The Injustice of Giving: Income and Racial Inequality in the United States Loanable Funds Market

Hank Harmon

Professor Art Goldsmith

I. Introduction

The loanable funds market plays an incredibly important role in the lives of almost every American. The mortgages, car leases, business loans, and student loans that generations of Americans have relied on to provide capital for their ideas, investments, and basic needs have helped the United States become one of the wealthiest nations in the world. Financial institutions and banks have provided loans to people across the nation to make sure they can thrive. Although these institutions have helped thousands, if not millions, achieve their financial and personal goals, they are not perfect. For as long as these financial institutions have been providing these life-changing loans, these same institutions have systematically excluded many subpopulations from the services and loans they provide. In particular, low-income communities and communities of color have experienced decades of discrimination in the loanable funds market. The extent of this discrimination has compounded over time and certain practices and policies within the loanable funds market continue to adversely impact the lives of these groups today. In this paper, we will explore the origins, consequences, and implications of market failures within the loanable funds market and how we can correct the years of mistreatment that poor and black communities have faced. This paper aims not only to carefully uncover the downfalls of the financial institutions and banks that provide loans, but also to critically examine ways in which these institutions can bring a safe market for loans to all Americans, no matter their income bracket or skin color.

II. Literature Review

In order to fully analyze and assess the nature of the credit market, in particular, the loanable funds market through which people and firms borrow money from financial institutions to purchase a home, a car, pay off other large expenses such as medical costs, or purchase plant and equipment, one must understand some of the inherent shortcomings of this market in the United States. In particular, this section aims to examine the ways in which the credit market disadvantages people in low-income groups, disadvantages black people and other people of color, and allows the existence of life-altering predatory lending practices. Each of these topics is separated into the three sections below.

A. The Credit Market and Low-Income Populations

Although this paper aims to examine issues related to the causes and consequences of poverty, this section focuses on individuals who are of "low-income" status because people in poverty are not the only people facing issues related to the credit market. The Official Poverty Measure stipulates that a household of one person earning more than $12,880 is not considered impoverished in the contiguous states of the United States (*2021 Poverty* 2). However, according to the National Association of Realtors in a recent New York Times article, in order to qualify for a mortgage loan for a median sale price house in 2021, an annual income of $68,032 would be required (Kolomatsky 4). Clearly, the credit market can be difficult to access for populations in the United States that expand far beyond the poverty line.

In addition to the difficulties accessing loans described above, banking institutions have steadily lent less money to low-income individuals over time. According to data released by the Federal Reserve, the three largest banks in the United States decreased the number of mortgage loans given to low- and moderate-income people by 17% from 2010 to 2016. The Federal Reserve defines low- and moderate-income borrowers as people who have incomes less than eighty percent of their area's median family income. Undoubtedly, this population includes individuals living above the Official Poverty Measurement. Economists believe that this decrease in lending stems from many institutions not being willing to take on mortgages insured by the Federal Housing Administration (FHA). However, many low-income individuals need to have their mortgage backed by the FHA, otherwise, they would face much higher interest rates in order to account for the risk they pose to banks. As a result, only fifteen percent of today's mortgages are given to the low- and moderate-income population (Bhutta 1-3).

With large banks making fewer loans available to low-income populations, the inability to access important lending services, along with many other factors, has led a staggering number of individuals to become unbanked. According to a National Survey conducted by the Federal Deposit Insurance Corporation (FDIC), approximately 7.5% of households in the United States do not have a checking or savings account (Breitbach 1). Accessing banking resources help a multitude of Americans make online transactions, save money, and easily make payments for bills. The Federal Reserve Bank of Boston estimated that the annual cost of being unbanked can be as high as $318, and this measure does not account for indirect costs of being unbanked such

as losing an opportunity to build credit or be protected against theft (Desmond, Tyler 24-26). An additional indirect cost of remaining unbanked is the amount of time spent arranging ways to pay bills through informal banking institutions.

In the credit market, many low-income individuals choose not to pursue loans or banking because it can be very difficult to understand. Attached here is the link to a Residential Loan Application form for a small financial institution called TrustBank. Perusing and completing the 17 pages of this loan application can be difficult to complete for even the most financially literate loan applicants. The immense amount of information one is required to know in order to complete this application is often too hard to find for anyone trying to get a loan online or in person. Beyond financial literacy, further barriers to creating bank accounts and receiving loans include monetary fees that deter people from reaching out to a bank.

An additional reason that many low-income individuals may not be participating in the credit market is due to feelings of frustration and hopelessness. Even upon completing tedious loan applications such as the one above, individuals can still be denied loans and not given answers about why the rejection occurred. J.P. Morgan Chase and Wells Fargo, two of the largest banks in the United States, have web pages dedicated to helping clients understand why their loans may have been denied and action steps for how to come back with a better loan application. Though this seems to be a valuable resource at first glance, the content and advice offered are not overwhelmingly helpful. Both web pages offer advice such as improving your credit score, decreasing your debt-to-income ratio, and having a more stable employment history. While all of these factors could help you achieve the loan eventually, paying off debts, improving bad credit, and having a more stable job are things that are long-term and not easy to achieve (*What to do…* 2). On the J.P. Morgan Chase website, one of their suggestions about what you should do after being denied is to just wait (J.P. Morgan 1). The cycle of frustration caused by denied loans, extended waiting periods, and difficulty with paperwork all come together to form a sense of helplessness for low-income individuals trying to enter the credit market.

B. The Credit Market and the Black Community

In addition to barriers in the credit market for impoverished people, many people of color in the United States also struggle to gain these services. Specifically, black Americans. Though

many treat issues related to poverty and race separately, they overlap incredibly often when examining the market for loanable funds. The historic trend of excluding African Americans from the credit market can be traced as far back to Jim Crow, redlining, and even the G.I. Bill after World War II (Brodie 363-364). The Federal government awarded fewer than 100 of the 67,000 mortgages insured by the G.I. Bill to non-white veterans after the Second World War, less than a century ago (Brodie 364). This mortgage disparity is still relevant to this day as it has been found that "if black and Hispanic families owned homes at rates similar to whites, the racial wealth gap would be reduced by almost a third" (Desmond, Matthew 1). Not only would the ability to access home loans help black and Hispanic families close the racial wealth gap, but by gaining the same amount of wealth historically awarded to white families, they would have lower credit risks due to increased assets, and have more access to credit today. With additional credit access, these populations would have more opportunities to begin a business, send offspring to college, and pay for unexpected bills for automobile damage or medical expenses.

