NEW FRONTIERS FOR ECONOMIC JUSTICE

The poor always pay more: financial access to address marginalisation

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Attempts to increase financial access for the poor have tended to create bifurcated banking systems, which systematically disadvantage those they are designed to include, and can exacerbate inequality. Institutional reforms are needed to make financial access more equal.

To date, much of the discussion about financial access and its role in creating more equal societies has been centred on the problem of financial exclusion and how to overcome it. This discussion is undoubtedly important. But many initiatives that have sought to overcome financial exclusion have created a parallel or bifurcated banking system in which practices such as a sub-prime mortgages, payday lending, and microfinance are offered to those to who are poor and/or marginalised, whereas other standard banking services such as deposits and regularly priced mortgages are for the non-poor; the experience of the poor is, therefore, substantially different from that of the non-poor. And instead of helping communities overcome

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marginalisation, products that are more expensive and have stricter repayment terms often contribute to worsening inequality: for this reason they are often described as 'predatory'. Because contemporary financial institutions are known for positioning themselves as essential for households and individuals to meet their housing, education, health and transport requirements, they possess a unique extractive capacity. Poor households and individuals are more prone to dependence on financial institutions: this is a symptom as well as a cause of uneven accumulation patterns.

At the core of uneven access is the emergence of the category known as 'sub-prime'. This term is used almost exclusively in a Western context and refers to clients, potential and present, who have an impaired credit history, either because of repayment problems in the past or because of missing information: they are thus ineligible for 'prime' lending rates. Outside of advanced capitalist countries, the term is less common because clients who are unable to access mainstream banking products may be described through the straightforward classification of 'poor'; this categorisation implies that their access is limited to that part of the financial system which is geared towards providing inclusive finance.

Regardless of geographical setting, uneven access to retail financial services is largely based on credit scoring practices, often digital, that separate prime from sub-prime customers for financial institutions. Prime customers are mainly middle and/or high income individuals, and are keenly pursued by retail financial services firms; they benefit from intense competition between institutions for their business and thus enjoy attractive rates and terms on services. On the other hand, sub-prime customers have low to moderate incomes and/or financial assets; they are either excluded from mainstream financial marketing campaigns for new products or, often, rejected when they apply to access services and products.[1] In this article I examine why these bifurcated markets exist, how they disadvantage the poor, and what institutional reforms governments could put in place to create a more equal financial system.

Adding responsibility, removing politics

Historically, the concept of a bifurcated financial market is not novel: for example, informal financial systems thrived alongside formal banking systems in South Asia under British rule. Colonial rulers were largely unconcerned with this alternative system and even after the countries of the subcontinent became independent, informal finance was seen as a temporary phenomenon that would

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cease when the formal economy became strong enough to absorb informality.[2] When, by the early 1970s, it became clear that this absorption was not occurring, the resilience of the informal economy was given special attention by organisations such as the United Nations Development Programme (UNDP), and valorised for its job creation and safety net functions.[3]

But the work of Dr Muhammad Yunus in 1970s Bangladesh illuminated how exploitative the informal financial system could be. His initiatives to free rural Bangladeshi women entrepreneurs from the usurious grip of the moneylender gained traction and eventually resulted in the inception of the now iconic Grameen Bank. The two founding principles of the Grameen Bank were that credit is a human right, and that the poor know best how to manage their own situation. The success of the Grameen Bank came to be celebrated by international organisations and donor agencies, including the World Bank. As a result, it led to the birth of a global microfinance movement, which celebrates self-help and assumes that poverty drives a demand for financial services. But because poverty also impedes access to mainstream finance, it creates a need for specialised – and segregated – financial institutions to serve the poor and marginalised.

The persuasive nature of this narrative is reflected in the tendency of governments, development agencies and international organisations to vociferously back the financial inclusion paradigm. In doing so, these institutions *responsibilise* the poor by compelling them to be both entrepreneurs and efficient borrowers. Additionally, other issues are *depoliticised* and attention is drawn away from the unequal structures – including lack of political representation, access to education, healthcare, transport infrastructure, etc – that cause poverty and marginalisation and also allow regular banks to abstain from servicing large segments of the public. These practices of responsibilisation and depoliticisation are recurrent features in neoliberal policies that seek to hold individuals rather than governments responsible for economic outcomes, and which present economic issues as irrelevant for democratic politics.

