Public Banking as an Institutional Design Project

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This Article offers a conceptual framework for analyzing public banking as an institutional form of finance. It examines the key elements of design of a public bank as a financial institution—its core functions, sources of funding, asset structure, and governance framework—and highlights the opportunities and challenges presented by various choices along these dimensions. By isolating a series of pivotal decision points, the Article constructs a basic roadmap for designing a public entity capable of delivering the desired set of public benefits. To maximize these benefits on a system-wide level, the Article calls for a new approach to institutional design that would expand policymakers' focus to the larger project of creating an ecosystem of public interest-oriented finance.

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Introduction

In the last hundred years, the United States has gone through three major banking crises: the Great Depression of the early 1930s, the savings and loan ("S&L") crisis of the 1980s, and the Global Financial Crisis of 2008-09. The clustered failures of Silvergate Bank, Signature Bank, and Silicon Valley Bank ("SVB") in March 2023 might have triggered the fourth systemic banking crisis were it not for the swift government action stemming the broader market panic.[1] Like every fully unfolded financial disaster before it, however, this mini-crisis exposed the disconcerting truth about banking business: in good times, it is run for private profit by private firms, but, in bad times, it becomes a direct public responsibility and a public expense.

There is a familiar explanation for why this happens. In the modern exchange-based economy, an uninterrupted flow of safe money and credit is a necessary background condition and, in that sense, a critical public good. When private banks are unable to maintain the safety and stability of money and credit flows, the government must step in and, in one form or another, absorb privately generated losses and guarantee privately issued obligations. This recurring practice of privatizing gains and socializing losses in the banking sector is deeply problematic in many respects. It creates perverse private incentives, undermines the integrity and efficiency of financial markets, and chips away at the government actors' credibility. Politically salient bank rescues are therefore usually accompanied by policymakers' vows to end government bailouts—a lofty goal that remains elusive.[2] As the SVB crisis shows, even the sweeping regulatory reforms enacted by Congress in response to the Global Financial Crisis have not changed the familiar dynamics of banking: it is still a private prerogative when the business is good—and a public burden when the business is bad.

So, why not make banking a public business in good times as well? If putting the full faith and credit of the sovereign public on the line is the only way to guarantee the safe and steady flow of money and credit when markets are gripped by fear, why not make this connection explicit when markets are calm?

There are many reasons to make public banking a permanent feature of our financial landscape. Unlike private firms, public banks lack the internal business motivation to engage in privately lucrative high-risk activities or otherwise abuse the public trust to maximize their sharehold-

1. *See* Emily Flitter & Rob Copeland, *Silicon Valley Bank Fails After Run on Deposits*, N.Y. TIMES (Mar. 14, 2023), https://www.nytimes.com/2023/03/10/business/silicon-valley-bank-stock.html [https://perma.cc/HA76-ARJM].

2. *See* Anna Gelpern, *Financial Crisis Containment*, 41 CONN. L. REV. 1051, 1053-54 (2009).

ers' returns. Their principal mission is to provide broad access to money and credit as a critical public service in support of the nation's economy. This defining public interest orientation renders public banks indispensable both as safeguards of systemic stability and as institutional pillars of a democratic economy. As separately constituted delivery channels for essential banking services, public banks can insulate society from excessive exposure to risks generated in private financial markets and ensure that no American is denied basic rights to economic participation. Not driven by private profit, public banks are well-positioned to act as an essential market-stabilizing force, a network of countercyclical credit providers that can keep the economy afloat during crises. For these fundamental reasons, public banking should be seen as a vital structural element of a truly efficient and resilient modern-day financial system.

Public banking is not as radical or as novel an idea as it may sound; it has a long and varied history that spans multiple countries and generations.[3] In the United States, where the Bank of North Dakota ("BND") is currently the only operating state-owned bank,[4] the interest in public banking surged in reaction to the speculative excesses and social injustices exposed by the Global Financial Crisis.[5] The slow and uneven post-2008 recovery, decaying public infrastructure, growing environmental problems, and continuing exclusion of millions of ordinary Americans from the financial system further fueled that interest, spurring the emergence of various public banking initiatives and advocacy groups. These include the Public Banking Institute,[6] the California Public Banking Alliance,[7] the Alliance for Democracy,[8] Public Bank LA,[9] Public Bank NYC

3. *See, e.g.*, William Roberds & Francois R. Velde, *Early Public Banks*, (Fed. Rsrv. Bank of Chi., Working Paper No. 2014-03, 2014), https://www.chicagofed.org/publications/working-papers/2014/wp-03 [https://perma.cc/Z9HV-MNBF]; ELLEN BROWN, THE PUBLIC BANK SOLUTION (2013); ANDREW P. SCOTT, CONG. RSCH. SERV., IF12216, PUBLIC BANKS: HISTORY AND RECENT PROPOSALS (2022), https://crsreports.congress.gov/product/pdf/IF/IF12216 [https://perma.cc/UMA9-B6WB].

4. *See History of BND*, BANK OF N.D., https://bnd.nd.gov/history-of-bnd [https://perma.cc/E3NB-23WJ]. Outside of the continental United States, the Territorial Bank of American Samoa was established in 2016. *See Territorial Bank of American Samoa Details its Origins*, SAMOA NEWS (Sept. 19, 2016), https://www.samoanews.com/local-news/territorial-bank-american-samoa-details-its-origins [https://perma.cc/2SK7-3UYP].

5. Esra Nur Uğurlu & Gerald Epstein, *The Public Movement in the United States: Networks, Agenda, Initiatives, and Challenges* 3 (Pol. Econ. Rsch. Inst., Working Paper No. 538, 2021), https://scholarworks.umass.edu/cgi/viewcontent.cgi?article=1247&context=peri_workingpapers [https://perma.cc/9TBR-EXTN].

6. *See About Us*, PUB. BANKING INST., https://publicbankinginstitute.org/about-us [https://perma.cc/9RAT-HQMJ].

7. *See* CAL. PUB. BANKING ALL., https://californiapublicbankingalliance.org [https://perma.cc/B2SF-6PFP].

8. *See Creating the New Economy: Public Banking*, ALL. FOR DEMOCRACY, https://www.theallianceforedemocracy.org/public-banking.html [https://perma.cc/4V9K-VRU2].

9. *See About US*, PUB. BANK LA, https://www.publicbankla.org/about/about-us [https://perma.cc/KRM3-V385].

Coalition,[10] and many other state- and city-level organizations whose collective efforts led multiple states to propose legislation to create public banks.[11] The COVID-19 pandemic gave the movement a renewed sense of urgency as it brought into sharp relief the human and societal cost of the private-profit-driven banking system's business priorities.[12] Today, the push for public banking reflects a much broader ambition than ensuring financial stability and ending bank bailouts. In many American states and cities, grassroots activists are "working to reclaim public money and redirect its flow, moving away from a profit-based system towards one centered on civic needs and equitable, sustainable economic development."[13]

10. *See Public Bank NYC*, NEW ECON. PROJECT, https://www.neweconomynyc.org/our-work/campaigns/public-bank-nyc [https://perma.cc/3HZB-YATA].

11. For a list of pending legislation, see *Legislation by State*, PUB. BANKING INST., https://publicbankinginstitute.org/legislation-by-state [https://perma.cc/JLP8-MPU2]. California has made some progress. In October 2019, Governor Newsom signed into law Assembly Bill 857 authorizing the creation of up to ten municipal public banks. *See* Assem. Bill 857, 2019-2020, ch. 442, 2019 Cal. Stat., https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB857 [https://perma.cc/3CET-L6Q5]. In October 2021, Governor Newsom signed the Public Banking Option Act establishing a special commission to study feasibility of public provision of free financial services to unbanked and underbanked Californians. Assem. Bill 1177, 2021-2022, ch. 451, 2021 Cal. Stat., https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202120220AB1177 [https://perma.cc/P67F-G8W7].

12. During the COVID-19 pandemic, when the lack of access to basic banking services put the most vulnerable Americans at a much higher risk, private banks often compounded the problem by mishandling the disbursement of government aid. *See, e.g.*, Press Release, Consumer Fin. Prot. Bureau, Federal Regulators Fine Bank of America $225 Million Over Botched Disbursement of State Unemployment Benefits at Height of Pandemic (July 14, 2022), https://www.consumerfinance.gov/about-us/newsroom/federal-regulators-fine-bank-of-america-225-million-over-botched-disbursement-of-state-unemployment-benefits-at-height-of-pandemic [https://perma.cc/EYQ7-U4QU]. As the households' and businesses' demand for low-cost credit spiked, banks rationally prioritized their own survival. *See, e.g.*, DAVID W. PERKINS. ET AL., CONG. RSCH. SERV., R46422, COVID-19 AND THE BANKING INDUSTRY: RISKS AND POLICY RESPONSES 1-3 (June 18, 2020), https://crsreports.congress.gov/product/pdf/R/R46422 [https://perma.cc/N23F-ZQSK] (describing the banking industry's vulnerabilities and the federal regulators' efforts to encourage banks to help borrowers in distress) For a critical analysis of U.S. banks' performance during the COVID-19 pandemic, see Graham S. Steele, *The Tailors of Wall Street*, 93 U. COLO. L. REV. 993 (2022). By contrast, the BND, the country's only publicly owned bank, proactively and effectively provided emergency credit relief and support for the state's student-borrowers and small and large businesses. *See* Cinnamon Janzer, *In North Dakota, Student Loan Borrowers Can Defer Payments Until October*, U.S. NEWS & WORLD REP. (Apr. 14, 2020), https://www.usnews.com/news/best-states/articles/2020-04-14/bank-of-north-dakota-defers-loan-payments-for-6-months-amid-coronavirus [https://perma.cc/9CP2-M3EH]; THOMAS MAROIS, PUBLIC BANKS: DECARBONISATION, DEFINANCIALISATION AND DEMOCRATISATION 264-66 (2021). Recognizing these realities, in October 2020, Representatives Alexandria Ocasio-Cortez and Rashida Tlaib introduced the Public Banking Act, H.R. 8721, 116th Cong. (2020), which sought to enable the creation of state and local public banks as a "much-needed financial lifeline" to communities in need. Press Release, Alexandria Ocasio-Cortez, Tlaib, Ocasio-Cortez Introduce Legislation Enabling Creation of Public Banks (Oct. 30, 2020), https://ocasio-cortez.house.gov/media/press-releases/tlaib-ocasio-cortez-introduce-legislation-enabling-creation-public-banks [https://perma.cc/5HDT-LR4B].

13. Trinity Tran, *Transcending Finance with Public Banking*, IFTF INSIGHT (Apr. 20, 2023), https://www.iftf.org/insights/transcending-finance-with-public-banking [https://perma.cc/V88H-S6VL].

But what would this new order look like in practice? How would a public bank fulfill its public interest-oriented functions in a private-profit-based economic system? These are critical questions that require clear—and clear-eyed—answers before public banking in the United States becomes economic and political reality.

Perhaps unsurprisingly, there is currently a great diversity of views on what public banks should—or could—do and how they should be organized, financed, and managed. Even the term "public bank" has multiple meanings, depending on the context and the purpose for which it is used. Public banking initiatives and activists typically envision a publicly owned bank that operates along the same lines as a private commercial bank, taking deposits and making loans—but on terms that would make these services widely available and affordable in their own communities. In this role, a public bank is meant to act as the dedicated financial hub for the unbanked and underbanked populations, underserved businesses, and local government entities that currently use high-cost private financial services.[14] Importantly, this conception of a public bank also often includes investing in currently underprovided social services and public infrastructure.[15]

The latter function, in turn, is the principal focus of public infrastructure and "green" bank advocates, who envision these institutions acting more like public investment funds than traditional banks.[16] In fact, the bulk of what has been written about public banking in recent years is centered on publicly owned investment and development banks, a well-established but highly specialized group of entities currently operating in many countries around the world.[17] In line with the international experience, proposals to create a similar institution in the United States typically do not contemplate direct provision of deposit services or consumer credit, which is so central to the idea of a public bank as a means of

14. *See, e.g.*, *Why Los Angeles Should Start a Public Bank*, PUB. BANK LA, https://www.publicbankla.org [https://perma.cc/XB4L-WHN4] (describing the purposes and functions of public banking).

15. *See id.* ("The Los Angeles Public Bank will leverage its deposit base and lending power to benefit LA residents with affordable housing, small business loans, modernization of public infrastructure, and other community needs.").

16. For up-to-date information and resources on U.S. "green" banks, some of which are already operating in several states, see COALITION FOR GREEN CAP., https://coalitionforgreencapital.com [https://perma.cc/H753-4YCJ]. *See also Green Banks*, U.S. ENV'T. PROT. AGENCY, https://www.epa.gov/statelocalenergy/green-banks [https://perma.cc/2Q3D-M5Y5].

17. For a small sample of this voluminous literature, see generally DEVELOPMENT AND PUBLIC BANKS (Stephany Griffith-Jones, Regis Marodon, Louis-Philippe Rochon & Jiajun Xu eds., 2022); THE REINVENTION OF DEVELOPMENT BANKING IN THE EUROPEAN UNION (Daniel Mertens, Matthias Thiemann & Peter Volberding eds., 2021); THE FUTURE OF NATIONAL DEVELOPMENT BANKS (Stephany Griffith-Jones & Jose Antonio Ocampo eds., 2018); PUBLIC BANKS IN THE AGE OF FINANCIALIZATION: A COMPARATIVE PERSPECTIVE (Christoph Scherrer ed., 2017).

providing universal access to affordable financial services—and thus democratizing finance, in the most immediate sense.[18]

The multitude of roles that public banks play, or can play, in a modern economy is what makes public banking an attractive and potent policy tool. But it can also create unnecessary fragmentation and even confusion in the debate on public banking. The malleability of this form heightens the need for a careful and targeted approach to designing specific institutions serving specific public purposes. Each of the core functions that a public bank is commonly expected to perform—deposit-taking, lending, and investment—raises its own issues and creates its own opportunities and constraints. A clear understanding of these issues, constraints, and opportunities is critical to designing an effective institution capable of fulfilling its mission.

The purpose of this Article is to develop a conceptual framework for a better, more granular, understanding of public banking as an *institutional form* of finance. It seeks to fill a critical gap in the voluminous and empirically rich academic literature on the subject, which consists overwhelmingly of case studies and comparative cross-country analyses of various public banks' organizational histories and operational records. The sheer diversity of structures, experiences, and circumstances covered in these studies makes it inherently difficult to draw theoretically generative yet sufficiently concrete conclusions and recommendations. In the United States, progressive legal scholars have recently begun re-engaging with the idea of public banking, mainly through the broader lens of public options[19] or (less directly) public interest-driven financial regulation.[20] While explicitly prescription-oriented, this literature has not yet articulated a clear framework for understanding what drives the differences

18. For an overview of recent policy proposals to establish a U.S. public investment entity, see Aaron Cantrell, *A United States Public Investment Institution*, FUTURE NEXUS (June 2021), https://www.futurenex.us/wp-content/uploads/2021/06/US-Public-Investment-Institution-Final-June-2021.pdf [https://perma.cc/5TAQ-7D3Y].

19. For recent analyses of public options in banking as a matter of democracy and inclusion, see generally GANESH SITARAMAN & ANNE L. ALSTOTT, THE PUBLIC OPTION: HOW TO EXPAND FREEDOM, INCREASE OPPORTUNITY, AND PROMOTE EQUALITY (2019); MEHRSA BARADARAN, HOW THE OTHER HALF BANKS: EXCLUSION, EXPLOITATION, AND THE THREAT TO DEMOCRACY (2015). For analysis of the underlying public-private division of roles in banking and finance, see generally Robert C. Hockett & Saule T. Omarova, *The Finance Franchise*, 102 CORNELL L. REV. 1143 (2017) [hereinafter *Finance Franchise*]; Robert C. Hockett & Saule T. Omarova, *Public Actors in Private Markets: Toward a Developmental Finance State*, 93 WASH. U. L. REV. 103 (2015).

20. For post-2008 scholarly work advocating the "public utility" model of bank regulation, which is normatively connected to but conceptually different from the idea of public banking, see generally Lev Menand & Morgan Ricks, *Rebuilding Banking Law: Banks as Public Utilities,* 41 YALE J. ON REGUL. 591; Morgan Ricks, *Money as Infrastructure*, 2018 COLUM. BUS. L. REV. 757 (2018); K. Sabeel Rahman, *The New Utilities: Private Power, Social Infrastructure, and the Revival of the Public Utility Concept*, 39 CARDOZO L. REV. 1621 (2018); Alan M. White, *Banks as Utilities*, 90 TUL. L. REV. 1241 (2016).

among various public bank options or how they relate to the traditional regulatory tools.

To gain a better insight into public banking as a modern financial market phenomenon, this Article focuses on the design of a public bank *as a financial institution*. As a starting point, it identifies the constitutive functional characteristics of a public bank: a depository, a credit provider, and a public investment vehicle.[21] This basic taxonomy of functions helps to pinpoint the main problems encountered and the principal choices to be made by a policymaker seeking to create a public bank serving specific purposes. By isolating these pivotal decision points, the Article constructs a basic roadmap for designing a public institution capable of delivering the desired set of public benefits.

The key benefits typically associated with public banking include free universal access to deposit-money and payments, affordable consumer and wholesale credit, and sustained investment in critical public infrastructure. As the Article shows, it is inherently difficult to design a financial institution that would effectively fulfill all these high-level policy goals in practice. There is, however, nothing existential or inevitable about that. To a large extent, the institutional design difficulties analyzed in this Article stem from a simple yet underappreciated fact that a stand-alone public bank must operate inside the broader financial market that otherwise remains intact. A public bank embedded in a system of private finance must adapt to its host system's rules, while producing outcomes that the system is hard-wired to suppress. Directly or indirectly, the public bank's balance sheet choices, the menu and pricing of its products, its personnel and administrative costs, and other day-to-day business activities and decisions would be shaped by the complex workings of the surrounding financial market. In fact, public banks' mandates often require them to run their affairs on principles of market-based commercial viability. This "double bottom line" mandate may be justified as a pragmatic, fiscally responsible, or politically sensible approach to creating a state-owned bank. Yet, it underscores the underlying tension: the more ambitious the non-profit mandate of a public bank, the less compatible the bank is with the dominant private profit-driven financial system. As an implant, an essentially foreign object in its business environment, a public bank inevitably faces the pressure to compromise, either by reducing its policy footprint or by softening its normative commitments—sometimes before it even starts operating.

