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# Why Latin America Urgently Needs CRA, and Why CRA Won't Work for Latin America

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When I speak of a Community Reinvestment Act (CRA) for Latin America, I mean a mechanism that monitors and makes bank activities public. Thanks to CRA, we know where banks lend, to whom they lend (by income, race-ethnicity, and gender), and to what degree these customers reflect the profiles of the banks' depositors. We can detect discriminatory policies toward the poor in both lending and deposits. The CRA has also created incentives for banks and other financial institutions to increase their presence in and their services to low-income neighborhoods.

CRA was conceived in the 1970s mainly to identify and to combat "redlining" in U.S. communities. Redlining was a common banking practice of labeling certain neighborhoods undesirable (mainly black and low-income areas). By withholding their services, banks accelerated the physical and economic deterioration in these stigmatized communities, the "urban ghettos," as they were known at the time. This disinvestment contributed to "urban blight" and white flight to the suburbs, which in turn led to more urban blight and more urban ghettos. CRA offered a tool to quantify and characterize financial services in poor communities, and to push banks to offer coverage to all, regardless of race, income, or geographic location.

To the degree that CRA has resulted in greater investments in low-income communities in the United States, it has counted on a tradition of community activism and local government, reinforced by a decentralized housing policy that came into being after CRA. David Erickson, in his recent book The Housing Policy Revolution, describes this "policy revolution" in support of local community efforts and argues that its impact extends beyond the CRA itself to a range of programs that it set in motion, such as the Financial Industry Regulatory Authority (FINRA) and others. The same argument can be applied to Latin America.

## Why a CRA Is Needed in Latin America

A drive across any of Latin America's cities reveals why. The drive begins in elegant neighborhoods with stately homes and gracious apartment buildings, well-lit parks, broad sidewalks and paved roadways. These are the neighborhoods that are home to the wealthiest 10 percent of the population and occupy about 25 percent of the urban map.

The drive continues through the "middle class" neighborhoods where another 40 percent live. Here the street scene varies. Some neighborhoods have streetlights, sidewalks, and parks. In others, street paving may be uneven and storm water drainage may not exist, leaving puddles and garbage piled at the curbs (if there are sidewalks) and at corners. But in general, the middle class enjoys all the basic services: running water and sewers, roads, transportation,

and electricity. (I refer to these as “network” services in the remainder of the article.) The housing itself tends to be standardized: modest but comfortable units and low-rise apartment buildings repeated along planned cul-de-sacs. The housing is generally built by professional developers and financed by local banks. The wealthy and middle class make up “the better half,” or the "formal" sector.

Moving now into the rest of the city, where the poorer half resides, things change. The view is urban blight on a grand scale. Houses range from tin-roofed shanties to unpainted block constructions with exposed re-bars. There are few, if any, shopping centers or public buildings, and very few “finished homes.” No-man’s land for developers and banks, these neighborhoods are referred to in the urban issues literature as examples of “progressive development,” whereby the transformation from squatter shanty to completed and fully-serviced home evolves block by block and may take more than three generations to be finished in the US sense. Banks do not make loans to the typical low-income self-help builder in Latin America. Instead, the owner-builder (or the “maestro”) buys materials as he or she can afford them, which explains the piles of cement blocks that often rise up in the yards of the low-income households. Of course the price of cement block increases when purchased in small numbers, so the owner-builder pays a premium. The owner-builder pays a second premium, ranging from 10 percent to 20 percent per month, for materials bought on credit. With time, progressive development can lead to respectable housing, but costs for the owner-builder can be ten times the cost for a mortgage on the same house, and neighborhood features remain few and network services scattered. Although running water reaches about half of the low-income neighborhoods, where there are connections, the actual hours of operation are far from regular. The large plastic barrels in front of homes are a dead give-away that residents rely on cistern trucks for at least some of their water supply. And if they have no water connections, it is a sure bet they also have no sanitary sewer connections and may not have electricity either.

A full quarter of Latin America's urban population is estimated to have no running water. Only half of urban families are believed to have domestic sewer connections. The lack of services is not owing to poverty. Ironically, the 25 percent of Latin American families that buy water from cistern trucks generally pay not only a far higher price than the families with running water, but they pay what could easily cover the installation and operation of full water and sanitation services. Furthermore, the low-income neighborhoods have solid records of repayment. Nongovernmental organizations (NGOs) have financed community services on micro-credit terms, emphasizing quick repayment (fewer than two years) and high interest rates (25 to 40 percent annually). Even with the high interest, monthly payments are still less than current service payments. Clearly, both communities and banks could benefit if financing were available but banks do not offer financing for neighborhood improvements. They of course finance service connections and infrastructure costs as part of a mortgage loan, backed by a house. But traditionally banks require some form of collateral for loans and no one has figured out how to use infrastructure to guarantee a bank loan because no

one has ever managed to repossess a street or aqueduct or sewer system. Micro-credits, as developed by NGOs, are issued on a "personal guarantee," and apply high interest rates and short repayment periods to cover their risks.