Black banking in the United States

In the United States, uneven access to finance is not a recent phenomenon, as institutionalised racism created a segregated banking system. Under this system, white Americans could easily avail themselves of mortgage finance while black Americans could not. This disparity shaped, and continues to shape, the patterns of wealth accumulation through property ownership that have systematically disadvantaged the black community.

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Segregated banking in the US has its origins in the black banks that were established after slavery was abolished: these gained traction in the 1860s as black soldiers used them to place the wages they had earned serving in the military. These institutions quickly became a necessity when the legitimisation of Jim Crow laws in the South and segregation effectively eliminated the black community from public life in America. The successes of the Civil Rights movement, which gained enormous traction in the 1960s, meant that the black community was granted equality in the form of legal and political rights; economic equality, however, remained elusive. When President Nixon took office in 1969, a radical black movement faced a strong white backlash: Nixon's politically savvy response was to responsibilise and depoliticise by 'opposing all forms of legal race discrimination while rejecting any government efforts at integration'.[4] Black banking was thus cast as a crucial feature of black capitalism: this was presented as a government programme to address the black community's demands. The notion of black capitalism implied that black-owned businesses would be able to overcome historic economic injustices by borrowing to grow their enterprises. Overwhelmingly, this was a strategy to shift the responsibility for poverty and inequality away from the political structures that were, and continued to be, dominated by whites.

But black capitalism could not resolve the problem of capital for black banks. The circular linkage between capital and bank profitability means that the more profitable a bank the more capital it can attract – to become even more profitable in turn. Because black banks had no choice other than to make riskier loans, they had higher costs, lower profits and could not attract capital for investment. Additional constraints were regulatory: for instance, in order to be classified as a black bank, the majority of shareholders had to be black. This limited the opportunity to raise capital as the potential pool of investors for black banks was relatively small. Another problem was deposit volatility: because black banks tended to see deposit withdrawals at a higher and more frequent rate relative to white banks, volatile deposits needed to be backed by government securities, which offered a low return and cut profitability. This segregated banking approach was thus a failure for multiple reasons, but primarily because the black banking system could not be integrated with the mainstream banking system: black banks relied on a weak deposit base because white depositors banked with mainstream banks. Black banks could not issue profitable mortgages in the same way that mainstream banks could, and when the financial crisis hit and the government bailed out banks in 2008, black banks were decimated as the black community lost over half its combined wealth.

This history of failures reveals the mechanics of the American racial wealth gap,

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much of which is guided by patterns of property ownership. To a large extent, these patterns have been shaped by discrimination in the form of 'redlining', which is the practice of marking out particular areas where mortgage banks and real estate agents avoid doing business because of demographics. Redlining is a key mechanism behind the decay of many urban neighbourhoods because it pushes down homeownership, property appreciation and credit scores for the black community. In the 2000s, the rising popularity of derivatives based on sub-prime lending, coupled with redlining practices, created a situation in which black Americans were given housing loans on distinctly unfavourable terms relative to their white counterparts: these findings are highlighted in the 2015 report from the American Civil Liberties Union (ACLU) which reveals how the racialised nature of sub-prime lending widened disparities following the 2008-2009 financial crises.[5]

Financial citizenship in Britain

In the United Kingdom, the problem of bifurcation relates to broader trends arising from the decline of the post-war welfare model. As social insurance loses importance, welfare provision becomes commoditised and privatised. Specific examples of this include initiatives from the state to replace welfare with 'work-fare', under which claimants are forced to look for a job in order to receive social security payments. Another key initiative to address marginalisation is that of 'asset-based welfare', which emphasises the economic redistribution of productive assets rather than income to achieve egalitarian goals. The New Labour version of this approach was the 'incorporation of individuals within the mainstream financial system', with the ultimate goal of creating an asset-owning society made up of individuals who are not only responsible but also economically ambitious, and financially independent.[6]