21. Given the diverse and dynamic nature of this discourse and the multitude of social and political forces driving it, this is necessarily a generalization. The Article's focus is not on any particular or "canonic" version of public banking but on the broadly defined types of financial market services that most commonly and prominently figure in various arguments for creating public banks in the United States.

Public bank activists and organizers are intimately familiar and accustomed to dealing with these pressures. Despite the difficult tradeoffs and limitations, each successfully established state or local public bank is a vital step toward a more democratic and stable financial order. Even if no single public bank can fundamentally redefine the overall dynamics of modern finance, collectively they can help to defeat entrenched stereotypes and serve as an essential proof of concept for public banking. By producing tangible benefits for their communities, public banks can shift the Overton window[22] and pave the way for a more ambitious set of structural reforms.

This Article argues that scaling *up* the public's ambition is the key to the long-term success of the public banking model. It calls for a new approach to institutional design, which aims to establish not just a standalone public bank but a broader *ecosystem of public banking*: a carefully constructed nationwide network of financial institutions with different functions and targeted mandates, whose coordinated actions can maximize the overall public benefits. At the core of the multi-entity system of public banking outlined in the Article is the country's central bank—the Federal Reserve System (the "Federal Reserve" or the "Fed")—that uses its own balance sheet to offer direct universal access to digital money and payments. The asset side of the central bank's balance sheet can be accordingly redesigned to support the flow of affordable credit through multiple public and publicly licensed private lending institutions. It can also provide vital liquidity backup for a separate set of public entities tasked with channeling investment in physical and social infrastructure and other publicly beneficial projects.[23] This modular approach gives policymakers the necessary flexibility in achieving multiple policy objectives—financial inclusion, systemic stability and elimination of bank bailouts, sustainable economic development, and so on—by creating multiple structural levers of public power in today's finance. To fulfill its promise, public banking needs to be reenvisioned as a truly systemic change.

The Article is structured as follows. Part I begins by examining the meaning of the term "public bank" and the key functional characteristics commonly associated with this type of an institution in today's policy debate. Part II shifts the focus to the process of designing a public bank. It identifies and discusses three principal sets of choices—or pivotal deci-

22. *See The Overton Window*, MACKINAC CTR. FOR PUB. POL'Y, https://www.mackinac.org/OvertonWindow [https://perma.cc/H4JE-57YG].

23. In articulating this vision, the Article builds on my prior work. *See* Saule T. Omarova, *The People's Ledger: How to Democratize Money and Finance the Economy*, 74 VAND. L. REV. 1231 (2021) [hereinafter *People's Ledger*]; Saule T. Omarova, *The National Investment Authority: An Institutional Blueprint*, BERGGRUEN INST. (Mar. 23, 2022), https://berggruen.org/news/the-national-investment-authority-a-blueprint [https://perma.cc/J5P6-F769] [hereinafter *National Investment Authority*].

sion points—that define this process. Part III outlines the more specific challenges and tradeoffs that arise in the process of designing a public bank tasked with performing a particular set of functions: deposit-taking, lending, or investment management. Part IV offers an alternative vision of public banking as an integrated nationwide system of functionally specialized institutions, designed to harness the power of modern finance for the maximum benefit of the public. Part V completes the discussion by addressing some of the commonly encountered arguments against the public banking reforms the Article advocates.

I. Unpacking the Concept: A Public Bank Is What A Public Bank Does

On its face, the phrase "public banking" is simply a combination of two concepts: "public" and "banking." In other words, it refers to "banking" that is "public." Even at this purely mechanical level, however, simplicity is deceptive. Depending on the context in which the phrase is used, each of its two components—"public" and "banking"—can have multiple meanings. Far from being self-explanatory, these terms convey and conceal a complex set of political aspirations and institutional choices.

This Part offers a roadmap to the debate by deconstructing the complex notion of public banking along functional lines. Focusing on three core functional characteristics of a public bank emerging from the current discourse, it identifies the key policy goals that public banking is expected to achieve and outlines some of the institutional precedents it builds on.

A. What Makes a Public Bank "Public"? Ownership v. Orientation

The term "public" can denote both the form of ownership of the relevant financial institution and its core mission. To simplify, it can answer two questions: (1) Who owns the bank? and (2) Whose interests does the bank serve? While closely related, these questions are sufficiently different to highlight the variety of factors that set "public" banks apart from their traditionally private counterparts.

In popular and academic discussions, government ownership is generally seen as the defining characteristic of a public bank. Wikipedia, for example, defines public banks as financial institutions in which "a state, municipality, or public actors are the owners."[24] Public banking initiatives across the country are built on an assumption of public ownership as an alternative to private shareholder profit-driven banking model. In the mainstream economic literature, the word "public" attached to a banking

24. *Public bank,* WIKIPEDIA (Jan. 15, 2024, 10:16 AM), https://en.wikipedia.org/wiki/Public_bank [https://perma.cc/V2UM-HYA2].

entity is also typically equated with government ownership.[25] In short, a "public bank" is commonly defined as a bank fully- or majority-owned by the national government or any type of subnational government unit.

On the one hand, this approach offers a clear, objectively verifiable standard for classifying banking entities as "public." Its elegant simplicity is particularly appealing to economists and other researchers relying on statistical tools to analyze performance, condition, or other matters involving government-owned banks. On the other hand, a simple ownership-based definition of a public bank can be a poor fit for complex institutional realities. For example, as a result of crisis-time rescue efforts, governments may acquire (and hold for some periods of time) controlling ownership stakes in well-established private banks. This is what happened during the Global Financial Crisis when the UK government acquired a 84% stake in Royal Bank of Scotland ("RBS") and the Dutch government nationalized ABN AMRO—thus putting two of Europe's largest, internationally active banking conglomerates under direct state control.[26] In situations of this type, however, an emergency transfer of ownership from private shareholders to the government does not by itself transform a profit-oriented business entity like RBS or ABN AMRO into a truly "public" bank.

What separates a "public" bank from a private banking firm is not simply its ownership structure but, more importantly, its principal organizational purpose and the resulting incentive structure. Public banks are mission-oriented entities, whose business models are geared explicitly toward providing some publicly beneficial service and meeting some public need. While public banks may, and often do, pursue profitable business opportunities, maximizing shareholder returns or company profits is not their top priority or even a cognizable institutional goal.[27] Public

25. This definitional choice, of course, was not ideologically neutral. Among other things, equating "publicness" with government ownership made it easier for generations of neoliberal economists to dismiss or discredit public banks as a form of inherently inefficient and corrupt state-owned enterprises. *See generally* Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Government Ownership of Banks*, 57 J. FIN. 265 (2002); THE FUTURE OF STATE-OWNED FINANCIAL INSTITUTIONS (Gerard Caprio, Jonathan L. Fiechter, Robert E. Litan & Michael Pomerleano eds., 2005); JAMES R. BARTH, GERARD CAPRIO, JR. & ROSS LEVINE, RETHINKING BANK REGULATION: TILL ANGELS GOVERN (2006).

26. *See* Federico Mor, *Bank Rescues of 2007-09: Outcomes and Costs* 6 (House of Commons Library Briefing Paper No. 5748, 2018), https://researchbriefings.files.parliament.uk/documents/SN05748/SN05748.pdf [https://perma.cc/NU7N-ZJG6]. Jill Treanor, *The RBS crisis: A Timeline of Events*, THE GUARDIAN (May 22, 2017), https://www.theguardian.com/business/2017/may/21/royal-bank-of-scotland-a-timeline-of-events [https://perma.cc/C5AW-Y992]; Cagan Koc, *Dutch State to Reduce Its Stake in ABN Amro to Below 50%*, BLOOMBERG (Feb. 10, 2023), https://www.bloomberg.com/news/articles/2023-02-10/dutch-government-to-reduce-its-stake-in-abn-amro-to-below-50 [https://perma.cc/8U63-C792].

27. As shown below, the lack of the shareholder profit-maximization imperative does not mean that public banks are entirely devoid of any revenue-generating motives in their business affairs. *See infra* Sections II.A-B. Profitability is not inimical to the public banking model; it's just not the principal goal that drives public banks' business decisions and dictates its priori-

banks' business activities necessarily reflect a more complex set of priorities centered around their core public-facing mandates. From this perspective, certain types of cooperatively or mutually owned banking entities can also function as—and be legitimately considered—"public" banks.[28] Central banks, regardless of their ownership structure, also fall in the "public bank" category by virtue of their explicitly public interest-focused mandate and mode of operation.[29] Central banks may not be fully owned by the government and may provide revenue-generating banking services to various private counterparties, but they are fundamentally different from profit-seeking commercial banks—they are public instrumentalities acting in pursuit of public goals.[30]

In short, the general tendency to focus on government ownership as the essence of "publicness" adds little to our understanding of public banking as a phenomenon. A public bank is defined not only by who owns it but by what it does and why and how it does it.[31]

But what exactly do (or should) public banks *do*? What functions set public banks apart from other public agencies? Why do we call them *banks*?

B. What Makes a Public Bank a "Bank"? Functional Features

In the world of private commercial banks, the core banking business model is based on combining two principal activities: extension of credit

ties. Public banks do not operate under the constant pressure to pay dividends, buy back shares from their shareholders, or increase profit-based executive compensation. That eliminates many of the socially undesirable and systemically destabilizing forms of "short-termism" plaguing private financial institutions. *See, e.g.,* Sheila Bair, *Lessons of the Financial Crisis: The Dangers of Short-Termism,* HARV. L. SCH. F. ON CORP. GOVERNANCE (July 4, 2011), https://corpgov.law.harvard.edu/2011/07/04/lessons-of-the-financial-crisis-the-dangers-of-short-termism [https://perma.cc/VXC6-LGL4](discussing the role of financial institutions' short-termism in generating systemic instability that led to the 2008 financial crisis); Alissa Kline, *As banks mull buybacks, the fate of Basel III looms large*, AM. BANKER (Jan. 31, 2024), https://www.americanbanker.com/news/as-banks-mull-buybacks-the-fate-of-basel-iii-looms-large [https://perma.cc/G9XB-G3W2] (highlighting the inherent conflict between banks' incentives to "return money to shareholders" and regulators' efforts to strengthen banks' resilience to financial shocks).

28. Some scholars use a broader concept of "alternative banking" as an umbrella category for state-owned banks, credit cooperatives, mutual banking associations, small savings and community banks, and similar entities organized around some social mission. *See, e.g.*, ALTERNATIVE BANKING AND FINANCIAL CRISIS 2-3 (Olivier Butzbach & Kurt von Mettenheim eds., 2014) (describing the diversity of "alternative banking" forms).

29. *See, e.g.*, Roberds & Velde, *supra* note 3, at 4 (examining the history of early public banks as predecessors of modern central banks).

30. This is, of course, true of the U.S. Federal Reserve System (the "Federal Reserve" or the "Fed"), which includes twelve regional Federal Reserve Banks technically owned by their member banks. *See generally The Fed Explained*, BD. OF GOVERNORS OF THE FED. RSRV. SYS. 1-4 (2021), https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf [https://perma.cc/7DA6-RWF4] (detailing the purposes, structure, and functions of the Federal Reserve).

31. *Cf.* MAROIS, *supra* note 12, at 10 ("What social forces have public banks *do* make them what they *are*.").

(on the asset side of the bank's balance sheet) and deposit-taking (on the liability side of the bank's balance sheet).[32] While these functions can be performed separately, bundling them allows banks to perform a crucial money-creation function—it is what makes banks "special" financial institutions.[33] When banks extend loans to creditworthy borrowers, they issue corresponding deposit liabilities, which then circulate throughout the economy as new quantities of *de facto* sovereign money.[34] This business model allows private banks to supply safe and liquid deposit-money in response to the economic actors' demand for credit.

Of course, private banks' ability to issue public money doesn't simply magically appear out of thin air; it is a product of an elaborate institutional arrangement that puts the sovereign's full faith and credit—a unique public good—behind banks' private liabilities. In this franchise-like arrangement, the sovereign nation's central bank—in the United States, the Federal Reserve—commits to support the continuous clearing and settlement of payments drawn on private banks' deposit accounts, thereby ensuring full convertibility of bank deposit-money into central bank money. Only publicly licensed and regulated banks enjoy the privilege of central bank accommodation and monetization of their liabilities. Bound by the terms of their license (i.e., the charter), private banks act as the "franchisees" of the central bank, authorized to generate and distribute—for profit—sovereign credit-money throughout the economy.[35] They act as the sovereign's agents "on the ground," identifying and pricing economic value-enhancing propositions and creating monetary resources necessary to bring them to fruition.

The logic of this public-private partnership explains a lot about how a modern banking system works. The mismatch in the maturity and liquidity of banks' traditional assets (long-term loans) and liabilities (demand deposits) renders banks' balance sheets structurally fragile. Be-

32. What exactly constitutes "banking" can be a surprisingly complicated question, especially from a legal perspective. Under U.S. banking law, for example, there is no statutory definition of the "business of banking," which effectively leaves it to federal bank regulators to decide on an ongoing basis which activities it encompasses. *See* 12 U.S.C. § 24 (Seventh); Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed the "Business of Banking,"* 63 MIA. L. REV. 1041, 1048-55 (2009). For the purposes of this Article, however, the term "commercial bank" is used as a generic reference to all private institutions legally authorized to engage in deposit-taking and lending.

33. The idea that banks are "special" references a famous phrase used in E. Gerald Corrigan, *Annual Report 1982: Are Banks Special?*, FED. RSRV. BANK OF MINNEAPOLIS, 7 (1983), https://fraser.stlouisfed.org/files/docs/historical/frbminn/1982_frb_minneapolis.pdf?utm_source=direct_download [https://perma.cc/6QER-BFHG].

34. *See, e.g.*, Michael McLeay et al., *Money Creation in the Modern Economy*, BANK ENG. Q. BULL. 14-26 (Q1 2014), https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2014/money-creation-in-the-modern-economy.pdf [https://perma.cc/74SQ-SJYY]; *Finance Franchise*, *supra* note 19, at 1153-64.

35. For a detailed analysis of these institutional dynamics, see *Finance Franchise*, *supra* note 19.

cause both sides of a bank's balance sheet are imbued with public interest, however, the source of this fragility cannot be eliminated. Instead, the solution is a combination of public subsidy (e.g., deposit insurance) and public oversight (regulation and supervision of banks' funding and investment activities).[36] In theory, regulation and supervision are supposed to prevent unauthorized uses of public subsidies and other abuses of economic power by private profit-seeking banks.[37] In practice, decades of deregulation and regulatory arbitrage enabled the growth of speculative "shadow" banking, "too big to fail" ("TBTF") banks, and other structural imbalances in our financial system.[38] The story hardly needs retelling at this point.

Against this background, it is not difficult to see the political appeal of public banking. Public banks offer a direct alternative to commercial banks, which have long abandoned their part of the bargain as agents of public interest. Not wired for private profit maximization, public banks are seen as potentially more appropriate institutional vehicles for delivering critical financial services without imposing excessive costs on the public. Interestingly, however, the concept of public banking is more supple and capacious than simply a different way of delivering traditional commercial bank services. In the current policy and academic discourse, the term "public bank" covers a wide variety of institutions conducting a diverse set of business activities. This category loosely encompasses postal banks, nonprofit providers of affordable credit, state and municipal depository and lending institutions, infrastructure and development banks, "green" banks, and even sovereign wealth funds. Depending on the context, the precise combination of institutional features and functions meant to constitute a "public bank" may differ quite significantly.[39]

Nevertheless, in principle, there are three core business functions that individual public banks either perform already or are expected to perform: (1) deposit-taking and the associated payments services; (2) extension of credit; and (3) public investment and development finance.

36. For more on the role of bank chartering and regulation in the "finance franchise" system, see generally Saule T. Omarova, *The "Franchise" View of the Corporation: Purpose, Personality, Public Policy*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 201-21 (Elizabeth Pollman & Robert B. Thompson, eds., 2021); Lev Menand & Morgan Ricks, *Federal Corporate Law and the Business of Banking*, 88 U. CHI. L. REV. 1361 (2021).

37. *See* Saule T. Omarova & Graham S. Steele, *Banking and Antitrust*, 133 YALE L.J. 1162 (2024) (analyzing key provisions of U.S. banking law that aim to prevent excessive concentration and abuses of structural power by publicly subsidized banking institutions).

38. *See generally* Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215 (2002) (tracing the gradual process of financial sector deregulation and the resulting destabilization of the financial system).

39. For a sample list of business functions and services currently provided by national and multinational public banks operating around the world, see MAROIS, *supra* note 12, at 98-100.

There are both well-articulated reasons for entrusting each of these functions to a public institution and well-known examples of public banks successfully performing them in practice.

1. Deposit-Taking

Deposit-taking and payments services are the most "natural" candidates for public provisioning. Continuous access to safe, liquid, and universally accepted deposit-money is a critical public good. The ability to make and receive payments without having to incur extra costs is the structural prerequisite for, and the indispensable means of, full participation in the economic exchange. In that sense, guaranteed access to sovereign money and payments is both an integral part of economic citizenship and the engine of the modern economy. Private banks, however, are not legally obligated to provide deposit services to "unprofitable" clients.[40] As a result of ongoing industry consolidation, branch closings, and shifting of banks' priorities toward high-profit trading activities, millions of Americans in marginalized urban and rural communities are left without access to the banking system.[41] Excessive risk-taking by private banks can also disrupt the system, triggering economically destructive deposit runs.

