



# **Rethinking Financial Inclusion: Designing an Equitable Financial System with Public Policy**

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# ABSTRACT

Remedies for financial inclusion have been rooted in mistaken assumptions about credit markets. Inclusion and “access to credit” are viewed as ancillary, gap-filling, or as a subsidized add-on to credit markets for those who are left out. This paper proposes a different understanding of financial inclusion, which situates the problem as one rooted in the design of the financial system. Achieving financial inclusion requires structural changes to the “normal” financial system, secured through democratic means and policymaking rather than as a result of innovative companies and products. The design of credit markets is an a priori choice that determines who has access to credit. Instead of financial inclusion, this paper proposes to reframe the problem as a matter of financial redesign.

# INTRODUCTION

As part of Congress’s financial stimulus response to the COVID-19 pandemic, the CARES Act included billions of dollars of direct loans, grants, and stimulus checks to millions of Americans. Though the ultimate success of this stimulus won’t be determined for some time, a problem quickly surfaced: How would \$1,200 checks be delivered to people? Treasury Secretary Steven Mnuchin suggested that they could be mailed to most recipients within six to eight weeks or otherwise deposited in bank accounts sooner. Unbanked and underbanked Americans would need to wait longer for their checks and cash them in person at a fee of up to 10 percent.

With almost 30 percent of Americans facing immediate unemployment during this crisis, and 40 percent unable to cover a \$500 emergency even before the pandemic, receiving a \$1,200 check in days rather than weeks makes a huge difference.

Fintech companies immediately offered to help with disbursement. On March 26, Square and Twitter CEO Jack Dorsey suggested that his Cash App could help with financial inclusion: “The technology exists to get money to most people today (even to those without bank accounts). Square and many of our peers can get it done. US government: Let us help.” That same day, Plaid CEO Zach Perret also offered his services: “Let fintech help.” Others quickly followed suit, including Gusto, a payroll processing company: “We’re urging the US government to partner with payroll platforms so we can

create an instant pipeline to get relief funds to small businesses—within 24 hours,” the company tweeted on March 27.<sup>1</sup>

Bank or fintech partnerships can disburse these funds in the near term—but in a \$2 trillion stimulus bill containing almost 900 pages of instructions and authority, why was it left to start-up fintech providers to actually deliver checks to the people? Several lawmakers, including House Speaker Nancy Pelosi (D-CA), Sen. Sherrod Brown (D-OH), and Rep. Rashida Tlaib (D-MI) did, in fact, propose that the Federal Reserve directly offer digital accounts to Americans through the post office; none of these versions made it into the final bill.<sup>2</sup>

This episode highlighted a longstanding truth: Financial inclusion is an afterthought in current policymaking, seen largely as the domain of fintech entrepreneurs, if not mainstream banks. Policymakers, regulators, and the finance community often assume that the solution to full financial inclusion is the right technology or innovation.

This is misguided. This paper seeks to reframe financial inclusion as a problem requiring structural redesign, rather than market-oriented patch fixes driven by neoliberal ideology.<sup>3</sup>

Financial inclusion is an umbrella concept that encompasses access to bank accounts, credit products, and financial services of all kinds. For several decades, the US Treasury, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Federal Reserve, Congress, and other regulatory bodies have held hearings, issued reports, and launched initiatives aimed at financial inclusion. In 2009, the FDIC began annually measuring the amount of “unbanked” or “underbanked” Americans.

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<sup>1</sup> <https://www.forbes.com/sites/jeffkaufman/2020/03/31/fintechs-say-they-can-speed-up-the-stimulus-if-the-government-just-lets-them/#37701bc95f76>

<sup>2</sup> <https://theweek.com/articles/905207/need-send-people-money-need-fix-how>; <https://www.forbes.com/sites/jasonbrett/2020/03/27/how-a-us-senators-digital-dollar-plan-offers-mark-zuckerberg-his-crypto-comeuppance/#2d5a5887306d>; <https://www.ft.com/content/457fc6d2-4f94-4a1f-bfb7-4142a45480c4>

<sup>3</sup> Darrick Hamilton and Nell Abernathy, New Rules for the 21<sup>st</sup> Century, [https://rooseveltinstitute.org/wp-content/uploads/2019/04/Roosevelt-Institute\\_2021-Report\\_Executive-Summary-1.pdf](https://rooseveltinstitute.org/wp-content/uploads/2019/04/Roosevelt-Institute_2021-Report_Executive-Summary-1.pdf); <https://rooseveltinstitute.org/transcending-neoliberalism-free-market-myth-prevented-climate-action/>; Mike Konczal and others, <https://rooseveltinstitute.org/empirical-failures-of-neoliberalism/>; Felicia Wong, <https://rooseveltinstitute.org/emerging-worldview-new-progressivism-moving-beyond-neoliberalism/>; <https://rooseveltinstitute.org/a-progressive-framework-for-free-college/> Brishen Rogers, <https://rooseveltinstitute.org/beyond-automation/>; Julie Margetta Morgan, <https://rooseveltinstitute.org/dismantling-broken-power-structures-in-higher-ed/>

More recently, fintech and blockchain initiatives have launched alternative financial projects whose stated aim is to increase financial inclusion. Facebook’s Libra, Google’s checking accounts, and many cryptocurrency representatives have promised that not only would their new products help with financial inclusion but that, in fact, financial inclusion was the primary aim of their enterprise. Regulators have responded with their own encouraging reports pronouncing that fintech, mobile banking, or other innovative new products will eventually lead to financial inclusion. When discussing financial inclusion, regulators and private actors use the terms “access to credit,” “the democratization of credit,” and “filling gaps.”<sup>4</sup>

The term “financial inclusion” itself is nebulous, broad, and relatively uncontroversial. Generally, it describes increasing access to basic financial services and a myriad of credit products, and it’s used in varying ways by payday loan companies, fintech firms, and consumer-oriented nonprofit groups. If there is a unifying goal, it is to *increase, expand, or otherwise make credit, services, or transactions more available.*

To cut through the confusion, it is important to distinguish between two distinct issues of inclusion and access and how each involves different structural issues and potential remedies. The two aspects of inclusion are, roughly speaking, *the payments system* and *the credit system*. Both of these systems are exclusionary for low- and moderate-income (LMI) individuals and communities; aspects of each can be deemed as essential; and both of these systems have public or quasi-public features.

Typically, when discussing financial inclusion of the “unbanked” or “underbanked,” the problem is lack of access to the *payments system*.<sup>5</sup> Each time you purchase something at a store or online, make a sale, pay a bill, write a check, or get paid for work, you are interacting with an expansive (if often hidden) payments system. When, for example, the CARES Act provides a stimulus check or forgivable

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<sup>4</sup> See *Infra*; See e.g., Dan Schulman, *Time to Democratize the Banking System*, CNBC <https://www.cnbc.com/2015/07/21/paypal-ceo-time-to-democratize-the-banking-system-commentary.html> (arguing for the use of technology to “democratize credit” by Dan Schulman, the CEO of PayPal); see also Examining Opportunities and Challenges in the Financial Technology (“FinTech”) Marketplace: Hearing Before Subcommittee on Financial Institutions and Consumer Credit (Jan. 30, 2018) (discussing the use of financial technology to increase access to credit); Barr, *supra* note 4, at 163 (urging legislators to pursue “alternative credit products” to increase access to credit to the poor); *2018–2022 Strategic Plan*, FDIC (January 29, 2018), <https://www.fdic.gov/about/strategic/strategic/supervision.html> Lael Brainard, *FinTech and the Search for Full Stack Financial Inclusion*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (October 17, 2018), <https://www.federalreserve.gov/newsevents/speech/brainard20181017a.htm>.

