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Is the proposed Municipal Bank of Los Angeles a good idea?

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Last week, the Los Angeles City Council's Economic Development and Jobs Committee approved a motion in support of the Municipal Bank of Los Angeles. It is a bad idea.

Supporters confuse lending with spending. The bank is supported by a variety of special interest groups – but there is no transparency. No information about funding for Public Bank LA – the organization promoting the idea — is available.

Labor endorsements for the Public Bank of Los Angeles are a red flag. According to Public Bank LA, union support includes: the Los Angeles County Federation of Labor, the United Food and Commercial Workers (UFCW) Local 770 (which represents grocery and retail workers), and UNITE HERE Local 11 (which represents workers in hotels, restaurants, and airports).

One can only conclude that unions anticipate influence over the final funding guidelines – perhaps borrowers will be required to pay union wages. This will preclude funds going to small inner-city businesses that many supporters of the bank imagine it will help and it would have the effect of crowding low skilled workers out of jobs.

In February, Public Bank LA held a virtual Town Hall to rally supporters. The Town Hall revealed that supporters have no idea of what a public bank could or would do.

President of SEIU 721 Bob Schoonover expects the bank to fund critical city services, including clean drinking water, and to improve healthcare and access to childcare in the city. Beverly Roberts, ACCE Action and Home Defenders League, was eager to see bank money used for "rental assistance, affordable housing, and housing services." She noted that a public bank "will allow funds to be allocated to low and very low-income communities."

Both Roberts and Councilmember Monica Rodriguez expect bank lending to mitigate the pain and tragedy associated with bank foreclosure and the "endless cycle of payday lenders." Susie Shannon, policy director at Housing is a Human Right, said that community investments on the part of the public bank will serve the unhoused.

This is spending not lending. A bank can only survive if it makes loans that are repaid. It cannot serve as a pot of money to be used to help people in dire straits. If enthusiasm about projects related to community improvement results in an inappropriate assessment of risk, public bank lending will lead to defaults and insolvency.

The last attempt at community banking in Los Angeles – the Los Angeles Community Development Bank – failed in 2004 because borrowers did not pay back loans. Credit officers at the not-for-profit bank lacked incentives to monitor loans on an ongoing basis. Not only was the bank encouraged to favor politically connected borrowers, but the bank was actively encouraged to fund ill-conceived, high-risk projects.

The Valley Economic Development Center (VEDC), a community development financial institution (CDFI) located in Los Angeles, promoted its efforts with annual events to highlight its successes. Yet it was forced to file for bankruptcy in July 2019. According to Councilmember Rodriguez, VEDC "ran off with millions in resources that should have been reinvested in small businesses."

At the LA Public Bank Town Hall Rodriguez said the public bank would direct money to "investments in people, infrastructure, that will create local jobs." Yet, studies of similar efforts as part of California's Enterprise Zones found the program failed to create jobs.

The expectations of the supporters of Public Bank LA are unrealistic and uninformed. What is most troubling is that members of the city council support the effort. Perhaps this is because they will be out of office when the loans come due.

Shirley Svorny is professor of economics emeritus at California State University, Northridge, and an adjunct scholar at the Cato Institute. Her article, co-authored by Robert Krol, "The Collapse of a Noble Idea," explained the failure of the Los Angeles Community Development Bank. It was published in the journal Regulation in 2004-05.