

The Municipal Banking Movement: An Opportunity for Baltimore

by Sean H. Vanatta

Executive Summary

Across the United States, local governments are reconsidering their relationships with private financial service firms. As finance has come to dominate the U.S. economy in recent decades—and as the financial services industry has become increasingly concentrated in a few gigantic banks—community resources seem to flow from Main Street to Wall Street, with few channels of return. The banking industry, by design, places private profits ahead of public service. Banks like Wells Fargo, meanwhile, remain mired in scandal. Communities are ready for change.

A countermovement is growing. Local governments and community activists seek to reclaim control of their financial destinies through the direct public ownership of financial institutions. Public banks, owned by state or municipal governments and dedicated to public service, have a proven track record of promoting local economic development and financial inclusion in the U.S. and abroad.

Banking is a privilege, a public trust. Advocates of public banking argue that it should be in public hands.

This report makes a preliminary case for public banking in Baltimore. It does so, first, by examining a new chapter in Baltimore's history of disinvestment. Across the city, large commercial banks are closing branches, shutting down critical points of financial access for individuals and small businesses and contributing to ongoing patterns of financial exclusion in the city's marginalized communities. Financialization has repackaged redlining.

From this foundation, the report then turns to the growing public banking movement, examining how advocates in other places have conceptualized public banking as a productive solution to challenges like those facing Baltimore. In cities as diverse as Los Angeles, Seattle, Philadelphia, New York, and Santa Fe, advocates are advancing public banking under two rubrics: "Government-led" public banking, advanced by state and municipal officials, focuses on developing public financial institutions that serve the needs of local governments and generate broad-based economic development. "Community-led" public banking, led by social justice advocates, dedicates more attention to overcoming financial exclusion and ensuring capital flows to traditionally marginalized communities.

Both government-led and community-led approaches to public banking can point to successful precedents in U.S. and global banking markets. The report provides brief case studies of three such models: the Bank of North Dakota, German Sparkassen, and postal banking. It also places these examples in conversation with the dominant, privately directed, public service financial infrastructure that U.S. policymakers have long preferred.

With these examples in mind, the report returns to Baltimore, where the city's existing network of Community Development Financial Institutions (CDFIs)

and new Neighborhood Investment Initiative Fund (NIIF) offer promising foundations for more ambitious public banking goals. But where city leaders are using finance to add resources to neglected communities, public banking can multiply these contributions, magnifying their impact.

The report concludes with a simple recommendation: Conduct a feasibility study. The failure of private finance to provide for the needs of the city and its diverse communities demands public response. Public banking is one such response, one that requires thoughtful and in-depth study.

Market Failure and Disinvestment in Baltimore

Baltimore, like many American cities, has not been well-served by the recent transformation of commercial banking markets. In the years leading up to the 2008 financial crisis, large national lenders contributed to a real estate boom that swelled with the national market and crashed locally with devastating force. Wells Fargo in particular steered many minority Baltimoreans toward predatory mortgages that were more expensive than the borrowers' credit warranted. As these mortgages predictably defaulted, foreclosed homes blighted many of the city's predominantly African American neighborhoods.¹

Wells Fargo's reverse-redlining of Baltimore residents illustrates an enduring challenge for city leaders and community advocates: Low-income and minority communities need access to credit and other financial services, but these communities must largely depend on profit-maximizing banks to supply them. The consolidation of the banking industry over the past 30 years has reduced the banking options available to Baltimore residents. Meanwhile,

entrenched legacies of racialized financial exclusion continue to structure lending decisions and local credit outcomes.

Concentration and Financial Exclusion

Before the 1980s, robust federal banking regulation ensured that a diverse archipelago of small and medium-sized banks provided community financial services within tightly bounded geographic markets. But in the years since, financial deregulation enabled a wave of bank consolidation, generating a few, continent-spanning banking firms. In Baltimore, two banks, headquartered outside the state of Maryland, control half of the local banking market. The top five, all based elsewhere, control nearly 80 percent. The pending merger of SunTrust and BB&T will likely result in fewer local banking options. In financial concentration, Baltimore is ahead of national trends. In the late 1990s, the top five U.S. banks controlled less than 30 percent of all commercial banking assets. They now control nearly 50 percent.²

Financial concentration means that banks are no longer rooted in the communities they serve. At corporate headquarters in Charlotte,

In 2013, the last year for which data are available, 41 percent of African Americans in the Metropolitan Statistical Area (MSA) that includes Baltimore City were underbanked, while 13 percent were fully unbanked.

Pittsburgh, or New York, bankers make lending and investment decisions about distant markets, reduced through financial calculus into quantified, impersonal risks. Bankers hardly know their borrowers from numbers on a screen.³

Deregulation was supposed to make credit access easier for low-income and minority communities, which had long been cut out of mainstream financial markets. Indeed, while community banks were able to forge close relationships with local borrowers and develop intimate knowledge of local economic conditions—advantages that they still have over large, distant banks—these lenders were also complicit in the postwar era’s deeply racist federal loan programs, designed to grow white suburban capital at the expense of urban minority communities. These programs created a thick legacy of financial disinvestment. Racialized credit exclusion continues to scar Baltimore’s urban landscape.

Yet, far from ameliorating these injustices, financial liberalization and concentration have merely repackaged them. As large commercial banks have increasingly relied on credit scores and computer modeling to make lending decisions, economists and banking scholars argue, communities that already lack credit access are further excluded from financial citizenship.