Although many financial institutions are now working harder than ever to eliminate this kind of discrimination in the loanable funds market, African Americans continue to have a difficult time accessing credit markets. According to econometricians James Stock and Mark Watson, the estimated racial difference in loan denial probabilities in black and white applicants is 7.1%. This means that when holding all factors equal besides race, a black loan applicant is 7.1% more likely to be denied than a white applicant. Their result was statistically significant at a 99% level and serves as an astonishing testament to how racial biases still exist in the credit market today (Stock 406-409). Although Stock and Watson were unable to determine whether this racial bias is due to racial animus or a miscalculation of risks due to stereotypes, they offer damning evidence of discrimination in the credit market.

C. The Prevalence of Predatory Lending

Due to the many difficulties related to credit market access for impoverished and black Americans, many individuals in these groups turn to predatory lenders to receive the loans that they need. Predatory lending takes many forms: pay-day loans, title loans, check cashing services, subprime mortgages, etc. For this paper, we will define predatory lending as any lending practice that imposes abusive loan terms on the borrower such as excessively high fees or small print that is deceptive. One infamous way that predatory lenders deceive their borrowers

is through incredible high interest rates that they disguise in contracts. For example, according to the National Consumer Law Center, "predatory lenders often propose bills that obscure the true interest rate, for example, by presenting it as 24% per year plus 7/10ths of a percent per day instead of 279%" (*Predatory installment*... 4). An interest rate of 279% is astronomically high and the people who are offering these loans are essentially profiting off of people desperate for loans. Although the Federal government tried to put an end to predatory lending through the Community Reinvestment Act (CRA), minorities and the poor still frequently become victims of exploitation by predatory lenders. The CRA is best defined as a banking regulation that required financial institutions to lend in underserved areas of their community. Despite the best efforts of the CRA, many people are still unable to receive loans due to low credit scores and other factors previously mentioned. Without safe lenders accessible in their communities, many poor and black Americans have turned to the predatory lending market to help them meet their financial needs. Sadly, the existence of these institutions has led approximately half of all people earning less than $15,000 annually to spend more than 40% of their income on servicing their nonmortgage consumer debt (Caplan 150).

One of the largest instances in which predatory lending impacted the lives of millions was the subprime mortgages that led to the Great Recession in 2007. The subprime loan market is an extension of mortgage credit that allows lenders to loan to borrowers who would have initially had a difficult time accessing a mortgage. In particular, subprime loans can be defined as "high-risk mortgages" that "became available from lenders who funded mortgages by repackaging them into pools that were sold to investors" (Duca 4-5). These sub-prime loans were desirable from the perspective of a financial institution because they allowed banks to drive up their return by bundling high-risk subprime loans with more secure loans. The investors who purchased a part of these mortgage pools received mortgage-backed securities which are valued according to the expected incoming mortgage payments from the pool (Andrews 4). In addition to the sneaky way in which banks bundled subprime loans with low-risk loans, lenders also took advantage of credit default swaps (CDS). Although a CDS can be thought of as an insurance contract against the default of a borrower, the incentive structures underlying a CDS are perverse. Owning a CDS allows lenders to make large loans to risky borrowers, and the protection of a CDS decreases a lender's incentive to monitor a borrower's ability to pay (Stulz

2-3). In other words, banks care less about having borrowers default because they can quickly get rid of risk very quickly by paying a fee.

The existence of these subprime loans led to increased demand for homes and subsequently drove up the cost of housing. This feedback loop led high-risk borrowers who could not pay off their loans to either sell their homes at a profit or borrow more money to refinance. Ultimately, this housing bubble reached a peak and the housing market burst, leading to fewer mortgages approved, increased foreclosures, and decreased family wealth across the country (Duca 5-6). When discussing what it meant for the housing bubble to burst, it essentially means that the consequences of high-risk lending to uninformed individuals came back to haunt both those who unwittingly signed the mortgages and the financial institutions that backed them. As defaults on mortgages began to rise, the values of mortgage-backed securities began to fall dramatically. This led to a lack of lending between financial institutions due to the fear of not being able to be paid back. Ultimately this adversely impacted any institution or individual tied to these sub-prime mortgage loans and their mortgage pools (Andrews 7-8).

Following this national incident, "the Department of Treasury… found that black families living in upper-income neighborhoods were two times more likely than white households in lower-income neighborhoods to have refinanced their homes with subprime loans" (White 6). The report also notes that black and Latino households were nearly 50 percent more likely to face foreclosure than their white counterparts" (White 7). Additionally, median income White families possessed thirteen times more wealth than median income non-White families following the recession. Before the recession, this ratio was only ten (Ellen 182). Clearly, impoverished and non-White communities in the United States are being exploited by predatory lenders due to an inability to access the safe credit market options that many of us take for granted.

III. Methodology

For this research project, I plan on generating insights surrounding my core interest in the loanable funds market experience by examining the market through the lens of economic research, law review, and an in-depth analysis of financial institutions. The topics of law review and financial institutions are separated into the two sections below, and the economic research perspective is focused on within the Theoretical Analysis and Empirical Analysis sections.

A. The Current Status of Credit Market Laws and Regulations

When examining the shortcomings of the loanable funds market through the lens of the law, there is no shortage of laws and government institutions to examine. Despite a broad pool of options to choose from, I plan on reviewing the Community Reinvestment Act (CRA), the Consumer Financial Protection Bureau and their functions in the credit market, and also North Carolina's anti-predatory mortgage lending legislation. By examining the impacts and functions of these laws and institutions, I aim to make suggestions regarding how these laws and institutions can be improved or potentially nationalized in the Conclusion portion of the paper.

The Community Reinvestment Act (CRA) is widely considered "the primary piece of legislation specifically aimed at improving access to financial services and credit for underserved groups and communities" (Brodie 724). The CRA was enacted in 1977 in an effort to rectify credit market failures. Specifically, it focused on expanding the provision of credit to low- and moderate-income communities. The motivation behind this legislation was primarily driven by the deteriorating conditions of American cities which was causing urban flight. The CRA is a banking regulation that mandates that financial institutions are required to lend in underserved areas of their local communities. Banks operating under the CRA are periodically evaluated on their performance, and the Federal Reserve has recently found that "CRA-related lending activity was at least somewhat profitable and usually did not involve disproportionately higher levels of default" (Brodie 723-725).

