

RESEARCH OF THE ROLE OF FINANCIAL INSTITUTIONS IN THE COMMUNITY ECONOMIC DEVELOPMENT IN ONE OF THE WORLD'S LEADING COUNTRIES

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Abstract: *The article addressed the community as the smallest unit in geography scope, which unites individuals, companies, and government. The role of each one is significant and irreplaceable. For this paper, the community is as a synergy between group of individuals, institutions, and a government that live and (or) operate within geographical, political, social, and economic boundaries. This article focuses on banks, as a link between individuals and government in the development process. In particular, the supply and retention of financial and human capital. The authors try to prove financial companies and banks play a key role in the community and economic development because they deliver financial capital to individuals and businesses. This research allows concluding that the Finance & Insurance industry contributes toward the development of both national and local levels with the high share and positive mix and competitive components.*

Keywords: *Community, Financial Institutes, CRA examination, The Shift-Share analysis.*

1. INTRODUCTION

The perception of the community depends on multiple factors. Economists assess the economy regionally, nationally, and globally. Within this approach, the community is the smallest unit of the region, state, and nation. While it is as a component of a regional and national sphere, each community has its unique structure, participants, and governance. Actors play a vital role in the development, the cooperation of them is crucial. This article focuses on banks, as a link between individuals and government in the development process. In particular, the supply and retention of financial and human capital. For the finance segment, the affordable loans create a monetary flow in the local economy. They are supplied by banks and regulated by the Community Reinvestment Act (1977). The human capital describes the employment, in the industry; the Shift-and-Share tool helps to analyze the trend and direction of it within the finance sector.

Most of the definition of community refers to area, it can also include social and economic relations. There are five approaches for the study of it: qualitative, ecological, ethnographical, sociological, and economic (Shaffer, 2004). The qualitative view defines community as a place to live; ecological relates to spatial unit. The ethnographical approach addresses the way of life, and sociological is a social relationship and social capital within the boundaries. The economic approach examines a community as a system of relationship between sectors. For this paper, the community is as a synergy between group of individuals, institutions, and a government that live and (or) operate within geographical, political, social, and economic boundaries.

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The first and critical part of the definition is a group of people. The main actors are individuals, who create flows in the economy, through institutions and supported by the government. The flows can be internal and external. The export base theory is a demand-based approach and considers monetary inflows as a driving force (Blair, 2009). They depend on export. The idea incorporated into this approach is that income earned from export activities will be spent and reused within the local economy.

Institutions have the power to employ people and supply produce and service. Individuals and companies are tight as they have a mutual benefit of partnership. The Central Place Theory reflects the importance of connections between business and consumers. Two assumptions of CPT are that companies will attempt to maximize profit, and consumers will minimize the travel distance. Accordingly, depending on the locality size and number of local entrepreneurs, each community will fall in the hierarchy (Shaffer, 2004). The business functions define the level, and the highest is metropolitan that includes more than five hundred establishments' wit convenience, specialty, and wholesale businesses. The New York City, in this case, falls in the highest level because it has more establishments of various specialties from basic groceries to high-end retailers.

In the market economy, the public institutions are fundamental for local economic development, as they create, implement, and enforce rules of operations (Shaffer, 2004). The government plays the role of policymaker, implementation, and control for the community development. Economists define two alternative perspectives for government involvement in the economy – conservative and liberal (Blair, 2009). The conservative approach values economic freedom and efficiency, the liberals tend to value equity, and interference of government in the local finances. In terms of development, there are basic strategies of government for the growth. They include incentives, regulations, joint ownership, market expansion, and capacity-building (Shaffer, 2004). The incentive part consists of capital financing for communities, including soft loans, grants, and subsidies.

The capital often relates to the financials and assets that can be converted into cash (Blair, 2009). However, economists consider produced goods that can be used for further production; it involves the input of physical, and human resources (Blair, 2009). Therefore, the capital includes financial, physical, and human components. Some approaches classify the capital assets more narrowly to private financial and public (Shaffer, 2004). A key element in community economic development is the availability of funds - financial capital and defining its vital role. The physical capital includes machinery, buildings, and infrastructure and can be accessed in a money equivalent. Human is combination of labor, skills, and knowledge available in the community or area.

The capital creates a linkage between all actors in the development field, as the government provides incentives, individuals consume and produce, and institutions support both. Financial companies and banks play a key role in the community and economic development because they deliver financial capital to individuals and businesses. Moreover, they support human capital by providing employment opportunities, and public welfare investments. Therefore, to understand the full impact of banks and financial institutions, we need to review every function in depth.