Many Baltimoreans fall through the financial cracks. In the Baltimore Metropolitan Statistical Area (MSA), a region that includes Baltimore City and its surrounding counties, the Federal Deposit Insurance Corp. (FDIC) found that 6

percent of residents were “unbanked,” lacking any relationship with a federally insured financial institution. Another 21 percent were “underbanked,” maintaining some relationship with a federally insured bank, but also continuing to rely on fringe financial service providers, like check cashers and payday lenders, for their financial needs.⁴

These aggregate measures, which include the city’s affluent suburbs, underrepresent the severity of conditions in Baltimore’s low-income and minority neighborhoods. In 2013, the last year for which data are available, 41 percent of African Americans in the MSA were underbanked, while 13 percent were fully unbanked.⁵

Without mainstream financial institutions in their communities, residents have no entry point for developing financial identities. Banks, meanwhile, find the high cost of obtaining credit information in these communities prohibitive. They cannot balance price and risk. Better to venture their capital elsewhere.⁶

Under these constraints, innovations like subprime lending offered a welcome development in areas of the city that had long been starved of financial access. In a 2008 suit filed by the city against Wells Fargo for its predatory practices, Baltimore City attorneys praised subprime lending. Subprime “opened the door to homeownership” to consumers, “especially low- to moderate-income and minority consumers, who otherwise would have been denied mortgages.” Access to credit—at any price—seemed preferable to continued financial exclusion.⁷

For communities long deserted by mainstream finance and without the capacity to develop digitized credit histories, the consolidation of American banking has pushed them even further to the margins. Geographic and structural distances compound like so much interest.

Yet, when profit-maximizing firms lack an affirmative public service mandate, subprime can quickly shade into predation. Following the relentless profit motive, distant, disembedded banks necessarily seek their interests over those of the communities they serve. Borrowers, often desperate for credit and with little financial experience, take the first loan terms on offer.

The final paradox of urban disinvestment in the age of financialization is the most problematic. As cities move to protect their residents—which Baltimore did by suing Wells Fargo, eventually securing a \$175 million settlement—they impose higher costs on troublesome banks while creating new anxieties for the firms following the rules. Unlike in the past, however, when geographic regulations confined banks within the communities they served, in our consolidated banking market, the nation's giant banks can pull back or pack up.⁸

Pulling Up Stakes

Since the 2008 crisis, many banks in Baltimore have taken just this approach. According to a Federal Reserve Bank of Philadelphia study, between June 2010 and June 2016, commercial banks closed 181 branches in the Baltimore MSA. In Baltimore County, these closings amounted to 25 percent of bank branches. The closings tended to occur in lower-income and non-white neighborhoods.⁹

Like financial concentration, this, too, is a national trend. Since the 2008 financial crisis, banks have aggressively closed branch offices,

transitioning from offering financial services through physical bank buildings to offering banking services online. In the digital age, the divergence of mainstream finance from local communities is accelerating.¹⁰

Community leaders, home buyers, and small-business owners, meanwhile, find fewer institutions with the knowledge and commitment to venture capital in risky neighborhoods. For communities long deserted by mainstream finance and without the capacity to develop digitized credit histories, the consolidation of American banking has pushed them even further to the margins. Geographic and structural distances compound like so much interest.

Baltimore residents and community advocates have followed these trends closely. In October 2017, the Charlotte, North Carolina-based Bank of America announced plans to close its Reisterstown Plaza branch in Northwest Baltimore, sparking significant community protests. Serving a moderate-income, predominantly-minority community, the branch had seen local deposits increase more than 200 percent from 2011 to 2016. Bank of America nevertheless closed the branch, its eighth such closure since 2006. According to the Maryland Consumer Rights Coalition, most of these closures took place in majority-minority communities, despite widespread deposit gains in these branches.

For Bank of America, the leading deposit holder in the city, the Reisterstown branch closure was the logical outcome of a strategy

aimed at reducing its physical footprint and shifting consumers toward online banking. Yet for residents and business owners dependent on the branch, the move marked a significant reduction in financial access. “They’re using the technology changes as an excuse to close inner-city branches,” Robert Strupp, of Baltimore Neighborhoods, Inc., told the website *Baltimore Brew* in October 2017. “But there are many people there who need them.”¹¹

The reduction in physical banking infrastructure in Baltimore has been matched over the same period by a declining commitment to small-business lending. In a report for Johns Hopkins 21st Century Cities Initiative, former U.S. Under Secretary for Domestic Finance Mary Miller and her coauthors found that large commercial banks have sharply decreased their lending to small firms in the city, from over \$400 million annually in 2006 and 2007, to under \$300 million in 2014 and 2015.¹²

Like branch closures, declining small-business lending is driven by big bank strategies that emphasize technology over physical branches. “National bank lending tends to focus on credit card loans,” Miller observes. Yet, “while credit cards are an important capital source for small businesses, they cannot replace the importance of larger working capital loans in helping to grow small businesses.” Credit card loans also fail to meet small-business owners’ needs for mundane but essential services, like depositing cash and making change, that depend on a physical bank infrastructure that national banks are eager to reduce.¹³

Moreover, economic research shows that small-business owners and would-be entrepreneurs without established credit rely on branch networks to develop relationships with bankers. Bankers learn about local economic conditions and borrowers’ intangible, personal traits—including character, competence, and work ethic—through local, interpersonal interactions. It’s this local knowledge that is at the heart of the “art and practice of small-business lending,” which Miller and her coauthors hope to revive.¹⁴

Altogether, the evidence points to a process of creeping disinvestment, as banks shift from place-based services delivered through branches to digital services delivered online. The data, however, do not account for areas of the city that have long been without mainstream financial services, and consequently lack the means of developing credit identities necessary to gain access through online platforms. Branch closings mean little to neighborhoods that lack branches to begin with.¹⁵

In a financialized world, where financial access and financial identity are essential components of full and functional economic citizenship, Baltimore’s unbanked and underbanked communities are effectively excluded—exclusion that is only likely to increase as for-profit banks reassess the relationship of price and risk in these neighborhoods and opt to locate elsewhere.