Moving away from the CRA, we can dive into one of the primary institutions in place to defend consumers from exploitation which is the Consumer Financial Protection Bureau (CFPB). Founded in 2010, the CFPB was the idea of Senator Elizabeth Warren and has the primary obligations of ensuring consumers have understandable and timely information about financial transactions, protecting consumers from unfair or abusive acts and discrimination, reducing overburdensome regulations, promoting fair competition, and advancing markets for consumer financial products and services. Ultimately, the CFPB aims to protect a consumer's ability to act as an informed buyer in financial markets. Although there continue to be exploitive predatory lenders in the United States, the CFPB has made valiant efforts toward achieving its goals (Brodie 728-730). The CFPB constantly makes rules for financial markets to follow which vary from Truth in Lending rules which ensure that leases are annually adjusted for inflation to Fair

Credit Reporting rules which ensure that consumer reporting agencies prepare valid consumer reports ("Final…" 4). In order to enforce their rules and standards, the CFPB frequently takes action in the court systems, sends warning letters to those who are out of compliance, and allows for input from whistleblowers within any industry ("Enforcement" 1). In essence, the CFPB can take various actions against firms in a wide variety of industries in order to uphold consumer safety.

Finally, one relevant piece of legislation enacted in the state of North Carolina is of interest when discussing the loanable funds market. Enacted in 1999, the NC Predatory Lending Law made North Carolina the first state to enact legislation to curb predatory mortgage lending. The impacts of this legislation were immediately recognizable. "During the first year after the law's passage, North Carolina's citizens saved an estimated $100 million as a result of the law" ("1999 NC…" 1). The main facets of this legislation include preventing the flipping of abusive refinances that strip an individual's wealth and generate fees, ensuring homeowners can defend against foreclosure when their loans have been sold, and banning prepayment penalties for home loans that are less than $150,000. This legislation effectively stymied the existence of predatory lenders across the state and revolutionized the way states addressed predatory lending. As of right now, only 33 states ensure that a two-year $2,000 loan has a full interest rate that is less than 36%. On top of this, 3 states have no cap at all on finance charges, which leaves many of their citizens vulnerable to predatory lending (*Predatory Installment*… 10-11).

B. How Private Institutions in the Credit Market Operate

Now, we will examine how private banking institutions are aiming to reach out to impoverished individuals and underprivileged communities. Although I have already discussed some of their required actions under the CRA and some of their less-than-ideal online resources, the focus of this section is to identify financial institutions in the United States that are going above and beyond to help impoverished individuals. For example, some banks in New York City are teaming up to try and offer poor people bank accounts, no matter their financial standing. In order to access the services of these banks, applicants must complete an IDNYC application online which gives them an identification card that helps them access these services. Overall, the application for an IDNYC card is fairly straightforward, though it does require three forms of identification and one must make an appointment at an Enrollment Center to apply ("How to…"

2). After receiving the card, anyone carrying IDNYC identification can apply for a bank account at one of a variety of banks in the city including PNC Bank and First Republic Bank. Also, individuals carrying this card qualify for discounts at grocery stores and for prescription drugs. Undoubtedly, the implementation of IDNYC and the collection of banks involved are making an effort to help citizens receive financial services that keep them secure and build credit for potential loans later down the line.

An additional example of a private institution dedicated to helping impoverished people is the Mission Asset Fund (MAF) which is based in San Francisco. Unlike traditional financial institutions, the MAF does not give out loans on an individual basis, but rather creates lending circles. The way that lending circles work is that a group of 6-12 people make monthly payments as low as $50 to the lending circle, and each month a new member of the lending circle receives a loan from the money pool until everyone has received a loan. One of the best parts of this service is that all of the loans given by the MAF have a 0% interest rate. This means that you can build credit without having to make payments greater than the amount you put in. In order to access a lending circle, one must fill out an online application and complete financial education courses. The MAF is available nationwide but has a limited number of local nonprofits around the United States. As for the results of joining these lending circles, on average, participants in a lending circle increase their credit scores by 168 points and decrease their debt by $1,000. Also, many of the individuals participating in lending circles do not have a credit score at all and by participating in a lending circle, 90% of these “credit-invisible” individuals receive their first credit score (“Lending…” 1-3).

IV. Theoretical Analysis

After examining the injustices that many poor and black Americans face in the loanable funds market, I hypothesize that many of these individuals do not trust the people who work within banks and financial institutions. In this section, I focus on constructing an economic model of the loanable funds market which takes into account the ways in which bankers mistreat certain subpopulations, and how these populations react to mistreatment. Examining Figure 1, we see a basic economic model of the loanable funds market. On the vertical axis, we find the interest rate that banks set for the repayment of loans, and on the horizontal axis, we find the quantity of loans that are taken from financial institutions. Within these two axes lie supply and

demand curves for the loanable funds market. The black line represents the supply of loanable funds which banks and financial institutions regulate by defining interest rates and deciding to who they award loans (aka the lenders). This line has a positive slope because as the interest rate rises, more people will be willing to save money to loan to others. The blue line represents the demand for loanable funds that consumers determine based on market conditions and personal preferences (aka the borrowers). This line has a negative slope because as the interest rate rises, fewer people will want to take out a loan. The remainder of this portion of the analysis section will discuss how the mistreatment of black and poor individuals in tandem with a lack of trust in financial markets interferes with initial market conditions and can lead to losses for both parties.

The first step an individual takes towards acquiring a loan is applying for said loan at a bank or financial institution, and then the bank decides whether or not they will allow for an individual to receive the loan. There are two primary ways that financial institutions determine whether a person will be approved for a loan and what interest rate the borrower will receive on a loan. These methods can be categorized as assessing the risk of the borrower and determining if the goals of the client are realistic and achievable. When confronted with low-income individuals, banks recognize that lending to these individuals poses a massive risk because they do not have a large financial base to lean on if their firm struggles. In this case, without much savings to fall back on – which is positively related to income – many poor individuals are likely to end up defaulting on their loans. Even if the goals of the low-income individual are well-constructed and likely to succeed, the risk associated with providing a loan to a low-income client is associated with a higher interest rate than seen in the loanable funds market of Figure 1. In Figure 2, we see how leaders in financial institutions adjust the supply of loans when confronted with low-income individuals. The increase in the graph denoted by the Θ symbol accounts for the perceived risk of the loan applicant. This symbol accounts for many factors that are not limited to the income status of the applicant, the race of the applicant, and the goals of the applicant. When encountering a high-risk applicant, lenders decrease the supply of loans by establishing large interest rates that are difficult for low-income people to afford, and also by denying them loans based on an initial analysis of their loan application. The restrictive practices that lenders enact in the face of low-income borrowers lead to higher interest rates and a lower quantity of loans being taken out.