In any case, we will never know the reasons how lending practices are related to the low community service and housing standards in Latin America without tracking the availability of loans and financing. A significant reason why CRA is needed in Latin America is thus to quantify the investments in infrastructure services and their distribution and to raise awareness across the board. Data are crucial to identifying and tracking the problem, and to resolving a key question: Does the lack of services in certain communities result from underinvesting?

Macroeconomic studies by the World Bank show a dramatic decline in overall investment in infrastructure in Latin America over the past two decades. In particular, private investment in infrastructure lags well behind other developed countries. Country-specific data show a similar pattern of distorted investments. An analysis of housing in Guatemala shows that in 2004, 80 percent of the total housing investment (public and private) went to families in the upper 15 percent of the income bracket. Another 16 percent of investment went to the one-fourth of families whose incomes place them in 50-75 percent income bracket. The lowest earners (60 percent of Guatemalan families) shared the remaining 4 percent. The investment patterns may not be the result of deliberate redlining, but the results are the same. Investments in the poorer half of Latin America's urban communities are seriously lagging.

***Stimulating Private-Sector Lending and Investment***

A CRA in Latin America could stimulate private-sector lending and investment in low-income communities. CRA may not be the banks' favorite regulation given that it rates them on their performance with low-income groups. But it has generated more business for the financial sector. Not only does the CRA offer a glimpse of what the competition is doing (or ignoring) in lower-income neighborhoods, but it also provides communities with basic information on how funds are being distributed, and what services cost. This stimulates a dialogue between lower-income groups and commercial banks, a dialogue that has produced legislation and tools for the community-based financial sector (for example, for Community Development Financial Institutions [CDFIs] and local development grants programs).

Our experience in Central America, Mexico, and Colombia proved that banks were extremely interested in data on their own industry and its coverage of low-income groups–the bottom 60 percent. Informally, bank managers admit that the industry has become stymied by its limited clientele. As one former president of a Mexican bank confided,

> The top 10 percent command a lot of money, a higher proportion of GDP, than the bottom 50 percent, but there's only so much they want to spend on financial services. And now that all but one Mexican bank are owned by non-Mexicans, they see the way to build the bottom line as cutting costs

> and inventing new and more dubious products. What we really need are new markets, but a fellow who comes over from Spain or Italy to manage a bank for two years just doesn't have the time to learn about the reality of Mexico.

During my work in Guatemala, I saw a good example of how information-sharing can stimulate bank action. In 2002, Jose Luis Gandara, the Guatemalan Vice Minister of Housing, brought a group of stakeholders to Washington, DC, to visit the World Bank and to attend the National Community Reinvestment Coalition (NCRC) conference. The group included the director of community micro-credits from a large Guatemalan NGO, Genesis Empressarial, and the president of the Guatemalan Bankers' Association, who is also president of one of the largest banks in Guatemala, the G&T Continental. The presentation by the director of micro-credits on loans for community improvement caught the attention of the president of the G&T Continental. Shortly thereafter, the bank opened its own micro-credit department, staffed by the former directors of Genesis Empressarial.

In Colombia, the dialogue took a different turn. As they shared their data on service distribution for the first time ever, the banks declared their interest in serving poor communities but explained to the community representatives that the risks of robbery and violence kept them away. Together with the bank regulators they hammered out an agreement by which banks could open branches inside police stations in low-income communities and rural towns. As we discussed the great interest the banks were showing in the new data, Colombia's then Minister of Finance confided to me, "They remind me of kids at a swimming pool. They all want to get into this new market. But no one wants to be the first one in. They'd rather someone else jump first. Let him find out how deep it is and where the rocks are." Maybe, I suggested, they needed the government to act like a life guard and blow a whistle for them all to jump.

In Guatemala, the data gathering and sharing led to the creation of a national stakeholders' council on housing and to an ongoing dialogue about how to increase investments in home improvement and community upgrading through private-sector participation. The group is currently focused on creating a facility to sell insurance to banks for loans to low-income communities for home improvement and community upgrading. Guatemala's program is the first to address the issue of group lending through micro-credit; investment in network service would require formation of a group to borrow and repay the investment. NGO experiences in Guatemala and in the rest of Central America suggest that the risks involved in lending to low-income groups are low. Poor families tend to pay off debts quickly. Furthermore, even with high micro-credit interest rates, monthly payments for network service installation and use is well below the monthly cost for water from cistern trucks.

### *Stimulating More and Improved Financial Services for Low-Income Communities*

In Latin America, the high percentage of "unbanked" residents (that is, those without bank accounts) means that up to 75 percent of the population is out of luck (and out of

pocket) not just for loans, but savings accounts, and making deposits, payments, and other transfers. This exclusion hurts the poor as much as discrimination in lending does. World Bank studies carried out with the Mexican government in 2002 and 2003 show that living on a "cash" cash flow in Mexico City can cost the unbanked up to 25 percent of monthly income. Further World Bank studies in Mexico, Colombia, and Brazil from 2002-2005 show that the percentage of unbanked ranging from 66 percent (Brazil) to 78 percent (Mexico), compared with 2 percent in Spain and Germany and 8 percent in the United States. The same studies show that the majority of the unbanked want savings and payment services more than loans. A CRA for Latin America would have to track bank depositors as well as borrowers.