In Baltimore—as in other cities—community advocates are looking for ways to overcome the market’s circular logic of financial exclusion. One option gaining momentum in cities and states across the country is public banking.

Public Banking: Finance with Public Purpose

Baltimore’s challenges are specific, but hardly unique; rather, across the nation, local officials and community advocates grapple with the persistent failure of for-profit financial firms to provide capital and prosperity where they are needed most. In the long wake of the 2008 financial crisis, communities continue to watch scandal-ridden Wall Street banks gamble in opaque financial markets, while promising local projects go unrealized for lack of funding. The ties that once bound banks to communities have frayed, generating impassioned calls to re-embed finance in the social fabric—to re-install banking with public trust.

Direct public ownership of financial institutions offers an unambiguous path toward achieving that goal. In cities and states across the country, politicians and activists see city- and state-owned banks as a means of withdrawing from relationships with troubled private firms like Wells Fargo, and instead investing public funds in socially motivated projects and broad-based financial inclusion. Building on successful examples from the U.S. and abroad, advocates seek to invigorate finance with public purpose. “A public bank will allow New Jersey to invest in New Jersey, period,” New Jersey Governor Phil Murphy argued in a typical call to action. “It’s the type of big thinking we need to get back on track.”¹⁶

Los Angeles: Public Banking on the Ballot

Arguably, the most advanced effort to institute public banking unfolded recently in Los Angeles. There, the public banking movement originated from a deceptively simple problem: what to do with all the cash generated by the city’s cannabis industry. In July 2017, LA City Council President Herb Wesson proposed an ambitious plan to develop a public bank that would provide financial services to the cannabis industry and, in turn, reinvest the cash generated by the industry in dynamic public projects. With a green foundation, as it were, the bank could invest locally, multiplying marijuana profits through the transformative power of finance.¹⁷

Once Wesson introduced his proposal, LA’s municipal banking movement gained a precipitous political momentum, eventually embodying a larger progressive-populist vision aimed as much at economic justice and local self-determination as the quaint concerns of pot dealers. In its expanded scope, the LA effort joined a growing public banking movement in cities across the country, including San Francisco, New York, Seattle, and St. Louis, and in more than 20 states, including Michigan, New Jersey, Pennsylvania, and Vermont.¹⁸

Three converging forces drove public banking advocacy in Los Angeles. The first was the marijuana industry, which stood to gain basic deposit safety and basic small-business financial services. A separate group of progressive activists, represented by groups like Public Bank LA, placed public banking at the center of an expansive economic justice mission. Municipal banking, these advocates argued, would enable cities to cut ties with predatory Wall Street banks, while offering underbanked city residents access to low-cost financial services.¹⁹

The third strand of public banking advocacy was driven by a similar impulse, but different actors. In the long shadow of the 2008 financial crisis, LA officials were eager to reduce the city government’s and city economy’s exposure to swings in global financial markets. To take one frequently cited example, during the crisis and years after, large banks sharply reduced local small-business lending. For the city government, a public bank promised a decisive source of countercyclical finance, filling local credit channels when bank capital dried up.²⁰

As Wesson’s proposal moved through the city council’s planning bureaucracy in late 2017, the three reform impulses all attached to what was provisionally called the Municipal Bank of Los Angeles (MBLA). In addition to Wesson’s initial plans for a cannabis bank, the council outlined seven objectives for MBLA, which can be summarized as:

1. To provide commercial banking and capital market services to the city government at a lower cost (and even at a potential profit).
2. To provide equitable access to financial services to city residents, especially those that enhance economic opportunity (e.g., small-business and student loans).
3. To provide direct investments to develop local infrastructure, housing, and economic growth.

Under the government-led public banking model, public banks use government funds to promote local economic development through local lending and investment, especially by partnering with existing community banks and mission-driven financial service institutions.

At base, these ambitious plans depended on harnessing the cash resources and financial service requirements of the Los Angeles government, which, according to the city's legislative office, "requires banking services similar to those of a multi-national corporation." By transferring these services from private firms to a public entity, advocates argued, the city would necessarily save money by cutting out the profit demands of private investors. Moreover, with the city's banking business as a foundation, MBLA would have been able to develop into a dynamic financial institution, generating revenue and returning profits to the city.²¹

Although it failed to meet voter approval, LA's public banking proposal offered optimistic solutions to concrete problems Baltimoreans will recognize. For many Angelenos, the banking market is broken. According to the FDIC, 9 percent of city residents are unbanked, and an additional 15 percent are underbanked. One in five LA neighborhoods has no financial institution within its borders. Residents of these so-called banking deserts cannot develop the credit histories necessary to participate in mainstream financial markets. An arid credit wind drives economic decline.²²