A public bank, by contrast, can offer low-cost deposit accounts in a non-discriminatory and reliable manner. Not driven by profit-maximization motives, a public depository institution is well-positioned to act as a true public utility, a provider of access to money as a form of critical public infrastructure.[42] To the extent public banking initiatives explicitly adopt financial inclusion and "banking the unbanked" as their principal policy goals, deposit-taking is central to their mission. Accordingly, many proposals to establish state and municipal public banks envision these institutions functioning as full-service depositories, particularly for public sector entities and low-income retail customers.[43]

Postal banking offers the best-known historical model of a public institution providing widely available low-cost deposit and payments services. Since the late 19th century, many countries—including the United Kingdom, France, Germany, Italy, Switzerland, Japan, China, India, and

40. For a discussion of the financial inclusion problem in today's United States, see Adam J. Levitin, *The Financial Inclusion Trilemma*, 41 YALE J. ON REGUL. 109, 117-123 (2024).

41. In 2022, approximately 19% of Americans were either unbanked or underbanked. *See Economic Well-Being of U.S. Households in 2022*, BD. OF GOVERNORS OF THE FED. RSRV. SYS 39-40 (May 2023), https://www.federalreserve.gov/publications/files/2022-report-economic-well-being-us-households-202305.pdf [https://perma.cc/2HQY-2F7Q] (showing that 6% of American adults were unbanked and 13% of American adults used nonbank check cashing or money orders (i.e., were "underbanked")).

42. *See generally* Ricks, *supra* note 20 (describing money as a form of public infrastructure).

43. *See, e.g.*, *What's a Public Bank?*, CAL. PUB. BANKING ALL., https://californiapublicbankingalliance.org/whats-a-public-bank [https://perma.cc/8KHP-KR84].

Brazil—have successfully utilized their postal office networks to offer basic banking services to their citizens.[44] In the United States, a national Postal Savings System operated between 1911 and 1967.[45] Building on that experience, several proposals to revive U.S. postal banking emerged in the wake of the 2008 financial crisis.[46] Notably, these proposals explicitly called for the U.S. Postal Service ("USPS") to offer not only retail savings accounts, as it had done in the past, but also transactional deposit accounts.[47]

2. Credit Extension

Lending is another critically important function typically seen as an integral part of the public banking model. The rationale for direct public provisioning of credit is, again, intuitively easy to grasp. Because private lenders price their credit products based on the risk of default, low-income borrowers, particularly in marginalized communities, are often priced out of the private credit markets. This exposes the already most economically vulnerable consumers to predation by payday lenders and other high-cost credit providers operating outside the traditional banking system.[48]

A mission-driven public bank offers a non-discriminatory and non-predatory alternative to the existing system, which perpetuates structural inequalities in modern America. In the absence of hard profitability constraints, a public lender has more flexibility to extend low-cost credit to traditionally disadvantaged consumers, communities, small and medium-sized businesses, and budget-strapped public sector entities. Because ac-

44. *See, e.g.*, *Post Office Banking Around the World*, AM. BANKER (Feb. 13, 2014), https://www.americanbanker.com/slideshow/post-office-banking-around-the-globe [https://perma.cc/3DFY-96EV] (describing different countries' approaches to postal banking). Although many of these postal banking systems have been privatized or significantly reformed, the overall efficacy and resilience of this institutional form continues to inspire the debate on public banking.

45. *See* Mehrsa Baradaran, *A Short History of Postal Banking*, SLATE (Aug. 18, 2014), https://slate.com/news-and-politics/2014/08/postal-banking-already-worked-in-the-usa-and-it-will-work-again.html [https://perma.cc/7RKP-MYFG].

46. *See, e.g.*, Postal Banking Act, S. 3891, 117th Cong. (2022); BARADARAN, *supra* note 19; *The Road Ahead for Postal Financial Services* , U.S. POSTAL SERV. OFF. INSPECTOR GEN. 1-3 (2015), https://www.uspsoig.gov/sites/default/files/reports/2023-01/rarc-wp-15-011_0.pdf [https://perma.cc/HC83-YYKD].

47. *See* sources cited *supra* note 46. The SVB crisis led to renewed calls for allowing USPS to offer deposit and payments services. *See, e.g.,* Mark Dimondstein, *The Bank Crisis is the Latest Argument to Expand Postal Service Banking*, THE HILL (Apr. 20, 2023, 10:30 AM ET), https://thehill.com/opinion/finance/3960583-the-bank-crisis-is-the-latest-argument-to-expand-postal-service-banking [https://perma.cc/ZD32-SAAS].

48. Thomas Herndon & Mark Paul, *A Public Banking Option as a Mode of Regulation for Household Financial Services in the United States*, ROOSEVELT INST. 5 (Aug. 2018), https://rooseveltinstitute.org/wp-content/uploads/2020/07/RI-Public-Banking-Option-201808.pdf [https://perma.cc/A63V-UP4T]; *See also 2021 FDIC National Survey of Unbanked and Underbanked Households*, FED. DEPOSIT INS. CORP. 13-20, 75-78 (2022), https://www.fdic.gov/analysis/household-survey/2021report.pdf [https://perma.cc/H469-6LS8].

cess to affordable credit is essential not only to individual wealth-building but also to the long-term growth and development of state and local economies, most (if not all) public bank proposals explicitly emphasize these institutions' lending function.[49]

Germany's public banks, including municipal savings banks (Sparkassen) and large regional public banks (Landesbanken), provide one of the best-known examples of public provisioning of credit for households, small businesses, and state and local governments.[50] Since their emergence in the late 19th century, these institutions have been a steady source of credit for local communities and an important factor in Germany's economic resilience and growth.[51]

Another prominent example in this respect is the BND, the only government-owned bank in the United States and the legal depository for all state funds in North Dakota.[52] Formed in 1919, the BND provides financial support for state and local government programs, extends student loans[53] and otherwise promotes the development of the state's economy.[54] The BND operates primarily as a "banker's bank," as most of its lending is done in partnership with local community banks and credit unions.[55] By participating in these banks' loans, the BND augments the flow of affordable credit into the state's economy.[56]

3. Investment and Development Finance

Long-term investment in public infrastructure and other projects with broadly diffused economic benefits is another function traditionally reserved for public institutions.[57] The rationale for giving public banks this task is rooted in the familiar logic of public goods provision. Private investors are generally averse to funding capital-intensive public infra-

49. *See, e.g., What's a Public Bank?* PUB. BANK LA, https://www.publicbankla.org/about/what-is-a-public-bank [https://perma.cc/TZ3N-EGNU] (enumerating proposed lending and community credit-related services).

50. *See, e.g.*, Nina Eichacker, *German Public Banks, Competition, and Risk: Deregulation of Landesbanks and German Vulnerability to Crisis*, 57 J. ECON. ISSUES 860, 863-65 (2023).

51. *See* Reinhard H. Schmidt et al., *The Persistence of the Three-Pillar Banking System in Germany, in* BUTZBACH & METTENHEIM, *supra* note 28, at 101-21; BROWN, *supra* note 3, at 265-75.

52. *See History of BND*, supra note 4.

53. BND offers student loans to North Dakota residents enrolled in schools located anywhere, as well as to out-of-state residents attending schools in North Dakota or any adjacent state. BND's student loan rates are among the lowest in the country. Stacy Mitchell, *Public Banks: Bank of North Dakota*, INST. FOR LOC. SELF-RELIANCE, https://ilsr.org/rule/bank-of-north-dakota-2 [https://perma.cc/H7HV-5URV].

54. *See Mission, Vision, Core Values*, BANK OF N.D., https://bnd.nd.gov/mission [https://perma.cc/7YLB-ZGNC].

55. Mitchell, *supra* note 53.

56. *Id.*; BROWN, *supra* note 3, at 364-69.

57. For the ease of reference, the Article often uses "public infrastructure investment" as an umbrella term for this set of diverse activities.

structure projects whose typically long timeframes and potentially uncertain returns render them too risky. Because individual investors cannot control the broader macro-environment, they rationally prefer to finance short-term, commercially profitable projects. Public actors, by contrast, are inherently "patient" investors with high risk tolerance, long time horizons, and a focus on public rather than private benefits. Accordingly, advocates often envisage public banks as institutions of public investment and infrastructure finance. The ability to mobilize and channel public capital into affordable housing, public transportation, local care economy, and other much-needed public improvements that do not get financed in private markets is an important argument for creating public banks.

There are currently hundreds of multinational, national, and subnational publicly owned infrastructure and development banks successfully operating around the world.[58] That list includes entities as diverse as the European Investment Bank ("EIB"), Germany's KfW, the China Development Bank, and the Canada Infrastructure Bank.[59] Depending on the mandate, these institutions invest not only in traditional infrastructure but also in agricultural development, social housing, export industries, and other public priority areas.[60] It was telling that, during the COVID-19 pandemic, public development banks stepped into the void left by private financial institutions and played a key role in keeping their national economies afloat.[61]

While the United States does not currently have a federal-level public development bank, the New Deal-era Reconstruction Finance Corporation ("RFC") provides an important historic precedent.[62] Established in 1932 and initially funded by Congress, the RFC played the central role in

58. *See* PUB. DEV. BANK & DEV. FIN. INST. DATABASE, https://www.dfidatabase.pku.edu.cn [https://perma.cc/6XPU-9LXJ].

59. *Id.;* CAN. INFRASTRUCTURE BANK, https://cib-bic.ca/en [https://perma.cc/V8H6-ED9Q].

60. *See FICS Progress Report*, FIN. IN COMMON 8-9 (2022), https://financeincommon.org/sites/default/files/2022-10/Finance%20in%20Common%20Progress%20Report%202022.pdf [https://perma.cc/E3TK-9QTN].

61. *See generally* PUBLIC BANKS AND COVID-19: COMBATTING THE PANDEMIC WITH PUBLIC FINANCE (David A. McDonald, Thomas Marois & Diana Barrowclough eds., 2020), https://publicbankscovid19.org/images/PDF_FILES/Public_Banks_and_Covid19_-_Full_Book.pdf [https://perma.cc/P777-UD5N].

62. Several states currently have infrastructure banks that operate on a limited scale and are set up primarily as revolving loan funds for specific purposes. For example, the California Infrastructure and Economic Development Bank ("Ibank"), established in 1994, is a state-level public investment bank that operates as a revolving loan fund and conduit bond issuer on behalf of qualifying public agencies and non-profit organizations. Ibank optimizes financing of in-state public infrastructure projects simply by capturing the benefits of scale and tax-exempt status of its bond issuances. *See Frequently Asked Questions*, IBANK, https://ibank.ca.gov/about/faqs [https://perma.cc/FB8T-F3YW]. Many state-level infrastructure banks specialize primarily (or exclusively) in providing low-cost financing to in-state surface transportation projects. *See* Ctr. For Innovative Fin. Support, *State Infrastructure Banks*, U.S. DEPT. OF TRANSP., https://www.fhwa.dot.gov/ipd/finance/tools_programs/federal_credit_assistance/sibs [https://perma.cc/KB7F-ZRB9].

leading the nation out of the Great Depression.[63] It financed banks, railroads, utilities, commercial and agricultural enterprises, municipalities, and other federal agencies at a time when private credit was scarce.[64] It took direct equity stakes in banks, insurance companies, and commercial firms in need of capital.[65] Hugely powerful, the RFC effectively functioned as the New Deal's "capital bank."[66]

The RFC and other real-life examples of institutionalizing public investment inspire and influence the ongoing efforts to create a 21st-century model of public banking in the United States. While there is no single canonical vision of what that model entails, a huge part of the political appeal and functional rationale behind the idea of public banking is its promise to finance the larger project of rebuilding the American economy on a more equitable, resilient, and sustainable basis.

What often escapes attention, however, is that this function—investment management and development finance—does not fit easily into the traditional business model of a commercial bank. U.S. banking law, for instance, generally prohibits deposit-taking banks from making substantial equity investments in nonbank companies.[67] And most non-U.S. development and infrastructure banks do not actually provide depository services or consumer credit, both of which are so central to the public banking advocates' vision. In theory, of course, that does not necessarily mean that combining multiple functional characteristics under a single organizational roof—a modern-day "universal" public bank—is an impossible task. But that task must be approached with great care and clear understanding of the inevitable tradeoffs and institutional design challenges associated with each of these three roles public banking is called to play: inclusive and affordable deposit services, provision of affordable retail and wholesale credit, and sustained public infrastructure investment.

II. Understanding Institutional Design: Three Pivotal Decision Points

The fundamental challenge of designing a public bank is that it is an inherently hybrid institutional form: it is both a financial market actor and a government instrumentality. Designing a viable entity that can suc-

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63. *See Final Report on the Reconstruction Finance Corporation*, SEC'Y OF THE TREASURY, at v, (1959), https://fraser.stlouisfed.org/files/docs/publications/rcf/rfc_19590506_finalreport.pdf. [https://perma.cc/Q56H-DG5W]; James Butkiewicz, *Reconstruction Finance Corporation*, ECON. HIST. ASS'N (July 19, 2002), https://eh.net/encyclopedia/reconstruction-finance-corporation [https://perma.cc/QR2L-4CJ7].

64. Butkiewicz, *supra* note 63.

65. *See* SEC'Y OF THE TREASURY, *supra* note 63, at 55-56, 62, 149.

66. JAMES S. OLSON, SAVING CAPITALISM: THE RECONSTRUCTION FINANCE CORPORATION AND THE NEW DEAL, 1933–1940, at 44 (1988).

67. *See* 12 U.S.C. § 24 (Seventh).

cessfully act in both capacities is a complicated undertaking. It is a highly context-specific process that requires far more than faithfully replicating some known institutional model, however successful or promising it may be. This Part identifies and examines three principal sets of design choices—or pivotal decision points—in this process. These choices pertain to the sources of a public bank's funding, the target composition of its asset portfolio, and its governance structure. To put it slightly differently, the process of designing a public bank revolves around three key questions: (1) How is the bank financed? (2) How does it use or invest its money? (3) How is it governed?

The first two questions go directly to the public bank's balance sheet, a snapshot of its projected or desired liabilities and assets. At the planning stage, the answers to these two questions will show what the institution *is meant to do* in the market and what it *can do* given its specific balance-sheet constraints. It is important to remember that these constraints result from choices made on both the liability side (funding structure) and the asset side (investment portfolio) of the institution's balance sheet. It is the complex interaction between these two elements that makes a public bank what it *is*.[68]

The third question goes to the distribution of power to direct the institution's operations—and thus to the politics of public banking.[69] The answer to this question will show *who controls* the public bank's decisions and how they can be held publicly accountable. Indirectly, it will show how effective and reliable the institution is likely to be in delivering the intended public policy outcomes.

The process of designing a public bank can start with any of these three questions, depending on the primary policy rationale or objective behind the effort. If, for example, the main reason to create a public bank is the desire to offer free transactional deposits to everyone, then the rest of that bank's institutional features will have to follow from the specific structure of its liabilities.[70] If, on the other hand, the primary goal is to provide affordable consumer credit for low-income borrowers, the process will begin with specific assumptions about its asset portfolio.[71]

68. For a more detailed discussion of what that interaction generally looks like, and the tradeoffs it involves, see *infra* Part III.

69. This is not to deny that the structure of a public bank's balance sheet is also a result of fundamentally political decisions. The point here is simply to emphasize the more visibly political nature of the choices made with respect to a public bank's governance structure.

70. *See* discussion *infra* Section III.A.

71. *See* discussion *infra* Section III.B. As this observation underscores, the critical step that launches the entire effort is deciding what an individual public bank is intended to accomplish—or what its core policy mandate is. Articulating an individual public bank's institutional mandate is a substantive policy decision that establishes the baseline and defines the parameters of the subsequent process of designing an institution able to carry it out. That decision is properly left to the policymakers in each specific situation. The focus of the present discussion is on unpacking the *design process* and examining, as a general matter, what it takes to build the insti-

In short, the institutional design task involves a series of decisions clustered around three main issues: a public bank's funding sources, asset composition, and governance structure. These issues form the core structure of the entire exercise, and how they are ultimately resolved determines its outcome. At each of these pivotal decision points, it is therefore essential to have a clear view of the available choices and the tradeoffs or compromises they may require.

A. How Is a Public Bank Financed?

In principle, there are four sources of funding for a public bank's operations: deposits, government budget, private borrowing, and internal revenues. The choice of a particular mode of financing directly affects—and can significantly constrain—the bank's capacity to produce the intended public policy outcomes.

First, a public bank's funding can come from deposits.[72] Bank deposits are, by definition, its liabilities that correspond to an equal amount of investable funds on its balance sheet. For commercial banks, retail deposits are the cheapest and "stickiest" source of funding, mainly because of federal deposit insurance—but also because retail depositors typically view their bank accounts not as a form of investment but as a safe way of keeping their liquidity at the ready. As the most ubiquitous form of public money, deposits are not only the issuing banks' *liabilities* but also their essential *product*. This duality has important implications. A bank must be able to redeem its deposit liabilities on demand in order to preserve both its own solvency and the integrity of the banking system's principal product market. Demand liabilities, however, are famously susceptible to runs, often in irrational waves that can be amplified by modern technology.[73] Accordingly, deposit funding creates a hard liquidity constraint on the institution's asset portfolio. Either that portfolio comprises fully liquid assets or the same effect is replicated through a system of outside liquidity support.

Second, a public bank can be financed through government appropriations. Typically, the government provides initial funding for a public bank, but it can also commit to make continuous contributions to the

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tution's ability to carry out its policy objectives. It does not speak directly to the issue of how these objectives are, or should be, set in any individual situation.

