Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

September 20, 2022

Public Banks: History and Recent Proposals

Overview of Public Banks

Banks are generally private enterprises chartered by state or federal regulators for the purposes of accepting deposits and making credit available to the communities they serve. As profit-seeking businesses, banks' motivations do not necessarily align with certain public policy goals. Policymakers use regulation and guidance to align some of banks' motivations with public interest.

For example, banks use deposits as a funding source for their lending. They may be indifferent to accepting deposits from various communities, but certain banks may prefer to lend only to affluent areas. The Community Reinvestment Act was enacted to ensure that banks lent to the communities from which they took deposits. Sometimes, the private sector may simply be unwilling to make credit available to certain markets or to offer deposit accounts to certain customers. To take another example, agricultural lending can be risky because of the unpredictable nature of weather patterns and crop yields, which impact borrowers' ability to make payments. Further, banks may be unwilling to open bank accounts for certain customers because the cost of due diligence is sufficiently high that it may not be profitable for them. In these examples, public policy goals of supporting domestic food markets and encouraging bank account access could be at odds with private market motivations.

One potential policy option to address certain issues would be for policymakers to establish a *public bank*, which would be chartered to serve in the interest of public policy goals not being met in the private sector. This In Focus discusses the potential role of public banks, including institutions that are wholly or partially owned by the government. It also discusses certain financial institutions chartered by the government with limited purposes tailored to achieving certain social policy goals.

History of Public Banks

Pre-1900 Public Banks, Since Closed

Following the economic struggles after the Revolutionary War, Alexander Hamilton—then Treasury Secretary—submitted a plan to Congress to charter a national bank to issue paper money, provide depository services, and offer banking facilities for commercial transactions, as well as to act as the government's fiscal agent. In 1791, Congress passed a bill that led to the First Bank of the United States. The charter lasted 20 years and was allowed to expire in 1811, rooted in fears, among other reasons, that a central banking system would crowd out a growing private banking industry. In 1816, following another economic turndown, Congress chartered a second national bank to provide relief for the country's economic woes and prevailing war debt. However, by 1832, President Jackson's distrust of a national bank led to an executive order to withdraw federal funds from the second national bank, and political infighting foreshadowed the institution's demise. In 1836, Congress did not renew the charter for the Second Bank of the United States, opening the door for states to start their own banks. For example, Alabama, Kentucky, Illinois, Vermont, Georgia, Tennessee, and South Carolina all created banks that were owned by the state government. Missouri, Indiana, and Virginia also had banks with the state holding a majority interest, and a number of states created banks with the state owning a minority interest. Other states, such as Louisiana, were active in chartering private institutions that focused on public policy goals such as building railroads and canals. However, the financial panic of 1837 and other issues led state-owned banks to struggle and ultimately close. Further, the National Banking Acts of 1863 and 1864 created a new national banking system, where privately owned banks could issue notes backed by Treasury bonds. In 1865, Congress enacted further measures to tax state bank notes, ushering in an era of federally chartered private banks. By 1900, most of these state public institutions had closed. One notable exception was the Delaware Farm Bank, of which the state of Delaware owned a 49% share from 1800 to 1975. The state increased its ownership to 80% in 1976. However, the bank encountered significant financial stress, and by 1981 it was acquired by a private bank in Pennsylvania.

Bank of North Dakota, 1919-Present

During the early 1900s, agriculture drove North Dakota's economy. Growing seasons were constantly jeopardized by drought and harsh winters, and private banks began to raise interest rates on farm loans, complicating access to financing vital to the industry. In 1919, the state legislature established the Bank of North Dakota (BND) "for the purpose of encouraging and promoting agriculture, commerce, and industry." BND is one of two currently operating public banks. It is operated, managed, and controlled by an industrial commission composed of the state governor, agriculture commissioner, and attorney general. The governor appoints an advisory board of directors comprising seven bank officers from private banking institutions generally owned by North Dakota residents. Today, the North Dakota legislature appropriates funds from BND when needed through the budget process or state law. All funds earned by the state (i.e., funds from penal institutions and educational institutions) must be deposited in BND. Deposits do not have federal deposit insurance but are guaranteed by the state and are exempt from state, county, and municipal taxes.