Although lenders certainly have a lot of power regarding who has access to the funds within the loanable funds market, borrowers can also impact the market in a different way. After experiencing injustices in the loanable funds market, it is fair to assume that black and low- and middle-income individuals tend to have a lower degree of trust in banks and financial institutions when compared to their wealthier counterparts. This low degree of trust, combined with the ability to remain unbanked or pursue predatory lenders as seen in the Literature Review section, leads many low-income individuals to no longer demand loanable funds in the traditional loanable funds market. This decrease in demand can be seen in Figure 3. In the figure, we notice that this decrease in demand can oftentimes lead to lower interest rates and fewer loans being given by financial institutions. Although this may seem as if black and low-income borrowers may see the benefits of lower interest rates moving forward, we must analyze the entirety of this issue by examining the reactions of borrowers and lenders together.

The combined effects of Figures 2 and 3 can be seen in Figure 4. With black and low-income borrowers demanding fewer loans due to distrust, the opportunity to pursue predatory lenders, and the opportunity to remain unbanked, and lenders supplying fewer loans to mitigate the risk associated with low-income borrowers, a market failure begins to develop which ultimately harms both parties. As seen in Figure 4, interest rates rise from the initial model which continues to disincentivize low-income individuals from demanding loans, and the quantity of loans provided decreases leaving fewer opportunities for banks and financial institutions to make money. Although it is unclear from my model whether the interest rate will rise, fall, or remain the same, I can be certain that financial institutions will be harmed by supplying fewer loans. Overall, the way in which lenders have made it difficult for black and low- and middle-income individuals to acquire loans has not only led them away from opportunities to make money through the market but also built a level of distrust in black and low-income communities that will likely lead fewer individuals to demand loans moving forward. Ultimately, determining how to correct this cycle of distrust and the associated market failure in the market for loanable funds is pivotal in creating a market that is fair and just for all individuals seeking a loan in a safe financial environment.

V. Empirical Analysis

To test my hypothesis that low-income Americans and Americans of color have developed a sense of low trust in financial institutions due to mistreatment in the loanable funds market, this section aims to engage in a true economic analysis. In particular, this section aims to perform an econometric analysis aimed at examining the ways in which variables such as an individual's race, family income, age, marital status, education level, gender, and political ideology impact their level of trust in the people who operate financial institutions.

Using data from the General Social Survey (GSS) from 2021, I aim to look at how indicators such as race and income impact an adult's trust in financial institutions. My first hypothesis is that the lower the income you make, the more likely you will be to distrust financial institutions. Additionally, I hypothesize that being black makes you less likely to trust financial institutions. Combining aspects of these two hypotheses together, I also hypothesize that low-income black individuals have the lowest degree of trust in financial institutions. All of these hypothesis's stem from evidence and theory explained in the Literature Cited section of this paper. By conducting regression analyses with this data, I aim to bolster evidence that historical and current trends have led disadvantaged communities to distrust the way financial systems operate. Below is the econometric model I plan on using to guide my exploration of the GSS data:

$$T = \beta_0 + \beta_1 R + \beta_2 I + \beta_3 RI + \beta_4 A + \beta_5 M + \beta_6 E + \beta_7 S + \beta_8 P + \epsilon$$

In the model above, the dependent variable *T* is representative of an individual's trust in financial institutions. The data for this variable is a ranking for which people responded to the survey indicating that they trust banks and financial institutions with a *great deal of confidence*, *only some confidence*, or *hardly any confidence at all*. The first explanatory variable *R* is representative of a dummy variable for race. It will be one if the individual is white, and 0 if the individual is non-white. The second explanatory variable *I* is a dummy variable that equals 1 if the individual makes the median level of income within the data set or higher. The third variable *RI* is an interaction variable that will provide deeper insights into how the intersection of income and race impacts trust in banks and financial institutions. The variable *A* is a variable that accounts for the age of the individual taking the survey. The variable *M* is a dummy variable that will account for the marital status of the individuals being surveyed. Further, the variable *E* will

be a dummy variable that accounts for the educational status of the person interviewed. The variable *S* is a dummy variable that will account for the sex of the individual survey. Finally, *P* will be a dummy variable associated with the political self-identification of the individual surveyed. With this model, I will aim to uncover how factors such as race and income impact the amount of trust Americans place on financial institutions as recent as this past year.

1. *Variables*

In order to more clearly understand the process of the analysis performed, one must first understand the variables in the dataset examined. The dependent variable which represents an individual's trust in banks and financial institutions is labeled *fintrust* and is scored in the integer range from one to three. These integers correspond to an individual having a *great deal of confidence* (3), *only some confidence* (2), or *hardly any confidence at all* (1) in financial institutions (*GSS* 143). In other words, the higher the value, the more trust one has in the people who run banks and financial institutions.

Next, the first explanatory variable looked at is a dummy variable for race called *white* which equals 1 if the individual is white and 0 if the individual is non-white. Next is the variable *medinc* which is a dummy variable that equals 1 if the inflation-adjusted family income is higher than the median of the sample and 0 otherwise. The dummy variable *mar* accounts for people's marital status and equals one if the individual is married and 0 if they are not. Also, the variable *coll* is an education variable that equals 1 if an individual received higher than a high school education and 0 if not. The variable *male* is an indicator variable which equals 1 if the individual identifies as male and 0 if the individual identifies as female. Finally, the variable *repub* is a binary variable that equals 1 if the individual identifies within the political spectrum as someone who is *independent and close to republican*, *a not very strong republican*, *or a strong republican* (*GSS* 72) – in this case, the reference is someone with an alternative political identity. Finally, the variable *medinc#white* is an interaction variable for the *medinc* and *white* variables.