<sup>5</sup> See Michael Barr, *No Slack*, and Lisa Servon, *Unbanked*, and the FDIC survey of unbanked.

loan, the means by which those funds reach a recipient is through the payments system. Historically, banks have been the intermediary between people, firms, and the government. Each time you swipe your credit card, cash a check, or withdraw cash from an ATM, at least one or two banks facilitate this transaction outside of the consumer's purview. Individuals with bank accounts receive most checking, debit card, credit card, and even mobile banking features at no cost (though retailers certainly pass the costs of their payments overhead to all their customers through pricing). Those without a bank account must pay a fee or a toll for payments service.<sup>6</sup> They pay to cash checks, purchase prepaid debit cards, pay for a money order, or use a third-party servicer like Western Union to send or receive money.<sup>7</sup> This class of fees and interest rates usually falls on LMI individuals who spend an average of 10 percent of their annual income on fees.<sup>8</sup> Due to the combined forces of deregulation, increased mergers, and heightened competitive pressures, many communities have been left without any banks at all. In these "banking deserts," businesses and individuals must travel to neighboring towns for bank services at a significant loss to local establishments or use alternative service providers such as check cashers, payday lenders, or gas station ATMs with charges between three and seven dollars per transaction. Losses in banking services are tied to community and individual wealth and prove the adage that "it is expensive to be poor." It is also time-consuming and stressful to mediate the various external services in the economy, such as check cashers, remittance services, bill pay offices, and prepaid debit cards.<sup>9</sup>

As such, policymakers have promoted "financial inclusion," and tech start-ups have made many promises over the years that their products are geared toward these communities.<sup>10</sup> As the recent CARES Act cash transfer mechanism has shown, digital access to the payments system is increasingly

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<sup>6</sup> See 2017 FDIC National Survey of Unbanked and Underbanked Households 1 (finding that more than one-quarter of Americans are unbanked or underbanked); see also Peggy Delinois Hamilton, *Why the Check Cashers Win: Regulatory Barriers to Banking the Unbanked*, 30 W. NEW ENG. L. REV. 119, 119–20 (2007) (explaining that the underbanked spend approximately 2 percent of their income on check cashing alone).

<sup>7</sup> See Providing Non-Bank Financial Services for the Underserved (Washington, DC: US Postal Service, 2014), 2 (noting that the unbanked and underbanked spend about 10 percent of their income on alternative financial services); see also Hamilton, *supra* note 1, at 119–20.

<sup>8</sup> See *id.* (noting that the unbanked and underbanked spend about 10 percent of their income on alternative financial services).

<sup>9</sup> See generally Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. (2004) (discussing the complex and expensive regulatory environment of various alternative financial service providers, such as payday lenders and check cashers).

<sup>10</sup> See e.g., Federal Reserve of Boston, *The US Regulatory Landscape for Mobile Payments*, Summary Report of Meeting between Mobile Payments Industry Workgroup and Federal and State Regulators on April 24, 2012 8 (July 2012) (explaining that the government's policy goal of financial inclusion can be aided by mobile technologies); see also Nizan Geslevich Packin, Yafit Lev Aretz, *On Social Credit and the Right to Be Unnetworked*, 2016 COLUM. BUS. L. REV. 339, 356 (2016) (regulators, policymakers, academics, and consumers share the understanding that broader financial inclusion is socially desirable).

necessary for participation in commerce—and should be recognized as a public good akin to railroads, telephones, and electricity.

“Access to credit,” the second pillar of financial inclusion, also boasts bipartisan public policy support and cachet as a marketing mantra. Credit access played an important role in initial bailout responses to the COVID-19 financial crisis: Fed monetary policy infused much-needed credit and liquidity into repo markets and commercial paper markets in order to increase access to credit for big financial institutions; on the fiscal policy side, the CARES Act increased access to credit for small businesses and employers. Innovative technology companies have long premised their enterprises on increasing financial inclusion through a variety of apps, platforms, or networks.<sup>11</sup> Peer-to-peer (P2P) lending, payday lending, and payroll advance services maintain that their mission is to increase access to credit. But there is little consensus on how best to achieve “access to credit,” and the panoply of proposals and credit programs has rendered the term practically meaningless for policymaking purposes.

This paper will make the case that all of these paradigms share a common hypothesis rooted in a flawed neoliberal theory: the idea that credit markets and the financial circuitry of the economy are a neutral and natural byproduct of market forces.<sup>12</sup> This view conceives of financial exclusion as a “bug” or gap in the general circuitry, with solutions ranging from new products outside the “normal” credit system to new methods of access. Those who find themselves outside of the normal channels of credit and money therefore must be “included” in the credit market using a *different* device or method than what is offered to those who already have access to credit and financial services. Those who cannot access a “normal” or “standard” loan can receive a microcredit, P2P, or payday loan. Those who do not have a bank account can be given an alternative route to transactions, such as a check-cashing service, a newly designed fintech product, or a blockchain currency.

This prevailing view of financial inclusion takes “the norm” for granted: Gaps are created by “market failures” that subsidies or financial education can overcome, but the credit market itself is guided by the invisible hand. People who are excluded find themselves outside of the financial markets because

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<sup>11</sup> See *infra* Part I; See also Jean Braucher, *Theories of Overindebtedness: Interaction of Structure and Culture*, 7 THEORETICAL INQUIRIES L. 323, 335 (2006) (noting that “creditors sometimes portray [alternative financial services] as promoting the democratization of credit . . .”).

<sup>12</sup> Martha T. McCluskey, *Efficiency and Social Citizenship: Challenging the Neoliberal Attack on the Welfare State*, 78 IND. L.J. 783, 785 Fn.2 (2003) (defining neoliberalism as the “contemporary reincarnation of the nineteenth-century ‘laissez-faire’ liberalism that advanced the primacy of ‘the market’ over ‘government regulation’”).

they are not “creditworthy,” either because they are deemed too high a default risk or because there is a flaw in the system—such as racial discrimination—that excludes “creditworthy” individuals unfairly.

This paper proposes a different theoretical framework: Exclusion is inherent to the historical design of the financial and credit system, a product of policy and institutional decisions shaped by certain industries and beneficiaries. Instead of filling gaps and offering new products to increase access to credit and services, we must change the system’s design to ensure democratic access. In other words, the “democratization of credit” cannot be achieved through market products, but through democracy itself.

This theory of credit evokes Progressive-era debates about the distributional effects of credit programs and money forms.<sup>13</sup> Progressives advocated a change in the monetary standard—from the gold standard to fiat currency—in order to increase “access to credit,” and they brought these questions to be settled over several elections and through various branches of government. In other words, changes in law and public policy changed the nature of credit markets and money supply—a vital lesson for today, when our system seems “natural,” fixed, and obvious to many.

In keeping with that lesson, this paper will advocate a public and democratic process of decision-making that goes beyond current discourse on financial inclusion and prioritizes financial redesign.

Rather than focusing on market choices, it centers legal design decisions in shaping credit markets, arguing that such decisions cannot be justified if they result in the exclusion of large segments of the populace—especially when those excluded are already poor and vulnerable.

## **WHAT WE TALK ABOUT WHEN WE TALK ABOUT FINANCIAL INCLUSION**

To visualize the problem, I have depicted the financial system below (Figure A), with an inner circle of credit access and an outer ring lacking access: This is the space for current financial inclusion efforts. (Figure B places the different models of inclusion in the circle.) Credit is represented as a finite good at the center, with access diminishing the further out a consumer gets from the center. Proximity to

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<sup>13</sup> See WILLIAM GRAHAM SUMMER (ED.), *A HISTORY OF BANKING IN ALL THE LEADING NATIONS* 413 (1896).

access usually correlates with wealth and income; financial inclusion is typically a problem for LMI individuals left out of the central credit markets. This misleading conceptualization of access creates several problems. First, this model of credit and financial inclusion views access to credit as a sliding scale—merely a matter of more credit or less credit. To increase access and inclusion necessarily requires *more credit*. “Access to credit” measures have had an escalation effect, with payday lenders, title lenders, subprime lenders, and other high-cost lenders using the concept to justify their services.<sup>14</sup> “Access to credit” discourse also does too little to discern the quality of credit available, usually focusing primarily on the quantity available. Second, and more fundamentally, this model takes for granted the credit at the center and shifts focus to the outer rings. It presupposes those at the center of the credit market deserve credit and access. As the next section illustrates, access to credit is a decision made by policymakers. In fact, as we move further away from the core toward the periphery, the federal subsidies diminish. It is therefore misleading to focus regulatory efforts on financial inclusion as an ancillary product supplementing the normal credit markets without examining the entirety of the system as an integrated whole, all of which is a result of public policy.