72. The BND, for example, is the sole depository for the State of North Dakota, which gives it a large deposit base, particularly given that state's fossil fuel-derived revenues. *See History of BND*, *supra* note 4; *Studies highlight impact of oil and gas industry on North Dakota's economy, counties*, N.D. OFF. OF THE GOVERNOR (Mar. 16, 2021), https://www.governor.nd.gov/news/studies-highlight-impact-oil-and-gas-industry-north-dakotas-economy-counties [https://perma.cc/RT7D-X69E].

73. The depositor run on SVB vividly illustrated these dynamics. *See, e.g.*, J. Anthony Cookson et al., *Social Media as a Bank Run Catalyst* (Univ. Paris-Dauphine Rsch. Paper No. 4422754, June 23, 2023), https://ssrn.com/abstract=4422754 [https://perma.cc/7UV4-QGYW].

bank's capital. This funding scheme does not create additional liabilities on the bank's balance sheet, which reduces the pressure on the bank to generate cash flows to cover its debt payments. However, it makes the bank directly vulnerable to changes in the relevant government's economic and political situation, thus creating potentially significant uncertainty for the bank and reducing its investment capacity.[74] Dependence on government appropriations also increases the danger of excessive political interference in the public bank's business decisions, which can erode its capacity to fulfill its mandate.[75] Accordingly, choosing this form of funding heightens the importance of ensuring that the bank has an effective governance framework and strong accountability mechanisms.

Third, a public bank can borrow in private markets by issuing bonds or other debt instruments. This is a common mechanism of financing the assets of many publicly owned infrastructure and development banks around the world.[76] Having a public bank issue bonds can potentially bring in more money than the government is able to contribute, thus augmenting the bank's investment capacity. It can help the bank get better integrated into the broader financial system, increase its expertise as a financial market actor, and introduce a significant element of market discipline that can potentially counterbalance political pressures. At the same time, however, bond financing imposes significant constraints on the public bank's ability to invest according to its policy mandate.[77] To meet its debt service obligations, the bank will be forced to prioritize—or limit itself to—loans and investments guaranteed to generate sufficient cash revenues within a relatively short timeframe. While commercial profitability is not incompatible with the concept of public banking, it should not be the principal consideration driving any public bank's investment activities.

Finally, a public bank may be able to finance its ongoing operations out of its current revenues. This form of revolving self-funding can

74. It is also important to note that government funding does not necessarily free public banks from having to succeed on private market terms. The relevant government, for example, can require the public bank to conduct its business in a commercially profitable manner. Incorporating this requirement into the bank's mandate would effectively limit its capacity to pursue many publicly beneficial but commercially unattractive projects.

75. The Government Development Bank of Puerto Rico is an example of these pernicious dynamics. *See, e.g.*, Arturo C. Porzecanski, *The Government Development Bank: At the Heart of Puerto Rico's Financial Crisis*, AM. UNIV. 3 (Sept. 18, 2014), https://arturo.porzecanski.com/The%20GDB%20at%20the%20Heart%20of%20Puerto%20Ricos%20Financial%20Crisis.pdf [https://perma.cc/35WP-KB9E]; D. ANDREW AUSTIN, CONG. RSCH. SERV., R44095, PUERTO RICO'S CURRENT FISCAL CHALLENGES 16-17 (June 3, 2016), https://crsreports.congress.gov/product/pdf/R/R44095 [https://perma.cc/QN7U-YYLT].

76. *See, e.g.*, *Green Banks: Examples from the Field*, U.S. ENV'T PROT. AGENCY, https://www.epa.gov/statelocalenergy/green-banks#examples [https://perma.cc/2Q3D-M5Y5] (listing bonds as a typical funding mechanism for U.S. state-level "green" banks).

77. For a historical account of the role of municipal bond financing in deepening racial inequality in American cities, see DESTIN JENKINS, THE BONDS OF INEQUALITY (2021).

strengthen bank's independence both from the government and from the bond market, while also enhancing its internal technical expertise. In practice, however, it is difficult for a public policy-driven financial institution to generate consistently high cash flows, unless it has a large core portfolio of profitable assets and/or access to large amounts of reliable capital (such as, e.g., earmarked portion of the government's oil royalties). Self-financing through profit reinvestment also creates a strong incentive for the bank to prioritize commercial returns in its asset portfolio.

These funding options are not mutually exclusive and can be used in combination, as long as the specific opportunities and constraints each option entails are taken into account.

B. What Does a Public Bank Invest In?

The asset side of a public bank's portfolio should clearly reflect its specific mandate and show how the bank goes about doing its work in practice. The bank's asset portfolio can potentially be structured in a wide variety of ways, depending in part on the choice of the bank's funding, discussed above.

For example, a public bank that derives a significant proportion of its funding from deposits—or, perhaps more accurately, is designed to provide free universal access to deposit-money and payments—must ensure that its asset portfolio is safe and liquid. A logical balance-sheet choice in this respect would be simply investing in Treasury securities or other "safe" assets.[78] This "narrow bank" model would ensure the bank's ability to meet its demand deposit liabilities and thereby fulfill its core objective as a public depository institution.[79] On the other hand, having its assets tied up in liquid government debt or similar financial instruments would significantly curtail the public bank's ability to provide affordable credit to low-income consumers, small businesses, nonprofits, and other categories of borrowers who need its services. These assets are too risky to qualify for a "safe" portfolio.

An alternative approach is to have a public bank act as a lender, which means the bulk of its assets would consist of low-cost loans, guarantees, and other extensions of credit to their target populations. The

78. The U.S. Postal Savings System operated in this fashion, investing its depositors' money in federal debt instruments. *See* Baradaran, *supra* note 45.

79. For more on "narrow banking" as a general business model (not in the context of public banking), see generally LAURENCE KOTLIKOFF, JIMMY STEWART IS DEAD: ENDING THE WORLD'S ONGOING FINANCIAL PLAGUE WITH LIMITED PURPOSE BANKING (2011); John H. Cochrane, *Toward a Run-Free Financial System* (2014), https://ssrn.com/abstract=2425883 [https://perma.cc/3FSD-79FW]; Adam J. Levitin, *Safe Banking: Finance and Democracy*, 83 U. CHI. L. REV. 357 (2016); Jaromir Benes & Michael Kumhof, *The Chicago Plan Revisited* (Int'l Monetary Fund, Working Paper No. 202, 2012), https://www.imf.org/external/pubs/ft/wp/2012/wp12202.pdf [https://perma.cc/YLX9-A8M9].

bank could also purchase debt securities issued by qualifying businesses, cooperatives, various nonprofit organizations, and municipalities and other public sector entities. The specific mix of credit instruments and risk exposures in the bank's portfolio would reflect its core priorities, as shaped both by its mandate and its geographic and socio-economic environment. Public banks operating in poverty-stricken urban areas may have a significant share of their assets in small-dollar consumer loans and revolving lines of credit for small businesses, while public banks in rural areas may specialize in farm and equipment loans. Generally, however, public banks' fundamental commitment to affordability and financial inclusion means that their credit portfolios are likely to carry significant risks.[80] That, in turn, potentially limits these banks' ability to offer demand deposit accounts and associated payments services, at least on a significant scale. It is important to recognize this structural tension built into any model of a public bank that ties together deposit-taking and affordable credit provision.

A public bank can also take equity stakes in qualifying businesses or make direct equity investments in public infrastructure projects. These assets are typically found in the portfolios of public infrastructure and development banks whose mandates explicitly include project financing. By becoming a shareholder or an equity partner, the public bank acquires management rights in the portfolio company. Direct control over the deployment of capital on the ground amplifies the public bank's ability to deliver the intended policy results. Equity ownership has the potential to generate high returns that strengthen the bank's financial position and enable it to increase its economic and policy footprint. On the other hand, equity investments are considered much riskier than loans because of their inherently more volatile nature and deeply subordinated status in the hierarchy of claims on the portfolio company's assets. As an equity holder, the public bank takes on the risk of losing its entire investment, which can significantly damage its finances. That is part of the reason why pursuing this investment strategy requires more specialized in-house expertise and why it generally does not get financed through demand deposits.[81]

80. This is, of course, a generalized statement, most clearly applicable to public banks focused on consumer credit and small-business loans in underserved communities. Public banks that operate as statewide conduits for optimizing the flow of credit to smaller but creditworthy public agencies or into public revenue-generating projects, may have more stable loan portfolios with somewhat different dynamics. California's Ibank is an example of such credit-mobilization model. *See supra* note 62. Moreover, as noted below, various public agencies and community-oriented lenders are successfully developing more accurate and flexible tools for accessing credit risk posed by low-income and underserved borrowers. *See infra* note 108 and accompanying text. These facts provide an important context for discussing public banks' lending practices.

81. As global experience shows, existing public infrastructure and development banks typically finance their operations through some combination of government money and bond issuance. *See* MAROIS, *supra* note 12, at 33-34.

Again, these different asset classes are not mutually exclusive and can be combined in a single bank's portfolio, as long as that does not exceed the bank's legal authority or conflict with its policy mandate. The precise formulation of the individual public bank's mandate can be a critical factor that determines both the bank's overall investment strategy and the characteristics of individual assets on its balance sheet. If the legislative mandate requires the bank to generate commercial profits or prohibits it from acquiring assets that are not commercially viable, the bank's investment portfolio would look much more like that of a private financial institution than a public provider of public goods. In particular, policymakers must be fully aware of the fact that imposing profitability constraints on a public bank potentially inhibits its ability to channel capital into things like affordable consumer credit and social infrastructure.

C. How Is a Public Bank Governed?

Institutional governance is a complex system that defines various channels and levers of control and oversight of an entity's operations. An individual public bank's ownership structure, internal decision-making processes, and external accountability mechanisms are all key elements of its governance system.

As discussed above, public banks are often government-owned entities.[82] A national or subnational government can set up a public bank as a government agency or as a special government corporation that, in turn, can be a subsidiary of some government agency or occupy a separate place in the administrative hierarchy. These choices may determine the extent of the bank's financial, operational, and political autonomy and its ability to pursue a coherent business strategy. The practical impact of these decisions, however, depends entirely on the context.[83] A public bank may also be mutually or cooperatively owned, which raises a somewhat different set of design issues, particularly with respect to its place in the broader ecosystem of public actors. Finally, a public bank can also be set up as a hybrid public-private entity, in which case the key design choices would involve the division of control and economic rights between the public equity holder and its private co-investors.

In designing the governance structure of a public bank, one of the most important tasks is to find the workable balance between technocratic control and democratic deliberation as mutually complementary inputs in the bank's decision-making. On the one hand, running a successful banking business requires technical expertise, clearly defined lines of au-

82. *See supra* Section I.A.

83. For example, placing a public bank inside a powerful government agency may more effectively insulate it from improper interference by elected politicians.

thority and functional divisions, and a streamlined procedural framework for the exercise of investment discretion by designated finance professionals. On the other hand, a public bank's actions must reflect and serve the interests of the entire community of which it is a part. Accordingly, the bank's internal organizational structure and decision-making processes should not be focused solely on business efficiency: they should also reflect the bank's practical commitment to the public interest, thereby enhancing their legitimacy.

This balancing task may be approached in a variety of ways. In principle, the key choice involves deciding whether the public bank should be governed more like a private business corporation or like a democratic polity. Adopting the traditional corporate governance model would result in a relatively streamlined and hierarchical structure of governance, where an equivalent of the corporation's board of directors would exercise control over the bank's business affairs, run by professional managers with financial expertise.[84] This model, common among public infrastructure and development banks, easily accommodates industry or other stakeholder advisory panels but is generally not geared toward incorporating broader public input and non-expert feedback into its business decisions. Adopting a more overtly political model of "democratic multi-stakeholder governance,"[85] by contrast, would place the power over the bank's business affairs in the hands of a representative assembly, which may include a large number of non-experts convening at certain time intervals. A separate, smaller, and more permanent, board of directors would oversee the implementation of the bank's strategic goals set by the assembly, to which it would be accountable.[86] This system, however, could blur the bank's internal lines of command and communication and weaken its capacity to take swift and effective action, essential for a financial market participant.[87] The fact that U.S. policymakers are general-

84. The public bank's governance body can be directly appointed by the founding government. The BND, for example, is governed by the Industrial Commission comprising the Governor of North Dakota, the state's Attorney General, and the Agriculture Commissioner. A seven-member advisory board of directors, appointed by the Governor based on their expertise, assists the Industrial Commission in running the bank. *Leadership*, BANK OF N.D., https://bnd.nd.gov/leadership [https://perma.cc/23WQ-FXC4].

85. Michael Brennan, *Constructing the Democratic Public Bank: A Governance Proposal for Los Angeles*, DEMOCRACY COLLABORATIVE 2 (July 14, 2021), https://democracycollaborative.org/publications/constructing-the-democratic-public-bank-a-governance-proposal-for-los-angeles [https://perma.cc/GN54-GQW5].

86. *See id.* at 20 (proposing a governance design for a "democratic public bank" model); Michael McCarthy, *Municipal Bank of LA: Democratic Governance Frameworks*, JAIN FAM. INST. 5-6 (May 2023), https://jainfamilyinstitute.org/wp-content/uploads/2023/05/Democratic-Governance_Berggruen-JFI-MBLA-5.11.23.pdf [https://perma.cc/84KU-J73G] (proposing a democratic governance structure that incorporates randomly selected peoples' assemblies and standing commissions).

87. As Thomas Marois observes, "Democratisation is not a natural way for public banks to be run." MAROIS, *supra* note 12, at 193.

ly unfamiliar with this governance model further amplifies the need for a thoughtful and thoroughly detailed analysis of its pros and cons.[88]

Of course, choosing the more established corporation-like governance structure for a new public bank does not mean giving up the idea of democratic input and oversight. In these circumstances, it becomes particularly important to embed into the bank's design specific institutional means of ensuring external transparency and democratic accountability. Regular internal and external audits of the bank's financial statements, periodic reporting requirements, and other standard governance tools may need to be supplemented with the more bespoke, context-specific mechanisms of public monitoring and assessment. If carefully structured, these mechanisms could help to keep a public bank true to its public purpose, without unnecessarily hindering its capacity to function as a financial market actor.

The three pivotal decision points, discussed in this Part, serve as the basic guide to the far more complex and context-specific process of designing an individual public banking institution. Depending on the core functions that institution is expected to perform, there are numerous questions to be answered, and choices to be made before its specific business model takes a sufficiently tangible shape. While it is not possible to anticipate the full range of problems in each concrete case, it is nevertheless helpful to identify some of the key design issues embedded in, or attached to, the functional characteristics of the public entity under construction.[89]

III. Designing a "Fit for Purpose" Institution: Functions and Challenges

This Part outlines in greater detail some of the more specific issues that need to be addressed—and crucial tradeoffs that must be weighed—in the process of designing a public bank with the intent to supply a specific set of public goods: low-cost deposit services, affordable credit, or sustainable investment in public infrastructure. As a matter of institutional design, each of these three core functions presents its own set of challenges and creates distinctive frictions in the concept of a seamlessly

88. Outside of the United States, Costa Rica's Banco Popular y Desarollo Comunal ("BPDC") is the best-known example of a successful public bank governed by a nearly 300-strong worker assembly. *See* MAROIS, *supra* note 12, at 206-15. For a comparative global study of innovative deliberative methods of public decision-making, see *Innovative Citizen Participation and New Democratic Institutions: Catching the Deliberative Wave*, ORG. FOR ECON. COOP. & DEV. (2020), https://www.oecd-ilibrary.org/governance/innovative-citizen-participation-and-new-democratic-institutions_339306da-en [https://perma.cc/UK5G-XD5S].

89. In line with its emphasis on the business functions of public banks, the following discussion intentionally brackets governance issues and focuses primarily on factors directly shaping the public bank's balance sheet.

integrated "all-purpose" public bank.[90] This Part tests the limits of that concept by exploring key tensions among a public bank's multiple mandates. Without purporting to provide a detailed decision tree for public bank architects, it seeks to clarify the thinking that goes into developing an institutional blueprint for a public bank fit for its purpose.

A. Public Bank as a Depository Institution

As discussed earlier, one of the key advantages of public banks is their ability to offer universally available and affordable deposit and payments services.[91] Unlike private banks or other financial firms driven by profit considerations, a public depository institution is well positioned to act as a true public utility, a provider of reliable and unbiased access to safe money as a form of critical public infrastructure. Furthermore, pursuing the goals of financial inclusion and "banking the unbanked" puts public provisioning of deposit accounts at the core of the public banking movement.[92]

From an institutional design perspective, however, incorporating a deposit-taking function into the public bank's business plan presents a series of complex issues.

1. Managing Deposit Competition

A public bank offering demand deposits, by definition, is manufacturing liquid stable-value liabilities. This particular type of liability is also the bank's principal financial product, which puts the public bank in direct competition with private deposit-taking institutions. That may present a serious political problem, especially since community banks and credit unions traditionally exert a lot of political influence in local and national politics.[93] The easiest way to minimize this political conflict is either to preclude the public bank from accepting deposits altogether or to impose explicit restrictions on its deposit-taking authority. The former removes multiple problems associated with the depository function but, by the same token, eliminates a potentially significant source of funding for the public bank's operations. The latter option—restricting the scope of public banks' depository activities—offers some flexibility in this respect. The public bank may be explicitly limited to taking deposits only from

90. Thomas Marois calls such multi-functional institutions public "universal" banks. *See* MAROIS, *supra* note 12, at 34.

91. *See supra* Section I.B.

92. *See supra* notes 41-47 and accompanying text.