2. *Descriptive Statistics*

Now that the variables involved in our study have been identified, we can begin to explore the initial findings of our data through the descriptive statistics outlined in Figure 5. Some of the most notable findings in the descriptive statistics are that of the 4,032 respondents to

the survey, only 2,660 answered the question related to trust in banks and financial institutions which is our dependent variable. According to the codebook for the General Social Survey, some respondents skipped this question or identified the question as *not applicable*, or *skipped over it* (*GSS* 143). This could be an indication that some of the individuals taking this survey were unbanked or do not utilize financial institutions. It is reasonable to believe that unbanked individuals are not very trusting of financial institutions. Thus, my results could be biased upward – in a more trusting direction – because these people are not in the analysis sample.[1] Also, it is important to note that the average for the financial trust variable was 1.294. Rounding this value down to one, this means that the average individual surveyed had *hardly any confidence at all* in banks and financial institutions. This indicates that before examining our regressions and paying attention to some of our most important explanatory variables, many Americans do not have a large degree of trust in the people who run financial institutions.

Additional descriptive statistics of note include the fact that the mean value for the variable male is 0.431. This means that approximately 43% of the sample were men, which seems lower than the baseline 0.5 we would expect for differences in gender. Another fascinating note is that the mean for the white variable is 0.795. This means that approximately 80% of all participants in the survey were white, and the remainder were people of color. Although this percentage is close to the 0.76 value for white that we would expect from data published in the latest census, it does seem that a low percentage of people of color took part in the survey (*U.S. Census…* 2).

3. *Results and Interpretations of Regression Analyses*

To empirically explore the association between trust in financial institutions and my set of independent variables – particularly race and family income – I specify the model below described at the beginning of this section.

$$fintrust = \alpha + \beta(white) + \varphi(medinc) + \gamma(medinc\#white) + \psi(X) + \epsilon$$

[1] Some of the individuals that did not answer may have skipped the question. This may have been done for a variety of random reasons such as impatience, or they felt unfamiliar with financial firms. In this case, they may have simply had no view on the issue of trust in this situation. Therefore, it is unclear whether these exclusions may bias the findings.

I hypothesize that being black and being of a lower income group is associated with lower levels of trust in banks and financial institutions. Specifically, I believe that low-income black individuals will have the lowest level of trust in financial institutions when compared with all other demographic and income subgroups. This hypothesis is based on the expansive evidence to support this claim seen in the Literature Review section. With the structure of the variables above, black individuals with less than median income are my reference group. With this knowledge, if low-income black persons are less trusting of financial institutions than low-income white people – low-income whites are more trusting - then $\beta > 0$. Also, if low-income black persons are less trusting of financial institutions than high-income black persons, then $\varphi > 0$. Finally, for the γ coefficient, if low-income white individuals are less trusting of financial institutions than high-income white individuals then $\gamma > 0$. The variable X contains my set of control variables which includes indicators for marital status, gender, age, education level, and political affiliation. I estimated the model using Ordinary Least Squares (OLS). The regression results are presented in Figure 6.

To begin my analysis of the results, I focus on the three variables of utmost interest: *medinc*, *white*, and *medinc#white*. Beginning with the *medinc* variable, we see a coefficient with a positive sign and a magnitude of 0.119. We can interpret this finding as meaning that black people earning more than the median level of family income have more trust in financial institutions than blacks earning less than the median level of family income. Moving on to the *white* coefficient, we notice that it is positive and has a magnitude of 0.086. Therefore, in comparison with my reference group of black people making less than the median family income of the sample, white individuals making less than the median family income have a higher degree of trust in banks and financial institutions. These findings uphold my hypothesis that poor black individuals have lower levels of trust in financial institutions when compared with poor white individuals and their wealthier black counterparts. Also, these results show that since the magnitude of the *medinc* coefficient is larger than the magnitude of the *white* coefficient, low-income white individuals have less trust in financial institutions than high-income black individuals. This difference exacerbates the close relationship that low-income status and distrust have in concern to the loanable funds market. Although these coefficients from my analysis are not statistically significant, they are still relevant in upholding the assertions made in my Theoretical Analysis section.

Moving on to the interaction variable *medinc#white*, we find that this variable has a negative coefficient with a magnitude of 0.19. This finding, unlike those discussed in the previous paragraph, is statistically significant and runs contrary to what I expected in my initial hypothesis. Not only is this variable negative, but it is of a high enough magnitude to where this interaction effect coupled with the coefficients of dummy variables *white* and *medinc* lead to a fascinating finding. Although this result upholds our hypothesis that affluent white individuals have more trust in financial institutions than their low-income black counterparts, they are the least trusting group compared to all others. For example, white individuals with family incomes above the median level are less trusting of financial institutions when compared to low-income whites and high-income blacks. This fascinating finding may be due to the fact that affluent whites have higher levels of historical experience with financial institutions and lenders, and these experiences have led to some degrees of distrust.

Moving on to some of my other control variables, I note that the marital status, gender, and political identity variables all have statistically significant impacts. The *mar* variable has a positive coefficient with a magnitude of 0.095, meaning that married individuals are more likely to trust banks and financial institutions when compared to their single or divorced counterparts. The male variable, on the other hand, has a negative coefficient with a magnitude of 0.078. We can interpret this as meaning that males tended to have lower confidence in financial institutions than their female counterparts. Finally, the republican (*repub*) variable had a positive coefficient with a magnitude of 0.146. Therefore, if one was republican, they were more inclined to trust financial institutions than their democrat counterparts.

Lastly, I examine some of the control variables that were found to be statistically insignificant which are the age and education variables. As for age, we see a positive coefficient with a magnitude of 0.002. Though we may find the low magnitude of the coefficient to be disappointing, this means that for every year you age, the more likely you are to trust financial institutions. The continuous nature of this variable implies that as you age, your trust in financial institutions tends to increase. Finally, for the education variable, we find that it has a negative coefficient with a relatively high magnitude of 0.038. It is truly fascinating there is no statistically significant difference in trust between those with a college education and those without one. The negative coefficient may allude to the fact that college-educated people are

more likely to be exposed to faults in the United States financial system by writing papers such as this one!

Overall, the results of my Empirical Analysis uphold my hypotheses and models described in the Theoretical Analysis section. The results of this econometric analysis support my hypothesis that black, low-income individuals have lower degrees of trust in financial institutions compared to their counterparts of different income levels and races. The implications of these findings, shown through the graphical analysis of the loanable funds market, lead to potential market failures that harm lenders, and possibly harm low-income borrowers. Clearly, the cycle of distrust and discrimination seen within the loanable funds market is beginning to harm financial institutions as well as borrowers. With these significant findings, I am confident I have contributed new insights into how the nature of discriminatory lending practices is harmful to banks as well as disadvantaged borrowers.