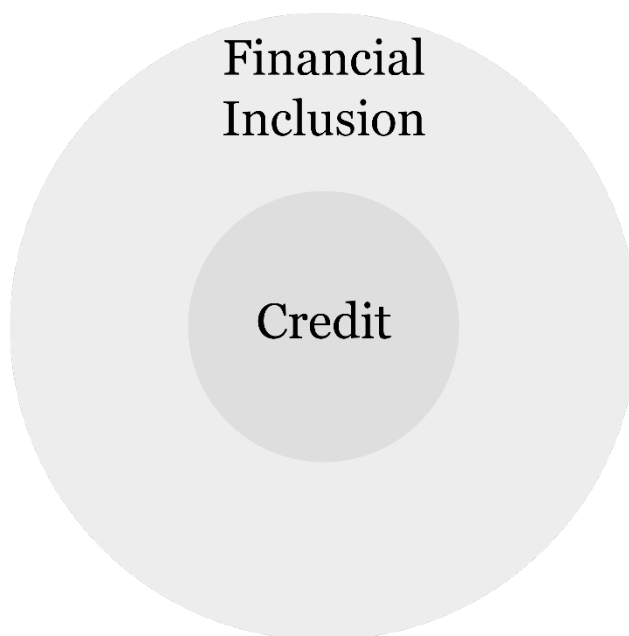


Figure A

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<sup>14</sup> See Michael Kenneth, *Payday Lending: Can "Reputable" Banks End Cycles of Debt?* 42 U.S.F. L. Rev. 659, 710 (2008) (arguing that properly regulated payday lending expands credit and “should be [viewed as] a positive business practice under the CRA”); Neil Bhutta et. al., *Consumer Borrowing after Payday Loan Bans*, 59 J.L. & ECON. 225, 226 (2016) (noting that supporters of payday lending emphasize its value to low-income households because it provides access to credit).



Often financial inclusion envisions a *product* or new innovative design that promises inclusion or access to credit. The provider of the new product is usually a bank, technology company, or non-profit.<sup>15</sup> Such products have focused on fee models (as in the case of PayPal), networks connecting borrowers and lenders, and newly designed systems of access (such as blockchain), honing technological innovation, marketing, and behavioral economics–inspired nudges. Most are designed around the assumption that people who fall outside the inner circle of credit have special or different needs.

## PAYMENTS AND CREDIT

There are two distinct services that banks provide: *payments* and *credit*. Though regulators, industry advocates, and commentators often lump both services together when discussing financial inclusion, there are key differences, which this section will explore.

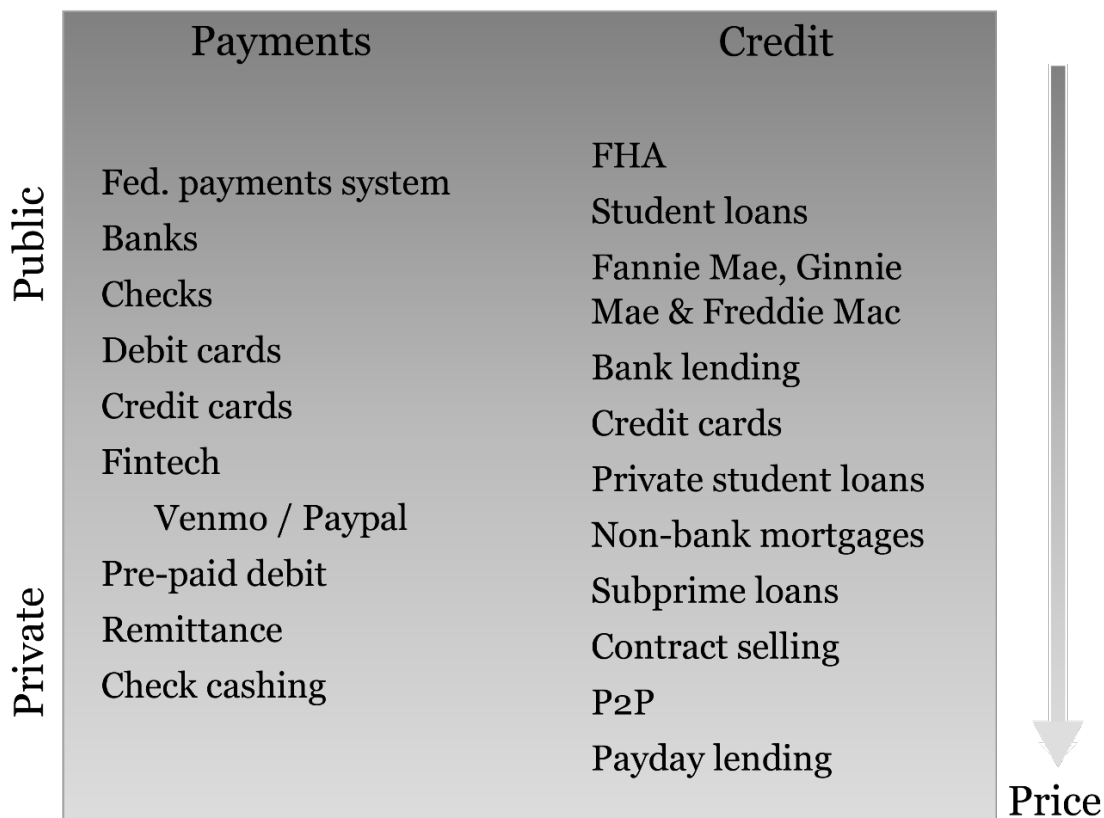
Those excluded from the *payments* portion of the financial sector are those who are unbanked or “underbanked” and must use available-for-sale (AFS) products for transactions including cashing checks or exchanging and transmitting money. Access to *credit* usually means being eligible for and receiving credit from the banking system. The term is nebulous though because there are many forms of credit with varying degrees of accessibility. Surely the ability to qualify for a standard mortgage loan differs from eligibility for high-priced subprime credit or a payday loan.

The bulk of payments and credit services are managed and designed by federal government agencies or legislators. The chart below depicts the trajectory from the core of mainstream credit (the top of the chart) to the periphery of “financial inclusion” (the bottom). As illustrated, the services at the top are usually less costly (as measured by fees and interest) than those at the bottom. More crucially, those at the top are more connected to *public* entities than those at the bottom. In other words, public provisioning and subsidies decrease from top to bottom—or from mainstream credit to the periphery.

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<sup>15</sup> NIKI COHEN ET AL., REIMAGINING FINANCIAL INCLUSION 13 (2015), <http://www.ideas42.org/wp-content/uploads/2015/11/Reimagining-Financial-Inclusion-Final-Web-1.pdf> (arguing that proper product design will lead to greater financial inclusion).

# Financial Inclusion



## Payments

The Federal Reserve is the primary regulator of the payments system and also operates the largest payments processing system.<sup>16</sup> Historically, the Fed created and operated a check-clearing system in which banks would settle their balances of transfer. According to the textbook *Payments Systems in the US: A Guide for the Payments Professional*, “the Federal Reserve Bank system, formed in the early 20<sup>th</sup> century, played an important role by requiring its member banks throughout the country to accept checks for deposit at par. This meant that the deposit bank would credit its customer with ‘one hundred cents on the dollar’ rather than some lesser percentage. The Fed’s requirement, coupled with the development of clearinghouses across the country, transformed checking into a true national payments system.”<sup>17</sup>

<sup>16</sup> “In the United States, the primary issuer of payments regulations is the Federal Reserve Board.” Coye Benson, Carol. *Payments Systems in the US - Third Edition: A Guide for the Payments Professional*. Glenbrook Press; Adam J. Levitin, *Public-Private Competition in Payments: The Role of the Federal Reserve* (June 23, 2009) at 3, Georgetown Law and Economics Research Paper No. 1420061, available at SSRN: <https://ssrn.com/abstract=1420061>.