93. *See, e.g.*, Mike Konczal, *The Power of Community Banks*, POLITICO (Aug. 25, 2016), https://www.politico.com/agenda/story/2016/08/political-power-community-banks-hillary-clinton-000192 [https://perma.cc/AXA6-WUV3] (describing the political power of the community banking lobby).

public sector agencies and customers unserved or underserved by private banks.[94] It may also be allowed—or required—to partner with local banks and credit unions, effectively subsidizing the broader provision of affordable depository services by these institutions. A recently passed California law, for example, prohibits public banks from offering retail deposit accounts unless in partnership with local banks or credit unions.[95] The BND offers only very limited and inconvenient retail deposit services, in line with its official policy not to compete with the private sector for retail deposits.[96]

Restricting public banks' deposit-taking capacity may be a politically sensible or even necessary compromise, but it is nevertheless a compromise. To the extent financial inclusion and public provisioning of public money are key normative considerations driving the public banking project, it is important to consider more effective options. Postal banking offers a historically grounded alternative in this respect. It is built around the idea of using its nationwide physical network and broad customer base to offer retail financial services, especially to the underserved.[97] Thus, despite the range of opinions on what exactly the U.S. postal bank should do, the possibility of it offering universally available retail deposits in direct competition with private banks is built into its very premise.[98]

2. Ensuring Safety of Deposits

Taking this possibility seriously—that is, assuming that a public bank can function as a stand-alone depository institution—leads to another set of hard questions. In designing a public bank with full deposit-taking capabilities, the principal challenge is to ensure the safety of its deposit-

94. As the BND example illustrates, public agency deposits can serve as a stable and sufficiently sizeable source of funding for a public bank. The extent to which any individual public bank can replicate this success, however, depends on multiple factors specific to that bank's and its public depositors' needs and circumstances. It is also worth remembering that many states' laws require banks to collateralize their deposit obligations to public agencies. While these requirements are meant to protect government finances, they impose additional costs on banks accepting public deposits. *See, e.g.*, Katherine Patnaude, Robert Provost & Melissa Szot, *Safeguards for Deposits in Public Banking Institutions,* PKF O'CONNOR DAVIES (June 20, 2023), https://www.pkfod.com/insights/safeguards-for-deposits-in-public-banking-institutions [https://perma.cc/Z6LG-YFC2] (summarizing public deposit collateralization requirements in Connecticut, New Jersey, and New York).

95. *See* Assem. Bill 857, 2019-2020, ch. 442, 2019 Cal. Stat., https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB857 [https://perma.cc/3CET-L6Q5].

96. *See Checking and Savings Accounts*, BANK OF N.D., https://bnd.nd.gov/public/checking [https://perma.cc/Z938-E9W5] ("Because of our unique structure, it is the Bank's policy not to compete with the private sector for retail deposits. Therefore, convenience products such as debit cards, credit cards or online bill pay are not offered.").

97. *See* sources cited *supra* note 46.

98. For a proposal explicitly embracing this premise, see Herndon & Paul, *supra* note 48. The authors argue that competitive restrictions can "prevent the public bank from offering meaningful services." *Id.* at 16.

money. There are both asset-side and liability-side solutions to this problem.

As discussed above, deposit liabilities impose a hard liquidity constraint on the institution's assets.[99] The narrow bank model, essentially limiting the bank's investments to risk-free assets like U.S. government debt and Federal Reserve balances, is the cleanest asset-side solution to the potential depositor run problem.[100] This choice offers safety of the public bank's deposit-money without the need for explicit government guarantees—and the regulatory burdens and requirements that come with them. But the efficacy of this solution depends on the bank's ability to maintain a fully liquid asset portfolio, which may not generate sufficiently high returns to sustain the bank's operations. More fundamentally, this approach precludes the public bank from acting as a large-scale lender for the community.

If serving as the source of affordable credit is part of the public bank's mandate, the most effective solution is to recreate the "safety" of deposits by having explicit government guarantees. The Federal Deposit Insurance Corporation ("FDIC") guarantees retail deposits, but that guarantee comes with significant regulatory and supervisory requirements. It is unclear to what extent these requirements are compatible with the non-traditional, public policy-driven business model of a public bank.[101] The public bank's deposit liabilities can also be guaranteed by the state government, but the efficacy of these guarantees depends on many factors, including the relevant state's credit rating.[102]

Even with deposit insurance, the decision to pair low-cost deposits on the liability side with low-cost debt instruments on the asset side creates a potentially significant fragility on the public bank's balance sheet. The fragility is amplified because, unlike their private counterparts, public banks are set up to take on commercially undesirable or unacceptable risks in the public interest. Of course, it is difficult to draw definitive conclusions as to the viability of this business model in the abstract, since

99. *See supra* Section II.A.

100. As a practical matter, a public bank offering deposit and payments services will have to become a member of the Federal Reserve, which is an important factor to consider as part of the bank's institutional design.

101. As deposit insurer, the FDIC focuses primarily on elaborate prudential safeguards that individual banks must have in place to avoid failure. These safeguards are fundamentally geared toward the traditional business model of private banks, which might make the FDIC understandably wary of guaranteeing liabilities of a depository institution operating on a different basis. *See generally About*, FED. DEPOSIT INS. CORP., https://www.fdic.gov/about [https://perma.cc/Y3DH-ET2Q].

102. The BND, the only operating U.S. public bank, does not offer FDIC-insured deposits. Its liabilities are backed by the State of North Dakota, which is constitutionally obligated to deposit all of its funds at the BND. *History of BND*, *supra* note 4.

much will depend on the specifics.[103] But it is crucial to be fully cognizant of the heightened danger it poses in the context of a public bank.

3. Addressing Regulatory and Administrative Issues

This heightened danger raises a question of potential regulatory oversight of public banks' operations. U.S. deposit-taking institutions are subject to an extensive and quite elaborate regime of prudential regulation and supervision, at the federal as well as state levels, aiming to ensure each institution's safety and soundness. The principal tool of prudential oversight is bank capital regulation, which works by mandating certain levels of shareholder equity commensurate with the riskiness of each bank's assets. Generally speaking, the riskier and more volatile an individual commercial bank's assets are, the higher the amount of required equity cushion such bank must maintain to protect its depositors against potential losses.[104] This extremely simplified description of bank capital rules illustrates how fundamental the presumption of private equity ownership is to the entire project of bank regulation and supervision, which works by controlling and shaping private bank owners' and managers' incentives and conduct. In the public banking context, this approach is unlikely to work for both practical and political reasons. Would one government agency force another government agency to contribute more "capital" to protect a public bank's creditors—including, perhaps, private bondholders—from losses on its portfolio of affordable loans to the underserved communities? How realistic or desirable is that scenario?[105]

Finally, there are numerous administrative and operational issues that impact the costs of the bank's deposit-taking business. For example, would the bank charge any fees, and how would these be calculated? What additional services can the bank offer? Will it operate physical branches, and where will they be located? These and other seemingly mundane questions can be highly politically sensitive in the context of public banking and thus need to be addressed at the designing stage.

103. It may depend on the size and diversification of the bank's asset portfolio, its capacity to generate revenue from other services, and many other factors.

104. *See, e.g.*, Joseph G. Haubrich, *A Brief History of Bank Capital Requirements in the United States*, FED. RSRV. BANK OF CLEVELAND, ECON. COMMENT. (2020), https://www.clevelandfed.org/publications/economic-commentary/2020/ec-202005-evolution-bank-capital-requirements [https://perma.cc/F7U6-7QRC] (describing U.S. bank capital regulation in historical context).

105. Of course, there may be other forms of regulatory oversight more appropriate for a public deposit-taking institution's business model. For present purposes, the key is to highlight the fact that the search for such alternative regulatory solutions would have to accommodate the unique institutional realities of public banking.

B. Public Bank as a Credit Institution

Designing a public bank around the lending function raises a separate set of issues. The core premise of the exercise is that a public bank's mandate is fundamentally focused on providing affordable credit to public sector agencies, consumers, and businesses, particularly in underserved and traditionally disadvantaged communities. There is a politically powerful sentiment behind this idea: public banks' job is to make sure that taxpayers' dollars serve their local communities' credit needs.[106] The public bank's lending function becomes even more politically salient where public banks are precluded from offering full-service, community-wide deposit services.[107]

1. Confronting Credit Risk

While the ability to direct low-cost credit where it is systematically under-provided by private lenders is essential from the public policy perspective, it is inherently problematic from the standard lending business perspective. The public bank's target borrowers are typically considered high credit risk because of their low levels of income or wealth, unstable revenues, or similar factors commonly used to justify private banks' unwillingness to lend to them and alternative lenders' ability to charge them predatory rates.

Extending high-risk loans at below-market rates—that is, at rates well below those demanded by private lenders—requires the bank to build multiple safety mechanisms into its lending operations and overall business model. Advanced technological capabilities can be a critical factor in optimizing the bank's credit risk management. More sophisticated and fine-tuned credit underwriting tools could improve the public bank's assessment of the actual risks presented by non-traditional borrowers.[108]

106. *See, e.g.*, *About: Our Priorities*, PUB. BANK LA, https://www.publicbankla.org/about/our-priorities [https://perma.cc/68HJ-ZFAP] ("A Los Angeles public bank will ensure that public tax dollars stay within the city and are invested in local communities.").

107. This is why, for example, a recent report outlining the case for a Los Angeles Municipal Bank is so heavily focused on various credit extension programs. *See Introductory Report: A Municipal Bank for Los Angeles,* JAIN FAM. INST. 24-30 (May 2023), https://jainfamilyinstitute.org/wp-content/uploads/2023/05/JFI-Berggruen_MBLA_Overview-Report_May-2023.pdf [https://perma.cc/9RCW-XFWB].

108. In developing more accurate and flexible risk management tools, public banks can build on the accumulated experience of various community development financing institutions (CDFIs) and other lenders that currently service low-income and underserved communities. Individual CDFIs' success with underwriting loans to small businesses and homebuyers traditionally considered high-risk borrowers is an important source of institutional learning for public banks. *See, e.g.*, Valentina Dimitrova-Grajzl et al., *Native CDFIs bring holistic approach to assessing credit risk*, FED. RSRV. BANK OF MINNEAPOLIS (Feb. 2, 2023), https://www.minneapolisfed.org/article/2023/native-cdfis-bring-holistic-approach-to-assessing-credit-risk [https://perma.cc/2QGV-QZWH] (describing Native CDFIs' practice of incorporating character-based criteria in credit underwriting); DARRYLL E. GETTER, CONG. RSCH. SERV., R47217, COMMUNITY

Asset diversification (both in the bank's portfolio of loans and in its overall portfolio) and dynamic risk hedging could lower its exposure to losses. Finally, simply not having to meet shareholders' expectations of regular returns should enable the public bank to pick less lucrative assets.

None of these factors or tools, however, can guarantee that the bank will be able either to price its loans "correctly" or to manage away any unpriced risks.[109] Nor can they remove the fundamental source of instability in the bank's loan portfolio. The fact that a public bank's failure carries extremely high political costs makes it imperative to minimize this instability. One way to do this is to tighten the scope of the public bank's discretion by limiting it to certain kinds of loans (e.g., loans to businesses and public agencies), mandating stricter credit underwriting standards (e.g., allowing loans only to borrowers meeting specified conditions), or imposing similar portfolio-level requirements. While these restrictions could improve the quality of the public bank's assets, they would do so by constraining the bank's ability to provide affordable credit to those in the community who need it most. It is a trade-off that may not prove sensible in the long run.

The more effective and lasting solution is to ensure that the public bank has sufficient and stable financing to support its lending operations through the entire cycle. To be able to withstand potentially significant loan losses, the bank needs to maintain a sufficiently high loss-absorbing cushion (equity or deeply subordinated equity-like debt), enjoy access to external liquidity support, or both. Accordingly, the most important and consequential choice to be made in the process of setting up a public *lender* concerns the sources and terms of its financing.

2. Ensuring Reliable Financing

As discussed above, deposits are generally not a suitable form of financing the public bank's credit operations.[110] That leaves two principal funding options: government budget transfers and bond issuance in capital markets.[111] Bond financing, however, is likely to be prohibitively expensive for a mission-driven public lender with low-yielding, high-risk asset portfolio. Moreover, private bondholders' presence in the public

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DEVELOPMENT FINANCIAL INSTITUTIONS (CDFIS): OVERVIEW AND SELECTED ISSUES (Sept. 29, 2023), https://sgp.fas.org/crs/misc/R47217.pdf [https://perma.cc/BSZ2-JVCN] (discussing the overall performance of, and challenges encountered by, CDFIs).

109. This brings up an important conceptual point. A public bank embedded in the broader private profit-driven financial market does not have the power to redefine the core credit valuation criteria prevalent in that market. Under these market-dominant criteria, low-cost loans to high-risk borrowers—regardless of their public policy rationale—are presumptively "mispriced" or "underpriced."

110. *See supra* Section II.B.

111. *See supra* Sections II.A-B.

bank's capital structure can exacerbate its fragility: if the bank experiences significant losses in its credit portfolio, it may be forced into bankruptcy by its private creditors.

Government financing is the most logical source of funding for a public bank with an affordable credit mandate. In addition to the initial capital contribution, an explicit government commitment to provide ongoing liquidity support or some form of guarantee against losses is essential to the bank's ability to fulfill its mission. It is also a political necessity. A public bank that lends to marginalized borrowers must deal with the possibility of frequent defaults, which raises difficult questions about enforcement of its contractual lender rights. Would the bank repossess the car or garnish the wages of a poverty-stricken single mother unable to repay a small loan? Or would it "restructure" the loan and take the loss? The former is not a palatable option for a public bank; the latter makes it look less like a loan and more like a fiscal transfer. While it is difficult to predict exactly what proportion of the bank's loans would end up in this scenario, the prospect of significant public subsidies flowing through the public lender's balance sheet is built into its model. The government standing financially behind the public bank simply acknowledges this reality.[112]

It also raises a host of thorny political issues.[113] Direct public subsidy of the bank's policy-driven credit portfolio sharply politicizes every aspect of the bank's business and governance. It potentially opens the public bank to criticism for lacking operational independence, business expertise, and, ultimately, legitimacy. If the public bank is widely perceived as merely a conduit for redistribution, the need for its existence is easily called in question. All of this gives the banking industry additional ammunition to oppose public banking as a form of inefficient and illegitimate state interference in private markets.

3. Lending Through Private Banks

The BND's business model is often seen as a practical solution to this cluster of problems. Most of the BND's lending is done in partnership with local community banks and other private lenders. These local banks originate industrial, agricultural, and mortgage loans that the BND

112. It is worth noting in this connection that existing CDFIs' lending to low-income and underserved segments of the population explicitly relies on access to no-cost or low-cost funding, particularly through multiple federal funding programs. *See* GETTER, *supra* note 108, at 17-23.

113. While the present discussion focuses on the factors affecting the bank's design and operations, subsidizing the bank's portfolio also raises potentially extremely difficult issues for the government, especially if it is a state or local government with finite financial resources or limited legal authority to make such commitments. The federal government is the optimal source of subsidy, at least from this perspective.

either purchases for its own books or co-finances—a technique known as loan participation.[114] This indirect credit extension strategy is widely credited for North Dakota's thriving ecosystem of community banks and credit unions, which consider the BND a vital business partner.[115] In effect, it allows the BND, a public bank, to subsidize and amplify the flow of private credit throughout the entire state.

Whether or not the BND's success can be replicated in other localities—most of which have very different demographic, economic, and political profiles and needs—is an open question. More generally, while subsidizing private bank lending to underserved borrowers may lessen the fiscal pressure on the government and diffuse the industry's opposition to public banking, it represents a major compromise. To the extent the new supply of affordable credit is mediated through private lenders' economic incentives, this compromise may have significant consequences for the public bank's ability to fulfill its mission.

C. Public Bank as an Investment Institution

As discussed above, public banks are often envisioned as institutional vehicles for channeling investment into critical public and social infrastructure that does not get financed in private capital markets.[116] Unlike private investors rationally averse to funding capital-intensive infrastructure projects with uncertain or delayed cash rewards, public banks are inherently patient investors. High risk tolerance, long time horizons, and focus on public rather than private benefits enable public institutions to take the risks private investors consider unpalatable. Many of today's most pressing economic and political challenges—revitalizing traditionally disadvantaged communities, fighting environmental degradation, modernizing and expanding affordable transportation and communication systems, and so forth—involve risks that require public investment, often on a large scale.

Traditional debt instruments cannot adequately absorb these types of risk, which is why the ability to take equity stakes in various projects is an essential element of existing public development banks' toolkits. As a development financier, a public bank will often act more like a venture capital fund than a commercial bank. It will have to identify and evaluate each potential project from the perspective of its long-term contribution to economic growth and well-being of the relevant community, estimate the size and timing of capital outlays, structure the investment to optimize its goals, monitor and manage the project's performance, and exe-

114. *See* MAROIS, *supra* note 12, at 174-75 (describing the BND's lending strategy). The BND extends student loans directly. *History of BND, supra* note 4.

115. MAROIS, *supra* note 12, at 174-75.

116. *See supra* Section I.B.

cute a successful exit. It will have to construct and dynamically manage a large, diversified portfolio of projects with different timeframes, risk profiles, and other characteristics.

1. Financing Public Investment Portfolio

Running a successful investment management business of this type requires stable and flexible funding. That rules out reliance on deposits.[117] Government appropriations are critical as the source of the bank's initial funding (or "seed" capital) but cannot reliably support its operations on an ongoing basis, especially as such operations grow in scale and complexity. Governments typically operate with limited resources (especially at the state and local levels), and their budgets are dependent on inherently unpredictable political dynamics. In practice, it is common for public development and infrastructure banks to raise capital in private bond markets. Bond financing allows the public bank to leverage public money, thereby amplifying its investment capacity, and lessens its dependence on the politically driven appropriations process. It also introduces an element of market discipline as a potential safeguard against excessive interference by incumbent politicians, which is important from the perspective of the public bank's effectiveness and legitimacy as a market actor. Unlike low-cost consumer loans to low-income borrowers, discussed above,[118] "hard" infrastructure assets with steady future cash flows can be an attractive proposition for private bondholders, provided the public bank picks individual assets with an eye to their potential to produce such cash flows in the not-so-distant future.