First, the most essential function of any bank is capital management, they offer investments and provide lending solutions. Banks are the first stop for small business loans, housing loans for individuals, and support for the development of state or local development programs (Shaffer,

2004). The government regulates financial institutions to ensure transparency and fair service for every customer in every community. The modern banking system is highly controlled by many regulations to avoid discrimination and provide availability of financing, among them, are:

1. Community Reinvestment Act (1977);
2. Truth in Lending Act (1968);
3. Fair Housing Act (1968) & Equal Credit Opportunities (1974);
4. Care Act (2020).

The Community Reinvestment Act established a requirement of a financial institution to serve the credit needs of low – and moderate-income communities (LMI), including minorities (Bates & Robb, 2015). It applies to institutions insured by the Federal Deposit Insurance Corporation (FDIC), such as national banks and savings associations. This act was signed into law in 1977 as a response to prevent discrimination for financing purposes. By design, CRA makes banks and financial institutions responsible to fulfill the credit need in the community, in which they operate, and provide capital for housing and economic development (Bates & Robb, 2015). Federal Reserve System, the Office of Comptroller of the Currency and FDIC are responsible for CRA administration and compliance. The act evaluates the performance of every financial institution based on their community involvement and assigns an appropriate rating. The assessment includes three tests: lending, investment, and services. Banks have a wide variety of options to complete tests with a high rank. Evaluation is vary based on the size and business model of the bank. The size of bank is defined by asset and indexed to inflation and Consumer Price Index, where “small” is less than \$307 million, “intermediate” has at least \$307 million, and large is more than \$1.216 billion in asset (CSR Report, 2017). The overall rating consists of combine score, for three tests, however they have different weight. Table 1 demonstrate the point system applicable for the examination with a minimum ranking requirement.

Table 1. Point system for CRA examination

Rating	Lending Test	Investment Test	Service Test	Minimum total score for large bank
Outstanding	12	6	6	20
High Satisfactory	9	4	4	12
Low Satisfactory	6	3	3	11
Needs to Improve	3	1	1	5
Non-Compliance	0	0	0	0

Source: Federal Financial Institutions Council, 2017

The lending test evaluates the number, amount, and distribution of mortgages, small business loans, personal loans, small farms loans across LMI communities. The investment test related to community development investments and service test assess the retail (branch) service, for example, discounted checking account. The points or credits for CRA tests may be awarded for the following activities:

1. Investing in special-purpose community development entities, which facilitate investment in LMI,
2. Enhancing the ability to serve the community through affordable banking services for women and minorities;
3. Facilitating financial literacy education;
4. Open or maintaining branches in LMI communities;
5. Providing low-cost education loans to low-income borrowers.

Regulators review rating as a factor when banks are looking to open branches or plan merge or accusation with another financial institution. It is critical to have at least a satisfactory rating to proceed. In case, the institution does not meet the requirement, the application will be declined until the score improves.

JP Morgan Chase is one of the largest financial corporations in New York City. The Office of Comptroller of Currency has a most recent examination of the bank completed in 2013 for the period starting January 1, 2011, through December 31, 2013. The performance evaluation consists of a comprehensive review of activities across the United States. The overall rating is satisfactory, which allows the company to proceed with opening new branches, or actions related to the bank's growth. The company received an outstanding rating for the investment test and highly satisfactory for lending and service.

The bank originated more than \$9.5 billion community development loans across the 24 states, 73% of loans provided affordable housing, and 8% sponsored social services for individuals with low or moderate-income. The letters of credit for the total amount of \$700 million were issued in New York State to support community development projects. JP Morgan Chase participated in multiple government grant programs, made over 394 000 FHA, VA and USDA loans, additionally issued about 13 000 loans for small businesses. In New York City are a mixed-use project was financed in the East Harlem area that included financing of the creation of affordable housing units with the DREAM Charter School, offices for a nonprofit organization and community park, the total loan amount is over \$40 million.

The investment test shows that the bank made direct investments in the Low-Income Housing Tax Credit partnership of funds or acted as an agent for other institutions. The total amount invested through the period is close to \$9 billion across the US. The largest investment in NYC was a total of \$52.2 million for a project for housing rehabilitation in West Harlem with a total of 167 units and \$25.7 million for 526 affordable housing units in the Bronx.

The service test demonstrated that during the period bank opened 563 branches, with 112 in LMI geographies. The critical part of the evaluation is providing financial and homeownership education. Bank collaborated with non-profit organizations to target more families in need. However, the number of partnerships declined that negatively affected the accessibility of financial literacy. The employees provided their leadership services for organizations as part of the board committee. In New York City the branch footprint is large and accessible for LMI communities, employees lead numerous classes for financial literacy. Branches hosted "Mortgage Days at the Branch" to educate customers about homeownership.