<sup>17</sup> Coye Benson, Carol. *Payments Systems in the US - Third Edition: A Guide for the Payments Professional*. Glenbrook Press. Kindle Edition.

Today, checks are not literally exchanged in a central location but through the electronic network operated and overseen by the Federal Reserve.<sup>18</sup> Only an officially chartered bank or credit card company has access to this payments system.<sup>19</sup> In other words, though the majority of transactions are processed by a public agency, only private banks and credit card issuers are given a charter to use it.<sup>20</sup> This protects the payments processing system from risks and frauds, but it also presents barriers for the unbanked.

The payments system operates behind the scenes of daily consumer transactions. A customer will swipe a credit or debit card, write a check, or even use an app like Venmo or Square without realizing that they are using the bank-mediated payments system that is processing the transaction. Though certain fintech apps present themselves as nonbanks, their payments transactions still operate through a bank.<sup>21</sup> Before consumers can “mobile bank” with Venmo or Cash App, they must link their bank account to the service.<sup>22</sup> The traditional banking system that the apps are meant to supplant is actually providing the background access, the rails on which the fintech train can run.

The ubiquity of the central bank’s payments system only becomes apparent when you consider how people outside of the banking system engage with the economy. Individuals without bank accounts must pay fees to cash checks or purchase debit cards, and without bank accounts, mobile apps are

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<sup>18</sup> *Id.*

<sup>19</sup> Anatoli Kuprianov, *The Monetary Control Act and the Role of the Federal Reserve in the Interbank Clearing Market*, 71 *Economic Law Review* 23, 26 (1985) (noting that “banks that were not members of the Federal Reserve System were required to maintain accounts with member banks for purposes of settlement”).

<sup>20</sup> The Federal Reserve operates the Automated Clearinghouse (“ACH”), which provides an electronic means to exchange debit and credit entries between depository institutions to settle customer transactions and is the Federal Reserve’s primary electronic payment system. The ACH processes approximately three-quarters of all electronic payments in the US, including recurring mortgage payments, utility bills, payroll direct deposits, Social Security disbursements, and large interbank transfers. Federal Reserve Bank of San Francisco, *What Is the Fed: Payment Services*, <https://www.frbsf.org/education/teacher-resources/what-is-the-fed/payment-services/>.

<sup>21</sup> PayPal, *About ACH Payments*, [https://www.paypalobjects.com/en\\_US/vhelp/paypalmanager\\_help/about\\_ach\\_payments.htm](https://www.paypalobjects.com/en_US/vhelp/paypalmanager_help/about_ach_payments.htm). See also Odinot, Christopher K., *Consumer Bitcredit and Fintech Lending (March 26, 2018)*. *Alabama Law Review*, Vol. 69, No. 781, 2018. Available at SSRN: <https://ssrn.com/abstract=2949456>.

<sup>22</sup> In fact, most of these services use a few specialty banks called ILCs that have access to the payments system due to a legislative loophole. ILCs, or Industrial Loan Companies, operate similarly to banks and have access to the Federal Reserve ACH payments system. ILCs have no limits on their size or the activities they may conduct, which, in cases like WebBank, can include general commercial activities. The Federal Reserve Bank of St. Louis, *On the Economy Blog: Fintech Interest in Industrial Loan Company Charters: Spurring the Growth of a New Shadow Banking System?* (Oct. 24, 2017). <https://www.stlouisfed.org/on-the-economy/2017/october/fintech-interest-industrial-loan-company-charters-spurring-new-shadow-banking-system>; Christopher Paridon, *New Changes and Challenges: Non-banks in the Payments System*, *American Bar Association Banking Law Committee Journal*, 2–3 (2007) <http://apps.americanbar.org/buslaw/newsletter/0065/materials/pp6.pdf>;

unavailable.<sup>23</sup> A CARES Act stimulus check would be direct-deposited by Treasury into an individual's bank account through the payments system. Alternatively, the check would be sent in the mail, and the individual would deposit the check at a bank, which would clear it through the payments system. If the recipient took the check and went to a check casher, that check would not clear through the public payments system. In this case, the check casher would provide the customer with the cash equivalent of the check amount minus a fee of up to 10 percent of the check. Then, that check casher would use their own bank to clear the check through the payments system.

Only banks and their customers have access to the payments systems, but banks are private businesses seeking profits and thus will not provide bank accounts at zero cost. Maintaining simple checking or savings accounts costs banks money. They must hire staff, pay for buildings, update technology, build ATMs, and send monthly statements. A simple bank account costs a bank around \$250 every year.<sup>24</sup> If there is too little money in an account, the profits are low or nonexistent. Simple business math suggests that if a product (like a small account) is not profitable, it should be avoided—which is exactly what banks do. Consumers that are deemed unprofitable are either rejected by the bank outright or repelled by punishing fees. The most prevalent fees on small accounts are overdraft fees, which make up 75 percent of all bank fees.<sup>25</sup> These costs are borne primarily by poor people—90 percent of the fees are paid by 10 percent of the customers. A 2014 report studied the annual costs of checking accounts at large banks among five categories of spenders and found that by far, the people in the lowest category—the “cash-strapped”—paid the most to use a checking account.<sup>26</sup> The FDIC has noted that overdraft fees, service charges, and minimum balance requirements are among the top reasons people do not open bank accounts.<sup>27</sup> Those with small means are hearing the

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<sup>23</sup> Unbanked or underbanked customers who use alternative financial services for basic banking services incur substantial fees, including check-cashing at a 1.5 percent to 3.5 percent face value charge. To access short-term, low-value credit, underserved customers often turn to payday lenders for paycheck or tax return anticipation loans with effective APRs over 470 percent. Julia S. Cheney, Federal Reserve Bank of Philadelphia, *Payment Cards and the Unbanked: Prospects and Challenges- Conference Summary* (July 13-14, 2005) <https://philadelphiafed.org/-/media/consumer-finance-institute/payment-cards-center/events/conferences/2005/PaymentCardsandtheUnbankedSummary.pdf>.

<sup>24</sup> Marcie Geffner, “Bank Account Costs \$250,” *Bankrate*, July 26, 2010, <http://www.bankrate.com/financing/banking/bank-account-costs-250/>

<sup>25</sup> Mark Maremont and Tom McGinty, “Why Banks at Wal-Mart Are Among America’s Top Fee Collectors,” *Wall Street Journal*, May 11, 2014, Available at <http://online.wsj.com/news/articles/SB10001424052702304734304579515730198367754?KEYWORDS=maremont&mg=reno64-wsj>.

<sup>26</sup> Megan Crepeau, “Less Money, Pricier Banking,” *Chicago Tribune*, September 8, 2014, p. 10; <http://www.newyorker.com/business/currency/the-high-cost-for-the-poor-of-using-a-bank>.