That, however, is also the fundamental problem with relying on bond markets to finance the public bank's investment portfolio: raising capital from private lenders subjects the bank to an iron-clad law of commercial profitability. To be able to repay its debt to the bondholders, the public bank will have to invest primarily, if not exclusively, in infrastructure projects that can generate commercial revenues from user-fees—such as toll roads and power plants, especially in or near populous urban areas. It will not be able to allocate much of its capital to projects not meant to generate commercial profits, especially by charging consumers—such as new toll-free roads or state-of-the-art energy networks in impoverished rural areas or inner-city neighborhoods.[119] In short, pri-

117. *See supra* Section III.A.

118. *See supra* Section III.B.

119. In theory, the public bank could construct a sufficiently large and diversified investment portfolio that may enable it to finance at least some publicly beneficial but commercially unprofitable projects. As a practical matter, however, it is difficult to tell how feasible that cross-subsidizing strategy is in any specific case, or how much leeway any particular borrower-bank will actually have in this respect.

vate financing of the public bank's investment portfolio can severely limit its autonomy and capacity to fulfill its public policy mandate. This is a critically important trade-off that cannot be ignored, even for ostensibly pragmatic reasons.

2. Balancing Governance Choices

Designing a public investment bank in a way that would maximize its decisional autonomy and policy efficacy involves factors beyond financing. The bank's governance and internal business management systems are crucial in this respect. The architects of a public bank whose principal function is to finance sustainable and equitable economic development and related social infrastructure must hard-wire the bank's governance and management structure to serve these goals. That is not an easy task because of the fundamental hybridity of a public bank as an institutional form. As a business entity, the bank will have to mimic certain functional features of the traditional corporate management and governance. These features, however, are not generally geared toward ensuring substantive outcomes other than those typically sought by private business firms: maintaining the solvency and liquidity of the firm's business operations, complying with contractual obligations, coordinating production and administrative processes, and so on. The broader public policy goals generally have parameters that cannot be easily captured by these "normal" business categories.

Accordingly, it is especially important that the bank's business procedures reflect its substantive objectives. Who sets the bank's investment strategy? What is the process for making individual portfolio-level investment decisions? Whose interests are considered, and how are they balanced? Are these investment decisions made in-house or outsourced to private experts? In the context of a public investment institution, these are not second-order operational details: they determine how effectively that institution carries out its public mission. Thus, both the principal substantive criteria and the clear procedural mechanisms for vetting and managing the public bank's portfolio investments are the constitutive elements of its institutional design.

3. Structuring Co-Investments

A critical issue in managing the public bank's portfolio investments is how the public bank would interact with private investment institutions. Should it aim to serve mainly as the key support layer for private capital, taking residual risks in certain infrastructure projects to make them more financially attractive to private investors? Or should it aim to play the leading role, taking equity stakes with the intent to exercise greater control over its portfolio companies? The former strategy "crowds in" private money by "de-risking" investments—the popular means of leveraging limited budget allocations to get much-needed infrastructure built quickly. It is also a politically more viable choice: insofar as risk-absorbing public participation benefits private industry without threatening its investment returns, it is less likely to trigger significant industry opposition.

On the downside, however, "de-risking" strategies can generate disproportionately high private profits at the public's expense, which would erode the public bank's institutional capacity and political legitimacy.[120] Whether or not that happens depends greatly on the specific structure of the public bank's co-investments in individual projects.[121] In structuring these investments, the desire to "crowd in" private capital must be carefully balanced against the need to prioritize public policy outcomes. A public bank is not a vehicle for subsidizing its private co-investors' profits. Its core mission is to manage public assets so as to maximize the full array of public benefits—including long-term benefits not fully captured in the performance metrics borrowed from the private sector. In some situations, reducing short-term outlays of public money by incentivizing private investment may meet that goal. Just as often, however, it may preclude more effective and lasting solutions to the underlying socioeconomic problems. Therefore, the public bank's institutional design must not, deliberately or inadvertently, constrain the bank's ability to choose and adapt its instruments to fit its public policy objectives.

D. Drawing Lessons: The Limits of Incrementalism

As the foregoing discussion shows, designing an effective mission-oriented public bank is a complex undertaking that involves multiple choices and requires difficult tradeoffs. While it is impossible to identify all such potential decision points in the abstract, a few key observations deserve reiteration.

The first point that emerges from this high-level analysis relates to the feasibility of combining the three core business functions commonly assigned to public banks: deposit-taking, lending, and investment management. There are solid policy reasons for entrusting each of these func-

120. For a discussion of the tradeoffs between "de-risking" private investors and maximizing public benefits generated by public investments, see Stephany Griffith-Jones & Natalya Naqvi, *Industrial Policy and Risk-Sharing in Public Development Banks* (Glob. Econ. Governance Programme, Working Paper No. 143, 2020), https://www.geg.ox.ac.uk/sites/default/files/2020-07/GEG%20WP%20143%20July%202020%20Industrial%20policy%20and%20risk%20sharing%20in%20public%20development%20banks.pdf [https://perma.cc/59R4-RCBZ]; Daniela Gabor, *The Wall Street Consensus*, 52 DEV. & CHANGE 429 (2021).

121. In fact, the term "de-risking" can be used to denote a great variety of financial instruments and techniques that put the floor under private investors' losses, create a publicly supported secondary market for trading private investors' claims, or otherwise limit specific risks that prevent private capital from flowing into desired infrastructure projects.

tions to a publicly owned and publicly oriented financial institution.[122] In theory, moreover, deposits can serve as a cheap source of financing public banks' business activities and investments, much like they do for commercial banks. Here, however, the logic of simply extending private banks' business model to a public institution breaks down. As discussed above, combining deposit liabilities with affordable loans or patient investments a public bank is expected to hold in its asset portfolio creates a particularly problematic form of balance-sheet fragility.[123] Because public bank's assets are meant to meet much broader and more diffuse criteria than revenue- or profit-generation, the level of financial risk the bank is set to carry on the asset side of its balance sheet is simply too high to be safely financed through the issuance of demand liabilities. Thus, both the bank's own solvency (a micro-level concern) and the safety of its monetary obligations (a macro-level concern) would likely require additional public subsidies. Access to the FDIC deposit insurance scheme—which may or may not be readily available to an individual public bank[124]—is a necessary but not sufficient element of this backup mechanism.[125] In most situations, a clear and credible government commitment to subsidize the ongoing operations of a "universal" or "all-purpose" public bank is a structural prerequisite for its future viability.

The second observation concerns the relationship between the public bank's funding structure and its ability to fulfill its policy mandate. It is important to understand, for example, that significant reliance on debt financing in private capital markets imposes potentially debilitating structural constraints on the public bank's investment strategy and decisional autonomy. While commonly viewed as a sensible alternative to scarce government funding, raising capital in the bond market severely restricts the bank's ability to finance economic activities not likely to generate sufficient revenues to cover the bank's repayment obligations. This indirect profitability constraint can effectively incapacitate a public bank with an ambitious financial inclusion or developmental policy agenda. The same problem arises where the enabling legislation explicitly requires the public bank to make commercially viable investments.[126] These choices may well be justified in the short run, but they need to be recognized for what they portend in the longer run.

Finally, thinking through the various institutional design options highlights the complex dynamics between public banks and private finan-

122. *See supra* Section I.B.

123. *See supra* Section III.A.2.

124. This is a particularly salient issue for state-level and local public banks.

125. *See supra* Section III.A.2.

126. This requirement may be phrased in various ways and is often referred to as a "double bottom line" mandate: achieving public policy objectives while also generating financial profits.

cial industry players. Depending on the public bank's mission and business model, private financial institutions—commercial banks, nonbank lenders, private equity funds, and so on—may perceive it either as an outright competitive threat or as a welcome repository of unwanted risks. Politically charged conflicts with the private industry are most likely to appear where a public bank is designed to offer widely available deposit services. As discussed above, private banks' delegated authority to create deposit-money, which circulates in the nation's economy as de facto sovereign money, is the ultimate source of their "specialness" and their access to explicit and implicit public subsidies.[127] A public bank capable of performing this public function *entirely in the public interest*, and not as a private profit-making business, is an existential threat to private banks. Accordingly, proposals to create a full-scale public option in deposit services—in whatever form—are bound to face massive political opposition.[128] Creation of a public investment bank, on the other hand, typically generates very different political dynamics, with the financial industry seeking to shape the public bank's design to serve its own interests. Here, the political battles are likely to focus on the extent to which the public bank can compete with private investment funds, as opposed to simply channeling public money into privately controlled infrastructure projects. The fundamental conflict of public and private interests does not disappear in this context, but it becomes less visible behind the rhetoric of alignment and partnership.

These are only a few general observations pointing to the tremendous complexity—albeit not impossibility—of the public banking project. From an advocacy perspective, the main takeaway is simple but weighty: a public bank's normative ambition and its institutional viability are often inversely related in practice. The bigger question, however, is *why* that is the case.

An analysis of structural constraints and compromises built into the design of a *viable* public bank reveals the deeper, more fundamental tension between the concept of public banking and the currently dominant system of private finance. Public banking is not simply a logical extension of, or a complementary addition to, the existing institutional arrangement—it is a competing paradigm. As a system of organizing the flows of money and capital based on public benefits, it offers a structural and normative alternative to the private profit-based financial system. The multitude of policy tradeoffs, frictions, and constraints faced by public banks are ultimately rooted in this conflict. The dominant system of private finance does not recognize and cannot accommodate a qualitatively

127. *See supra* notes 32-38 and accompanying text.

128. *See, e.g.*, *Public Banks: ABA Position*, AM. BANKERS ASS'N, https://www.aba.com/advocacy/our-issues/public-banks [https://perma.cc/LLS9-E6MC].

different value scale and transactional motivations that define public banking. A stand-alone public bank embedded in that system, regardless of size or status, must accommodate *its* values and motivations. It is expected to conduct its business in conformity with the private market's rules, incentives, and performance criteria—while prioritizing objectives and producing outcomes this regime routinely supplants or suppresses. Unilaterally internalizing this system-level conflict is a survival imperative for a public bank nestled inside the much larger and more powerful private financial ecosystem. Yet, it inevitably weakens the bank's capacity to bring about a truly transformative change.

How do we correct this imbalance and enable public banks to realize their full potential as financial market actors? Is it possible to change the institutional environment in which public banks do their work, so that they can do it without compromising their mission?

In short, can we expand the limits of public power in today's finance?

IV. Rethinking Design: From a Public *Bank* to a Public Banking *System*

Understanding the underlying public-private power dynamics, described above,[129] allows us not only to appreciate the complexities of designing a public bank under the current conditions, but also to envision a more comprehensive and effective model of next-generation public banking. If public banks provide important public benefits, the socially optimal solution to their present difficulties is not to scale down their policy ambitions to fit the externally restrictive environment but to scale them *up* by creating more supportive *systemic* conditions. To reach its full potential, public banking needs to be elevated to the level of a high-priority national project. It needs to be re-conceptualized as a multi-tiered system of publicly oriented financial institutions performing core financial-market functions—deposit-taking, credit extension, and investment management—in an integrated manner.

This Part outlines the basic contours of what this new ecosystem of public banking could look like. It reimagines a nationwide network of specialized institutional channels for delivering each of the key benefits public banking is expected to produce: universal access to fully safe deposit-money, affordable credit, and sustained investment in public infrastructure and economic development. At the core of this network is the country's central bank, the Fed, redesigned to serve as the ultimate platform supporting the flow of public finance toward public goods.[130]

129. *See supra* Section III.D.

130. This Part builds on and adapts proposals advanced in my prior work. *See* sources cited *supra* note 23.

A. Public Money Creation

Continuous access to fully safe, liquid, and universally accepted deposit-money is a critical public good. It is an essential element of full economic citizenship in, and a prerequisite for the healthy functioning of, the modern exchange-based economy.[131] Provision of low-cost, nondiscriminatory deposit services to currently underserved communities, accordingly, is an important goal animating today's public banking movement. As discussed above, however, deposit-taking is a challenging undertaking for a state- or municipal public bank, both politically and as a matter of its balance sheet management.[132]

But there already exists a highly successful form of publicly issued deposit-money: central bank reserves. These are direct monetary liabilities of the central bank that serve as the system's final settlement asset, the fully sovereign—and safest—form of digital money. In the United States, only banks (and certain other institutions) enjoy the privilege of having reserve accounts at the Fed.[133] In this sense, the Fed operates as a "banks' bank" that uses its own balance sheet to accommodate banks' monetary liabilities, thereby enabling private banks to create *de facto* public money.[134]

In the post-2008 era, this arrangement at the heart of the current franchise system of finance, described above,[135] came under increasing scrutiny, especially as new financial technologies opened the possibility of broadening direct access to central bank money.[136] While the idea of allowing ordinary Americans to open deposit accounts directly at the Fed has been around for decades,[137] it was the advent of central bank digital

131. *See supra* Section I.B.

132. *See supra* Section III.A.

133. *See* 12 U.S.C. § 342 (banks). For the limited number of other categories of entity authorized to hold Federal Reserve Accounts, see, e.g., 12 U.S.C. § 391 (Treasury); 12 U.S.C. §§ 1435, 1452(d) & 1723a(g) (mortgage government-sponsored enterprises); 12 U.S.C. §§ 347d, 358 (foreign governments, banks, and central banks); 22 U.S.C. § 286d (International Bank for Reconstruction and Development, International Monetary Fund); 12 U.S.C. § 5465 (designated financial market utilities).

134. *See Finance Franchise, supra* note 19, at 1155-57.

135. *See supra* notes 32-38 and accompanying text.

136. For a sample of the debate among economists on using digital technologies to expand access to central bank reserves, see generally Dirk Niepelt, *Reserves for All? Central Bank Digital Currency, Deposits, and their (Non)-Equivalence* (CESifo, Working Paper No. 7176, 2018), https://www.cesifo.org/DocDL/cesifo1_wp7176.pdf [https://perma.cc/R3VV-J66J]; David Andolfatto, *Fedcoin: On the Desirability of a Government Cryptocurrency*, MACROMANIA (Feb. 3, 2015), https://andolfatto.blogspot.com/2015/02/fedcoin-on-desirability-of-government.html [https://perma.cc/U86C-WNGA]; Robert Sams, *Which Fedcoin?,* CRYPTONOMICS (Feb. 5, 2015), https://cryptonomics.org/2015/02/05/which-fedcoin [https://perma.cc/5APS-MKLT]; J.P. Koning, *Fedcoin*, MONEYNESS (Oct. 19, 2014), https://jpkoning.blogspot.com/2014/10/fedcoin.html [https://perma.cc/DF89-RDVZ].

137. *See* James Tobin, *Financial Innovation and Deregulation in Perspective*, 3 BANK JAPAN MONETARY & ECON. STUD. 19, 25 (1985) (suggesting allowing "individuals to hold deposit accounts in the central bank, or in branches of it established for the purpose and perhaps

currency ("CBDC") that put the concept of "Fed accounts for all" within practical reach. In simple terms, CBDC is a digital version of sovereign money, such as the U.S. dollar, which is currently available to individuals and non-bank entities only as physical cash. Having the Fed as their deposit provider would enable everyone, and not just banks, to make and receive electronic payments in the safest form of modern money: central bank money.[138] It would transform what is presently a special institutional privilege into a basic economic right.

The harsh realities of the COVID-19 pandemic reignited the interest in opening the Federal Reserve's deposit services to the general population and briefly propelled the idea into the national spotlight.[139] The official CBDC debate, however, has quickly moved away from this notion, focusing instead on the technical details of designing CBDC that preserves (rather than disrupts) the existing arrangement and ensures the continuing indispensability of private banks as monetary institutions.[140] Today, the world's central bankers discuss CBDC not as a tool of democratizing their balance sheets by establishing a direct relationship with their fellow citizens, but as purely technological means of preserving the

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located in post offices."). For a popular recent re-articulation of this idea, see Morgan Ricks, John Crawford & Lev Menand, *Central Banking for All: A Public Option for Bank Accounts,* GREAT DEMOCRACY INITIATIVE (2018), https://rooseveltinstitute.org/wp-content/uploads/2021/08/GDI_Central-Banking-For-All_201806.pdf [https://perma.cc/8RP7-RJLH] (calling for allowing the general public to open accounts at the Federal Reserve).

138. *See Central Bank Digital Currency (CBDC),* BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/cbdc-faqs.htm [https://perma.cc/7BYD-J7YK].

139. *See* Mike Konczal, *A Federal Reserve Reform Agenda: Eight Recommendations*, ROOSEVELT INST. 10-11 (Sept. 2020), https://rooseveltinstitute.org/wp-content/uploads/2020/09/RI_FedDA_Working-Paper_202009.pdf [https://perma.cc/73AS-JKY7] (advocating postal banking services with FedAccount backing); Ameya Pawar, *'Fed Accounts' For All—With Automatic and Recurring Payments Triggered by Economic Crises*, MARKETWATCH (July 25, 2020), https://www.marketwatch.com/story/fed-accounts-for-all-with-automatic-and-recurring-payments-triggered-by-economic-crises-2020-07-21 [https://perma.cc/H9CR-EPRF] (arguing that every American should receive a bank account at the Federal Reserve); Sylvan Lane, *Biden-Sanders Unity Task Force Calls for Fed, US Postal Service Consumer Banking*, THE HILL (July 8, 2020), https://thehill.com/policy/finance/506469-biden-sanders-unity-task-force-calls-for-fed-us-postal-service-consumer [https://perma.cc/93Y7-ZBDZ] (calling for the Federal Reserve to provide every American with an "affordable bank account"); Nikhilesh De, *US Lawmakers Talk Digital Dollar, FedAccounts in Thursday Hearing*, COINDESK (Sept. 14, 2021), https://www.coindesk.com/watch-us-lawmakers-will-talk-digital-dollar-fedaccounts-in-thursday-hearing [https://perma.cc/3EQ4-WAVZ] (discussing "FedAccounts" and digital currencies). In March 2020, Senator Sherrod Brown introduced legislation to allow every American to open a "digital dollar wallet at the Fed. *See* Banking for All Act, S. 3571, 116th Cong. (2020).

