a) argues UBS is more of an attempt to solve the PO problems than address financial inclusion. Certainly, the PO's network of 17,500 offices is struggling to adapt to economic and social changes (Postcomm, 2001; 2002). PO counters lost £163 million in 2001/02, and post offices have been closing at a rate of 1–2% a year for more than ten years, with the majority of the closures in rural areas (often as a consequence of sub-post masters and mistresses retiring). The PO promises, in the future, it will not close any PO in a deprived urban location (that is, in one of the poorest 10% of wards in the United Kingdom) where there is no branch within half a mile. Rural post offices will also be maintained until 2006 (Corbett, 2002). However, in the context of Postcomm's (2002) concern, it seems reasonable to be sceptical about whether UBS will provide suitable access to financial services for the financially vulnerable.

Community, mutuality, and exclusion
Although considerable effort has been devoted to combating individual and household exclusion, less attention has been devoted to the role of the financial sector in investment in the wider community and the way in which this intersects with exclusion. The Social Investment Task Force (2000) recommended, based on a review of the more extensive US community investment infrastructure, the expansion of 'alternative' financial institutions to promote more commercially orientated private sector investment in deprived areas. This included a tax relief for private and corporate investors to channel money through CDFIs to enterprises in deprived communities, and this was duly announced at a rate of up to 5% of the value of the total investment in 2002. The Task Force also recommended government funding (set at £20 million) for a venture capital partnership fund between government and the private sector, to facilitate long-term investment in businesses in disadvantaged areas. This builds on the Phoenix Fund that provides £96 million to promote enterprise in deprived areas including a development fund and direct financial support for CDFIs (Hambly, 2002). The Task Force also proposed greater latitude for investment in community initiatives and this has resulted in a clarification of the charitable position of CDFIs. Greater support for the CDFI movement is being provided by the development of a trade association and a training support programme (Hambly, 2002). However, more needs to be done to assist CDFIs that tend to operate on the margins of the existing legal and regulatory system.

While government has recognised the contribution of mutually owned CDFIs to mitigating financial exclusion, it is curious that they should neglect the potential contribution of the much larger mutual building societies. Between 1986 and 1999, ten of the fifteen largest building societies demutualised, accounting for approximately 60% of the assets of the sector. The demutualisation of some building societies was unstoppable when New Labour came to power in 1997. However, they failed to appreciate or respond
to the negative social impact of demutualisations including financial infrastructure withdrawal, and have been short sighted about the potential for the mutual building societies to contribute to their wider policy objectives with regard to financial exclusion. Based outside the City of London, with strong community ties and a commitment to social responsibility, societies are sensitive to the needs of their local community, and in tune with government’s social priorities. Moreover, government has until recently been deaf to the pleas of the remaining societies for protection from carpetbaggers arguing that demutualisation is solely an issue for the members of a society (Marshall et al, 2003).

This neglect is particularly surprising given that the initial reaction of most of the high street banks to the thrust of government policy towards greater social responsibility was lukewarm (Treasury Select Committee, 2001). Most banks saw themselves as “commercial companies responsible to their shareholders and their depositors”, who work “with their local communities primarily in order to further their business” (Buxton, 1999, page 1). They argued government’s emphasis on both increasing competition and enhancing social responsibility was contradictory (BBA, 2000, page 1; Sweeney, 1999, pages 3–4). Attitudes in the industry have softened and institutions have under pressure become more sensitive about, and slowed the pace of, branch closures. A plethora of new social initiatives has been pursued, as indicated by the extensive social reports of the main institutions (see http://www.co-operativebank.co.uk, http://www.society.barclays.co.uk, and http://www.lloydstsb.com). Nonetheless, relations between the government and the banks have remained strained, and the sector has been under an almost continuous process of review as the government has striven to get its way. The banks are still some way off investing extensively in deprived communities for commercial reasons alone. These depressed communities are perceived by the financial community as places where normal market conditions do not exist, and where public and private enterprise has failed. Andrew Robinson, Head of Community Development Banking at NatWest/Royal Bank of Scotland argues, “the biggest block to bank involvement [in community development] is a lack of awareness of the market potential and a predisposition to respond to the problems associated with poverty with charity” (Palmer, 2002, page 15). As Peter Kelly, Head of Barclays’ Financial Inclusion Unit says, the approach is still very much “lending and learning” (Palmer, 2002, page 15).

