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It's Time For a Public Option in Banking

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Post offices can provide ordinary citizens with banking services without greed and overcharges.

By Mehrsa Baradaran

The Federal Reserve decided last month that it will not be raising interest rates the quarter of a point they were contemplating.

To be clear, for the last decade, banks have been borrowing money from the Fed at zero percent interest. This is not even to mention the trillions of dollars the Federal Reserve spent in Quatitative Easing 1 through 3 buying up bank assets and the billions in TARP bailout funds. The Federal Reserve has been pushing so much money at the banking industry that when it does decide to slow down the money supply, they will not be able to just turn off the spigot. They will actually have to start to paying banks billions of dollars to not lend the trillions it has been giving them since the financial crisis!

Why throw all this money at banks? The point of all of this lending is that the banks are the "engines of the economy." All this credit pumped into the banks is to be for the benefit of the public. The premise of the bailouts was, according to President Bush, not to save the banks, but "to help American consumers and businesses get credit to meet their daily needs." Obama reiterated by saying "we're all in this together." Ken Lewis, CEO of Bank of America said during the bailout "We are so intertwined with the U.S. that it's hard to separate what's good for the United States and what's good for Bank of America...they're almost one and the same."

But as it turned out, we were not in it together.

While Bank of America made an impressive $10 Billion in profits last year, a growing portion of the American population is left completely out of the banking industry because the industry has stopped serving those who are too poor to bank. Banks, like Bank of America, use high fees and penalties to repel customers with too little money to save. These people who have little to begin with end up having to pay 10% of their income just to use their money and pay their bills. Indeed, it is very expensive to be poor.

And the tragedy of money being siphoned from the paychecks of ordinary Americans is the least egregious part of a much larger problem.

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Somewhere between 20 to 40 percent of the U.S. population have to rely on modern-day loan sharks for their credit needs. Sometimes those who live paycheck to paycheck face an unexpected emergency. Over half the people in the United States are so cash-strapped that they would not be able to access $400 without selling something or borrowing money.

The need to borrow to deal with emergencies — often at rates over 300% APR and from the least regulated and most unscrupulous lenders — adds another layer of financial strain on those least able to bear it and the crushing cycle of debt makes it that much harder for them to escape poverty.

There are millions of individuals whose otherwise stable financial lives can be upended by one wrong turn and a large and growing percentage of the population whose bills are much more constant and predictable than are their paychecks. For these people, paying several thousands of dollars in accrued interest can turn a temporary cash flow problem into a full blown financial disaster. Contrast that to Vikram Pandit's expression when he saw the terms of CitiBank's bailout: "This is very cheap credit!"

So while this cheap credit saved the banking industry from insolvency, very costly credit is crushing "the other half."

Of course the function of the central bank or Federal Reserve is to provide this credit to banks. When the financial sector experiences financial stress, the Federal Reserve infuses liquidity into the troubled banks so that they could withstand temporary credit crunch and get back on their feet. This is where the contrast between the credit markets for the average people-as-borrowers and the credit markets for the banks-as-borrowers becomes stark.

The government provides banks low-cost loans when they are illiquid (short on cash) and also when they are insolvent (bankrupt). The reverse is true in the credit market for the poor. Fringe lenders lend at oppressively high interest rates to the illiquid as well as the insolvent, with the result that often, those who were merely illiquid become insolvent. Whereas the government, through the central bank, is in the business of resurrecting dead banks through credit, the fringe lenders are in the market of suffocating the illiquid until they are insolvent.

The banking system is supported, protected, and even saved from its own malfeasance because the state needs it — both to carry out the State's own monetary policy as well as to lend to the people. If banks fail, it is reasoned, so will the American people.

But many people are failing. They are failing even as the banks are succeeding, and they are failing because the banks are no longer involved in providing them credit.

The government has outsourced the provision of credit to the banking system, which it is supplying with "very cheap credit" — cheap credit that is not flowing out to reach those who need it most. When the banks categorically exclude almost half the population from the credit they are entrusted to provide, leaving that group to the wolves, it creates a glaring disparity and a grotesque irony.

If the intended result is to help the public with credit, why continue to use banks as a medium when they are clearly leaving out a significant portion of the population? Why not provide credit directly to those who need it, in order to be certain they get it?

It is time for a public option in banking — a central bank for the poor.

The post office would be the perfect institution to provide the poor with savings accounts and other transactional services. The public option could even provide short-term credit to individuals so that they can withstand a personal credit crunch and get back on their feet. Only the Federal Government is able to provide credit to the biggest banks and only the federal government can do so directly to the people — without having to wait for the banks to do it.

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When President Wilson created the Federal Reserve, he wanted it to be an institution that minimized the power of the likes of J.P. Morgan and private financiers — to provide credit to the public without having to rely on the biggest lenders. Wilson announced that "the great monopoly in this country is the monopoly of big credits. So long as that exists, our old variety and freedom and individual energy of development are out of the question. Our system of credit is privately concentrated."

The Federal Reserve was thus created as a public institution, instead of a private cooperative as was initially suggested by Wall Street magnates, to check this power. It is important to ask whether it is still working for the broader American public. The fear of concentrated bank power is even more acute today. There are now a handful of behemoth banks, including Bank of America, that control the vast majority of the country's banking assets. And while the government continues to provide banks with 0% interest credit, it has allowed interest rates to the poor to skyrocket to triple digits. There's something wrong with this picture. ■

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