140. *See* Dirk Niepelt, *Digital Money and Central Bank Digital Currency: An Executive Summary for Policymakers*, CTR. FOR ECON. POL'Y RSCH. (Feb. 3, 2020), https://voxeu.org/article/digital-money-and-central-bank-digital-currency-executive-summary [https://perma.cc/GS5E-EQ8G] (summarizing the CBDC debate); *Central Bank Digital Currency: Virtual Handbook*, INT'L MONETARY FUND (2023), https://www.imf.org/en/Topics/fintech/central-bank-digital-currency/virtual-handbook [https://perma.cc/WX43-QR3X] (operationalizing the current consensus on the key design parameters of CBDC).

status quo in the changing financial markets by continuing to accommodate privately issued moneys.[141]

It is nevertheless important to explore the possibility of a bigger institutional reform that would transform the Federal Reserve from a "banks' bank" into a "people's bank"—or a public bank, in a very direct sense. The core element of this reform is to allow all U.S. citizens and lawful residents, public sector agencies, businesses, and non-business entities to open digital dollar (i.e., U.S. CBDC) transaction accounts directly with their regional Federal Reserve Bank. These FedAccounts would function just like any standard checking account; they would pay interest at the rate determined by the Fed; and they would be free of charge. As natively digital money, FedAccounts would also provide the basic transactional conveniences of digital wallets, only with no payments risk.[142] Periodic disbursements of public funds—such as social security payments, tax refunds, or emergency assistance—would be credited directly and instantaneously to each recipient's FedAccount, which would greatly improve the efficiency of this system.[143] In short, the Federal Reserve would perform the core function of a modern-day public depository on the national scale.

From the perspective of designing an effective system of public banking, placing the deposit-taking function at the central bank is the optimal solution that removes the challenges and avoids the tradeoffs faced by any other public bank.[144] As the issuer of the nation's money, the Fed does not have the liquidity constraints that can significantly hamstring other deposit-taking public banks' operations. Its monetary liabilities—physical cash, existing reserve balances, or proposed FedAccounts—*are* the ultimate instruments of liquidity. Concentrating public money creation in the central bank's hands also maximizes the network effects and ensures the "singleness" of digital money.[145]

For purposes of administering its deposit network, the Fed would license community banks, credit unions, and state and municipal public banks to offer "pass-through" FedAccounts, fully backed by the corresponding deposits at the Fed.[146] These institutions would operate physical

141. *See*, *e.g.*, BANK FOR INT'L SETTLEMENTS, ANNUAL ECONOMIC REPORT 2023, at 85-109 (2023), https://www.bis.org/publ/arpdf/ar2023e.htm [https://perma.cc/4K4R-JKN4].

142. This explains the importance of the CBDC element in the FedAccounts architecture. While CBDC technology is not strictly necessary for the Fed to issue deposits, it creates the vital capacity for real-time settlement, programmability, and effective "layering" of additional functionalities that improve end-users' experience.

143. *See People's Ledger*, *supra* note 23, at 1258-59.

144. *See supra* Section III.A.

145. The concept of "singleness" of money is "the property that payments denominated in the sovereign unit of account will be settled at par, even if they use different forms of privately and publicly issued monies." BANK FOR INT'L SETTLEMENTS, *supra* note 141, at 86.

146. Under this scheme, each depositor of a licensed banking institution would be entitled to the proportional amount held by the institution in its "master FedAccount," on the

branches and ATMs, conduct customer onboarding and identity verification procedures, manage day-to-day account information, provide standard customer services, and otherwise act as the Fed's customer-facing agents.[147] For these services, the Fed would pay these institutions a reasonable fee, providing a steady revenue stream. As exclusive providers of FedAccount services, these banking institutions—including public banks—would be well-positioned to offer depositors their own revenue-generating products: savings accounts, certificates of deposit, credit products, investment advice, and so forth.[148]

Importantly, this would both encourage the creation and support the operation of multiple state and local public banks. These entities would be able to offer a solid suite of depository and related services to their target constituencies, without worrying about potential runs or having to scale down their affordable lending or public investment goals.[149] This approach, moreover, would bring a large number of private community banks inside the public banking system, making them indispensable partners of the Fed.[150] In effect, the system of FedAccounts administered through local community-oriented public and private banks would put the power of public money creation behind these institutions' socially beneficial work.

This brief sketch of the FedAccounts proposal does not address the inevitably complex legal, technological, political, and other issues posed by such fundamental rewiring of the existing monetary and financial infrastructure.[151] Its purpose is to reframe the ongoing debate on public banking as a matter of more ambitiously systemic change—and to highlight the transformative potential of the Fed's balance sheet as the ultimate public banking platform. Direct issuance of digital dollar deposits to the public would fundamentally alter the relationship between the Fed and the people it is supposed to serve. It would solve the problem of fi-

fully reserved basis. To maximize the intended benefit of this system to local communities around the country, only entities below a specified asset-size threshold would be eligible for the license. Public banks would qualify regardless of their asset size. The USPS offices may also be utilized as physical branches offering "pass-through" FedAccounts. In general, this is a similar arrangement to what was proposed by Senator Brown in Senate Bill 3571. *See supra* note 139.

147. Critically, this system can be designed with the view to protecting the privacy of depositors' financial information, among other things, by legally and administratively shielding certain granular transactional data from the Fed, so that such information stays with the customer-facing bank (much as it does today).

148. *See People's Ledger, supra* note 23, at 1265; Saule T. Omarova, *How to Make Banks Safer for Depositors and Boost Free Markets, Too*, WASH. POST (Apr. 12, 2023), https://www.washingtonpost.com/opinions/2023/04/12/banks-crisis-fed-accounts-lending [https://perma.cc/DB4K-HHA9].

149. *See supra* Section III.A.

150. This partnership, however, would fundamentally differ from the present "finance franchise" system: the Fed's new franchisee-institutions would not engage in money creation, as is currently the case.

151. For a discussion of some of these issues, see *People's Ledger*, *supra* note 23.

nancial inclusion and affordable access to banking services. It would also help to stabilize the monetary and financial system by creating a fully safe—i.e., run-free—sovereign form of digital money available for universal use. In the absence of private profit incentives, public money creation would become a true public utility function and not a lever of publicly subsidized private power.

B. Public-Private Credit Allocation

Provision of affordable credit, especially for underserved borrowers, is another important function of public banks. As discussed above, it raises its own distinct set of difficult issues, related mainly to public banks' limited access to sufficiently stable and flexible financing.[152] The principal sources of public bank funding—government contributions and private bond markets —typically impose direct or indirect constraints on their capacity to perform their policy mission.[153]

Once again, the Fed, as the nation's central bank, is precisely the kind of a financier public banks need: it has a high-capacity balance sheet, long time horizons, and a public interest mandate. Originally designed to be a "lender of last resort" for its member-banks, the Fed has gradually expanded its traditional role as an emergency liquidity provider to a wide range of private financial and even non-financial firms, often in a politically controversial manner.[154] Given the proven efficacy of the Fed's existing tools, it is important to consider repurposing them to provide continuous, rather than crisis-driven, funding to public banks and public benefit-oriented lenders.

The issuance of FedAccounts, proposed above,[155] creates the perfect opening for—and even necessitates—such repurposing. As a result of simple accounting convention, the dramatic increase in the Fed's liabilities would generate the corresponding additional investment capacity on the asset side of its balance sheet. In the mainstream CBDC debate, this accounting inevitability is a source of grave concerns about "a potentially larger central bank footprint" in the financial system.[156] From the perspective of public banking, however, this purported problem is a game-changing opportunity: the Fed can use its new asset-side capacity to finance publicly beneficial lending by state and local public lenders. The

152. *See supra* Section III.B.

153. *See id.*

154. The COVID-19 pandemic provides the latest example of an extraordinary expansion of the Fed's emergency lending facilities. *See, e.g.*, LEV MENAND, THE FED UNBOUND: CENTRAL BANKING IN A TIME OF CRISIS (2022) (describing the Fed's emergency facilities during the pandemic).

155. *See supra* Section IV.A.

156. BANK FOR INT'L SETTLEMENTS, ANNUAL ECONOMIC REPORT 2020, at 87 (2020), https://www.bis.org/publ/arpdf/ar2020e.pdf [https://perma.cc/C4BY-2A92].

simplest way to implement this strategy is to redesign the Fed's existing discount window program, which operates as the source of short-term backup liquidity for troubled banks, by turning it into a permanent Fed lending facility geared toward economic policy goals.[157]

As proposed in my earlier work,[158] the New Discount Window ("NDW") would be open to all public banks and private lenders that meet specified qualification criteria.[159] These "qualifying lending institutions" ("QLIs") would be able to borrow from the Fed, at preferential rates and against qualifying high-quality collateral. The collateral eligibility criteria can remain substantially similar to the current requirements so that the assets pledged by the QLIs would have to be of sufficiently high quality, much like they would be under today's discount window regime.[160] For public banks, however, it would make sense to broaden the range of qualifying collateral, taking into account their public policy-driven lending mandate.[161] In addition, the Fed could explicitly preference certain asset categories—including, e.g., loans to small and medium-size non-financial enterprises and minority-owned businesses, student loans, credit supporting development in underserved communities, and bonds issued by firms in certain sectors of the economy—which would likely constitute a significant proportion of public banks' credit portfolios.[162]

The availability of this affordable, stable, and expressly public benefit-oriented funding would enable public banks across the country to focus on their public policy objectives without worrying about liquidity shocks. It would boost the growth of public banks in numerous localities, increasing the density and strength of the public banking ecosystem.

157. Under the Fed's well-established discount window program, banks experiencing temporary liquidity problems can use their assets (typically, loans) as collateral for short-term loans from their regional Federal Reserve Banks. *See Discount Window Lending*, BD. OF GOVERNORS OF THE FED. RSRV. SYS. https://www.federalreserve.gov/regreform/discount-window.htm [https://perma.cc/7BHL-SLBK].

158. *See People's Ledger*, *supra* note 23, at 1270-72.

159. For private lenders, these entity-level eligibility criteria could include certain activity and affiliation restrictions (to prevent potential arbitrage and abuse of the public subsidy), effective internal credit underwriting and risk management systems, and so forth.

160. *See Collateral Eligibility - Securities and Loans*, FED. RSRV. DISCOUNT WINDOW & PAYMENT SYS. RISK, https://www.frbdiscountwindow.org/Pages/Collateral/collateral_eligibility [https://perma.cc/GE52-GHCW].

161. This is in order to avoid the problem with the Fed's Municipal Liquidity Facility, established to provide emergency funding to state and local governments during the COVID-19 pandemic. The program's strict eligibility requirements, relatively high interest rates, and other conditions severely limited its practical efficacy. *See* CONG. RSCH. SERV., IF11621, COVID-19: THE FEDERAL RESERVE'S MUNICIPAL LIQUIDITY FACILITY (2020), https://crsreports.congress.gov/product/pdf/IF/IF11621 [https://perma.cc/DFY8-3LRJ].

162. *See People's Ledger*, *supra* note 23, at 1271-72. To maximize the flow of credit into productive economy, certain asset classes—such as, e.g., margin loans, private equity bridge loans, or highly engineered asset-backed securities—could be explicitly excluded from the Fed's definition of eligible NDW collateral. *Id.*

Moreover, by incentivizing community banks, credit unions, cooperative lenders, and other private financial institutions to become QLIs, the Fed would effectively expand that ecosystem beyond the bounds of formal public ownership. These public and publicly licensed private lenders would be in a position to utilize their localized informational advantages and community roots to allocate capital in the manner that is both publicly and privately efficient. Thus, putting the Fed's capacious balance sheet behind this new public-private credit allocation network would unlock much greater and dynamic flows of affordable credit into productive economic activities and equitable and sustainable economic development throughout the entire country.

Importantly, the Fed's expanded balance sheet would be able to accommodate a more direct flow of capital toward long-term developmental goals. In addition to eligible QLI loans, the Fed's portfolio of assets could include a new category of instruments supporting massive public and publicly managed investments in critical social and industrial infrastructure.

C. Public Investment Management

As discussed above, many public banks around the world operate as vehicles for public investment and state-led developmental policies.[163] The absence of, and the need for, a similar institution in the United States has long been a topic of intense political debate.[164] While some states have infrastructure banks operating on a limited scale (mostly as revolving loan funds),[165] there is currently no federal institution that could optimize and coordinate public investment on the national scale.

The National Investment Authority ("NIA"), proposed elsewhere, could step into the void.[166] Envisioned as an amplified modern-day ver-

163. *See supra* Section I.B.

164. *See* Sadek Wahba, *An Infrastructure Bank Could be the Issue that Unites a Divided Congress,* THE HILL (Jan. 18, 2023), https://thehill.com/opinion/finance/3818006-an-infrastructure-bank-could-be-the-issue-that-unites-a-divided-congress [https://perma.cc/5JEP-ZAPY]; Sadek Wahba, *The US Needs an Infrastructure Bank that Models the World Bank,* THE HILL (Jan. 4, 2021), https://thehill.com/opinion/finance/566307-the-us-needs-an-infrastructure-bank-that-models-the-world-bank [https://perma.cc/DC8V-JCBX].

165. *See supra* note 62.

166. For a full proposal, see *National Investment Authority, supra* note 23. *See also* Saule T. Omarova, *Why We Need a National Investment Authority* (Cornell Legal Studs. Rsch. Paper No. 20-34, 2020), https://ssrn.com/abstract=3566462 [https://perma.cc/KLG2-UB8L]; Saule T. Omarova, *Crises, Bailouts, and the Case for a National Investment Authority*, JUST MONEY (Apr. 1, 2020), https://justmoney.org/s-omarova-crises-bailouts-and-the-case-for-a-national-investment-authority [https://perma.cc/6GYS-ZT23]; Saule T. Omarova, *The Climate Case for a National Investment Authority*, DATA FOR PROGRESS (2020), https://www.filesforprogress.org/memos/white-paper-nia.pdf [https://perma.cc/BJK4-BEFA]; Saule Omarova, *Public Investment Reimagined: A National Investment Authority*, AM. PROSPECT (Dec. 1, 2020), https://prospect.org/economy/public-investment-reimagined-a-national-investment-authority [https://perma.cc/AE3Z-UBPP].

sion of the RFC, the NIA would be an independent federal agency responsible for devising and implementing a comprehensive national development strategy. The NIA would function as a direct financial market participant, actively channeling public and private financial resources into large-scale public infrastructure projects.

To maximize its market-actor capacity, the NIA would operate through several subsidiaries with specialized asset portfolios.[167] One subsidiary, for example, would pursue well-established credit-mobilization strategies: originating, guaranteeing, and maintaining secondary markets for loans to public and private parties that undertake publicly beneficial infrastructural projects. As discussed above, however, many truly transformative infrastructures require more risk-tolerant equity financing.[168] To target these projects, a separate NIA subsidiary would take on more venture capital-like functions. Following the business model of a typical asset manager, it would set up a series of collective investment funds (structured similarly to traditional private equity funds) and actively solicit outside investors—including, e.g., pension funds, insurance companies, university endowments, and various public investment vehicles—to purchase passive equity stakes in its funds. The NIA's dedicated professional teams would then select and actively manage individual funds' portfolios of public infrastructure assets: nationwide systems of high-speed railroads, state-of-the-art production facilities for advanced clean technologies and products, networks of social and community care services, and so forth.[169]

This critical element of the proposed NIA's business model sharply separates it from the "public-private partnership" ("PPP") structure widely used in infrastructure finance. In a deliberate reversal of the typical PPP mode of "public capital, private management," the NIA would make "public management, mixed public-and-private capital" the new industry baseline. Maintaining control over the funds' investment portfolios is essential to the NIA's ability to fulfill its ambitious developmental goals.[170]

Partnering with private investors is nevertheless important for purposes of shifting the systemic dynamics in finance by redirecting institutional capital away from speculative assets and into publicly selected pro-

167. The full organizational and governance structure of the proposed NIA is discussed in *National Investment Authority, supra* note 23.

168. *See supra* Section II.B.

169. *See National Investment Authority, supra* note 23, at 35-41 (outlining the general structure and functions of the NIA as a fund manager).

170. This is a critical factor that distinguishes the NIA's mode of partnering with private institutional investors from the currently suboptimal forms of public "de-risking" or "crowding in" strategies that effectively place the public bank in the position of a passive bearer of unwanted investment risks. *See supra* note 120 and accompanying text.

ductive investments.[171] It is difficult to overestimate the significance of this structural shift in market incentives, as a matter of both financial stability and economic growth. The intimate connection between these macro-level policy objectives underscores the multi-dimensional nature of public investment as a market-reshaping tool.[172]

To be successful, however, the NIA would have to be able to reward private investors for their participation in financing long-term economic growth-boosting projects—even where such projects do not generate easily privately "capturable" revenues.[173] Giving the NIA access to the Fed's balance sheet is vital in this respect. The Fed could both maintain a revolving credit facility for the NIA and purchase NIA bonds, either directly or from private investors in the open market, much like it currently does with Treasury bonds and certain mortgage-backed securities.[174] The Fed's commitment to hold NIA instruments in its portfolio would make them highly desirable "safe" assets for institutional investors, which would make it easier for the NIA to raise capital for its operations.[175]

An important aspect of the NIA's overall strategy would be to encourage and support the growth of a nationwide network of state and local public banks, green banks, and other public and private entities pursuing various publicly beneficial investment goals. The NIA would augment their, often limited, financial resources through direct project participation, purchasing and securitizing their bonds, coordinating their activities, and providing necessary supporting services. These efforts would relieve the pressure on the Fed, allowing it to calibrate the need for additional credit facilities targeting specific aspects of various public investment institutions' activities.

