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If the U.S. Government Treated Poor People as Well as It Treats Banks

A proposal: Transform underused post offices into public banks that would bail humans out of financial emergencies.

Stefan Wermuth / Reuters

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One of the great ironies in modern America is that the less money you have, the more you pay to use it. The country's "unbanked" must pay high fees to fringe banks to turn their paychecks into cash, pay their monthly bills, or send money to a spouse or a child. The unbanked pay much of their income —up to 10 percent—just to use their money. For these families, the total price of simple financial services each month is more than they spend on food. Indeed, it is very expensive to be poor.

This problem, however, reaches well beyond those traditionally considered poor. More than 70 percent of Americans consider themselves "middle class," yet anywhere from 20 to 40 percent of the population must rely on check cashing or payday lending services. And the tragedy of money being siphoned from the paychecks of ordinary Americans is the least egregious part of a much larger problem. Sometimes, those who live paycheck to paycheck face an unexpected emergency. Over half the people in the United States are so cash-strapped that they would not be able to access $400 without selling something or borrowing money. The need to borrow to deal with emergencies—often at very high interest rates—adds another layer of financial strain on those least able to bear it.

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For example, Thelma Fleming, a mother of three children and a grandmother of 10, lost one of her two jobs. To survive, she emptied her bank accounts, gave up her car, and pawned some of her possessions, including gifts from her grandchildren. When she still needed an extra $300 to cover monthly expenses, she went to a payday lender, who lent her the money at 300 percent interest. She would eventually take out five loans to buy the time she needed to pay off the original $300. In the end, she had paid $2,500 in interest over the course of 10 months in order to borrow just $300.

Stories like Fleming's are quite common. Most payday loans are followed by at least another loan but often another 10 payday loans. This cycle of debt is an obvious problem, but the very existence of the fringe banking sector is a symptom of something deeper.

Consider another story. Steven Thomas earned great money before the financial crisis, but he had made some investments that all started to go bad during the crisis. From one day to the next, Thomas couldn't pay his daily expenses. Despite his best efforts, he was headed for financial ruin. He was confident he could get back on his feet if someone would just help him survive this short-term financial emergency. Luckily, he found a miracle lender who would make generous loans and charge him an exceptionally low rate—the lender happened to feel that it was in its best interest for Thomas to avoid bankruptcy, so it was willing to ignore the obvious credit risk he posed.

This is a true story, but Steven Thomas is not a real person. He represents the largest American banks, and that miracle lender is the federal government. Why is it that Thelma Fleming and Steven Thomas are treated so differently?

This inequality is not inevitable and cannot be chalked up to the basic economic laws of supply and demand, which require a higher cost of credit for the average person than the average bank. Both Fleming and the banks should have failed, according to market rules, but the government intervened on the banks' behalf. In the United States, the banking market does not operate according to standard market rules.

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The truth, though, is that the source of Fleming's loans is the same as the banks'—only the banks got it for practically nothing, and Fleming got it bundled with life-crushing interest. Payday lenders, which consist of a handful of large corporations, get their loans from the largest commercial banks at low interest. These banks, of course, get most of their credit through customer deposits and the federal government. Even their use of consumers' deposits, for which they pay virtually nothing, is made possible by an insurance scheme backed by the full faith and credit of the federal government. Banks also receive direct Federal Reserve money at a cool 1 percent interest, not to mention "discount window" loans, which help banks survive a credit crunch.

The difference between a bank and an individual is that when a bank can't pay its bills on time, the Federal Reserve gives it a short-term loan, so it can survive without having to sell off any assets. In this way, banks are unlike most businesses, which can't rely on other people's money or cheap loans when they can't make ends meet.

And that's just the beginning. None of this takes Steven Thomas's loan—aka the government bailout—into account. In the aftermath of the financial crisis, the federal government pumped trillions of dollars into a failing banking industry with equity infusions, loans, guarantees, asset purchases, and other forms of financial support. This help arrived on very favorable terms with interest rates not available to the rest of the market. The arrangement was so good, the CEO of one of the largest bailed-out banks saw the terms of the deal and remarked, "This is very cheap credit!"