Bifurcation in finance has also been shaped, in Britain, by the changing geography of retail financial services, particularly during the 1990s, as bank and building society closures deprived many households of access to savings, loans, insurance and payment services. This has been attributed to a 'longer story of bank and building society branch rationalisation that has, over the past 20 years or so, seen the number of branches in Britain shrink by almost a third'.[7] Research from *Which?* indicates that between 2015 and 2018 bank branches in the UK were closing at an average rate of 60 per month.[8] The poorest communities are prone to the highest rates of net branch closure, and the impact of branch closure is most severe for these communities.[9]

These trends reflect how responsibility for short-term income smoothing and long-term financial security has been abandoned by the state and passed over firmly to the citizen and the retail financial services sector.[10] It is in such a society that predatory lenders like Wonga have thrived and subsequently collapsed, and where numerous economic pressures have created a banking system with two parts: one for deposits and mortgages and another for short-term credit.

Must the poor always pay more?

Uneven access to financial services may be viewed through a lens of financial citizenship. The notion of financial citizenship draws attention to the issue of an 'inside' and 'outside' to the financial system and emphasises the importance of the financial system to everyday life: there is thus a need to formalise the right and ability of people to participate fully in the financial system.[11] Given this, how may alternative approaches meet the banking needs of the poor and vulnerable? These needs may be summarised thus: safe access to deposit facilities, reasonably priced loans, and efficient and affordable means of transferring payments.

Two possible solutions address the problems of safe access to deposit facilities, and efficient and affordable payment transfers. These are post office banking – which could address the geographical constraints of branch access – and central bank deposit accounts, which could simplify deposits and transfers. While access to reasonably priced loans is only partially covered by these solutions, there is scope here for government subsidisation of lending if banking fees were collected by the state instead of private institutions.

The origins of post office banking are British: first used in 1861, it spread from Great Britain to the Empire and commenced in Canada in 1868, New South Wales in 1871, and in New Zealand in 1876. By the turn of the century, almost every Western country had adopted nationwide post office banking. The goal of post office banking was financial inclusion: in Great Britain, these banks initially offered a deposit rate of 2 per cent, which was less than mainstream banks. In the US, post office banks were endorsed by President Ulysses S. Grant in 1873 (earlier proposals for these banks to offer deposit rates of 4 per cent to attract savings had been rejected because of pressure from mainstream banks).[12]

American post office banking was largely successful until deposit insurance quelled instability in banks in the 1950s. The appeal of post office banks before this has been attributed to their role as a safe haven for deposits, particularly in the 1930s, and also to their role in mobilising funding through treasury bonds for the war, in the form of Defense Savings Stamps, during the 1940s. The formal

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demise of post office banking was in 1970 when the United States Postal Service (USPS) ceased to be a cabinet department and became an independent agency, which was now required to fund itself.[13]

There was a recent call for a revival of post office banking in the US, in a 2014 white paper from the Office of the Inspector General (OIG) of the USPS, which noted that the postal service could provide affordable financial products to benefit the 68 million underserved Americans who either did not have a bank account or relied on expensive services like payday lending.[14] More recently, in April 2018, Senator Kirsten Gillibrand sponsored legislation to 'provide that the United States Postal Service may provide certain basic financial services'.[15] Support for post office banking assumes that a public bank with a wide geographical presence can offer a broad range of services at a lower cost: not only would such an institution avail itself of economies of scale and scope from existing infrastructure; it would also be able to offer products at, or close to, cost because of the absence of profit-maximising shareholders.[16] Placing the USPS in a banking role could also help to stem the financial decline of a historic institution which has suffered from the rise of digital communications; given the significance of post office services to many isolated communities, this fact is significant.

