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Solution to the Budget Crisis: Keeping the State's Money in the State

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Cut spending, raise taxes, sell off public assets – these are the unsatisfactory solutions being debated across the nation; but the budget crises now being suffered by nearly all the states did not arise from too much spending or too little taxation. They arose from a credit freeze on Wall Street. In the wake of the 2009 financial market collapse, banks curtailed their lending more sharply than in any year since 1942, driving massive unemployment and causing local tax revenues to plummet.

The logical solution, then, is to restore credit to the local economy. But how? The Federal Reserve could provide the capital and liquidity necessary to create bank credit, in the same way that it provided $12.3 trillion in liquidity and short-term loans to the large money center banks. But Fed Chairman Ben Bernanke declared in January 2011 that the Fed had no intention of doing that — not because it would be too costly (the total deficit of all the states comes to less than 2% of the credit advanced for the bank bailout) but because it is not part of the Fed's mandate. If Congress wants the Fed to advance credit to local governments, he said, it will have to change the law.

The states are on their own. Policymakers are therefore considering a variety of reforms designed to increase bank lending, particularly to small businesses, the hardest hit by tightening credit standards. One measure that is drawing increasing interest is the creation of a bank modeled on the Bank of North Dakota (BND), currently the only state-owned bank in the country. The BND has a 92-year history of safe, secure and highly profitable banking. North Dakota has the lowest unemployment rate in the country; and in 2009, when other states were floundering, it had the largest budget surplus it had ever had.

Eight states now have bills pending either to form state-owned banks or to do feasibility studies to determine their potential. This year, bills were introduced in the Oregon State legislature on January 11; in Washington State on January 13; in Massachusetts on January 20 (following a 2010 bill that lapsed); and in the Maryland legislature on February 4. They join Illinois, Virginia, Hawaii, and Louisiana, which introduced similar bills in 2010. The Center for State Innovation, based in Madison, Wisconsin, was commissioned to do detailed analyses for Washington and Oregon. Their conclusion was that state-owned banks in those states would have a substantial positive impact on employment, new lending, and state and local government revenue.

State-owned banks could be a win-win for everyone interested in a thriving local economy. Objections are usually based on misconceptions or a lack of information. Proponents stress that:

1. A state-owned bank on the BND model would not compete with community banks. Rather, it would partner with them and support them in making loans. The BND serves the role of a mini-Fed for the state. It provides correspondent banking services to virtually every financial institution in North Dakota and offers a Federal Funds program with daily volume of $330 million. It also provides check clearing, cash management services, and automated clearing house services. It leverages state funds into credit for local purposes, funds that would otherwise leave the state and be leveraged for investing abroad, drawing away jobs that could go to locals.

2. The BND not only does not compete for loans but does not compete for commercial deposits. Less than 2% of its deposits come from consumers. Municipal government deposits are also reserved for local community banks, which are able to use these funds for loans specifically because the BND provides letters of credit guaranteeing them. Virtually all of the BND's deposits come from the state itself. All state revenues are deposited in the BND by law.

3. Although the BND is a member of the Federal Reserve system, it is insured by the state rather than by the FDIC. This does not, however, put deposits at risk. Rather, it helps avoid risk and unnecessary expense, since the BND's chief depositor is the state, and the state has far more to deposit than $250,000, the maximum covered by FDIC insurance. FDIC insurance is not only very expense but subjects members to FDIC regulation, making the state subservient to a semi-private national banking association. (The FDIC calls itself an independent agency of the federal government, but it receives no Congressional appropriations. Rather, it is funded by premiums that banks and thrift institutions pay for deposit insurance coverage and from earnings on investments in U.S. Treasury securities.) North Dakota prefers to maintain its financial independence.

4. BND officials stress that the bank is run by bankers, not politicians bent on funding their favorite development projects or bestowing political favors. The bank is run very conservatively, doing only creditworthy deals and avoiding speculation in derivatives and risky subprime loans. By partnering with local banks, the BND actually shields itself from risk, since the local bank takes the initial loss if the borrower fails to pay.

5. The BND does not imperil state funds or tax money but is self-funding and self-sustaining. It manages VA, FHA and other forms of loans that are federally guaranteed and would otherwise go to large out-of-state banks. Profits on these federally-guaranteed loans are then used to build a capital surplus from which riskier loans can be made to local businesses and development projects. The BND has a return on equity of 25-26% and has contributed over $300 million to the state (its only shareholder) in the past decade — a notable achievement for a state with a population less than one-tenth the size of Los Angeles County. Compare California's public pension funds, which entrust their money to Wall Street and are down more than $100 billion, or close to half the funds' holdings, following the banking debacle of 2008.

6. Partnering with the BND allows community banks to fund local projects in which Wall Street is not interested, leveraging municipal government funds that would otherwise not be available for loans. Further, infrastructure projects can be funded through the state bank at substantially less cost, since the state owns the bank and gets the interest back. Studies have shown that interest composes 30-50% of public projects.

8. The North Dakota Bankers' Association does not oppose the BND but rather endorses it.

North Dakota has the most local banks per capita and the lowest default rate of any state.

Other states could realize similar benefits, if they were to form banks on the BND model. Paying interest to coupon clippers on state and municipal bonds means sending money out of the state on a one-way trip to Wall Street. Having a state-owned bank allows the state to keep its money local, flowing into the state treasury and the local economy.

Originally posted by Yes! Magazine. Ellen Brown is an attorney and chairman of the Public Banking Institute. She has written eleven books, including Web of Debt: The Shocking Truth About Our Money System and How We Can Break Free (2007, 2010).