With the demutualisation of most building societies, and the small scale of the CDFI sector, credit unions are the only locally owned, mutual financial institutions in many communities. The Treasury Task Force (HM Treasury, 1999b) argued for a more commercial model of credit union development, not unlike that in the USA where credit unions operate together with established financial institutions in the provision of finance for local development. This included the professionalisation of credit unions, to provide a platform for the expansion of their low-cost financially inclusive services aimed at those who are currently not part of the financial mainstream. It also recommended the provision of an improved legislative and regulatory framework and the establishment of a Central Services Organisation. In 2002 credit unions were brought under the FSA’s regulatory umbrella, so depositors could be afforded the same degree of protection and security as depositors in banks or building societies (Kelly, 2002; Davies, 2000). Minimum prudential standards were introduced, and the restrictions on the availability of external sources of finance to credit unions relaxed. Credit unions are expanding their membership (by 17% a year), however, the majority are quite small, and there were only 300,000 members in 700 credit unions in 2001, and approximately half of credit unions were employer based rather than operating in the community (Spiers, 2002). A Central Services Organisation, which
could provide credit unions with back office administrative support and the financial and technical expertise for them to provide a broader range of services, remains elusive. Extensive negotiations with the high street banks have broken down, though Barclays is currently supporting pilot projects. The Co-operative Bank has also agreed to provide a PayPoint facility for credit unions that will enable members to make deposits through 10,000 accessible outlets across the country. However, for credit unions to be successful they will need to overcome their image as the financial institution for the poor (Spiers, 2002). They will also need to resolve the tensions implicit in combining a new more commercial and wider economic development approach with their traditional socially inclusive and mutually committed role (Fuller and Jonas, 2002).

Though British policy on financial exclusion has drawn extensively on US experience, one important strand of US policy is missing. No parallel to the Community Reinvestment Act (CRA) has been introduced. A CRA, with an explicit geographical focus along the lines of the existing act in the USA, has been advocated by community groups (Campaign for Community Banking Services at http://home.btclick.com/ccbs; French, 1997). Government has even used the possibility of a CRA as a threat to encourage financial institutions to cooperate with its policies (Palmer, 2002). However, the dominant view is that the current voluntary approach and its associated national targets should be given a chance to work (BBA, 2002; Donovan and Palmer, 1999; HM Treasury, 1999a). As a consequence, there is a real danger that in Britain the individual initiatives described above will not make coherent sense at the local level.

US policy towards financial exclusion: the Community Reinvestment Act

The act

The CRA is a central plank of the US approach to combating financial exclusion. It was introduced in 1977, in response to evidence that US banks and savings associations designated ‘no-go’ areas for new investment based on the racial composition, age, or income characteristics of an area (so called ‘redlining’). However, in practice, the CRA is not solely aimed at combating such discrimination. The premise underlying the CRA is that markets left to their own devices tend to restrict the flow of capital to older, lower income, and ethnic minority borrowers concentrated in inner cities, and that this is an important cause of the physical deterioration of such neighbourhoods (White Haag, 2002). Financial institutions may overlook opportunities for investment in these areas because of a lack of information and specialist knowledge, low levels of investor confidence, high transaction costs, and the attraction of alternative investment opportunities. The CRA aims to jump-start healthy market forces by encouraging banks to take a second look at such subprime markets. Banks are regarded as having a public obligation to serve these markets as a quid pro quo for the subsidies and benefits provided to them by the state through their charter to operate, deposit insurance, access to the payments system, and low-cost credit (Litan et al, 2000).

As established in 1977, the CRA provided banks and savings institutions with an affirmative obligation to meet the credit needs of the entire community (in a manner consistent with safe and sound banking practices), including low and moderate income (LMI) borrowers and borrowers (individuals or businesses) in LMI neighbourhoods. The CRA focuses primarily on widening access to mortgages and small business

