

The CRA: Good Goals, Flawed Concept

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Overview

- The CRA's goals are good; but
- The basic concept is flawed
- There are better ways to achieve the CRA's goals

The basic concept is flawed (1)

- Banks (and thrifts) are being leaned on to make loans and provide service that they wouldn't otherwise provide
 - Are the loans profitable?
 - Are the bankers lazy, inefficient, ill-intentioned?
 - Is there inadequate competition?
 - Are the loans unprofitable?
 - Are there monopoly profits that can be used for cross-subsidization?
 - Is there inadequate competition?
 - Are there spillover effects that a single bank can't capture?
 - Do loans elsewhere mean that deposits are being “drained” out of a local area?

The basic concept is flawed (2)

- Excessive attention to localism
 - Contrary to the broader sweep of public policy
- Vague and subjective enforcement
 - Somewhat better since 1995
 - “Meet the needs...” remains vague and subjective
- CRA may well discourage banks from establishing branches in LMI communities
 - Extra costs and extra requirements
 - Barriers to exit are barriers to entry

But don't blame the subprime debacle on CRA

- CRA isn't responsible for the subprime debacle
 - A high fraction of subprime loans were made by non-CRA lenders (e.g., mortgage banks)
 - A high fraction of the mortgage-related securities were held by non-CRA investment banks
 - WaMu, Wachovia, IndyMac, Citi, etc., originated and held their loans because of expected profitability, not because of CRA

Better policies (1)

- Vigorously enforce statutes that prohibit discrimination with respect to race, ethnicity, etc.
- Vigorously enforce the antitrust laws, promote robust competition
- If more entry is needed, authorize bank ownership for companies that have a business model of providing good value to LMI households
 - How about allowing Wal-mart to enter banking?

Better policies (2)

- If there is a good social case for local lending and investment that local lenders somehow do not satisfy, use the public fisc
 - On budget; transparent; good government
 - Expand CDFIs
- If CRA persists in its current form, quantify the obligation and make it tradable among banks
 - Analogous to “cap and trade”

Conclusion

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