<sup>27</sup> FDIC, “Addendum to the 2011 FDIC National Survey of Unbanked and Underbanked Households: Use of Alternative Financial Services” (June 2013). Available at [https://www.fdic.gov/householdsurvey/2013\\_afsaddendum\\_web.pdf](https://www.fdic.gov/householdsurvey/2013_afsaddendum_web.pdf). Michael Barr’s survey results from his book

banks' message loud and clear. There are approximately 9 million Americans who do not have a bank account or access to traditional financial services.<sup>28</sup>

Those without a bank account pay the most for payments services. Not having a bank account reduces take-home pay (between 5 to 10 percent just to cash the paycheck<sup>29</sup>) and makes it difficult for families to save and establish a credit history.<sup>30</sup> In 2017, the unbanked spent a total of \$173 billion on financial transactions alone.<sup>31</sup>

## Credit

In the credit market, the public/private continuum is much more pronounced. The credit market is heavily subsidized by the federal government, and the private nonbank market is very expensive. Most standard mortgages and student loans are guaranteed, bundled, or subsidized by the FHA or the government-sponsored enterprises (GSEs) Fannie Mae, Freddie Mac, Ginnie Mae, and Sallie Mae. The majority of home loans<sup>32</sup> and student loans<sup>33</sup> are insured by and sold to the federal government. The Department of Education issues most student loans—with \$1.2 trillion of the \$1.6 trillion student loan market comprising direct loans from the US government.” The Department of Education originates the loans, holds the note, and then contracts with third-party servicers who collect on the contracts. The Treasury collects the payments from borrowers and is involved in some collection practices, such as tax refund offsets and wage garnishments. This type of lending, unlike mortgage lending, is a direct budget line item on the Treasury's balance sheet. The credit line is created by the

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*No Slack* show that when the unbanked are asked what changes to bank accounts would induce them to open an account, 29 percent of respondents said lower fees, 20 percent said convenience, 10 percent said getting money faster, 14 percent said lower minimum balance, 16 percent said less confusing fees, and 11 percent said nothing. Barr, *No Slack*, 32.

<sup>28</sup> FEDERAL DEPOSIT INSURANCE COMPANY, 2017 FDIC SURVEY OF UNBANKED AND UNDERBANKED EXECUTIVE SUMMARY 1 (2018).

<sup>29</sup> Michael S. Barr, *No Slack: The Financial Lives of Low-Income Americans* (Washington, DC: Brookings Institution, 2012), 3.

<sup>30</sup> Michael S. Barr, “An Inclusive, Progressive National Savings and Financial Services Policy,” *Harvard Law and Policy Review* 1 (2007): 164, 164.

<sup>31</sup> CENTER FOR FINANCIAL SERVICES INNOVATION, 2017 FINANCIALLY UNDERSERVED MARKET SIZE STUDY 4 (2017).

<sup>32</sup> CONGRESSIONAL BUDGET OFFICE, FANNIE MAE, FREDDIE MAC, AND THE FEDERAL ROLE IN THE SECONDARY MORTGAGE MARKET ix (Dec. 2010) (“[T]wo GSEs owned or guaranteed roughly half of all outstanding mortgages in the United States . . .”).

<sup>33</sup> See Kelly D. Edmiston et al., Student Loans: Overview and Issues (Update) 4 (Fed. Reserve Bank of Kan. City Research, Working Paper No. 12-05, 2013); Laura Fvelson, Alvaro Mezza, and Kamila Sommer, *Student Loan Debt and Aggregate Consumption Growth*, FEDS Notes, The Federal Reserve (Feb. 21, 2018), <https://www.federalreserve.gov/econres/notes/feds-notes/student-loan-debt-and-aggregate-consumption-growth-20180221.htm> (“The federal government guarantees more than 90 percent of outstanding student loan debt . . .”).

federal government and lent to students, and then repayments flow back into the federal government's coffers.<sup>34</sup>

These GSEs purchase almost every mortgage and student loan in the country and resell them to investors. Before 2008, GSEs enjoyed the implicit backing of the federal government, but since 2008, they have been under direct conservatorship; thus, all standard student and mortgage loans are now guaranteed by the federal government, and the majority of these loans issued by banks are essentially risk-free. The banks and investors are paid interest rates by borrowers even though GSEs protect lenders from default. GSEs enable banks to lend exponentially more loans than what their customer deposits would allow. At the crux of our banking system, then, is a state-enabled credit system.

And that's not to mention government bailouts, the staggering magnitude of which were on full display during the 2008 financial crisis and the COVID-19 crisis. Using its 13(3) emergency lending powers, the federal government bailed out a failing banking industry in 2008 with several trillion dollars of equity infusions, loans, guarantees, asset purchases, and other forms of financial support. While it took several months in 2008 for the Federal Reserve to roll out swap lines, repo support, and quantitative easing (QE), during the 2020 crisis, the Fed unveiled trillions of dollars of credit support over an unprecedented few days. The help came on very favorable terms, with interest rates not available on the market. The Fed's credit support was supplemented by the trillions of dollars of credit stimulus in the CARES Act. In just the first round of stimulus, \$350 billion of forgivable credit went to small businesses, \$500 billion to large corporations, about \$560 billion to individuals, and \$340 billion to state and local governments.<sup>35</sup> A week after the CARES Act went into effect, the Federal Reserve added another \$2 trillion in funds.

Between the 2008 and 2020 crises, most of the Fed's monetary support was issued through banks as intermediaries. The money created through the Fed programs in 2008 was supposed to pass through banks and be used to lend to the market. Yet there is no requirement that the banks must lend these funds, and there is evidence that the main result of these extraordinary measures was to

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<sup>34</sup> Julie Margetta Morgan, *Who Pays? How Industry Insiders Rig the Student Loan System—And How to Stop It*, (June 2018), <https://rooseveltinstitute.org/wp-content/uploads/2018/06/How-Industry-Insiders-Rig-the-Student-Loan-System.pdf>

<sup>35</sup> <https://www.npr.org/2020/03/26/821457551/whats-inside-the-senate-s-2-trillion-coronavirus-aid-package>.

boost bank profitability.<sup>36</sup> Even when the Fed unveiled a new small business lending liquidity program in 2020, it did so in partnership with banks.

Another less well-known example of monetary policy is Interest on Excess Reserves (“IOER”). Violating the seeming laws of the market and basic common sense, the Fed pays billions of dollars in interest to banks on their reserves.<sup>37</sup> In just one year, the Fed paid about \$7 billion in interest to commercial banks, including more than \$100 million to Goldman Sachs and more than \$900 million to JPMorgan Chase. Though these payments are supposed to “pass through” the banks to the depositor, excess reserves pay higher interest than Treasury bills, providing a risk-free, high-interest opportunity; thus, banks absorb IOER payments as profits and thereby increase inequality. Each dollar held on reserve is a dollar not lent for real estate, infrastructure, or business operations in the American economy.<sup>38</sup> These payments increased after the 2020 crisis as reserve funds increased.

Through asset purchases, credit, guarantees, and reserves, the Fed controls the amount of money circulating in the economy.<sup>39</sup> By flushing banks with money in the hope that they will lend the surplus, the Fed has pumped trillions of dollars of investments and loans into the banking system over the last decade.<sup>40</sup> In 2020, trillions more were infused into the market through a variety of credit programs.<sup>41</sup> The Fed even created liquidity lines for foreign central banks in 2020, which seemed to cement the place of the US dollar as the world’s currency. Viewed through this lens, it was the policies and actions of public agencies like the Treasury and the Fed that determined the scope and shape of the circle of credit, including who was left outside. The lending choices of GSEs and the legislatures that create their mandates determine the amount of available credit, its costs, and availability. Even more crucially, the types of loans the government will guarantee and the kinds of borrowers who are eligible for the loan are determined through public policy. Through democratic decision-making and legislative action, several types of loans have been promoted by public policy, including student

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<sup>36</sup> <https://www.politico.com/news/2020/04/09/federal-reserve-coronavirus-relief-176808>

<sup>37</sup> FED. RES. BANK OF ST. LOUIS, REQUIRED RESERVES OF DEPOSITORY INSTITUTIONS (Nov. 8, 2018), <https://fred.stlouisfed.org/series/REQRESNS>.

<sup>38</sup> Walker suggests that the Federal Reserve sell about \$180 billion in mortgage-backed securities or longer maturity Treasury securities per year in order to prevent future inflation. Walker Todd, *The Problem of Excess Reserves, Then and Now* 15-16 (Levy Econ. Inst. of Bard C., Working Paper No. 763, 15-16, 2013).

<sup>39</sup> Konczal and J.W. Mason, *A New Direction for the Federal Reserve: Expanding the Monetary Policy Toolkit*, The Roosevelt Institute (Dec. 2017).

<sup>40</sup> William Greider, *Unusual and Exigent: How the Fed Can Jump-Start the Real Economy*, Levy Economics Institute of Bard College (2013).