Ethics

After analyzing how key factors such as income and race impact the trust people put in banks and financial institutions, it is vital that the Analysis sections are contextualized from an ethical standpoint. Further, it is important to recognize that not only is trust in financial institutions dwindling, but minority populations such as people of color and the poor are being mistreated in the loanable funds market. Therefore, this section is divided into two sections: one which focuses on the ethics of trust related to financial institutions and one which focuses on why the mistreatment of certain populations in the loanable funds market is unjust.

a) The Importance of Trust in Public Institutions

To begin our analysis of the ethics behind the class-based and racial discrimination we have exposed in the loanable funds market, we first examine the ethics of trust. In the Empirical Analysis section, we examined how lower-income individuals have lower trust in banks and financial institutions and that overall, trust in these institutions is not high. Though trust tends to be thought of as an extremely personal sentiment, many philosophers have found that trust is far more important than individual perceptions. In particular, by examining the views of philosophers Paul Faulkner and Trudy Govier, we come to find that trust in institutions such as the banks that offer loans is critical to a healthy society.

According to Faulkner, trust is essential to acquiring knowledge. Without trust in another person, Faulkner points out that we cannot accept the testimony they offer. For example, suppose we meet someone and they inform us that there has been an accident down the road that is interrupting traffic. Without trust in that individual, the only way we can acquire knowledge about the accident is by going and seeing the accident for ourselves (Faulkner 6-7). Therefore, without trust in others, we give way to skepticism and self-reliance which slows down human progress and individual happiness. In the case of financial institutions, if people distrust those who work within banks, this distrust could lead to a lack of testimonial knowledge acquisition between people and institutions leading to people becoming unbanked and hopeless. Further, according to Faulkner, trust and sincerity are the foundations of the human community, and the human community is the foundation of a flourishing individual (Faulkner 173-176). After examining the results of the Empirical Analysis section through Faulkner's understanding of trust, we find that a lack of trust is indicative of suffering for individuals who are unable to flourish, and also suffering for institutions that lose customers.

Building off of Faulkner's viewpoint of trust as the groundwork for a flourishing society, Trudy Govier adds to the concept of trust within institutions through her exploration of trust within client-patron relationships. In her words, a client-patron relationship is one in which "the client buys protection and in return accepts the patron's control" (Govier 147). Whenever someone enters the market for loanable funds, they assume the role of a client who relies on the funds of the patron - in this case, the bank or financial institution – and the patron controls their contract through interest rates and fees. Govier asserts that client-patron relationships such as these are inherently unequal and not the grounds to form trust. She even goes so far as to say that "inequality, hierarchy, lack of dignity, and a sense of partiality… make the system seem less than good even to participants" (Govier 150). In the case of financial institutions, they display partiality towards those of higher social standing and income. Despite many high-earning individuals being widely accepted in this market, they too also experience a relationship of inequality with lenders due to the lender's position as the patron (Govier 146-151). Financial institutions will always have a degree of power over the people they serve, as is the nature of the client-patron relationship, but there are certainly ways in which the market can become more equitable to the less advantaged. Though this market may appear to Govier as a place where trust can never be established, I would argue that relationships in the loanable funds market can

certainly be improved upon for the benefit of all those involved as discussed in the Analysis sections.

b) The Unjust Nature of the Loanable Funds Market

After thoroughly examining some of the many ways the loanable funds market has discriminated against impoverished people and people of color, and uncovering a lack of trust in the financial institutions that provides loans, I now argue that many aspects of the loanable funds market are unjust. Although many people may understandably argue credit markets are justified in turning away those who do not have a strong financial history, the lack of access many impoverished and black people face in relation to the loanable funds market is unjust. The Rawlsian perspective of justice, which adopts a social contract moral theory, adequately defends the stance that the inaccessibility of the loanable funds market for certain populations is unacceptable. Rawls' theory of justice states that all people should, above all, have certain unalienable liberties such as property and speech. However, in addition to these unalienable liberties, Rawls' Theory also claims that there should be fair equality of opportunity and there should be a safety net for everyone so long as this does not infringe on anyone's liberties. Examining the most important aspect of Rawls' theory of justice, the existence of unalienable liberties, financial institutions and banks should have the right to decline loans for those who have a poor financial history. If a financial institution's decision to decline a loan for someone is based on a process that does not promote an inequality of opportunity, it would infringe upon the liberty of people working within that institution to force them to give loans to those struggling financially.

However, many financial institutions deny clients searching for a loan for discriminatory reasons and do not give clients the information and resources they need to eventually become an eligible client. Through this lens of examining the loanable funds market, it is clear that this defies the premise of fair equality of opportunity under Rawls' theory of justice (Rawls 115-117). If one was justifiably denied a loan from a financial institution and not told how to improve their application in a way that allows them to access the loanable funds market in the future, the person being denied this information is not receiving fair equality of opportunity. They are left powerless in their struggle to establish good credit. This sense of powerlessness and disappointment has culminated towards a large degree of distrust in financial institutions and

many people deciding to remain unbanked. As seen in our Literature Review and Analysis sections, this sense of powerlessness is currently creating market failures in the loanable funds market. Without information on how to receive loans and institutional practices that do not promote fair opportunity between populations, there is an unjust inequality of opportunity in the loanable funds market. Overall, the inequality of opportunity outlined throughout the bulk of this paper uncovers an injustice that must be addressed.

VI. Conclusion

The contents of this essay were meant to elicit many feelings from the reader. After reading through the details of distrust, discrimination, and inequality in the loanable funds market, it is not shocking that many may feel angry, disappointed, and wronged by this information. Though this is a step in the right direction, this paper aims to close with actionable steps and ideas about how to begin mending the broken nature of the United States loanable funds market. Looking back at the Methodology section, two subsections focused on the current status of credit market practices from bureaucratic standpoints and the standpoint of private institutions. Without specific policy suggestions for both of these spheres of influence in relation to the credit market's impact on disadvantaged communities, change will not come. Therefore, the remainder of this paper consists of recommendations and ideas for these influential bodies to consider.

For governmental entities, I will focus on the Community Reinvestment Act (CRA), the Consumer Financial Protection Bureau (CFPB), and state legislation as points of critique. First and foremost, the CRA must be amended in a way that drives action. Currently, the CRA acts as a successful policy initiative to invest in low-income communities, but it needs to be bolstered. Oftentimes, financial institutions that do not lend to low-income communities out of accordance with the CRA may only receive warning letters for their actions or a low-performance score. Also, CRA evaluations by governing bodies such as the FDIC only occur every 3-4 years (Office of the … 2-3). I suggest that CRA evaluations are completed at a more regional level so that rolling evaluations can regulate entities more closely, while still reporting to the federal government. I also advise stricter consequences be put in place for banks that are found to be out of accordance. Without a tighter timeline and more punitive measures, it becomes too easy for

banks to sneak under the radar and only invest in low-income communities when evaluators come to visit.