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(2) LMI individuals as defined by the Federal Financial Institute Examination Council for the CRA are borrowers with household incomes of less than 80% of the median family income for the local Metropolitan Area. LMI areas are census tracts with median family incomes of less than 80% of the average for the Metropolitan Area. Low-income individuals are defined in the CRA regulations as those with less than 50% of the median income and those on moderate income with 50–80% of the median income.
lending for those on modest incomes. It does not target the very poorest and socially excluded in society, nor does it address individual access to transactional banking (or insurance) which has been the focus of policy interest in Britain. The three main elements of the CRA are disclosure of the pattern of lending and investment behaviour of financial institutions (allowing banks and local parties to identify gaps in the market); a rating system of their behaviour (thus affecting their reputation if they are not sensitive to the needs of the community); and sanctions against those institutions that do not comply with the legislation. The principal means of enforcement is the direction that federal banking regulators assess an institution’s CRA record when evaluating its application for additional deposit facilities, mergers, and other expansions. Local community groups can also monitor an institution’s record of lending, and challenge a pending application on the basis of CRA concerns. This process provides an opportunity for them to negotiate commitments by an institution to invest in their area. Several other laws relating to community investment intersect with the CRA and increase its effectiveness (Mayo and Mullineux, 1999). The Fair Housing and Equal Credit Opportunity Acts ensure equal access to credit. The Housing and Community Development Acts state that no person may be excluded from participation in a funding programme on the grounds of race, colour, or sex. The Home Mortgage Disclosure Acts require that depository institutions publish detailed information on mortgage lending by income, gender, and race for each census tract. The CRA reinforces this legislation by providing a mechanism to ensure that institutions serve the entire community.

A more aggressive enforcement of the CRA regulations was signalled in 1989 when the Federal Reserve refused an application by the Continental Bank Corporation to acquire the Grand Canyon Bank of Scottsdale (Joint Center for Housing Studies, 2002). Public accountability was reinforced by amendments to the CRA in 1990 that required regulators to prepare written public evaluations of an institution’s record in meeting the needs of the entire community. Enforcement was improved in 1995 by focusing on an institution’s actual record of lending in its delineated community rather than the more vague assessment of whether an institution met community needs. This approach has effectively shifted the emphasis of regulation from the documentation of efforts to the actual performance of institutions. A specific category of community development investment was also introduced for evaluation. Today the most extensive CRA regulations, those for larger institutions with more than $250 million in assets, are based on three tests (Avery et al, 2000). The most important is a lending test that evaluates an institution’s record of home mortgage and small business lending in an assessment area defined by its physical facilities. An investment test considers whether a banking institution’s record of community development investment benefits the area in which it is based. A service test considers the availability, in LMI areas, of an institution’s retail banking and community development services. This focuses on an institution’s record of opening and closing branches, and the availability and effectiveness of alternative means of delivering retail banking services to LMI areas and individuals. Following an evaluation of an institution’s performance in these areas, it is given an overall rating of ‘outstanding’, ‘satisfactory’, ‘needs to improve’, or ‘substantial non-compliance’. This rating is then taken into account when regulators act upon an institution’s application to merge or establish a deposit facility (for details see Joint Center for Housing Studies, 2002, pages 19 – 36; White Haag, 2000, pages 22 – 30). Few banks have received a negative report on examination. Between 1997, when the new regulations became operative, and 1999 approximately 20% of the banks examined received an outstanding CRA rating, 79% a satisfactory rating, and 1% a non-compliant or a needs to improve rating. However, where an institution is refused approval to expand or merge specifically on CRA grounds this has a high-profile impact.
Research evidence on the impact of the CRA

Debate on the impact of the CRA is extensive and the conclusions of some research are disputed (Joint Center for Housing Studies, 2002). A comprehensive review of the impact of the CRA, initiated by Congress in 1999, demonstrates that the CRA has had an important influence on community lending and investment. The Treasury Department’s research shows that in 1998 lenders covered by the CRA provided $135 billion of residential mortgage lending to LMI borrowers and areas, $33 billion of lending to small businesses in LMI areas, and $16 billion in community development investment (Litan et al, 2000). A survey of the lending of the largest retail banking institutions and other research evidence compiled by the Federal Reserve Board (Board of Governors of the Federal Reserve System, 2000; Canner and Passmore, 1997) shows that lending under the act has been largely profitable. This suggests the CRA is not forcing institutions into unsound lending practices.

Research indicates that, between 1993 and 1998, there was a rapid growth in residential lending to LMI borrowers and areas, and lending to these groups increased faster than lending to other segments of the population. A number of factors lie behind the aggregate increase in lending, including rapid economic growth, modest mortgage rates, and the development of innovative products for LMI buyers. However, the actions of institutions covered by the CRA, though difficult to quantify precisely, contributed to the increase in the share of lending accounted for LMI borrowers and areas (Litan et al, 2000). This positive impact of the CRA on residential lending is confirmed by regression analysis and evidence from firm interviews and case studies of individual metropolitan areas (Litan et al, 2001). However, this expansion in lending to LMI borrowers has not reached the most vulnerable, the so-called ‘sub-subprime’ borrowers (Kempson et al, 2000). Research by the Urban Institute (1999) also concludes that there is still evidence of racial and ethnic discrimination in the mortgage market. However, such discrimination plays a secondary role compared with families’ financial situation in explaining their different access to credit. Research specifically on African-American homeownership suggests that black homebuyers are more likely to move into more segregated neighbourhoods (Immerluck, 1999). This is possibly consistent with other disputed conclusions that low-income homebuyers are more likely to be successful in applying for a loan in a predominantly poor neighbourhood (White Haag, 2002). Ethnic minority groups may also still be subject to predatory lending where they are charged excessive fees and interest rates, because such lending satisfies CRA requirements (Immerluck and Smith, 2001).