Competing Approaches: Government-Led vs. Community-Led Public Banking

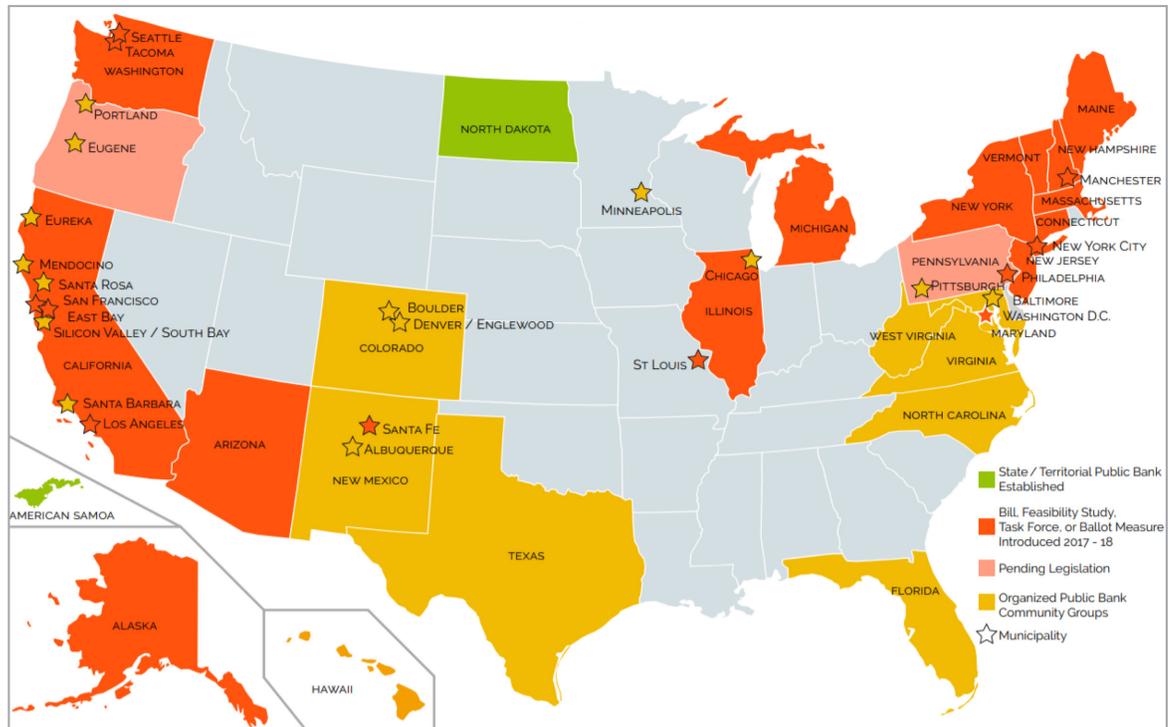
The Los Angeles public banking proposal, and those like it in cities and states around the country, is a bold call to reinvigorate public purpose in banking. Having long been subject to the power and caprice of finance, local

governments now wish to control it—to reclaim ownership of their community assets from distant financial firms.

The three pillars of the public banking movement in Los Angeles represent three paths toward government-owned banking that have largely been pursued independently in other places. The first, marijuana banking, we will set aside—the political and legal obstacles, entwined with federal criminal law, make the issue too complex for our present discussion. The next two positions might be profitably labeled "government-led public banking" and "community-led public banking"—terms meant to suggest the foundation of each approach's political support and the thrust of their objectives. As in the Los Angeles proposal, the goals embodied in these approaches are distinct, but not mutually exclusive.

Government-led public banking, promoted by organizations like the Public Banking Institute (PBI), primarily emphasizes using state or municipal funds to establish publicly owned banks that then provide local governments with low-cost financial services. Government-led public banks, in turn, enable local governments to end their reliance on what advocates characterize as unethical Wall Street banks, which charge local governments expensive fees to invest community resources in distant financial markets. Instead, under this model, public banks use government funds to promote local economic development through local lending and investment, especially by partnering with existing community banks and mission-driven financial service institutions.²³

2018: The Year of the Public Bank Cities and states around the country have new legislation to create Public Banks



Source: Public Banking Institute, "Map of Public Banking," <http://www.publicbankinginstitute.org>

In Seattle, a city-led initiative outlines the goals of public banking as follows:

1. To achieve independence from socially irresponsible financial institutions.
2. To establish fiscal benefits for the city through lower-cost financial services (or profits generated by performing these services).
3. To grow public benefits by overcoming market failures to meet community needs.²⁴

Investing community resources in local public banks, advocates argue, generate both government economy and local development. Using standard multiplier analysis, a study examining Governor Phil Murphy's proposal in New Jersey found that for every \$10 million in new lending generated by a state-owned

public bank, New Jersey could expect to reap an increase of between \$16 million and \$21 million in overall state output, and between 60 and 93 new jobs. The twin slogans of Pennsylvania's Public Bank Project—"Banking for Main Street, not Wall Street," and "more jobs-less taxes"—capture the aims and bipartisan appeal of these proposals.²⁵

The Public Banking Institute (PBI), a hub for public banking advocacy nationwide, makes the case most strongly. "Public banks can help us create the communities we want," PBI argues. "We want parks, good roads, safe bridges, clean energy, and housing we can afford. We want lower interest rates for local small-business loans, local control of our tax dollars, investment in our local communities, and ethical and transparent financial institutions managing our public funds. Public banks can be the financial engine that makes this happen for our communities."²⁶

Focused more on governments' financial service needs and broad-based economic development, the government-led public banking model is less explicitly concerned with social justice and financial disfranchisement. Government-led proposals focus less on the unbanked and more on infrastructure financing.