171. Importantly for the purposes of the present discussion, it also enables the NIA to raise equity (as opposed to the typical debt) financing from its limited partners. Passive equity contributions would not constrain the NIA's investment discretion, thus avoiding one of the main drawbacks of bond financing. The proposed structure would allow the NIA to channel risk-absorbing capital into projects, based purely on their potential to generate long-term macroeconomic or other public benefits—a critical advantage compared to the presently prevailing forms of public bank financing. *See supra* Section II.A.

172. *See* Saule T. Omarova, *What Kind of Finance Should There Be?* 83 LAW & CONTEMP. PROB. 195 (2020) (discussing the complex interactions between financial market tools and macroeconomic outcomes).

173. *See National Investment Authority, supra* note 23, at 21-23, 38-41 (outlining the methods and techniques of financial and legal engineering the NIA could adapt to this end).

174. The Federal Reserve regularly purchases mortgage-backed securities issued by the Fannie Mae and Freddie Mac, the two principal housing government-sponsored enterprises. *See Agency Mortgage-Backed Securities Operations*, FED. RSRV. BANK OF N.Y., https://www.newyorkfed.org/markets/desk-operations/ambs [https://perma.cc/P3M4-HK9B].

175. A crucial benefit of this approach is that it would enable the Fed to channel credit into the nation's public infrastructure without having to make any direct credit-allocation decisions on a project-by-project basis—a task explicitly reserved for the NIA. From the Fed's perspective, purchasing NIA instruments is a much higher-level portfolio strategy that generally falls within its traditional toolkit. *See People's Ledger, supra* note 23, at 1281.

Of course, such an ambitious proposal raises many complex issues related to the NIA's structure and operation, which fall outside the scope of this Article.[176] For present purposes, the key is to emphasize the game-changing potential of this approach to public banking as an institutional design project. Reframing the traditional infrastructure finance function as a special form of public asset management, while firmly embedding in within the wider public finance platform, helps to find targeted solutions to specific issues that currently result in publicly suboptimal business decisions and policy tradeoffs. If thoughtfully implemented, this reform would engender an entire ecosystem of diverse public investment institutions serving every community across the country. Along with the Fed-Accounts and the NDW facility, this augmented flow of public and public-private infrastructure investment would make public banking in all its forms—regardless of individual public banks' size, location, or service profile—a truly meaningful and powerful alternative to the presently dysfunctional forms of private finance.

V. Who's Afraid of Public Banking?

A new public finance ecosystem that combines direct public provisioning of money and payments services, public-private credit allocation, and massively scaled-up public investment flows, as outlined above,[177] would fundamentally shift the balance of public and private powers and responsibilities in modern finance. This Article argues that such a shift is the necessary condition for individual public banks to be able to fulfill their specific policy mandates while thriving in the surrounding market environment.[178] Creating viable public options in consumer lending, local project financing, or any other specific area where private financial service providers currently fall short, requires a deeper systemic change.

In practice, however, any attempt to give public institutions greater control over the process of generation and allocation of the nation's money and credit is bound to meet intense political opposition and criticism. From the banking industry's perspective, having public institutions create public money and offer direct depository services is seen not as an efficiency-enhancing elimination of self-interested middlemen but as an illegitimate encroachment upon private banks' current money-creation monopoly. Protecting its turf, the banking lobby attacks public banking as an unnecessary and dangerous form of governmental meddling in osten-

176. For a full elaboration of the proposed design, including the key governance and accountability mechanisms, see *National Investment Authority, supra* note 23.

177. *See supra* Part IV.

178. *See supra* Part IV.

sibly private financial markets.[179] The idea of introducing broadly available digital-dollar FedAccounts, which would effectively make the central bank a true *public bank*, has elicited a similarly strong opposition from the banking sector and its allies. Politically powerful community banks have been at the forefront of the public fight against the Fed issuing any form of CBDC, which they perceive as a direct threat to their existence.[180] An ambitious reform proposal calling for the creation of a multi-level ecosystem of public finance, along the lines outlined above, is bound to run into an even higher wall of political resistance not only from the banking sector but also from the rest of Wall Street, Big Tech, crypto lobby, and a loose coalition of political objectors and conspiracy theorists.[181]

The strength and breadth of political opposition to the idea of public banking, especially of the type envisioned here, reflect the potentially game-changing impact of institutionalizing direct public provisioning of core financial products and services on the national scale. What is at stake in this fight—or, more precisely, multiple fights fought in multiple fora—is whether publicly-subsidized private interests will further solidify control over our rapidly transforming financial system, or whether the American public will be able to reclaim the right to manage its own financial resources.

The principal arguments against direct public participation in financial markets illustrate this underlying tension.

The most common objections to public banking focus on its potential to breed corruption and politically motivated abuses of economic power.

179. The American Bankers Association's public position on public banks captures the gist of the industry's political argumentation. *See supra* note 128.

180. *See, e.g.*, *ICBA opposes U.S. central bank digital currency,* INDEP. CMTY. BANKERS OF AM., (May 23, 2022), https://www.icba.org/newsroom/news-and-articles/2022/05/23/icba-opposes-u.s.-central-bank-digital-currency [https://perma.cc/A499-RC4Z] (claiming that "[a] U.S. CBDC would obstruct the ability of banks to take deposits and make loans"). Such unnuanced hostility is misguided and ironic, given the fact that CBDC can, and should, be designed to save community banks from being effectively obliterated by large techno-financial conglomerates. *See supra* notes 146-148 and accompanying text. Perhaps even more ironically, community banks' vociferous lobbying has allowed giant Wall Street banks to keep their own efforts to prevent any potential CBDC plans from reducing their outsized—and continuously growing—market power largely behind the scenes.

181. For a small sample of the standard rhetoric employed by the crypto lobby and various ideologically driven groups, see Natalie Smolenski & Dan Held, *The Dangerous Implications of Central Bank Digital Currencies*, BITCOIN MAG. (Oct. 3, 2022), https://bitcoinmagazine.com/legal/the-dangerous-implications-of-cbdcs [https://perma.cc/8VQ5-AG7E] (arguing that CBDC is a threat to financial privacy); Siddharth Venkataramakrishnan, *How Digital Cash Got Caught Up in the Culture Wars*, FIN. TIMES (Sept. 6, 2023), https://www.ft.com/content/ab8fbe73-34bf-4624-b394-97f995551f7a [https://perma.cc/QS8T-T3MY] (describing the proliferation of politically driven conspiracy theories and misinformation about CBDC); Norbert Michel, *Central Bank Digital Currencies and Freedom Are Incompatible,* CATO INST. (July 18, 2022), https://www.cato.org/commentary/central-bank-digital-currencies-freedom-are-incompatible [https://perma.cc/F5ZN-8J5N] (claiming that "CBDCs are government's attempt to protect its privileged position and exert more control over people's money").

The principal concern is that a government-owned bank would operate not as a bona fide market participant, making impartial business decisions in furtherance of its official mandate, but as a tool of purely self-serving politicians and bureaucrats. For example, public banks could be used to finance projects in which government officials have personal business interests, through ownership or kickbacks, or whose primary purpose is to influence elections. By misallocating or even wasting public resources, these actions could hurt, rather than help, the intended beneficiaries of public banking and distort, rather than stabilize, financial markets.

A related concern is the potential susceptibility of public bank managers to capture by private interests. A well-researched concept in the academic literature, agency capture comes in a variety of forms, ranging from straightforward "buying" of specific policy outcomes by the powerful private groups[182] to the more subtle methods of influencing public servants' decision-making and beliefs.[183] A systematic misalignment of incentives, whereby government officials pursue policies serving private interests, rather than the public interest they purport to serve, is an especially insidious problem in the financial sector.[184] In this context, public bank managers could be coopted by private industry actors and align their institutions' strategic priorities with these private actors' demands instead of public policy goals.

It is important to take these concerns seriously. Corruption and private capture of public institutions pose a continuous threat not only to the efficient functioning of economic markets but, more broadly, to our society's democratic ideals and the rule of law.[185] It is equally important, however, to contextualize this fact by recognizing that corruption is not an incurable defect exclusive to public power or public finance. Private finance is notoriously prone to corrupt behavior, including varieties of investor fraud and improper self-dealing.[186] And, while there may not be an easy or truly permanent solution, this problem can be controlled via legal and institutional means that reduce or eliminate incentives and opportu-

182. For a classic exposition of the concept of capture through the lens of public choice theory, see MANCUR OLSON, JR., THE LOGIC OF COLLECTIVE ACTION (1965); George Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGM'T SCI. 3 (1971).

183. *See, e.g.*, James Kwak, *Cultural Capture and the Financial Crisis*, *in* PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT 71 (Daniel Carpenter & David A. Moss eds., 2014) (examining the phenomenon of "cultural capture" as a channel of improper industry influence of financial regulators).

184. Saule T. Omarova, *Bankers, Bureaucrats, and Guardians: Toward Tripartism in Financial Services Regulation*, 37 J. CORP. L. 621, 629-32 (2012) (discussing the general dynamics of regulatory capture in the financial sector).

185. *See generally* LAURA S. UNDERKUFFLER, CAPTURED BY EVIL: THE IDEA OF CORRUPTION IN LAW (2013) (examining the concept of corruption and its role in law and politics).

186. *See, e.g.*, James Chen, *Corruption: Its Meaning, Type, and Real-World Example*, INVESTOPEDIA (May 13, 2023), https://www.investopedia.com/terms/c/corruption.asp [https://perma.cc/9LSQ-58PB] (providing multiple examples of corrupt practices in financial markets).

nities for improper conduct. The key to this effort is meaningful decisional transparency and multiple accountability mechanisms built into the institution's design. This includes, among other things, clearly defined managerial responsibilities and carefully distributed executive functions, formal internal and external reporting requirements, regular internal and independent external audits, and other governance measures deliberately aiming to prevent potential abuses of concentrated decision-making authority inside the public bank. To strengthen public banks' accountability and transparency, it may be particularly helpful to explore more direct forms of institutionalized public participation in the governance and oversight of public banks.[187] From this perspective, giving the public a seat at the table is not only a tool of democratizing banking but also a structural check on potential institutional drift and corruptibility.

Of course, no amount of institutional engineering can fully overcome the most persistent objections to public finance rooted in a deeper sentiment: the generalized skepticism of the state as a market actor. In the standard neoliberal narrative that continues to dominate the U.S. policy discourse, the government is generally portrayed as an extra-economic force, a market outsider that operates through political imposition rather than productive entrepreneurship.[188] Accordingly, public financial institutions are often presumed to be inherently inefficient and politically driven—which, in turn, reinforces the underlying distrust of government power in the economic realm. From this perspective, enabling state actors to exert greater and more direct influence on financial flows raises a specter of bureaucratic takeover of private markets and the end of efficient credit allocation through decentralized market exchange.

The Federal Reserve's institutional profile, technocratic independence, and formidable balance sheet make it a particularly convenient target for attack along these lines.[189] At the same time, its hybrid public-private ownership structure has long raised alarm among those who see it as an instrument of the banking industry's outsized power over public money.[190] In this context, any reform proposal envisioning further expansion of the Fed's legal mandate or balance sheet is bound to invite criticism for further centralizing power in the hands of unelected bureaucrats

187. *See supra* notes 85-88 and accompanying text.

188. President Ronald Reagan's famous quote epitomizes this worldview: "[G]overnment is not the solution to our problem; government is the problem." First Inaugural Address (1981), *available at* https://www.reaganlibrary.gov/archives/speech/inaugural-address-1981 [https://perma.cc/TR3P-ZMTK].

189. For examples of these attacks in the context of the CBDC debate, see sources cited *supra* note 181.

190. *See, e.g.*, *A People's Fed*, FED UP CAMPAIGN, https://fedupcampaign.org/wp-content/uploads/2021/05/FED-UP_public-fed-summary_final-Output2.pdf [https://perma.cc/6VH9-VTNU]; Jordan Haedtler, Andrew Levin & Valerie Wilson, *Making the Federal Reserve Fully Public: Why and How,* ECON. POL'Y INST. (2016), https://files.epi.org/2016/A-Public-Fed-Why-and-How.pdf [https://perma.cc/6DFG-YA34].

effectively shielded from democratic oversight. The FedAccounts proposal, outlined above,[191] is especially controversial in this respect. To its critics, the proposed migration of transaction deposits to the Fed would make that institution unmanageably big and dangerously powerful.[192] A related concern is that expanding the Fed's balance sheet would make the Fed responsible for too many social problems, forcing it to put its financial strength behind things far removed from traditional monetary policy and thus exceeding its competency.

This "hyper-centralization" argument erroneously transposes the dysfunctional features of the current financial system onto a qualitatively new relational universe. It is the structural imbalances and inefficiencies in our existing financial system and macroeconomy that cause both the continuous growth of the Fed's assets and the expanding scope of its private market-support responsibilities.[193] A comprehensive restructuring of the Fed's balance sheet would fundamentally change these dynamics. Under the proposed approach, the Fed is not meant to be the single point of financial control—it is embedded in a vibrant system of public finance, where multiple entities perform various specialized functions in support of the nation's economy. More to the point, the Fed's relationship with private financial market participants is not severed but transformed from the present open-ended subsidy commitment into clearly defined—and mutually fair—functional cooperation. In this ecosystem, the greater scale and scope of the central bank's portfolio reflect its expanded role in ensuring stable and plentiful financing of the nation's economy, rather than blind consolidation of bureaucratic power. This fundamental difference must be recognized if we are to have a productive policy debate.

To be clear, the purpose of this Article is not to debunk every potential argument against the proposed model of a public banking system. It is far more instructive to focus on the fundamental economic interest-based drivers of the financial industry's hostility toward that idea. Behind the familiar assortment of common misgivings and misconceptions, the real political pushback is ultimately rooted in the dynamics of public subsidy—and the private actors' fear of losing it.

In this respect, the industry's fears are well-founded. Transforming the Fed's balance sheet into a platform for the integrated public management of the economy-wide flow of sovereign money and credit will have significant structural implications for the entire U.S. financial sys-

191. *See supra* Part IV.

192. A corollary to this argument is the oft-heard concern that the Fed would use its newly acquired control over individual citizens' deposits for political surveillance and otherwise violate their privacy. As discussed in my earlier work, safeguarding privacy of FedAccounts is a critical element of the proposed system. *See People's Ledger*, *supra* note 23, at 1267.

193. *See, e.g.*, MENAND, *supra* note 154 (describing the gradual expansion of the Fed's responsibilities as the guarantor of economic and financial stability).

tem.[194] Free universal access to sovereign money, issued in digital form directly by the nation's central bank, would remove the need to rely on private banks as indispensable providers of that critical public good. That would, in turn, obviate the need for explicit public subsidies currently enjoyed by deposit-taking banks. Bank bailouts would become unnecessary. Withdrawal of public subsidy would also radically change the current incentive structure in the financial sector well beyond banking. Without the extraordinary economic advantages that currently come with a banking charter, there would be no incentive for nonbank firms to seek affiliation with publicly subsidized banks, forming TBTF financial conglomerates. Furthermore, to the extent that systematic abuses and leakage of bank subsidies feed the growth of an increasingly complex shadow banking sector, that sector would inevitably shrink in size and lose its current ability to destabilize financial markets.[195]

In short, redefining the public-private power balance at the core of the existing financial system would render it less speculative, less complex, more transparent, and more effectively governable. In this sense, the creation of an integrated system of public banking would help to achieve what we have not been able to achieve through the traditional methods of financial regulation and supervision. It would end the pernicious pattern of "privatizing gains and socializing losses" that erodes public trust in the financial system. Private finance, of course, would not disappear—it would simply be restored to its proper function as a sphere of private risk-taking subject to private market discipline. And public finance would be empowered to generate the public benefits it is designed to produce.

Conclusion

The Global Financial Crisis of 2008 has reignited the interest in public banking as an alternative to the crisis-prone and often dysfunctional private profit-driven U.S. banking system. The COVID-19 pandemic and the SVB mini-crisis of 2023 further reinforced the argument in favor of creating public financial institutions with an explicit mandate to serve the interests of ordinary Americans, communities they live in, and businesses they run. The appeal of public banks lies in their ability to serve as democratically controlled providers of universal access to fully safe money and payments, affordable credit, and sustained investment in public infrastructure—critical public goods persistently undersupplied by the private profit-driven financial system.

194. For a detailed analysis of these implications, see *People's Ledger*, *supra* note 23, at 1282-99.

195. *See id.* at 1288-96 (tracing potential structural changes in the key segments of the shadow banking sector).

Designing an effective public bank capable of delivering these benefits in practice, however, is a technically complex process that involves potentially difficult choices and tradeoffs. The Article argues that these difficulties are fundamentally rooted in the underlying imbalance of public and private powers in modern finance. To resolve these institutional design problems and to realize the full transformative potential of public banking, we must reimagine it as a truly systemic change unfolding along multiple lines and on multiple levels.

From this perspective, creating an effective public option in banking is a much bigger undertaking than designing stand-alone institutions. Notwithstanding the inevitable political opposition and implementation challenges, each successfully established state-level or local public bank should be seen as an important step toward a more stable, just, and socially efficient financial system. By performing the day-to-day services for their communities, public banks can gradually reshape the relevant political context and create an opening for more comprehensive structural reforms outlined in the Article. These structural reforms, in turn, would unlock the growth of public banking institutions across the entire country and critically augment these institutions' capacity to fulfill their policy mission and maximize their market impact. In sum, the long-term success of America's nascent public banking project requires the creation of an integrated nationwide network of functionally specialized public financial institutions, centered around the most important and powerful public bank—a redesigned and democratized central bank.