There is less information available on the impact of the CRA on small firm lending and conclusions are more tentative, but it appears likely that the CRA has been less effective. Since 1993, CRA regulations have required large depository institutions to report their small business loans by census tract. The data suggest that bank lending to small firms in poorer areas is lower than lending to more affluent areas (expressed as lending rates per firm). Furthermore, though bank lending to small firms increased during the latter 1990s, it increased more rapidly in upper income areas (Immerluck and Smith, 2001). CRA data on the distribution of small business loans by neighbourhood racial composition suggest that lending is lower in predominantly minority neighbourhoods, and that rejection rates for ethnic minority businesses exceeded those for white-owned businesses (White Haag, 2000). So, though it seems probable that the CRA is dampening down spatial disparities in bank lending to small firms, it is unlikely that it is having a significant positive impact. In contrast, under the CRA large institutions must report loans that have as their primary purpose community development. Evidence here suggests that the CRA has fostered partnerships between mainstream financial institutions and a variety of CDFIs, including locally based
credit unions and microenterprise loan funds. Mainstream financial institutions offer additional financial muscle to the CDFIs, while the specialist local knowledge of the CDFIs allows them to make more risky or unconventional investments than banks and savings institutions. CDFIs also have a positive impact on investor perceptions of an area or type of investment (White Haag, 2000).

In conclusion, then, since the 1990s when the CRA became more effective it has encouraged banks and savings institutions to invest in LMI individuals. The spatial focus of the CRA has both attracted attention to the geographical impact of the lending behaviour of financial institutions and in turn influenced that behaviour. The CRA, when taken together with the Home Mortgage Disclosure Acts and data available from the US Census Bureau, provides detailed information on the activities of financial institutions. Reviewing this aspect of the act, White Haag comments,

“Apart from revealing the lending patterns themselves, the literature suggests the critical role of the expanded data on residential lending ... This data ... has made meaningful analysis of residential lending patterns possible in the first place, while apparently influencing those lending patterns themselves through the public accountability they have created” (2000, page 5).

The effectiveness of the act has been improved by the supporting community affairs responsibility of the twelve ‘regional’ Federal Reserve Banks and grants, loans, equity investments, technical assistance, and targeted tax incentives provided by CDFIs. The CRA itself also helped spawn a community development infrastructure including considerable academic research and advocacy capacity.

The impact of differences in banking regulation and supervision in the United States and Britain

British and US policies towards financial inclusion and community reinvestment reflect their different regulatory and supervisory contexts, and the ways in which these have been modified in the last thirty years. This is often presented as an externally induced change; however, in practice government-led reform of financial systems has helped create the environment in which regulation and supervision are undertaken. (3)

US banking regulation and supervision

According to Moran (1991), the financial services sector in the USA is highly politicised and fragmented, thanks in large part to a federal structure that both separates and distributes power. The US regulatory system is characterised by a wide range of competing institutional actors playing overlapping and at times competing roles. An elaborate framework of law and quasi-law-like regulations matches this elaborate institutional structure. Change to regulation tends to be incremental because there is no single institution capable of deciding and carrying out comprehensive reform. Though the regulatory framework changes slowly, the courts, pressure groups, and financial institutions influence regulators to reinterpret and reassess statutes incrementally, and Congress itself is an important site for regulatory struggles.

In this context, the USA has developed a distinctive multiagency patchwork of bank regulation. Three federal agencies, namely the Federal Reserve, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) regulate banks. The Federal Reserve regulates bank holding companies, holding companies that own or have a controlling interest in banks and foreign banks operating in the USA. The FDIC insures deposits in banks and, in addition, is the primary regulator of state-chartered banks that are not members of the Federal Reserve Board.