Moving onto the CFPB, although they are the face of consumer protection and support in the United States, they must extend their reach toward addressing predatory lenders. As discussed in the Literature Review section, predatory lenders frequently put low- and middle-income individuals in crippling debt through deception and misinformation. There is no better target for a large CFPB action than this subsect of the loanable funds market. Whether this action is through a class-action suit in the courts or legislative acts proposed to Congress, the CFPB has a responsibility to defend the rights of the consumers who have been wrongfully taken advantage of in the predatory lending market. As previously mentioned in the Methodology section, there are still 3 states who do not have a cap on any financing charges. A large push for action from the CFPB, coupled with state-based anti-predatory lending legislation such as that in the state of North Carolina, has the potential to cripple large-scale predatory lenders into extinction.

Moving on to private institutional practices that have the potential to help assist in the correction of injustices within the credit market, I advocate for the expansion of programs such as IDNYC and lending circles such as the Mission Asset Fund (MAF). The way in which many private banks in New York City have banded together to help underprivileged New Yorkers access bank accounts has been incredible and should be imitated nationwide. By removing the stigma of being rejected by a bank due to fees and other stipulations on opening an account, IDNYC empowers people to establish a secure foothold in the financial services industry. If the banks involved in the IDNYC program encouraged other branches of their bank to establish identification cards in other localities, the effects could ripple nationwide. Overall, the nationalization of this concept would help more members of the general population open bank accounts without financial or administrative difficulties, banks would be exposed to more customers, and middle- and low-income individuals could begin their path to establishing credit without fear. As for loaning circles such as the MAF, I also support the widespread expansion of these institutions that focus less on profit and more on helping those in need. Though the MAF has had an astoundingly impressive impact, lending circles are oftentimes regional, and cannot reach many people in need. However, if private banks and financial institutions become more invested in referring declined loan clients to organizations such as the MAF, they have a better

opportunity to give loans to those clients in the future and remove some of the inequality of opportunity that many denied applicants face. The way in which organizations such as the MAF help low-income people establish credit and expand financial literacy through practice has the potential to have resounding effects on communities everywhere.

Clearly, despite the many failures and frustrations that exist in the loanable funds market today, there are opportunities for the United States to improve the experience of marginalized communities in this market in a way that uplifts both financial institutions and their clients. The first step in working towards solving the issue of inequality in the credit market is acknowledging that an injustice exists. By outlining the history, implications, and ethics of this pervasive issue, I hope this paper inspires others to make an impact in the communities they love. Financial institutions and government entities have the power to make a change in the lives of those who are frequently excluded from the joys many of us take for granted. It is time that all Americans, regardless of skin color or income bracket, have an equal opportunity to pursue purchasing a home with a mortgage, being approved for student loans, sending their child to college, securing small business loans that make dreams come to life, or any opportunity the loanable funds market has to offer.

