

## Surging Economic Inequality Fuels the New Redlining



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### Predatory Lending & Fringe Banking Nurture Inequity While Two-Tiered Financial Services System Increases Disparities

#### Strengthening Community Reinvestment Act Could Help Reverse Trend

**WASHINGTON** –The development of a two-tiered system of financial services, driven by the rising economic inequality in the United States, is ushering in a new era of *de facto* redlining, according to a new paper from the Economic Policy Institute, “Do Subprime Loans Create Subprime Cities? Surging Inequality and the Rise in Predatory Lending.”

In the paper, published by EPI as part of its Agenda for Shared Prosperity, author Gregory D. Squires, a George Washington University sociologist, contends that increasing economic inequality and diminishing access to conventional financial services have become inextricably linked.

“Rising inequality of income and wealth in the United States has intensified the segregation of metropolitan areas by class, with race and ethnic segregation continuing at high levels,” said Squires. “For residents of these increasingly segregated low-income and minority communities, the range of opportunities, including access to financial services, becomes more and more limited.”

This void has opened the door to “fringe bankers” – check-cashers, payday lenders, pawnshops and others – to target working families, low-income and minority communities concentrated in central cities. When coupled with predatory subprime mortgage loan practices, this trend is widening the gap between the wealthy and poor.

As a result, this system of separate and unequal financial services has emerged, one featuring conventional products distributed by banks and savings institutions primarily for middle- and upper-income, disproportionately white suburban markets, and the other featuring subprime, high-priced, often predatory products offered by fringe bankers.

The report notes that while not all subprime loans are predatory, virtually all predatory loans are in the subprime market. Subprime lending and fringe bankers are concentrated in communities with high unemployment rates and declining housing values, and they serve to reinforce those neighborhood characteristics.

The 1977 Community Reinvestment Act (CRA), which bans the practice of discrimination by lenders based on where people live, or redlining, is no longer enough to counter today’s economic trends, Squires concludes.

“While the Community Reinvestment Act has over the years allowed many households and communities long denied conventional financial services to find access to credit, it wasn’t drafted with today’s fringe bankers and predatory loan products in mind,” said Lawrence Mishel, president of Economic Policy Institute.

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“Often fringe bankers are the only financial services companies available to low-income and minority communities, but fringe bankers aren’t required to adhere to CRA standards,” said Squires. “As a result, inequality not only persists, it is reinforced. Fringe banking tactics are even more insidious and damaging to low-income and minority communities than refusing credit based on neighborhoods.”

“To fix inequities in the provision of financial services we must address the structural sources of inequality,” said Squires. “Public policies and private practices have shaped the uneven development of metropolitan areas, and alternative policies and practices can ameliorate those patterns.”

“Reform of predatory lending practices is a necessary first step, but a comprehensive approach must take into account the connections between the evolution of financial services and rising inequality, particularly as they affect mortgage lending,” said Squires. “Thus, indexing the minimum wage to keep up with the cost of living, living wage laws for government contractors, strengthening the bargaining power of workers and limiting corporate tax deductions for executive compensation should be part of the policy solutions.”

Strengthening the CRA’s ban on redlining, which requires mortgage lenders to understand and be responsive to the credit needs of their entire service areas, including low- and moderate-income communities, would address today’s uneven lending structure. Recommendations detailed in the report include:

- Expand the CRA to cover credit unions, independent mortgage bankers, insurers, and other entities that now account for well over half of all mortgage loans. Currently the CRA applies only to federally chartered depositories (e.g., banks and thrifts).
- Provide sanctions for those that engage in predatory practices and credits for those that pursue equitable lending in their communities.
- Require evaluation of lenders’ CRA performance when they seek approval from regulators for mergers, acquisitions, or any other significant changes in their business operations to ensure they are providing fair, equitable credit and combating predatory lending.

Some cities are not waiting for changes in the law. In January 2008, Baltimore became the first city to sue to recover costs of foreclosure caused by racially discriminatory lending practices. It sued Wells Fargo Bank for targeting minority neighborhoods for predatory loans leading to high foreclosure rates – costing the city millions of dollars in lost tax revenues, added fire and police costs, court administrative costs, and social programs to maintain healthy neighborhoods.

Cleveland followed by suing 21 financial institutions for flooding the local housing market with subprime loans to people who could never repay, leading to a foreclosure crisis costing the city millions of dollars to maintain boarded-up homes and respond to increased arson and other violent crimes.

*The Economic Policy Institute is an independent, nonprofit, nonpartisan research institute that examines the impact of economic trends and policies on working people in the United States and around the world. EPI’s Agenda for Shared Prosperity is a set of comprehensive policy proposals promoting a broad distribution of the benefits of economic growth.*