(3) This brief analysis is unable to explore informal practice that is seldom as clear cut as the formal law, regulation, and institutional structure.
The OCC charters, regulates, and supervises nationally chartered banks. In addition, the Office of Thrift Supervision also examines federal and many state-chartered thrift institutions, which includes savings banks and savings and loan associations. All these regulators have responsibility for the operation of the CRA, and because there are considerable elements of judgment involved, there is inevitably some suspicion that regulators operate in an inconsistent manner (Stegman et al, 2002).

The US system of bank regulation is also locally embedded. Since the National Banking Act of 1865, the USA has had a dual system of banking regulation with banks chartered and regulated at both state and federal level. Even the 1913 Federal Reserve Act forming the Federal Reserve System as the central bank and lender of last resort, established several regional Federal Reserve Banks. The McFadden Act of 1927 also restricted interstate bank branching. As a result the local component of the banking sector in the USA is much stronger than in Britain. This means that the focus of the CRA on community investment appears more pertinent to financial institutions because the well-being of the local community and the institution itself are seen as more directly connected.

The regulatory history of the USA is the key to understanding what Shull (1999) calls “limited banking”, where the financial sector has retained elements of regulatory uniqueness in banking and its separation from the rest of the financial sector. This special status of banks in turn justifies the provisions of the CRA that banks should in return invest in their local community. The regulatory system created in the 1930s aimed to control competition between banks and other financial institutions, believing that the integration of banking with the rest of the financial sector underpinned the stock market crash and depression. The 1933 Banking Act (the Glass–Steagall Act) distinguished between commercial banking (the business of taking deposits and making loans) and investment banking (underwriting and dealing in securities). All banks were required to select one of these two areas of business and to divest business relating to the other. In time, the separation of investment and commercial banking in Glass–Steagall has been eroded. In the 1970s banks exploited a loophole in the definition of a bank in the act to engage in investment activities. Though this loophole was subsequently closed, the FDIC ruled in 1984 that Glass–Steagall did not apply to affiliates of banks that were not Federal Reserve members. Roughly half of the states, therefore, authorised affiliates of such banks to extend their securities business. From 1987 the Federal Reserve also allowed so-called ‘section 20 subsidiaries’ to permit limited bank diversification under Glass–Steagall. In the 1980s many states also passed laws that gradually eroded the federal restrictions on interstate banking. The 1994 Riegle–Neal Interstate Banking and Branching Efficiency Act (implemented in 1997) legitimised the actions of the various states and effectively eliminated the remaining barriers to interstate banking. In 1996 the OCC permitted national banks to expand their financial activities through their operating subsidiaries. Finally, in 1999 Congress passed the Gramm–Leach–Bliley Financial Modernisation Act (GLBA), repealing parts of Glass–Steagall and the Bank Holding Company Act of 1956 that separated commercial banking from other financial services, and allowing financial holding companies (including savings and loan companies and other thrifts) to offer banking, securities, and insurance.

As negotiations on GLBA concluded, its impact on the CRA and the potential curtailment of its provisions became a significant issue. It was agreed that financial holding companies with banking subsidiaries would not be allowed to engage in new activities or acquisitions unless each of the banks in the holding company received a ‘satisfactory’ rating in their CRA assessment. It is intended that this will encourage institutions to raise their CRA performance to allow them to diversify. In addition, so called ‘sunshine provisions’ of the GLBA require financial institutions to report
CRA-related community lending agreements and contracts to the relevant regulatory agency which would then be made public. However, this recognition of the continued relevance of the CRA left unresolved wider questions about the impact of the deepening integration of banking and finance on the CRA.

Integration of banking and finance is a threat to the CRA because it undermines the argument that banks are distinctive from the rest of the financial sector, which in turn underpins the special provisions of the act that banks should invest in their community. The integration of the financial sector also makes it more difficult to implement the CRA provisions effectively. The act is based on assessing institutional performance in an assessment area surrounding its physical facilities. Although there has been some debate about the value of this feature of the act, the proliferation of nonbranch delivery systems, both within and outside the traditional banking sector, including telephone and electronic forms of banking and the Internet, makes this aspect of the CRA increasingly problematic. The deepening integration of the financial services industry, and the expansion of institutions not covered by the act means that it applies to a declining subset of the financial sector (Litan and Rauch, 1997). Based on the Federal Reserve’s Flow of Funds data, in 1945 banks and thrifts accounted for 63% of all financial assets, but by 1999 the proportion had fallen to 29%. Finally, the growth in competition between banks and other financial institutions adds weight to the traditional argument against the CRA that it is effectively a discriminatory tax because it does not apply to all financial institutions (Macey and Miller, 1993).