Emerging from the foment of Occupy Wall Street and rising tide of democratic socialism, community-led public banking groups, like Public Bank LA and Public Bank NYC, instead put social and economic justice at the center of their public banking agenda. Like government-led advocates, community-led public banking proponents emphatically want to remove public funds from the coffers of goliath banks. But the positive objectives of these groups, here from Public Bank NYC, are more diverse and more ambitious:

1. To make equitable investments that support low- and extremely low-income housing, union and living wage jobs for New York City residents, democratically controlled clean energy, public infrastructure, cooperative ownership, and small businesses, prioritizing minority and women-owned businesses and locally based enterprises.
2. To foster community wealth-building and neighborhood-led development, including by financing cooperative, not-for-profit, and non-speculative models that provide long-term public benefit.
3. To expand high-quality, affordable financial services to low-income and immigrant communities and communities of color, by partnering with nonprofit and mission-driven community development financial institutions, especially community development credit unions.
4. To promote transparency and accountability in municipal finance, including by providing comprehensive, non-extractive banking services to New York City and New York City agencies.²⁷

While each of these objectives contains much to unpack and digest, community-led public banking, at its core, recognizes what Baltimore residents know well: A rising economic tide does not, perforce, lift all boats. Historical racial, class, and gender exclusions have left entrenched legacies. Robust, targeted policies will be necessary to overcome them. In a financialized world, these solutions must incorporate financial institutions, whether to provide a bridge from fringe to mainstream finance, or to redefine the mainstream altogether. Where private finance is unable or unwilling, these advocates contend, public finance must play an essential role.

Skeptics will doubt the feasibility of these goals. They may point to federal policies, like the Equal Credit Opportunity Act or the Community Reinvestment Act, that are designed to address such community needs. Yet, as the priorities of the current administration make clear, federal enthusiasm and enforcement fluctuate with national politics. Public banking advocates of all stripes demand instead local control and local accountability.

And advocates are getting results. Public banking, in a variety of forms, is solidly on the agenda in cities and states across the country, where policymakers have proposed legislation and undertaken feasibility studies. As they have done so, advocates have looked to existing public banking institutions, in the U.S. and abroad, for models to apply and extend.

Public Banking in Practice

Both government-led and community-led public banking approaches have a firm basis in public banking experience, in the United States and in markets across the globe. As Baltimore officials and community advocates grapple with the city's varied financial needs, they should look to these examples as test cases for the approaches discussed above. As they do so, however, they must also account for the existing privately directed, public-service financial infrastructure—the preferred vehicle for channeling financial flows toward public needs.

The Bank of North Dakota

In the United States, public banks have played a significant, though minor, role in the nation's financial history. Many individual states operated development-oriented banks before the Civil War, but longstanding traditions of private corporate ownership, fears of political corruption, and specific nuances in U.S. banking law, effectively stymied the development of a truly public banking sector. Instead, much of U.S. development finance, especially since the New Deal, has operated through public guarantees of private loans.²⁸

An important exception is the Bank of North Dakota (BND), chartered in 1919 to promote "agriculture, commerce, and industry" in that state. BND is the sole depository of North Dakota state funds, and it promotes a robust local development agenda through its active management of agricultural, real estate, business, and student loans. It is the archetypal government-led public bank.

In making local loans, the bank largely avoids competition with other in-state lenders, using loan purchases and participations to provide liquidity, while leaving decision-making with local banks. One consequence of this strategy is that North Dakota has the highest per-capita rate of community banks in the country.

Because of its prudent management and the state's recent growth on the back of the shale oil boom, BND has emerged as a case study in government-led public banking success. Through its partnerships with community banks, BND provided an important source of local liquidity in the aftermath of the 2008 financial crisis. In 2017, the bank experienced its 14th consecutive year of record profits, reporting \$145.3 million in net earnings on \$7 billion in assets and \$825 million in capital. Those profits, in turn, form a small but significant portion of the state's operating budget.²⁹

Nevertheless, the bank's success is largely a function of the circumscribed role it plays. BND works in partnership with—rather than in competition with—local banks, and largely leaves risky, social, and development lending to other North Dakota state agencies. In this way, North Dakota is like other states and municipalities, which operate special purpose financial institutions, like housing authorities, that make loans in the public interest and socialize the risk of these lending activities.³⁰

Sparkassen and Other Global Examples

The Bank of North Dakota, then, supports a deep, localized financial infrastructure, still largely dependent on private initiative to finance local development. It does not serve the needs of unbanked and underbanked communities, nor does it operate in an urban context. In the financial systems of Western Europe, however, municipal and regional public banks have long existed to serve just these markets.

In Germany, for example, publicly owned municipal banks, or Sparkassen, make up a significant component of the country's financial sector, accounting for 15 percent of bank assets in 2017. Sparkassen are geographically restricted to their home cities, where they are supervised by local stakeholders. These firms carry out an explicit public mandate to provide financial services to the poor, while investing in sustainable, local economic development.³¹

Deeply embedded in the communities they serve, Sparkassen are important conduits of small-business lending within the German economy. Small German firms largely rely on long-term bank financing, generated through close, interpersonal relationships with local financial institutions. With their geographic restrictions and local investment mandates, Sparkassen are particularly well-suited to this kind of lending. They know their communities. This local knowledge, in turn, reduces transaction costs for small firms with limited credit histories.³²

Community-led public banking, at its core, recognizes what Baltimore residents know well: A rising economic tide does not, perforce, lift all boats. Historical racial, class, and gender exclusions have left entrenched legacies. Robust, targeted policies will be necessary to overcome them.