<sup>41</sup> For a helpful summary of all the 2020 programs, see <https://www.federalreserve.gov/monetarypolicy/2020-02-mp-part3.htm>; <https://nathantankus.substack.com/p/the-federal-reserves-coronavirus>; <https://nathantankus.substack.com/p/the-federal-reserves-coronavirus-276>

loans, home loans, and certain small business loans. The federal government has \$1.24 trillion in direct loan programs and \$2.37 trillion in loans it guarantees—all mortgage and student loans.<sup>42</sup>

Despite many claims that these loans should and could be forgiven, as of this paper’s writing, the Fed has not done so.

Historically, the major credit programs have centered both student loans and mortgages through the Federal Housing Administration (FHA), an illustrative example of how loan guarantee policies can shape markets. The FHA was created as part of the National Housing Act of 1934 and was supplemented and expanded through the 1944 Servicemen’s Readjustment Act (the GI Bill), administered by the VA.<sup>43</sup> The FHA did not lend money itself, but it created a large insurance fund, backed by the Treasury, that would guarantee all approved mortgage loans, shifting the bulk of the risk of loan default from banks to the government.<sup>44</sup> This new government buffer opened the floodgates for an unprecedented amount of private capital and mortgage loans; it fueled a worldwide market in mortgages, created the middle class, and produced a stable and profitable banking sector. This transformation was aided by the 1938 creation of the Federal National Mortgage Association (FNMA or Fannie Mae), which created a securitized secondary market in mortgage loans.<sup>45</sup>

Banks increasingly relied on the protocol and standards provided by the government agencies that were insuring the mortgages and managing their resale. Interest rates and terms converged, as did the types of borrowers. Banks were much less likely to take risks on borrowers who did not fit the gold standard, which was white, middle-class, and male. Yet to call those who qualified for these loans “the middle class” is an evasive and circular description. Many were blue-collar wage workers, but it was precisely through these mortgages that they became the much-heralded American middle class.<sup>46</sup> These borrowers would not have been able to buy homes before these reforms; over half of

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<sup>42</sup> US Office of Management and Budget, *Analytical Perspectives: Budget of the US Government*, 227 (2018), <https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/budget/fy2018/spec.pdf>.

<sup>43</sup> *Id.* at 96 (discussing the creation and effect of the Servicemen’s Readjustment Act).

<sup>44</sup> The federal guarantee revolutionized mortgages because the fund insured 90 percent of individual home mortgages. According to Julian Zimmerman, FHA commissioner in the 1950s, when the scheme was first proposed, “it was such an innovation that many considered it radical and unworkable.” According to Zimmerman, “it was the last hope of private enterprise. The alternative was socialization of the housing industry.” LOUIS HYMAN, *DEBTOR NATION: THE HISTORY OF AMERICA IN RED INK* 53 (2011) (citing FHA, *THE FHA STORY IN SUMMARY, 1934–1959* (1959)).

<sup>45</sup> According to Louis Hyman, the FHA program “completely reversed . . . the conventional justification for government intrusions.” FHA money was “not the dole” and “not taxpayer money.” LOUIS HYMAN, *DEBTOR NATION: THE HISTORY OF AMERICA IN RED INK* 55 (2011).

<sup>46</sup> LOUIS HYMAN, *DEBTOR NATION: THE HISTORY OF AMERICA IN RED INK* 71 (2011).



mortgage borrowers earned less than \$2,500 per year.<sup>47</sup> With these programs, mortgage loans became more accessible than ever, as banks significantly reduced down payment requirements, lengthened loan terms, and slashed interest rates.<sup>48</sup> In the transformed mortgage market, people could pay less in mortgage payments than they were paying in rent. A borrower who moved from renting a small apartment in the city to owning a large home in the suburbs was actually saving money.<sup>49</sup>

Many Americans, however, were left out and pushed into alternative and higher-cost credit markets. The bureaucracy of the FHA decided that lending to Black people was too risky and cut off their credit supply—the only route to building capital. That policy choice has had lasting consequences. Today, Black Americans are disproportionately unbanked and underbanked and are more likely to have to resort to high-interest credit products like payday loans. When the underlying nature of the credit markets shifted, these communities were also more likely to be sold subprime mortgages, contract sales, and other wealth-stripping mortgage products. The gaps that led to financial exclusion and exploitation were the result of government credit and banking policies—not “natural market forces.”<sup>50</sup>

The FHA is an example of a government credit program with the power to redesign the entire credit landscape. By nature of these mortgages, many Americans built intergenerational wealth and social capital and gained access to other low-cost credit and services that have continued to enhance the lives of their progeny. Today, these programs have become the economic engine that most Americans rely on to attend school or buy a home.

As this section shows, the banking system is shaped by public policy, subsidized by public funds, and built on a public monopoly. Now, we can turn our attention to the periphery and propose a new way to articulate the nature of financial inclusion and access to credit.

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<sup>47</sup> LOUIS HYMAN, *DEBTOR NATION: THE HISTORY OF AMERICA IN RED INK* 71 (2011).

<sup>48</sup> See KENNETH T. JACKSON, *CRABGRASS FRONTIER*, 204–205, (1985); LOUIS HYMAN, *DEBTOR NATION: THE HISTORY OF AMERICA IN RED INK* 56–57 (2011).

<sup>49</sup> MELVIN L. OLIVER AND THOMAS SHAPIRO, *BLACK WEALTH/WHITE WEALTH: A NEW PERSPECTIVE ON RACIAL EQUALITY*, 17 (Routledge, 2006).

<sup>50</sup> Baradaran, Jim Crow Credit. Keeanga Taylor, *Race for Profit*, *Crabgrass Frontier*

# PROGRESSIVE MONEY

At certain moments in American history, decisions about the nature and quantity of money and credit in the economy were viewed as a matter of fierce political and legal debate,<sup>51</sup> around which political factions and parties coalesced. Gold vs. silver, specie vs. fiat money, national currencies vs. state currencies—policymakers and legislators understood that these pivotal monetary choices would have effects on market prices, employment rates, credit availability, and even inequality levels. Significantly, many of these battles were fought on the terrain of legal analysis and interpretation. Of particular importance were the decisions made in times of large-scale shifts in the economy.

These issues of money and credit were central to the progressive and populist movements, which introduced public platforms advocating “access to credit” and looser monetary standards as a matter of policy.<sup>52</sup> To these reformers, access to credit was not about the outer rungs of the system; they had in mind a complete rewriting of the financial code and the design of banking. Some of these movement coalitions were even dubbed by the money standard they were advocating. Groups called the “free silverites” and “the greenbackers” were part of the base of the Progressive Party and were one-issue voters. It was amid this era of upheaval and public debate that terms like “access to credit” and the “democratization of credit” entered the political lexicon.<sup>53</sup>

To progressive reformers, credit accessibility was a binary choice: gold or silver. Progressive reformers and the entrenched interests that opposed them linked the monetary standard with the availability of credit. The gold monetary standard made credit scarce; silver and fiat made it more abundant.

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<sup>51</sup> See, e.g., Ellen E. Meade, *The FOMC: Preferences, Voting, and Consensus*, Fed. Res. Bank of St. Louis Rev., March/April 2005, at 93.

<sup>52</sup> Daniel T. Rodgers, *The Progressive Era to the New Era, 1900–1929*, THE GILDER LEHRMAN INSTITUTE OF AMERICAN HISTORY, <https://www.gilderlehrman.org/history-now/progressive-era-new-era-1900-1929> (last visited Feb. 22, 2019).