Restructuring in the financial sector has resulted in the loss of many locally owned banks lending to lower income and minority borrowers in their area, and it is these institutions that have helped to make the CRA effective. Between 1980 and 2000 the number of small community banks was reduced from 11000 to fewer than 6000 (DeYoung and Hunter, 2001). Merger and acquisition have also resulted in consolidation and branch closures, and the latter have been significantly concentrated in lower income communities (Avery et al, 1997). Residential lending in areas where acquired institutions had branches has also declined (Avery et al, 1997). However, the proportion of loans going to lower income and minority borrowers and neighbourhoods increased, suggesting some positive CRA impact (Avery et al, 2000).

Firm surveys indicate that, associated with the integration of banking and finance, substantial differences are emerging in corporate strategy and management philosophy among banks. Some institutions are diversifying aggressively into a wide range of financial service markets, whereas others are concentrating on core banking business. Some institutions continue to emphasise ‘bricks and mortar’ and extensive branch networks whereas others are developing aggressive electronic banking strategies. Differences in corporate culture and strategy influence the attitude of institutions to community development and the CRA, with some institutions vigorously pursuing an outstanding rating and others seeking a mere satisfactory (Litan et al, 2001). These differences in corporate strategy have implications for the likely future effectiveness of the CRA.

In a masterpiece of understatement Litan et al sum up the cumulative impact of several of these trends,

“When the CRA was enacted in 1977, depository institutions conducted their business in relatively confined local areas, both because statutes and regulations severely restricted their ability to do otherwise, and because capital markets and technology constrained all but the largest of institutions from accessing global sources of capital or lending to far-flung markets. Over time, most of these legal restrictions on bank and thrift activity have been eliminated or eased, and charters that are truly national in scope have become commonplace. In today’s global marketplace, financial institutions have a wide variety of funding sources, including
raising deposits far from their main offices. With advances in technology and financial innovation, institutions also have a wide range of options for lending and investing their funds, from global loan syndications to credit-scored small business and home mortgage loans on a national basis. In this context, a financial institution’s efforts to help meet the credit needs of its ‘entire community’ will require increased flexibility and innovation” (2000, page 20).

Though the GLBA brought US banking laws closer to those of most other countries, the USA still grants fewer powers to banks than many other countries and provides them with fewer opportunities to mix with commerce (Barth et al, 2000). Banks continue to be subject to lender-of-last-resort facilities, capital-adequacy requirements (to curb excessive risk taking), and deposit protection because of the central role they play in the financial system and the view that a bank run would have serious wider implications for the financial system as a whole. Financial regulation is still conducted by specialist institutions in the traditional areas of banking, securities, and insurance with differing regulatory objectives and techniques. In other countries, this compartmentalised approach to financial services regulation has been reformed and the distinctiveness of banking eroded (Group of Ten, 2001). The implications for policies towards financial inclusion can be seen in Britain.

The modernisation of British banking regulation

The British financial sector was traditionally protected from external competition by a host of informal restrictive practices. The Bank of England played the role of co-ordinator, protector, and ‘praetorian guard’ for a privileged world of self-regulation with hardly any reference to the statute book (Moran, 1991, page 62). The ‘Big Bang’ in the 1980s swept much of this arrangement away, and replaced it by a more competitive market with fewer barriers to entry and open to international ownership, modelled on the US financial sector. The new regulatory regime introduced in the 1986 Financial Services Act was also shaped by the functionally specialised system of regulation in the USA. The Bank of England was responsible for the supervision of banks, and the Department of Trade and Industry for insurance. The Securities and Investment Board dealt with securities business, though it devolved responsibility to three further self-regulatory organisations.

In 1997 one of the first acts of the New Labour government was to consolidate this financial regulation and supervision under a Financial Services Authority (FSA) with a purview that included supervision of banking, insurance, and securities. The Bank of England was relieved of its supervisory responsibility for banks, but given greater independence and made responsible for monetary policy and the soundness of the overall financial system. The thinking behind these changes, and similar moves in Scandinavia, Japan, and Germany, is that the growth of worldwide financial turbulence requires a reevaluation of the US-inspired financial reforms of the last two decades. As Crockett, the General Manager of the Bank for International Settlements puts it, “it is hard not to suspect that, to a significant degree, much of the observed instability [in the financial sector] is inherent in the behaviour of a liberalised environment. Episodes of instability in both industrial and emerging market countries, reflecting pronounced boom and bust cycles in the financial sector have been too recurrent to be a transitional phenomena. And the similarities with comparable episodes during the hey-day of the Gold Standard and leading up to the 1930s, when financial markets had last been unfettered, have been too strong” (Crockett, 2002, pages 978 – 979).