In many developing countries, publicly owned banks play even more important roles, providing a full range of financial services, especially regional and infrastructure development. In India, 26 publicly owned banks make up roughly three-quarters of the financial sector, operating more than 80,000 branches nationwide. These firms balance explicit social policy and profitability mandates and form, scholars argue, “an integral part of the public policy to support sustainable development and poverty alleviation.”³³

Ultimately, scholarly research on how well public banks perform compared to their private counterparts is hotly contested. But since the 2008 financial crisis, scholars examining markets across the globe have reappraised the role of public banks. According to one recent analysis, current “literature suggests that public banks contribute to financial stability, provide lending support during periods of instability and economic recession, avoid the extreme moral hazard problems associated with private banks, encourage constrained behavior often accompanied with development objectives, and promote economic growth.”³⁴

Postal Banking

One form of public banking that in the past has proven especially well-suited to providing low-cost financial services to low-income and disadvantaged communities is postal banking. Following models developed in Western Europe, the United States Post Office began offering insured savings accounts to small savers in 1911. Successful in the years before the Great Depression, postal accounts

were a haven for small savers during the 1930s banking crisis. Yet private bank opposition and a Cold-War era aversion to public ownership ultimately killed the program in the mid-1960s.³⁵

As a public banking model, postal banking has many distinct advantages. Handling small retail accounts is inherently expensive, but postal banks use the existing postal infrastructure, dramatically reducing overhead costs. Post offices are also spread throughout rural and urban communities, maintaining a physical presence in just the places often neglected by for-profit firms. And as University of Georgia law professor Mehrsa Baradaran argues, “people at every level of society, including the unbanked, have a level of familiarity and comfort with the post office that they do not have with more formal banking institutions.”³⁶

Baradaran promotes postal banking as a model for offering low-cost financial services to marginalized communities, embracing the original savings mission of postal banking, while also expanding into basic credit granting. Although her proposal focuses on federal services through a federal agency, city and state governments also have developed physical infrastructures of offices and schools that could be repurposed to accommodate small finance on a local scale.³⁷

Public-Service Financial Infrastructure

Owing to a combination of political ideology, national myth, legal culture, and racialized perceptions of public goods, U.S. policymakers

have long sought to incentivize or direct private initiative to promote public policy goals rather than founding purely public institutions. As policymakers consider the roles public banking can play, they must account for the existing privately directed public-service infrastructure that already seeks to direct finance toward marginalized communities.

This infrastructure is deeply rooted. At the turn of the 20th century, urban reformers developed a variety of specialized financial service firms designed to serve those we would now call “unbanked” or “underbanked.” Credit unions for small-business loans, savings and loans for homeownership, and Morris Plan banks for small personal loans all successfully served low-income communities. During the New Deal, U.S. policymakers doubled down on this model, creating federal insurance programs for these so-called thrifts, while also developing a host of loan guarantee programs to encourage private firms to invest in socially desirable sectors, like housing and small-business lending.³⁸

The very existence of these publicly oriented firms and programs might seem to undermine the case for public banking. Yet, harnessing the private interest for the public good also runs into two predictable roadblocks. First, private interests are difficult to restrain and direct. In Baradaran’s account, a significant proportion of credit unions, savings and loans, and Morris Plan banks eventually placed profits above their public-service mission. The most dramatic example came with the savings and loan crisis in the 1980s.³⁹

This failing is not confined to the United States. In Germany, many Landesbanken, regional equivalents of the municipal Sparkassen, converted into commercial banks during the run-up to the 2008 financial crisis, giving up their public purpose in pursuit of profit—often with disastrous consequences.⁴⁰

Meanwhile, public service institutions, when successful, draw forceful political opposition

from private firms that chafe at what they perceive as advantaged competition. The primary opponents of postal banking were for-profit banks. Credit unions and for-profit community banks remain locked in endless conflict over tax rules and membership requirements that seem to advantage one kind of firm over the other.⁴¹

Some approaches to public and quasi-public banking are better suited to mollifying private interests. The Bank of North Dakota, again, serves primarily as a bankers’ bank, making loans in participation with private financial institutions, providing liquidity, and promoting local investment without competing with for-profit firms. Moreover, the most prominent bankers’ banks are the Federal Reserve Banks, which represent the ultimate functional (and ambiguous) mix of public and private interests (and which some scholars argue should offer deposit accounts like the old postal banks).⁴²

More recently, Congress has tried to revitalize financial investment in urban areas through Community Development Financial Institutions (CDFIs). Emerging from then presidential candidate Bill Clinton’s 1992 call for a network of 100 community development banks, CDFIs now take a variety of forms, from deposit-taking institutions to venture capital funds. Under current law, they serve defined geographic areas or target populations, providing loans and equity investments to underserved communities.⁴³

CDFIs have made significant contributions to community development in underserved markets. In 2016, these institutions made nearly \$4 billion in loans, 80 percent of which went to distressed areas and populations. But the program also faces stark limitations and is subject to the annual anxieties of federal budget appropriation. Moreover, by statute, CDFIs cannot be “an agency or instrumentality of the United States, or of any state or subdivision of any state.” Or, in plain English, a CDFI cannot be a public bank.⁴⁴

In a sense, too, the emergence of CDFIs illustrates another core challenge inherent to the nation's privately directed, public-service financial infrastructure: its labyrinthine multiplicity. Comprised of a host of mostly small institutions, struggling for limited federal and grant funding, the financial patchwork leaves small-business owners, home buyers, and other potential borrowers facing a complex and enigmatic set of institutions and programs.

