Unlocking the Federal Reserve
By Jon Coss

Over the course of the past fifty years, the American public has swayed from banking crises to banking crises, ranging from the Latin American Debt crisis, to the Savings and Loans crunch, and culminating in the credit-default swap fiasco. Even today the banking system is underlined with cynical banks. For example, over the past three years, employees at Wells Fargo purposely created 1.5 million fictitious accounts, over .5 million unauthorized credit lines, and a further 3.5 million fraudulent accounts. These actions resulted in fines totaling hundreds of millions of dollars, resignations at the board of directors level, and transformative rules and regulations placed onto the company by the Federal Reserve (White).

The American public has no other option besides the private sector for banking services, a private sector that has grown accustomed to dealing with negligent bank after negligent bank, banks whose ranks include Wells-Fargo, Lehman Brothers, and Lincoln Savings and Loans. After a flood of inquiries from the public regarding requests for bank accounts, the Federal Reserve Bank of Atlanta released a statement stating, “Individuals [can] not have accounts at the Federal Reserve” (Ausick). This does not have to be the case. What if the American public were given a “public option” for banking, an option that allowed for private, individual accounts to be opened at the Federal Reserve. Over the course of this paper, I will put forth the case that the American public should have the option to open accounts at the Federal Reserve, for this would remedy several problems linked to the consumer side and government side of banking.

Across the United States, those who hold no bank accounts are disproportionately penalized by the current banking system. In total, seven percent of the residents across the United States have no access to banking services, and a further twenty-percent of residents have been deemed to be “underbanked” by the Federal Reserve (Ricks, et al, 2, Moon). The FDIC’s national survey revealed
that the root cause plaquing the unbanked and underbanked community was, “a lack of trust in banks and excessively high account fees” (Moon). Individuals who are priced out of services offered by banks are forced to turn to non-banking establishments for everyday services, services such as cashing paycheques.

Cashing a paycheque at a non-banking institution results in a fee totaling five percent of the paycheque. Considering that the average salary for individuals with no financial accounts is $18,203, the poor, who are disproportionally disenfranchised from the banking sector, are forced to contend with crippling service fees, with no alternative in sight (Armstrong). This establishes a scenario where the poor are made poorer simply by residing in a banking ghetto. Families who dwell on the periphery of the current system must contend with fees and service surcharges which erode away precise income. As it stands forty percent of all fines and fees related to banking are paid by the poorest twenty percent of Americans (Armstrong). This creates an environment where those with little to no banking ties spend billions annually on simple financial transactions, resulting in unbanked households being caught up in a “cycle of debt” (Ricks, et al, 6). Bank accounts should be a primary platform that allows for individuals and families to escape from a life confined to poverty, not become confined to it.

In light of this, personal accounts at the Federal Reserve pose the potential of remedying the banking problems plaguing the American public. These deposit accounts would operate just as any found at a commercial institution, offering an array of positive benefits for the American people. First of all, this policy puts the public on a path towards financial inclusion in the modern economy, allowing for over sixty-million Americans to transition away from banks that charge crippling account fees, minimum balance requirements, and seventy-two-hour clearing delays (Ricks, et al, 9), to an establishment that does not impose such unnecessary burdens. Second, customers would move past predatory lending practices that cost the bottom quartile of the economy, “$9.1 billion
each year of lost credit, back-end penalties, and excess interest paid” (Stein). Personnel deposit account at the Federal Reserve would ensure that consumers have an alternative to the fines, fees, and predatory practices found in the private banking sector. A public option for bank accounts would offer the American public a banking service that puts their needs first, as opposed to the current one which is aimed at servicing wealthy clients “who receive personalized guidance from a wealth counselor and where typical fees are waived” (Palmer).

Low-income communities across the US are disproportionately harmed by the current banking practices. As it stands, low-income neighborhoods across the US contain fewer bank branches than their affluent counterpart. Bank branches where, if present, offer fewer hours of service and at less convenient times than hours of comparable branches found in wealthy districts. These very same banks who offer services that are few and far between in impoverished communities mandate, “Minimum balance requirements, account fees, and delays in check clearing” these demands deter low-income households from participating in the banking sector. (Ricks, et al, 8). Juxtapose these banking services offered to what is available to pecunious patrons, and the divide is clear. When servicing the affluent, banks waive servicing fees, offer personalized investment strategies, supply premium products, and distribute bonuses to accounts with holdings exceeding one-hundred thousand dollars. Current banking practices dramatically deter low and middle-income families from participation in the banking sector, reducing the likelihood of investing, saving, and escaping poverty for those who are not awash with capital.