(4) This analysis of financial regulation and supervision applies to the United Kingdom as a whole but for consistency with the rest of the paper it continues to refer to Britain.
In Britain it is argued that a simplified regulatory structure that mirrors business institutions avoids competitive inconsistency, duplication, and gaps that might characterise a regime based on specialised regulatory agencies (Briault, 1999). It is suggested that it is no longer so important to identify separate regulatory objectives for the individual parts of the financial sector, because institutions no longer coincide with identifiable lines of business. Banks are no longer uniquely exposed to systemic risk because product convergence, whereby institutions such as banks and insurance companies offer products that compete across established industrial boundaries, means their activities have become intermingled with nonbanks. Regulatory evenhandedness and a level playing field between institutions become more of an issue. The regulatory objective of systemic stability and lender of last resort now effectively extends to the rest of the sector as well as the banks (Dale and Wolfe, 2003). There also needs to be a stronger emphasis on maintaining the stability of the financial system as a whole because in the current more integrated financial sector environment there is increased risk that the failure of one troubled financial institution will trigger a wider collapse (Briault, 2002).

Llewellyn (2000, page 309) claims Britain now has, as a result of these changes, “one of the most liberal [regulatory] regimes in the world, certainly compared to the United States.” There are few restrictions on the allowable business of financial institutions and there is no regulatory division between banking (commercial and investment), securities trading, and insurance. Unlike the US financial sector, the British financial sector is dominated by a few large firms that have developed national networks, and regional banking largely disappeared in the mid-19th century (Pratt, 1998). The result of regulatory change is ‘financial conglomeration’, with little restriction on nonfinancial firms (for example, supermarket stores) offering banking services. However, conduct of business regulation in Britain remains prescriptive, especially concerning the selling process in retail markets.

Thus, the British approach to promoting financial inclusion cannot rely on a compartmentalisation of the financial sector. Policy is designed to work with the grain of an open and integrated British financial market, and it is therefore appropriate to take a comprehensive approach to inclusion, incorporating banking, credit, and insurance. Nor is the legalistic compulsion of the CRA consistent with the British tradition of self-regulation, reinforced by the independence granted to the Bank of England. The Bank of England now has no day-to-day responsibility for financial institutions; this has been delegated to the FSA. Though the FSA is a privately incorporated body, it is accountable to the Treasury (and Parliament), and the Treasury is responsible for the institutional structure of regulation, and for the legislation that governs it. Therefore, policy towards financial inclusion inevitably emphasises collaboration of the various actors involved in the absence of a prescriptive legislative framework. In a context where many financial institutions require convincing that community investment is a significant issue, this requires considerable effort to make joined-up policy work. Cowell and Martin distinguish between different forms of joined-up government,

“First, joined-up working may involve more integrated policy development at a strategic level, or better collaborative working at an operational level. Second, a distinction can be drawn between intraorganisational and interorganisational joining up. Third, there are important differences between horizontal integration between local agencies, or between departments within the same local agency, and vertical joining-up between tiers of government” (2003, page 161, italics in the original).

Financial exclusion requires joining-up at all these levels. Arguably at the strategic level policy has been reasonably effective in analysing the various aspects of financial
inclusion and commissioning work to identify potential policy solutions to overcome them. However, notwithstanding the efforts of the various policy units charged with developing and coordinating government policy, the deeply ingrained habits of central government mean that it still seems to work predominantly along departmental lines. The centre is not always effective in resolving conflicts (Policy and Innovation Unit, 2000a). The government itself may contribute to institutional fragmentation, at times blurring lines of accountability, duties, and responsibilities. Arguably, it is in integration between agencies at the local level that joining-up of policy on financial exclusion is most limited. The vertical integration so valued by government in its national priorities, targets, and performance indicators (HM Treasury, 1999a) limits the scope for the territorial management of policy. Thus, despite the comprehensive range of national policies promoting financial inclusion, only three of the eighty commitments in the Action Plan for the National Strategy for Neighbourhood Renewal explicitly address the financial sector (Social Exclusion Unit, 2001). The local Strategic Partnerships coordinating the National Strategy, led by local authorities and supported by Government Offices for the Regions, are primarily concerned with increasing local jobs and improving public services, such as education, health, crime, and housing. There is a territorial gap in policy promoting financial inclusion and this has attracted British attention to the operation of the CRA in the USA.