<sup>53</sup> [Search of corpus linguistics]



Crucially, progressives understood that choices about the monetary standard were flexible, had distributional effects, and therefore should be decided through the democratic process. The Populist Party platform of 1892 expressed the issue as follows:

We demand a national currency, safe, sound, and flexible, issued by the general government only, a full legal tender for all debts, public and private, and that without the use of banking corporations, a just, equitable, and efficient means of distribution direct to the people . . . We demand free and unlimited coinage of silver and gold at the present legal ratio of 16 to 1 . . . We demand that the amount of circulating medium be speedily increased to not less than \$50 per capita . . . We believe that the money of the country should be kept as much as possible in the hands of the people, and hence we demand that all State and national revenues shall be limited to the necessary expenses of the government, economically and honestly administered . . . We demand that postal savings banks be established by the government for the safe deposit of the earnings of the people and to facilitate exchange.<sup>54</sup>

This, plus a provision on taxation, was the entire platform. Gold vs. silver would be decided at the polls, or more accurately, by the representatives elected by the people. Backers of gold often rejected the popular demands for bimetallism by stating that the gold standard was “natural” and “scientific.”<sup>55</sup> In actuality, the gold standard was a result of legal design. The progressives and populists lost the battle to abolish the gold standard, but they won the war. The gold standard was abandoned slowly but irrevocably in favor of a flexible fiat currency with Federal Reserve control over

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<sup>54</sup> KIRK H. PORTER & DONALD B. JOHNSON, NATIONAL PARTY PLATFORMS 1840–1964 91 (1966).

<sup>55</sup> Face Value, O'Malley.

the money supply. Much like the inner circle of credit outlined above, the monetary system was seen as natural and unchangeable—until it was changed.

Though few serious scholars or policymakers are interested in relitigating the gold standard, the theories upholding the fixed and natural state of money have reemerged and held sway over academics and government policy for decades. Milton Friedman’s influential theories of monetarism influenced a generation of economists and, more significantly, Fed chairs. Neoliberal economic models have rendered money invisible, treating it as just a background measurement of “real economic value.”

This is what leads to the misconception of financial inclusion as aside and apart from the “normal” and market-driven money and credit markets. The levers that control credit availability and money supply have been hidden behind a curtain of complex technical calculations by the Fed. If gold was seen as the “natural” (and thus unchangeable) money standard a century ago, today monetary policy is determined purely by “scientific calculations,” which also take credit and money design out of the democratic process. Though historians, legal scholars, and economists have begun challenging these monetarist views, their nascent movement has yet to influence policymakers or the broader public.

This paper, joining several others, is one attempt to envision how recognizing the true nature of money could yield inclusive public policy. What the Progressive Era view of money revealed, and what neoliberalism has obscured, is that our credit and monetary systems are a result of policy decisions. Money is a public good—albeit a very abstract type of “good.” Put another way, money is a mutually agreed upon value system; it is a social construct that ties together the members of a society and creates a shared measurement of value.

As economist Hyman Minsky explains, “Everyone can create money; the problem is to get it accepted.” The monetary system can be changed so long as these changes are codified in the legal structure and enforced by a legitimate state authority. Legal scholar Christine Desan has called money “a democratic medium,” recognizing that “societies produce it by structuring claims of value in ways that make those claims commensurable, transferable, and available for certain private as well as public uses.” In creating or changing financial designs, value can be reassigned and goods can be reallocated. Money does not just measure value; it creates it. As economist Felix Martin explains about the creation of new monetary regimes, “There is therefore nothing intrinsically wrong with moving the fulcrum of the scales of justice, since their purpose is not to achieve accuracy—a notion without meaning in the social world—but

fairness and prosperity.” In other words, when there are inequalities created by the monetary regime, it is legitimate and perhaps necessary “to move the fulcrum to restore balance.”<sup>56</sup> Indeed, justice is the purpose of financial redesign.

## REDESIGNING THE FINANCIAL SYSTEM

Public policies and infrastructure created the payments and credit systems; therefore, financial redesign is a matter of public policy, rather than a problem to be solved by entrepreneurs outside of mainstream markets. We must recognize that many aspects of the financial system—including certain credit programs, payments, and access to safe deposits—are essential services that must be provided for all and should be considered a public utility.

In order to meaningfully participate in the economy, the unbanked and underbanked need access to the Fed’s safe and subsidized payments system, a public service currently open only to banks, which operate as intermediaries. Opening this system to the unbanked and underbanked would not cause any disruptions to the financial market, but would be a boon to LMI families who currently pay to use a public resource.<sup>57</sup> In previous work, I have suggested a public option through postal banking.<sup>58</sup> Postal banks would offer free savings and checking accounts, which would enable the unbanked and underbanked to engage in simple financial transactions through the public payments system instead of high-cost nonbank options, such as check-cashing or prepaid debit cards.<sup>59</sup> Such an option would put approximately \$89 billion per year back into the pockets—or bank accounts—of the unbanked.<sup>60</sup> Other researchers have built on the postal banking suggestion and improved on its basic structure.<sup>61</sup>

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<sup>56</sup> MARTIN, *supra* note 189, 264–65 (2015).

<sup>57</sup> KRISTOPHER M. RENGERT & SHERRIE L. W. RHINE, BANK EFFORTS TO SERVE UNBANKED AND UNDERBANKED CONSUMERS 32 (2016),

[https://www.fdic.gov/consumers/community/research/qualitativeresearch\\_may2016.pdf](https://www.fdic.gov/consumers/community/research/qualitativeresearch_may2016.pdf).

<sup>58</sup> See BARADARAN, *supra* note 208, at 190–91; Baradaran, *supra* note 123; Mehrsa Baradaran, *It’s Time for Postal Banking*, 127 HARV. L. REV. F. 165, (2014); Mehrsa Baradaran, Opinion, *The Post Office Banks on the Poor*, N.Y. TIMES, Feb. 7, 2014, <https://www.nytimes.com/2014/02/08/opinion/the-post-office-banks-on-the-poor.html>; Mehrsa Baradaran, *Postal Banking’s Public Benefits*, 2 AMERICAN AFF. 18, (2018).

<sup>59</sup> CAMPAIGN FOR POSTAL BANKING, POSTAL BANKING: KNOW THE FACTS, <http://www.campaignforpostalbanking.org/wp-content/uploads/2015/05/KnowtheFacts.pdf> (last visited Feb. 28, 2019).

<sup>60</sup> OFFICE OF INSPECTOR GENERAL, PROVIDING NON-BANK FINANCIAL SERVICE FOR THE UNDERSERVED 2 (2014), [https://www.uspsioig.gov/sites/default/files/document-library-files/2015/rarc-wp-14-007\\_0.pdf](https://www.uspsioig.gov/sites/default/files/document-library-files/2015/rarc-wp-14-007_0.pdf).

<sup>61</sup> See, e.g., David Dayen, *The Post Office Should Just Become a Bank*, THE NEW REPUBLIC (Jan. 28, 2014), <https://newrepublic.com/article/116374/postal-service-banking-how-usps-can-save-itself-and-help-poor>; Randall K. Johnson, *How the United States Postal Service (USPS) Could Encourage More Local Economic Development*, 92 CHI.-KENT L. REV. 593 (2017).

Ricks, Crawford and Menand have proposed a Fed Accounts system, in which the Fed would offer accounts to all individuals by way of the post office.<sup>62</sup> Both Fed Accounts and public banking through the post office were considered in early drafts of the CARES Act.<sup>63</sup>

On the credit side, the Fed could operate as a public bank. A public bank need not be linked to the Fed, but given the history, capacity, and structure of the Fed, it is likely the institution best suited for such an endeavor. Public banking could remove banks as an intermediary in credit markets and offer direct services, including credit and transactional services. Policymakers already make decisions that affect the price of credit and the types of borrowers who are given subsidized loans. The federal government, for example, provides credit to the middle class for mortgages and student loans.<sup>64</sup> Under its legal mandate to boost the economy, the Fed has also provided unprecedented funds to banks through payments on reserves, QE, and other programs.<sup>65</sup> Yet the Fed has deferred to the banks to make lending decisions. A public bank can boost the economy directly by offering direct loans and direct accounts.

Public banking can take many forms. Like the public state bank of North Dakota, a federal public bank can finance large or targeted infrastructure projects by offering public bonds or using its flexible monetary policy mandate. For example, in my proposal for a 21<sup>st</sup> century Homestead Act, I have suggested that Fed financing can help close the racial wealth gap by purchasing abandoned and blighted properties in formerly redlined cities.<sup>66</sup> Other target projects might include roads, hospitals, rehabilitation facilities, public housing, and environmental cleanup projects.