Here it is worth noting that the system of post office banking in the UK is different from what was in place, and is now being proposed again, in the US. The system in the UK is centred on the Post Office Card Account (POCA), which provides a facility for the withdrawal of benefit, pension and tax credit payments: it is not possible to make deposits, but it is possible for customers with deposits at some other banks to carry out transactions through the post office. Alternatively, individuals may open a current account at the Post Office, which is offered by the Bank of Ireland. Mainstream banks are often disinclined to cooperate with financial inclusion initiatives involving competitors (hence their reticence to sign up for network banking agreements). Until recently, only a small number of UK banks offered their customers access through the post office, but under a 2017 agreement, customers of most major banks are able to manage their accounts – including withdrawals, deposits and reviewing balances – through the Post Office. The example of the UK suggests that it is likely that, for post office banking to be successful, assistance from the state to ensure linkages with the mainstream system is essential.

Another strategy to extend financial citizenship proposes accounts for the general public at the central bank. This form of account, which would be used for deposits and payments, may be described as a 'FedAccount' or central bank deposit

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account.[17] A similar proposition, discussed by the Bank for International Settlements (BIS), is that of central bank digital currencies (CBDCs).[18] These proposals have a common starting point: the acknowledgment that central banks *already* provide digital money in the form of reserves or settlement account balances that are held by commercial banks and certain other financial institutions at the central bank. These accounts are not available for individuals and nonbank businesses, and pay a higher interest rate than ordinary bank accounts. Payments between these accounts clear instantly, and, perhaps most importantly, central bank accounts consist of base money, meaning they are fully sovereign and non-defaultable, no matter how large the balance. Essentially, such a FedAccount would do for non-physical money what the government already does for physical money, in order to make it function like an 'open-access resource': particularly compelling is the viability of real time payment transfers that can be carried out free of cost.

The CBDC approach is radical in that it effectively entails a shift from fractional reserve banking – in which only a fraction of bank deposits are immediately available for withdrawal – to a central bank administered narrow-banking or full reserve system, where all deposits are available as liquid cash. As a result, banks would only be able to lend out what they hold in deposits, and would no longer have the capacity to create money.[19] Nouriel Roubini also points out that the implementation of a central bank system of digital money would obviate the role currently played by cryptocurrencies, because 'CBDCs would likely replace all private digital payment systems, regardless of whether they are connected to traditional bank accounts or cryptocurrencies'.[20]

Conclusion

Initiatives to address marginalisation and poverty through financial access have tended to be based on the twin logics of responsibilisation and de-politicisation. Such initiatives tend to bifurcate the financial system so that there is one set of institutions for the poor and another set for the non-poor. This separation reinforces patterns of marginalisation and deprivation, and reproduces inequalities. In the US, black banking was offered by the Nixon regime as a way for black-owned businesses to overcome historic economic injustices by borrowing to grow their enterprises: but this approach was a failure because, given existing structures, it was not possible for black banks to grow their capital. In the UK, as banks focus increasingly on affluent clients to enhance profitability, branch closures across the country mean that the poorest and most vulnerable communities – which are also the most vulnerable to austerity measures – are

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deprived of financial access: this creates a vacuum filled by predatory lending institutions.

I argue for two initiatives that seek to overcome the bifurcation of banking: (1) post office banking, which is already somewhat established in the United Kingdom; and (2) central bank deposit accounts. Both of these initiatives rely on a combination of government intervention and technology. Post office bank accounts seek to overcome the geographical constraints of bank branch access under the assumption that post office networks are more widespread and resilient against profitability concerns than privately owned banks. Central bank deposit accounts seek to offer individuals a service similar to that already offered to banks, though they have an exclusionary tendency in that they rely on digital rather than physical cash.

Importantly, none of these solutions seeks to address the problem of indebtedness. If the problem of unequal access to financial services is to be fully addressed, there is a need for discussion on the current reliance of many people on credit in order to meet their basic consumption needs – and also on the limitations of personal finance to overcome structural inequalities. We need to revisit what has been called 'a social contract of banking'.[21] This describes an implicit arrangement in which the government or state offers banks a safety net – in the form of protection from runs, liquidity shortages and investor irrationality – while, in exchange, banks commit to operating safely and meeting the collective and individual borrowing needs of communities for economic expansion. In the crises of 2008-09 the government clearly upheld one part of this contract by providing a safety net to rescue banks: it would not be unreasonable now to have banks fulfil their contractual obligation.

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