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Should California create a public bank?

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Nearly 200 local and national banks operate more than 6,500 branches in California. But lawmakers believe the state needs one more. A bill in Sacramento establishes a public bank with “a zero-fee, zero-penalty public option for basic financial services.”

Assembly Bill 1177, the California Public Banking Option Act, would create BankCal. BankCal would strengthen “the financial stability of the state’s most vulnerable residents,” “unbanked and underbanked,” who tend to be minorities, and “pay proportionally more for their financial services, lack secure means of saving, have fewer opportunities to build credit, and are rejected for loans at far higher rates.”

Assemblymember Miguel Santiago, AB1177’s author, says money saved by BankCal customers avoids “exorbitant fees” at retail banks and “could be used for food and rent or rebuilding from the economic devastation wreaked by the pandemic.”

Is Santiago, a Democrat from Los Angeles, at the cutting edge of an overdue banking revolution? Opinions vary.

“When the government owns the banks, lending decisions become increasingly driven by politics rather than economics,” the Cato Institute says.

It’s a valid concern. When government duplicates or replaces private businesses, the outcomes are undesirable except for those running the public programs, the politicians who instituted them and the chosen beneficiaries.

Think of Fannie Mae and Freddie Mac, the “quasi-public banks at the federal level,” says Mark A. Calabria, the Cato paper author. Their recent history “illustrates that mismanagement and corruption are alive and well at the intersection of the public and private.”

Public banks’ ability to provide credit to borrowers turned away by private banks is a common argument among supporters. It might be more bug than feature, though. Hester Peirce of George Mason University’s Mercatus Center pointed out that “the 2007-9 (banking) crisis demonstrated, encouraging lending to customers who cannot repay imposes terrible human costs.”

The “implicit government backing” private banks rely on to offset poor business decisions is already a taxpayer burden. It’s only a portion of the liability that would be generated by public bank losses.

But maybe we're not talking about a public institution at all. Trinity Tran, co-founder of the California Public Banking Alliance, denies that BankCal would be a government-owned bank. BankCalNow claims that AB1177 "does not create a new bank."

"Instead it creates a statewide retail banking option through which every California worker can access zero-cost financial services."

It's hard to defend these statements. While the word "charter" is nowhere in the bill's text, it does "establish the BankCal Fund in the state treasury" and "make moneys in the fund available upon appropriation by the Legislature."

It further says BankCal's board can "accept, for deposit to the program fund, any grant, gift, legislative appropriation or other moneys from the state, a unit of federal, state or local government."

As Chime, Ally, and other online services have demonstrated, banks don't need four walls to be a bank. Nor does BankCal have to be perfectly modeled on traditional public banks.

Should AB1177 become law, California would not be the leader in public banking. North Dakota has a state-owned, state-managed bank. It's no pioneering enterprise, but rather a relic of antiquity. Public financial institutions such as the Bank of North Dakota were common in the 1900s, and "they all failed miserably," says Calabria, "and at great expense to the taxpayer."

And of course, "they were also magnets for corruption."

Two years ago, a task force compiled a "thoughtful analysis of the financial costs and benefits of creating a municipal bank" in San Francisco. It did generate some startling numbers.

Depending on the model chosen, it would take between 10 to 56 years for a city bank to break even. It estimated that startup costs, operational subsidies, and capital investments – depending on the model chosen would be $184 million, $1.6 billion or $3.9 billion.

Lawmakers should look hard at both sides of the cold, hard ledger sheet. Just in case one side doesn't add up.