So too for bold community development projects. Financing options exist, but borrowers are often left to cobble together funding through a variety of programs, adding time and expense. A recent study focusing on Baltimore and Los Angeles found that minority small-business owners consistently lacked knowledge about and access to services best suited to their specific credit needs.⁴⁵

In sum, institutions like the Bank of North Dakota, German Sparkassen, and postal banks offer models that match the ambitions of government-led and community-led public banking advocates. Such institutions, however, cannot and will not operate in isolation. Rather, advocates must also account for the existing public-service financial infrastructure, in all its multiplicity and complexity, seeking ways to leverage local knowledge and experience to develop initiatives that meet common local goals.

Public-Service Initiatives in Baltimore

In Baltimore, community advocates and policymakers clearly understand the longstanding problems of urban disinvestment and financial exclusion in their city. In addition to existing public programs aimed at revitalizing neglected communities, such as the city's Land Bank and Community Catalyst Grant Program, Baltimore has eight active CDFIs providing community development and lending services. Indeed, despite the branch closings and disinvestment by large out-of-state banks, community advocates sense a potential turning point for financial services in the city.

Financing has long flowed into what Professor Lawrence Brown has termed the city's "White L," an area of racial and economic advantage running through downtown to the Inner Harbor. But community and government efforts are beginning to spread economic resources to the disadvantaged minority neighborhoods on either side.⁴⁶

Investment and economic opportunity in these neighborhoods are the explicit mission of Baltimore's recently inaugurated Neighborhood Impact Investment Fund (NIIF), a program that, at its core, looks a lot like a public bank. In a deal negotiated with the Maryland Economic Development Corporation (MEDC), the city has leased three city-owned parking garages to the MEDC in exchange for a 30-year, \$52 million loan—money the fund will then invest in blighted Baltimore neighborhoods.⁴⁷

The NIIF is fundamentally promising. Like the Bank of North Dakota, it is designed to aid existing institutions, leveraging local initiative for maximum public benefit. "One of the things I really would like to see," NIIF CEO Mark Kaufman explained, "is the capacity and impact of the CDFIs in the city increased, so we are aggressively going to work as a complement to those intermediaries, not as a competitor."⁴⁸

Nevertheless, NIIF is also fundamentally limited—as a fund, not a bank. It can only lend the money it has on hand. To safeguard the fund's resources, it can only devote a small percentage of its \$52 million to individual projects. Relying on other institutions to provide the bulk of the financing, it can only add to existing efforts. "The goal" is only, as Kaufman has said, "to fill gaps."⁴⁹

The difference between a fund and a bank is the difference between addition and multiplication. Both operations contribute meaningfully to public goals. A fund, though, is fixed; a bank can expand. Using its capital as a foundation, a bank can take deposits and make more loans. By making loans, it can generate deposits. Banks, in a fundamental sense, not

Community leaders will need to conduct a rigorous, independent study to determine whether and how public banking can work for Baltimore. This is the path other public banking initiatives have taken.

only allocate existing funds, but they also create money. A local, publicly owned bank would create money *and* invest money locally.

By way of illustration—and following the ratio of capital to assets found in the Bank of North Dakota—a bank with a \$52 million capitalization might expect to invest more than \$440 million. With those resources, it could do more than “fill gaps.”

Caution, of course, is warranted. Banks multiply capital. They also multiply risk. The rules governing banking are strict and complex, and the risks to public resources should be weighed differently than the risks to private funds.

Rather than a critique, then, this illustration offers a starting point for thinking about public banking in Baltimore. As a narrowly conceived institution, designed to overcome specific market failures, NIIF stands a better chance of success than a sprawling entity like the Municipal Bank of Los Angeles. It may also offer a wedge. With success, policymakers may expand its mandate; with success, they may find that the path through the thickets of regulatory approval is easier for a fund becoming a bank, than a *de novo* bank starting from scratch.

Recommendation: A Feasibility Study

Whether community leaders choose to build on the NIIF or forge a new direction, they will need to conduct a rigorous, independent study to determine whether and how public banking can work for Baltimore. This is the path other public banking initiatives have taken.

Establishing Broad Goals and Answering Narrow Questions

Before undertaking a study, community leaders must agree on a broad framework. Will they pursue a government-led plan, built around providing municipal financial services and promoting local economic development? Or, will advocates pursue a community-led path, aimed more aggressively at ensuring financial inclusion and economic justice? Will they pursue a strategy that prioritizes investment, as the NIIF does? Or will advocates seek a public bank that contributes more directly to small-business lending or individual financial inclusion?

Again, before undertaking the study, advocates should establish a clear set of policy guidelines for what a public bank aims to accomplish. A deeper analysis will address a host of subsidiary questions:

1. What are the city's current relationships with private financial institutions? What services do those institutions provide? At what cost?
2. What public benefits does the community most need? What public benefits are most feasible for a public bank to provide?
3. What mode of organization will meet its purposes? Will the bank be an office within the city's finance department or a branch network designed to interface with the public?