The two presidents who administered the bailouts, George W. Bush and Barack Obama, made it clear that the state must support the banking system, for if the banks collapsed, so too would the American public. In their telling, the banks and the people were one—the nation must lend to banks so that they can lend to the nation. This codependency is not always made clear, but the justifications given for the bailouts brought this crucial relationship into sharp focus. Many describe modern banks as private enterprises, but this conceals their true nature. To be sure, individual banks are private companies, but each of these private banks sits atop a foundation of state support. In discussing the bailout of 2008, Bank of America's CEO, Ken Lewis, made this key point well: "We are so intertwined with the U.S. that it's hard to separate what's good for the United States and what's good for Bank of America . . . they're almost one and the same."

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Yet this depiction of unity between the banks and the people could not be further from the truth. If everyone is in this together, why must such a large segment of the public be left to modern-day loan sharks? The Wall Street crisis cannot be "an American crisis," as Barack Obama called it in 2008, if its remedy means that unprecedented federal support goes to a banking system that has effectively shut out much of the population. The truth is that government-supported banks serve the well off, and a Wild West of fringe lenders and check-cashing joints answer the needs of everyone else, at a hefty price.

This is not merely an economic problem; it undermines democracy. Presidents and bankers alike are claiming unity amidst obvious disparities. A banking system supported by the people must serve all the people—not merely a subset.

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The fight for equality in banking, which started before the ink dried on the Constitution, ended sometime in the last few decades, as deregulation did away with most meaningful attempts to restrict banks' power. What eventually happened was predictable: Banks became large and powerful and served the sectors of the population that best served their business interests. Instead of resisting, politicians pushed laws favoring bank profitability and efficiency over public needs. Any suggestion that banks should be forced to lend to less profitable borrowers was seen as an intrusion into a private market, and the accumulated power of banks has become harder to dislodge.

When commentators discuss the era of deregulation, they tend to focus on the creation of too-big-to-fail financial giants and their size, power, and riskiness. No less consequential, however, was the loss of banking services for average people. For much of U.S. history, the answer to banking for the poor—whether the rural farmer or the working-class city dweller—was local and community-controlled credit. Local banking institutions, such as credit unions and savings and loans, were supported by the government and enlisted to meet the clear-cut mission of lending to the poor.

Eventually, though, these institutions failed because after deregulation, they couldn't compete with larger, better-funded, and more diverse financial institutions. Once community banks left the scene, fringe lenders filled the void. As long as half the population needs to borrow money to deal with emergencies, and the banks won't or can't lend to them, the payday industry will remain vibrant. It has made policymakers, the media, and the public deeply uncomfortable since it arose, despite the industry's assertion that its rates are justified by market prices. In fact, though, they are not charging market prices, but the highest interest rates allowable by law.

Federal and state governments have engaged in a frustrating game of whack-a-mole to ban the unscrupulous practices of payday lenders and the like. These lenders skillfully avert new rules by creating new products, crossing state lines, or escaping to do business from Native American reservations.

They cannot be regulated away because the payday lending industry is doing what any successful business does: fill a market need.

There is a solution, though: a central bank for the poor. The core function of the Federal Reserve, the U.S.'s central bank, is to infuse liquidity into troubled banks so that they can withstand temporary credit crunches and get back on their feet. A public version of this would provide the same short-term credit help to individuals so that they, too, can withstand a personal credit crunch and get back on their feet. Indeed, in the modern banking landscape, only a large, liquid lender is able to lower the costs of lending to the poor. The federal government is in a unique position to lend to the poor and cover its costs without having to answer to shareholder pressure to maximize profits. Economies of scale and government backing can be used to bring down the costs of lending to the poor.

One way the federal government might do this is through the existing U.S. Postal Service structure. In fact, postal banking was the largest and most successful experiment in financial inclusion in U.S. history and remains the primary tool for financial inclusion across the world. The basic idea of modern postal banking is a public bank offering a wide range of transaction services, including financial transactions, remittance, savings accounts, and small lending. These institutions would remain affordable because of economies of scale and because of the existing postal infrastructure in the U.S. Plus, in the absence of shareholders, they would not be driven to seek profits and could sell services at cost.

A public option in banking would balance the scales of government support for the banking industry and could potentially drive out the usurious fringe-lending sector, which profits from Americans' financial woes. There are millions of individuals whose otherwise stable financial lives can be upended by one unexpected event that snags them in an otherwise temporary liquidity crunch. These people, like Tanya Fleming, should be deemed creditworthy—at least as creditworthy as Steven Thomas.

This article has been adapted from Mehrsa Baradaran's book, How the Other Half Banks: Exclusion, Exploitation, and the Threat to Democracy.

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