Generally, BND is empowered to make, purchase, guarantee, or hold loans to and for a range of borrowers and purposes, including state-chartered and federally chartered lending institutions as well as other financial institutions and certain farmers who are residents of the state. BND can also make agricultural real estate loans in order to participate in the secondary market, similar to how government-sponsored enterprises such as the Farm Credit System work. Further, BND can establish an electronic fund transfer system for its customers and serves as the custodian for all securities required to be deposited with the state except those the treasurer is explicitly responsible for. Most of BND's lending is done in partnership with local banks and credit unions. About two-thirds of the bank's $4.7 billion loan portfolio consists of commercial and agricultural loans, and a quarter of its loans are student loans. The rest are residential loans.

Territorial Bank of American Samoa, 2016-Present

In the early 2000s, the territory of American Samoa faced a considerable withdrawal of bank services, which was further exacerbated when the Bank of Hawaii—the last remaining domestic bank in the territory—announced its intentions to close its operations there in 2012. (The bank agreed not to fully cease operations until suitable alternative financial services were established.) In 2016, the American Samoa government established a public bank, the Territorial Bank of American Samoa, which provided basic banking services to its citizens and remains one of the only options for domestic banking services in the territory. While the public bank has been considered a success, it is ineligible for federal deposit insurance, and this has sparked debate over whether or not it should be privatized to give its citizens access to deposit insurance.

Other Public Bank Proposals

From 2010 to 2012, several states—including Washington, Oregon, Vermont, Maine, Massachusetts, and Hawaii—conducted separate studies on the potential benefits and feasibility of establishing public banks to help stabilize the economy in the wake of the 2007-2009 financial crisis, serve small business lending goals, and support community banks. While some of these studies identified potential benefits to establishing a public bank, the costs of doing so and the limited evidence for widespread profitability contributed in part to each state resisting any formal policy development.

In 2018, the California state treasurer noted that in light of the state recently legalizing the marijuana industry, California would study the potential benefits and issues with setting up a state-owned bank to service the cannabis industry, which faced challenges accessing financial services due to federal prohibition. In 2019, the California state senate approved a bill to create limited-purpose state-chartered cannabis banks to help cannabis companies get around restrictions on access to banking services. Under the state legislation, private banks or credit unions would have been able to apply for a limited-purpose state charter so they can provide depository services to licensed cannabis businesses. The bill did not pass the California state assembly. However, in 2020, California enacted a law that provided safe harbor for private banking institutions doing business with cannabis companies that are legally licensed in the state.

In 2019, California enacted a law to study how city-run banks would work and enacted another in 2020 to examine state-run banks, particularly with an aim toward supporting access to financial services among the unbanked. The analyses are due to be completed in 2024, after which the legislature is supposed to vote on whether to launch the banks. Cities in California, such as San Francisco and Los Angeles, have also considered establishing municipal banks.

Federal Reserve/Fed Accounts

With the rise of private digital currencies, such as Bitcoin, some have called for the Federal Reserve (Fed) to create a central bank digital currency (CBDC). This technology, if implemented, could facilitate personal accounts held at the Fed, giving consumers an alternative to banking with private institutions. One potential benefit of this could be that consumers who struggle to maintain access to affordable financial services might be able to obtain them from accounts held directly at the Fed. Policymakers have debated whether individuals should be able to store CBDCs in personal accounts at the Fed.

Postal Banks

Somewhat similar to a Fed account is the concept of a bank account held at a local post office. Over the past several years, legislative (see, for example, S. 3891 in the 117th Congress) and policy proposals have been introduced on how and whether postal banks could address financial access issues. The Postal Service has physical locations in most neighborhoods, giving populations where access to financial services is geographically scarce—such as in rural areas—a potential option for basic depository services. Some advocates suggest that the Postal Service could extend credit at more affordable rates than private banks could. The costs and efficacy of these proposals continue to be debated.

Government-Sponsored Enterprises (GSEs)

Congress has long used its ability to charter institutions to influence financial markets. For example, after the Civil War, Congress chartered a bank to provide newly freed slaves with depository accounts. In 1916, Congress chartered the Farm Credit System to ensure access to credit for the agricultural industry. And perhaps most recognizable today is the set of housing GSEs that Congress established in the decades following the Great Depression. Fannie Mae and Freddie Mac—still in conservatorship by the Federal Housing Finance Agency since the 2007-2009 financial crisis—as well as the Federal Home Loan Bank Board, were chartered to support lending in housing markets.

Andrew P. Scott, Analyst in Financial Economics

IF12216

Disclaimer