Opening up the public market for consumers would boost savings rates and incomes for the poorest Americans. This would be seen as consumers experience an increase in the interest rate being paid for deposits and a reduction in fees and overdraft fines. The Federal Open Market Committee would offer an interest rate on accounts equal to that given to commercial banks. This would equate to a current rate of 2.20 percent, leaps and bounds above rates offered by commercial
banks today, deposits at Wells Fargo offer an interest rate of 0.00 percent (Gruen 11). Accounts becoming available at the Federal Reserve would ensure that all citizens across all economic backgrounds are offered the same good and service, a service that—it must be said—would include higher interest rates, no fees, universal accessibility, and no complications for the American public.

Along with this, opening up deposit accounts for the American public would remove distortive subsidies found in the current banking system. In 2017, banks who maintained accounts at the Federal Reserve collected 25.7 billion dollars from interest paid on those accounts, The Economist called this transfer of wealth, “a government subsidy” (Gruen 23). With the dual public-private option, customers would have the ability to transition their hard-earned money away from accounts that, “convince vulnerable consumers to ‘opt-in’ to . . . fees by using aggressive and sometimes misleading marketing practices” (Morgan, et al 6), to accounts responsibly managed by the Federal Reserve. This would force banks to either offer market-competitive interest rates and reduce regressive fees, or accept the outflow of funds to deposits at the Federal Reserve. Either way, the “government subsidy” that flows towards banks would be substantially reduced, as the transfer of wealth flows to consumers, instead of corporations.

From the perspective of the United States Government, a move towards a competitive market, when it comes to deposits, offers multiple tangible benefits. Primarily, the move, experts expect, would improve banking behaviors. The Economist forecasts that the move towards dual option banking would force banks, “To offer useful services and competitive rates, rather than hidden fees.” An improvement in banking practices would ultimately improve the fiscal health found within the United States. In an expanded market, non-competitive banks would be compelled to reform or risk irrelevancy, this would be seen as fees pushed onto the poorest Americans would be dramatically reduced, and predatory banking practices would become few and far between, all while tens of millions of Americans would have newfound access to banking services.
Coupled with this, the move towards dual options would usher in a new era away from mammoth banks. As it stands the five largest US-based banks hold fifty-two percent of all the deposits in the US, hardly a market where local banks have the opportunity to flourish (Oranan). An option for deposits at the Federal Reserve would inevitably allow wary consumers to place their savings in a solid financial institution, incentivizing banks to reward consumers with better practices, higher paying interest rates, and lower fees, reducing the market power of the largest institutions. Along with this, the largest six banks hold assets exceeding ten trillion dollars, “twice as much as the next 30 [banks] combined” (Oranan). The Federal Reserve has deemed the seventeen largest US-based banks too big to fail, and the IMF has issued warnings that these institutions receive, ”$480 billion in annual savings. . . [from] the belief among lenders that governments won’t let big banks go under.” The dual accounts would reduce the size of the largest banks, therefore removing part of the 480 billion dollars that banks receive annually in the form of assumed government protection (Gruen).

The banking sector present in the United States remarkably mirrors that of the descriptions for oligopoly and non-competitive markets mentioned in, with the Saint Louis Federal Reserve stating that the US banking sector earned an HHI value of 3468 (Federal Reserve Bank of St. Louis). As it stands, the current banks are a price setter, not a price taker, able to collude and coordinate actions that yield plumb profits, while shunning competition from outside forces.

All told, a simple wording change by the Federal Reserve would create the avenue for the American public to open accounts at the institution. The ramifications of this move would be in the best interest of the American public and the US government. Consumers would bear the brunt of the positive externalities, benefiting from higher interest rates, reduced fees and penalties, an increase in choice, and increased financial stability. From the Government perspective, the positive effects would include a banking sector that must reform away from negative practices, a removal of
disruptive subsidies to the largest institutions, and a transition away from a few dominant banks, towards a competitive banking market.
Citations