Mayo and Mullineaux (1999) propose adapting elements of the CRA to make it effective in a British context. They suggest applying a CRA-like requirement to serve communities to a limited number of key products such as loans, mortgages, and overdrafts across the whole financial sector. Such a policy would still need to assess whether an institution is responding to the financial needs of the community and indeed what is meant by the community in a nationally integrated financial sector (Leyshon and Thrift, 1997). Mayo and Mullineaux (1999) and the Social Investment Task Force (2000) also emphasise that the US evidence suggests disclosure by institutions of their deposit, lending, and investment behaviour at a detailed postcode level is a useful policy tool. The Bank of England already has responsibility for monitoring the small businesses lending of the banks in deprived areas. In response, the British Bankers’ Association (BBA, 2002) has published preliminary information on bank lending in deprived areas by postcode, though considerable work needs to be done in making this information meaningful. This approach would circumvent the need for a link, as in the CRA, between the physical facilities of the institution and the local community it serves. It also avoids the need for the detailed institutional reports that form part of the CRA, and provides a mechanism whereby the authorities can monitor the activities of financial institutions. The US evidence suggests such disclosure and monitoring increase corporate social responsibility by making the actions of financial institutions transparent. However, regulators will still need to resolve technically how to assess whether the observed investment behaviour is appropriate. The difficulties involved are indicated by the preliminary conclusion of the Bank of England, after monitoring commercial bank lending since the early 1990s, that there is no generalised shortage of finance in disadvantaged communities (Bank of England, 2001; 2002). Rather, the issue is more subtle, with a lack of information and mutual understanding on the part of both entrepreneurs and investors restricting the flow of investment. At the same time, branch closures are distancing banks from their borrowers in disadvantaged communities and there are limits to the extent to which centralised lending software can substitute for the lack of personal relationships and local knowledge (Mayo et al, 1998). However, for monitoring to be effective, there still needs to be some sanction that is appropriate for a financial sector, unlike that in the USA, dominated by a small number of very powerful institutions.
Policy in Britain has not developed the institutional support that helps to make the CRA effective. There is no equivalent in Britain to the regional arm of the Federal Reserve Board, though it would be possible to expand the regional role of the Bank of England. The FSA's responsibility for individual financial institutions means that in theory it is better placed to perform a regional role, but it has little understanding of spatial issues. The current institutional arrangements underpinning the National Strategy for Neighbourhood Renewal look inadequate for dealing with the financial sector. An alternative would be to widen the responsibility of the Regional Development Agencies. Although these organisations currently lack the necessary expertise to deal with the financial sector, the attraction of this idea is that it acknowledges social exclusion is not solely an individual or household problem, but is linked to wider local economic development processes.

Conclusion: combating financial exclusion in deprived areas

There are multiple causes of financial exclusion, and economic and sociocultural differences shape both individual uses of financial services and the regulatory framework for financial institutions. Therefore, it is not surprising that there is not a single policy solution to financial exclusion. Nevertheless, in both Britain and the USA, governments are seeking to combine top-down policies setting the context for community investment with bottom-up community-based initiatives. Financial institutions are encouraged to take a proactive approach, treating those individuals without bank accounts or other financial services as a business opportunity, and not just regarding them as part of their charitable giving. Partnerships are sought between mainstream and alternative financial institutions as well as other not-for-profit organisations. As research has shown, the CRA in the USA provides a strong incentive for financial institutions to invest in disadvantaged areas and a framework within which partnerships between mainstream and alternative financial institutions can develop. Despite the successes of the CRA, attempts within Britain to achieve financial inclusion and community development without the legislation itself are of interest because the deepening integration of the financial sector undercuts the regulatory compartmentalisation that underpins the CRA. Significant differences in policy towards financial exclusion in Britain and the USA reflect important differences in financial sector regulation and supervision between the two countries. In turn, these reflect a distinctive British approach to promoting the competitiveness of the City of London and maintaining financial soundness and stability in an increasingly interconnected financial world. British initiatives towards financial exclusion are arguably more coherently focused on the most disadvantaged and wider ranging than their US counterparts. However, the British experience indicates that in an open and integrated financial sector dominated by large international institutions, where a tradition of self-regulation and freedom from state interference is highly prized, financial inclusion and community investment are difficult to achieve.

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