4. What sources of capital are available for the bank? How much will be necessary to meet its initial and long-term goals?
5. Will the bank be independent from city government? What does independence mean philosophically and practically? Will the bank be publicly accountable, and if so, how?
6. What method of governance will meet this purpose? What kind of banking charter will the bank need (and what will be necessary to obtain it)?
7. What city, state, and federal laws will it need to comply with? What regulatory and supervisory approvals are necessary?
8. What is the proper geographic scope of a publicly owned bank? Should it be bound by neighborhood, city, municipal, or state borders?
9. What are the prospects for profitability in the short and long term?
10. Are there other methods, besides chartering a public bank, that can help overcome the market failures the study has identified?
11. How can advocates mollify political opposition from for-profit firms and other opponents?

Likely Results and Immediate Next Steps

Though optimistic and earnest, most public banking analyses have also been cautionary. Their concerns have squarely focused on the likelihood of profits and the regulatory challenges a public bank would face. These challenges will certainly exist in Baltimore as well, though they will manifest differently the vagaries of federalism and the ambitions of advocates.⁵⁰

Should the feasibility study prove successful, it will not be the advocates' last step; rather, advocates must then develop a business plan for the public bank. The business plan will have three constituencies. It will need to convince the public

and their political representatives to support the venture. It will need to convince the ultimate source of capital, which will likely include both policymakers and bond markets, that the proposal is sound, is independent of corrupting influence, and stands a significant chance of generating profits. And finally, it will need to convince a variety of federal and state regulatory and supervisory bodies that it will likewise be safe, sound, and in the public interest.

Indeed, perhaps the most salient lesson of LA's Charter Amendment B is that a public banking plan cannot advance without a functional business plan. Concerned that without a detailed plan the bank would quickly become a boondoggle, the editorial board of the Los Angeles Times was unambiguous in its opposition: "Charter Amendment B is one of the most ill-conceived, half-baked ballot measures in years." The paper's advice: "Vote no." And LA voters did. Advocates must forestall this response—and result.⁵¹

Alternate Approaches

Public banking, whether following the BND model or some more ambitious formula, is not a panacea. Although a public bank will not seek to maximize profits, profitability will nevertheless be a critical metric of legitimacy, inherently excluding projects where returns alone may not justify costs. Public banking also involves significant risk. How well will the public or politicians stomach the high start-up expenses or loan losses when the market turns? Public banking may enable the public to claim a larger share of the upside on investment projects, which usually accrues to private interests, but it exposes taxpayers to downside risk as well.

There are alternatives. First, Baltimore City could use its procurement contracts, alone or in concert with other cities, to mandate that firms the city banks with invest locally as well. Such mandates will very likely increase the cost of such contracts, but they may achieve the ends of public banking without the risk and expense of

the city providing the service directly. Of course, if this is not the case, it serves as an additional argument in public banking's favor.

Baltimore could also provide greater coordination and support for local and mission-driven finance, as the NIIF explicitly sets out to do. Calls for public banking result from the erosion of community banking, while the existing mission-driven financial infrastructure can be confusing for potential borrowers. City governments can take on a coordinating role, while seeking to build local financial capacity through strategically awarding contracts to smaller firms. This approach will necessarily take time—Seattle found no takers when it tried to disaggregate its financial needs and portion them off to small banks.⁵²

Finally, federal advocacy for financial inclusion is important. Any effort to create a city- or state-owned publicly owned bank will require complex and difficult federal approvals. The whole process would be significantly eased by the creation of a federal public banking charter. Moreover, the Federal Reserve Banks could be the foundation of a new era in public banking, offering a variety of services from infrastructure lending to small savings accounts. Public banking is a local movement, but advocates should keep federal policy firmly in view.

Conclusion

A narrative is developing around public banking: It's too difficult, too expensive, and too uncertain. No one wants to be the first to try. The failure of LA's Charter Amendment B is only likely to exacerbate these concerns.

The most effective models of public banking, whether the Bank of North Dakota or the German Sparkassen, were founded deep in the past and developed slowly over time. The lesson from history may be that public banking's moment passed long ago, when Andrew Jackson vetoed the Second Bank of the United States, or when the National Banking Acts precluded public ownership. A private financial structure grew up instead, and it is

through that private structure that federal and state policymakers allocate the alphabet soup of financial welfare, from FHA and SBA loans, to CDFIs making investments in ailing cities. The financial crisis seemed like a moment when reform was necessary. Perhaps its momentum too has dissipated.

History offers another lesson. Ideas—ambitious, expansive, unproven—solidify as well as dissipate. Deposit insurance, which we take for granted, disastrously failed in New York in the 1840s. William Jennings Bryan proposed it again in the 1880s; a handful of states tried it again, and failed miserably again, in the 1910s and 1920s. But the idea remained available, and with the right institutional circumstances, became the foundation of our consumer financial system.

Public banking can be another such idea. It needs to be tested. It demands careful thought—about capital structures, legal frameworks, and independence from politics. But it is a formula that has worked and can work. With leadership and vision, it can work for Baltimore.

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**The Municipal Banking Movement: An Opportunity
for Baltimore**

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The Abell Foundation is dedicated to the enhancement of the quality of life in Maryland, with a particular focus on Baltimore. The Foundation places a strong emphasis on opening the doors of opportunity to the disenfranchised, believing that no community can thrive if those who live on the margins of it are not included.

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