These projects can be funded with a combination of Fed financing and Treasury guarantees, with a program profitable enough to invest in other sectors. Many such programs already exist. Infrastructure investment funds can issue investment shares through a securitized bond, which will be structured as fixed-rate, with variable terms between 5 to 20 years open to all investors. The bond can be

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<sup>62</sup> See MORGAN RICKS, JOHN CRAWFORD & LEV MENAND, CENTRAL BANKING FOR ALL: A PUBLIC OPTION FOR BANK ACCOUNTS 1 (2018), <https://greatdemocracyinitiative.org/wp-content/uploads/2018/06/FedAccountsGDI.pdf>.

<sup>63</sup> <https://theweek.com/articles/905207/need-send-people-money-need-fix-how>

<sup>64</sup> Rachel Fishman, *The Wealth Gap PLUS Debt*, NEW AMERICA (May 2018), [https://d1y8sb8igg2f8e.cloudfront.net/documents/Wealth\\_Gap\\_Plus\\_Debt\\_FINAL.pdf](https://d1y8sb8igg2f8e.cloudfront.net/documents/Wealth_Gap_Plus_Debt_FINAL.pdf).

<sup>65</sup> Mark Thoma, *Explainer: How Does the Fed Stimulate the Economy?*, CBS NEWS (Nov. 14, 2013), <https://www.cbsnews.com/news/explainer-how-does-the-fed-stimulate-the-economy/>; Kimberly Amadeo, *Quantitative Easing Explained*, THE BALANCE (Jan. 30, 2019), <https://www.thebalance.com/what-is-quantitative-easing-definition-and-explanation-3305881>.

<sup>66</sup> Mehrsa Baradaran, *A Homestead Act for the 21st Century*, THE GREAT DEMOCRACY INITIATIVE, 18-27 (2019) <https://greatdemocracyinitiative.org/wp-content/uploads/2019/05/Homestead-Act-050719.pdf>.

guaranteed by the Treasury, lowering the risk of investment and attracting much more private capital.<sup>67</sup> These investment funds can be structured much like the Export–Import Bank and other New Deal credit programs that became self-sustaining and even profitable. After a decade of initial funding through congressional appropriation, the Export–Import Bank and other credit programs have been self-sustaining, operating based on their own revenues.

The Fed can use a variety of methods modeled after existing stimulus programs. Over the past decade, the Fed has used its monetary policy tools and authority—including asset purchases, emergency loans, interest rate payments on bank reserves, and other unconventional and creative programs—to boost economic activity. However, while average real estate prices and stock market gains have recovered, the recovery has not been spread evenly. Specifically, the racial wealth gap and regional disparities have grown over the past decade. One reason for this inequality is that the Fed’s interventions have gone through banks as an intermediary. In order to spur development, lending, and investment, the Fed should bypass the middlemen and fund the development directly.

The Fed can also use its 13(3) powers to extend emergency loans to municipalities facing acute financial pressure.<sup>68</sup> When a city, state, or municipality is in a state of crisis, it does not get the same treatment from the Fed as failing banks do—and even as nonbanks do, like AIG in 2008 and Boeing and airlines in 2020. As economist Mike Konczal said, “it is hard to see why the failure of AIG or Bear Stearns was not acceptable, but the failure of financially-constrained governments to deliver basic public services to millions of Americans is.”<sup>69</sup> The Fed has the tools to rescue cities in crisis, alleviate the toll of financial exclusion and mortgage foreclosures, and spur economic revitalization where needed by buying public debt. As economist William Greider remarked, “Fed money is not exactly ‘free,’ but it has this great virtue for government: It doesn’t cost the taxpayers anything. Fed expenditures do not show up in the federal budget, nor do they add anything to the national debt.”<sup>70</sup> Konczal and J.W. Mason have suggested that the Fed can use its large portfolio of asset purchases acquired through QE investments to buy student debt. This intervention would likely do more and do it more directly than investing in bank-held mortgage-backed securities, which may or may not eventually lead banks to lend more.

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<sup>67</sup> See Konczal & Mason, *supra* note 141.

<sup>68</sup> <https://nextcity.org/daily/entry/the-feds-secret-superpowers-to-support-cities-through-covid-19-and-beyond>

<sup>69</sup> See Konczal & Mason, *supra* note 141.

<sup>70</sup> See William Greider, *Unusual and Exigent: How the Fed Can Jump-start the Real Economy*, LEVY ECON. NOTES ARCHIVE 13-08 (2013), [http://www.levyinstitute.org/pubs/pn\\_13\\_8.pdf](http://www.levyinstitute.org/pubs/pn_13_8.pdf).

For longer-term projects, the Fed can purchase bonds to fund student debt relief, close the racial wealth gap, address the opioid crisis, or target environmental recovery. The quick and robust response to the COVID-19 crisis showed the flexibility in Fed policy and the availability of funds when needed. We need not wait till the last minute to mobilize credit programs. Poverty, climate change, and housing are ongoing crises that fiscal and monetary policies can address now. Providing funds directly is a much more efficient way to meet the Fed’s goal of stimulating the economy.

Such public financing through the Fed will likely face political opposition. But the Fed has used its monetary policy mandate to stimulate the economy in unprecedented ways in the aftermath of a recession or in the midst of one—as we’ve seen in 2008 and 2020. Many communities suffer from a constant recession, but these communities are ignored because their crises are not as acute. Legally, these actions can be justified given the Fed’s original legislation; if necessary, new authorizing legislation can be written.

Fed action to promote inclusion and equality is justified within its dual mandate as specified by Congress and authorized under the law. The Federal Reserve Board and the Federal Open Market Committee are authorized to “maintain long run growth of the monetary and credit aggregates commensurate with the economy’s long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates.” Per section 14(b) of the Federal Reserve Act, the Fed is also authorized to buy and sell bonds issued by municipalities, states, or other instruments backed by the Treasury.<sup>71</sup> Moreover, section 13(3) allows the Fed to lend at a discount in an emergency.<sup>72</sup> This is the authority the Fed relied on for its extraordinary bailout provisions starting in 2008. Through longer-term lending at a fixed rate, the Fed can tailor credit facilities to support public financing programs according to communities’ residential and economic development needs. Due in part to the Fed’s credibility and market-stabilizing

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<sup>71</sup> LOUIS HYMAN, *DEBTOR NATION: THE HISTORY OF AMERICA IN RED INK* 71 (2011).

<sup>72</sup> See Federal Reserve Act, 12 U.S.C. §343 (1913). 3. Discounts for individuals, partnerships, and corporations: In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 14, subdivision (d), of this Act, to discount for any participant in any program or facility with broad-based eligibility, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal Reserve bank: *Provided*, That before discounting any such note, draft, or bill of exchange, the Federal reserve bank shall obtain evidence that such participant in any program or facility with broad-based eligibility is unable to secure adequate credit accommodations from other banking institutions. All such discounts for any participant in any program or facility with broad-based eligibility shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.



presence, establishing community development credit facilities could result in benefits that greatly exceed the actual volume of loans extended by the federal government to new homeowners.<sup>73</sup>

This is by no means an exhaustive list of financial redesign possibilities. Rather, the programs above are examples of what might be possible through creative financial redesign with a focus on equity.

Financial exclusion is a result of policy decisions that have centered bank credit as a principal means of access; financial redesign—not new technologies at the margins—can remedy the problem by changing the paradigm. Like moving from gold to silver, a change in the legal foundations of credit and financial policy can create a more just and equitable economy.

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<sup>73</sup> One obstacle is that the Fed is currently only authorized to purchase state and local government debt with a maturity date of less than six months. This law should be changed to enable the Fed to purchase long-term debt as part of a land trust owned by the Fed and state and city governments collectively. See Konczal & Mason, *supra* note 144.

## **ABOUT THE AUTHOR**

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