The Community Reinvestment Act requires banks and financial corporations to participate in the development process of the community where they operate. If an institution does not comply with regulations, it can lead to the limitation of bank operations. Since the CRA implementation, it positively affected many LMI areas by attracting capital inflows. However, it remains uncertain if the system covers all the regions in the US and not only the ones where the bank operates. The example of JP Morgan Chase proves that examination applies only to the twenty-four states, based where the bank operates. The rural areas, in this case, may suffer because the small bank in their communities will not be able to provide similar investments. Another challenge for the CRA is digitalization, the general trend of most financial institutions is online access, which is positive in terms of accessibility for individuals, but shrinks the bank presence in a certain area.

Another significant role that banks and financial corporations play in the community economic development is employment and skills enhancement. Banks are present in every community, and it requires staff to operate. Some of the positions require a High School diploma, and some will need a specialized degree. Moreover, banks participate in multiple projects for the teaching skills essential for working in a bank. Some institutions have a special student program, that allows high school students to apply for a job in a school branch that operates based on the same procedures, technology, and structure as the regular branch. The JP Morgan Chase encourages employees to participate in “Skilled Volunteerism”, where professionals share their knowledge with individuals. In 2019 as a result, the fifty-six thousand volunteers dedicated 383 thousand hours and participated in almost four thousand projects (JP Morgan Chase Institute). The signature programs for community development include:

1. Tech for Social Good;
2. Fellowship Initiative;
3. The Service Corp.

All programs include the technological aspect ensuring the following of general banking trend. Last program allows top-performing employees to join a non-profit for three weeks, where they can share their skills and help the organization. It accompanied by three-month remote support from experts. Participation in projects allow developing a strong sense of social responsibility. Moreover, it creates social tights between community, company, and employee.

For better understanding the significance of financial companies in economic development, the employment component can be analyzed using the Shift-Share tool. The tool allows measuring the growth of a particular industry. There are three components of the area of growth (Shaffer, 2004). The first is the industry is growing at the same pace as at the national level, so the share in the same (Blair, 2009). Second, the local level has a faster or slower trend. Third and the last shows if the area may have a competitive advantage. Many developers utilize these tools and it requires the information on employment in the community and in the US. The data for analysis of NYC finance and insurance industry provided in Table 2.

Table 2. Shift- Share Analysis Data

Sector	New York City		US	
	2008	2018	2008	2018
Finance & Insurance	377,866	445,174	9,107,200	10,394,600
Total employment	2,689,340	3,121,586	179,213,900	200,746,000

Source: Bureau of Economic Analysis

For the 10 years, the number of jobs in the US grew by approximately 12%, accordingly, the NYC total employment should be 3,012,457. The City jobs grew faster than the national level and exceeded the expected jobs number by 109,129 and the Finance & Insurance industry will show 423,265, which is 21,908 less than the actual result. Consequently, the total employment and the industry grew faster than the national. Both mix and competitive components of Shift and Share analysis resulted in positive numbers of 8,015 and 69,578 respectfully. This allows concluding that the Finance & Insurance industry contributes toward the development of both national and local levels with the high share and positive mix and competitive components. However, the NYC economy is unique with one of the biggest financial industry in the United States, which explains a highly competitive result. The data shows the importance of the financial industry and may be utilized as a perspective for development in the areas where this industry is not growing.

2. CONCLUSION

The article addressed the community as the smallest unit in geography scope, which unites individuals, companies, and government. The role of each one is significant and irreplaceable. Banks and financial institutions possess their place in this field. The capital is a link between all actors and the bank, which is responsible for the capital generation, distribution, and maintenance. The government implemented various regulations to control and assure fair banking policies. The Community Reinvestment act signed in 1977, created a control system, where banks are required to invest in community development, and low- and moderate-income neighborhoods. The evaluation is performed based on three tests. The lending test assesses the number of loans, the investment measures the community investments, and service ensures affordable and accessible retail services. A satisfactory rating is critical for the bank to perform further operations. The CRA review of JP Morgan Chase confirmed the importance of government stimulus to invest in communities. The bank invested billions in affordable housing, community project, and LMI development. In spite of CRA being a comprehensive instrument for the community development, it remains hard to ensure equal investment distribution through all the US. Additionally, with the change of banking business towards a digital perspective, the coverage of the Act may be limited because of shrinking the retail branches' presence. Considering these new circumstances, the CRA needs to be redesigned accordingly. All the communities need to receive equal capital despite the bank or financial company location. This will lead to the development of rural areas, where now they might be disadvantaged because they have only one community bank.

The Shift-Share analysis supports the importance of the financial industry. It plays a vital role in employment and skills development. Where the jobs grew fast at the national level, at the local level, it performed even better. Besides the job availability, another crucial role of banks is developing social responsibility of employees, who will volunteer through multiple projects to share and teach individuals from LMI communities or minorities, valuable skills from basic budgeting to leadership, and IT systems. The growth of the financial industry can be a development strategy for some areas. The opening of financial centers attracts additional capital inflows, employment opportunities, and community development projects.

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