To add further evidence that Latin America could benefit from a CRA, consider the impact of the lack of investments in social, economic, and environmental development when 60 percent of the population is involved. While it would take a bit of analysis, it does not take much imagination to see how the situation of Latin America's urban poor could be vastly improved with access to credit and banking services. The slums of Latin America pose health hazards and raise morbidity rates for the entire community. This, in turn, reduces national capacity for productivity, and when 60 percent of the population lives on a cash economy, it makes for a very inefficient financial system. All told, the financial exclusion of half the urban population creates a serious counterweight to regional economic development. Latin America's need to bring its marginalized populations into the mainstream is no less urgent than that of the United States in the 1970s.

## Why a CRA Won't Work in Latin America

Although I would energetically advocate for a CRA in Latin America, I recognize that it will take much more than a simple passage of legislation to rectify the inequities and stimulate increased investments in poor communities. So let's look at why a CRA won't work in Latin America.

For starters, Latin America's political system, like Europe's, is not based on geographic representation. Neighborhoods cannot point to their particular congressperson because political parties vote for representatives. While this helps eliminates "pork" in legislation and guarantees representation of a broader range of political interests, it also makes it harder for local issues to get a national hearing. At the local level, the fact that "unserviced" communities are not counted as part of the urban map means they cannot register for municipal elections. Only the neighborhoods that already have network services are considered "urban." The others are by definition rural. The neighborhoods that stretch alongside rivers and in gullies in Latin America's major cities do not belong to the city and are not the responsibility of the mayor or city council. If a person lacks a water connection, then they also lack an urban address, and with that, the right to vote in a municipal election.

Another reason CRA will not happen soon in Latin America is the possibility that the existing situation suits the municipalities politically. When low-income families cannot buy access to network services, the government, in this case the municipality, becomes the only

available provider. Therefore, the party in power locally decides who will get water, sanitation, and energy–and who will not. This translates into gratitude, loyalty, votes from the lucky families who are connected, and in turn political clout. If the "informal belts" surrounding Latin American cities could buy their own water and sanitation, they would vote for mayor and city council representatives. While this might be considered a good thing in the long run, it has not occurred to any local or national governments, perhaps because the present situation better serves their purposes.

This makes for a final ironic reason why a CRA would not work in Latin America. Because the state provides the services, the service is cheap. Traditionally the public sector runs deficits for its public works. A commercial bank could not finance such works and not get paid back. In many Latin American countries, network hooks-ups and service charges are subsidized by the government on the basis of income, which makes it difficult for private builders and banks to compete. Studies of private network provision routinely conclude that nongovernment networks cost less than government services, although comparison is always complicated by lack of transparency and subsidies in the public sector. Nonetheless, the popular view is that if the government provides a service, it comes free, although it may take time and will certainly be less than perfect when it arrives than a network which is privately financed and built. Still, some communities are ready to pay the extra cost. The director of micro-lending at Genesis Empresarial told the story of a low-income community that applied for funds to install an electrical network to enable the community to purchase power from the national energy company. Why, she asked the community leaders, would you want to borrow at micro-finance rates when the government will install the network for free? The answer: "We know we could get the electrical services for free if we wait for the government, but we'd rather pay to have the services now, not in five, ten, or twenty years."

A community development organization might enjoy fighting these limits and finding financing for community investments. But a tradition of grassroots and community organization does not exist in Latin America, despite the large number of internationally backed NGOs. If the unserviced communities could manage to form a political union, like an NCRC, they could represent a powerful political block in each country. A CRA could provide the information necessary to argue for and to create incentives for banks and local governments to support investments in low-income communities. But politics of interest is not part of the Latin American tradition. I can recall only one political movement purporting to speak for the low-income communities: "El Super Barrio" from Mexico City in the 1980s. Super Barrio was a political force that managed to end the long-standing monopoly of the Partido Revoluconario Institucional (PRI) in Mexico City's politics, ushering the Partido Revolucionario Democratico (PRD) into the mayor's office. But Super Barrio has since disappeared from the map. To match CRA's achievements, Latin America needs to develop strong local voices or to develop its own variety of support institutions. So here's a last reason CRA isn't happening in Latin America: If the municipalities won't do it, and if the communities can't do it, would the banks propose a CRA for Latin America? It is hard to imagine banks looking for more regulatory requirements.

A vicious circle? Absolutely. Latin America desperately needs legislation that monitors and discloses who benefits from banking services and who does not, and that prods the private sector to correct existing discrimination. But as long as Latin America's communities have no voice or political power, and while local governments are comfortable with the situation and banks will not argue for their own regulation, Latin America will be unable to take advantage of what a CRA has to offer.

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