Figures

Figure 1: An Economic Model of the Loanable Funds Market

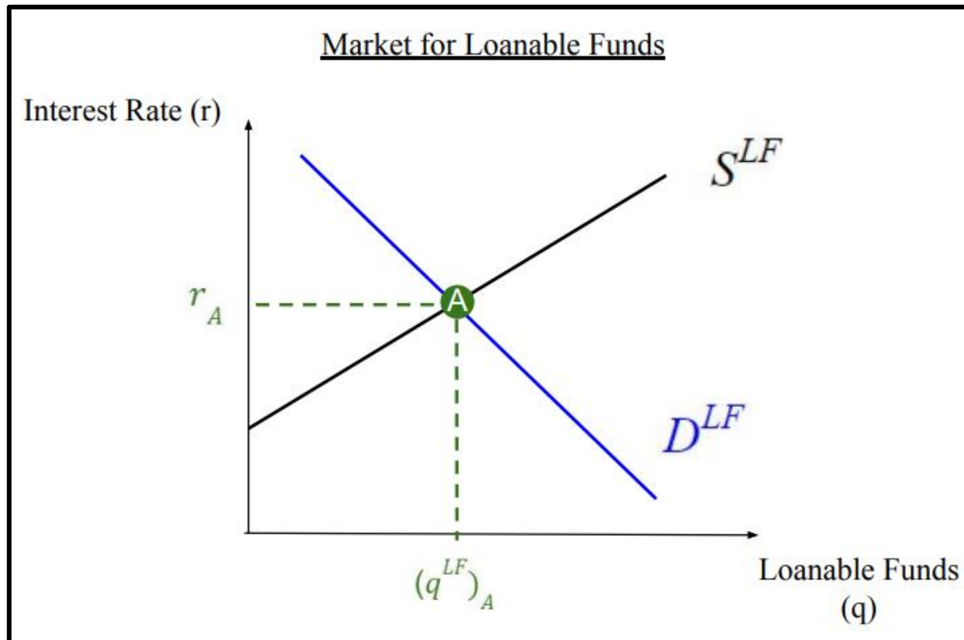

Figure 2: How a Decrease in Supply Impacts the Loanable Funds Market

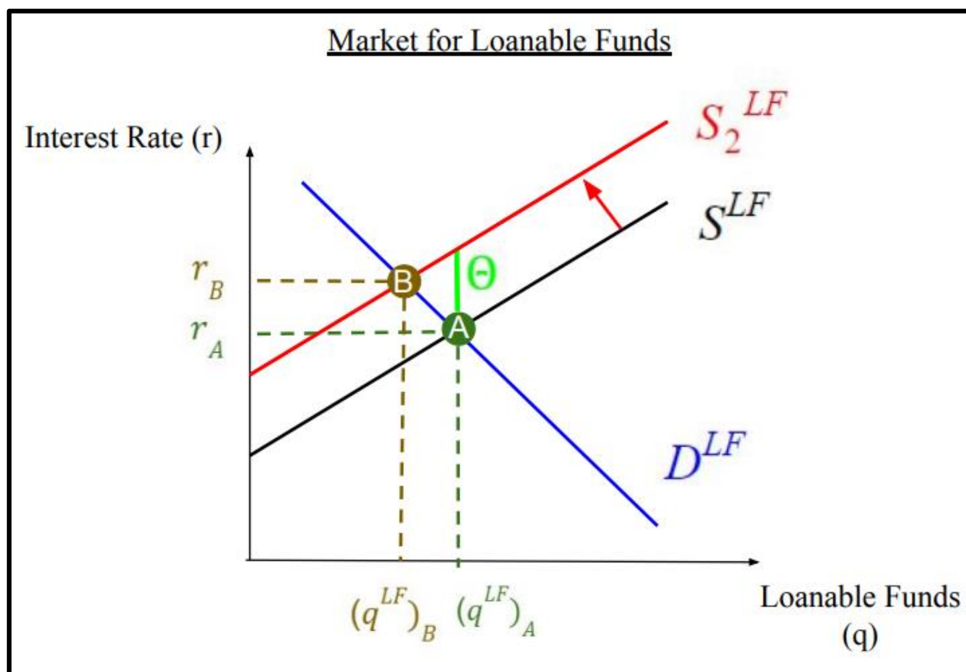

Figure 3: How a Decrease in Demand Impacts the Loanable Funds Market

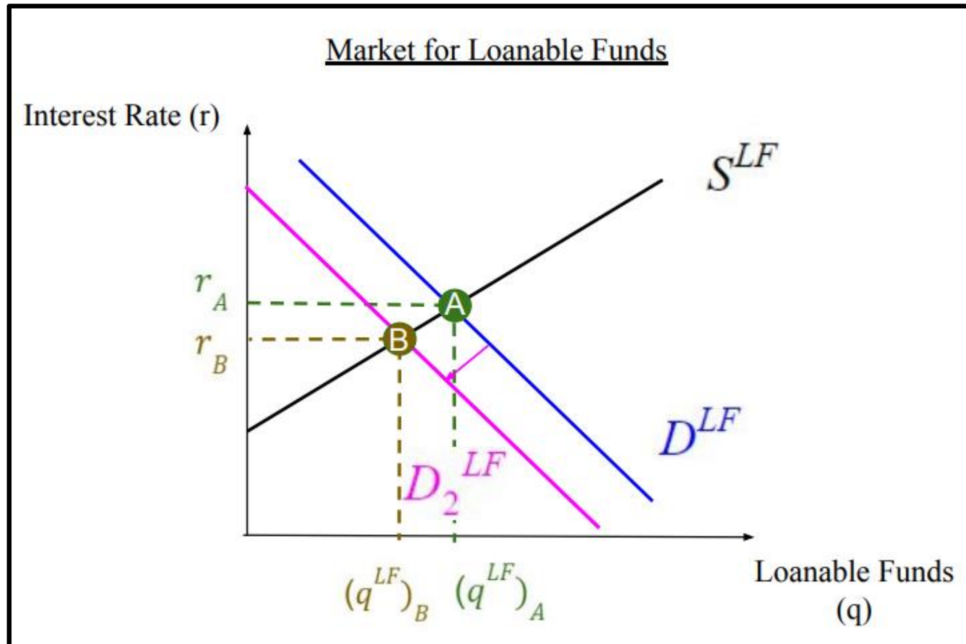

Figure 4: The Aggregate Consequences of Discrimination in the Loanable Funds Market

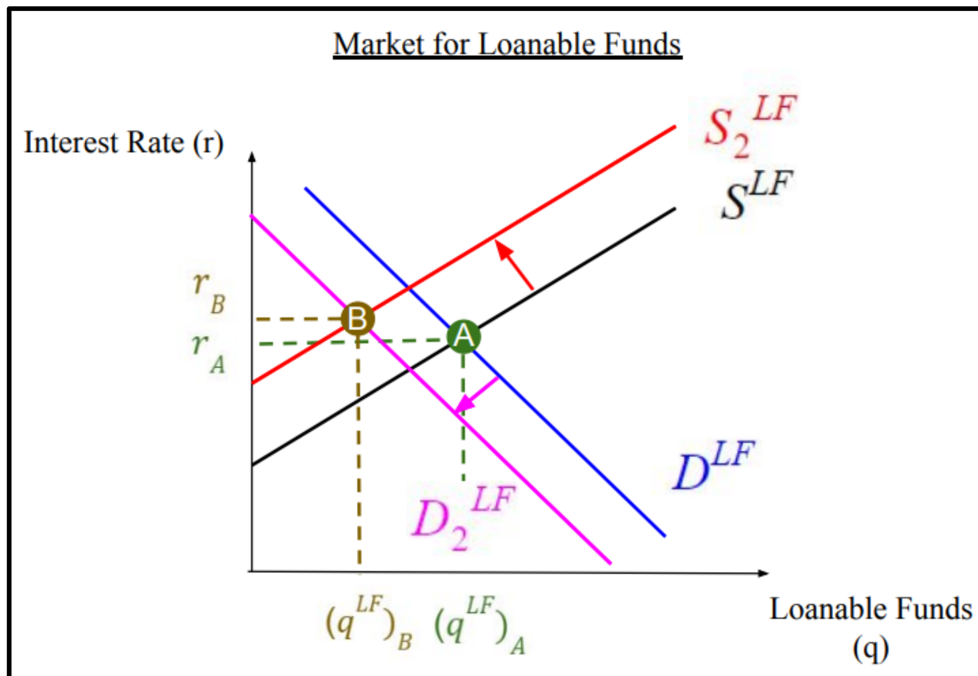

Figure 5: Descriptive Statistics Related to the Core Variables in Regression Analyses

Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
fintrust	4032	1.294	1.062	0	3
white	4032	.795	.403	0	1
medinc	3509	.532	.499	0	1
age	3699	52.165	17.233	18	89
mar	4032	.496	.5	0	1
coll	4032	.543	.498	0	1
male	4032	.431	.495	0	1
repub	4032	.306	.461	0	1

Figure 6: Results of Regression Analyses

VARIABLES	(1) fintrust
medinc	0.119
	[0.088]
age	0.002
	[0.001]
white	0.086
	[0.064]
mar	0.095**
	[0.040]
coll	-0.038
	[0.039]
male	-0.078**
	[0.037]
repub	0.146***
	[0.041]
medinc#white	-0.190**
	[0.095]
Constant	1.125***
	[0.078]
Observations	3,336
R-squared	0.010

Standard errors in brackets
*** p<0.01, ** p<0.05, * p<0.1

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