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# Taking Back the Money Power: How Hidden Pools of Government Money Could Help Save the Economy

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For over a decade, accountant Walter Burien has been trying to rouse the public over what he contends is a massive conspiracy and cover-up, involving trillions of dollars squirreled away in funds maintained at every level of government. His numbers may be disputed, but these funds definitely exist, as evidenced by the Comprehensive Annual Financial Reports (CAFRs) required of every government agency. If they don't represent a concerted government conspiracy, what are they for? And how can they be harnessed more efficiently to help allay the financial crises of state and local governments?

The Elusive CAFR Money

Burien is a former commodity trading adviser who has spent many years peering into government books. He notes that the government is composed of 54,000 different state, county, and local government entities, including school districts, public authorities, and the like; and that these entities all keep their financial assets in liquid investment funds, bond financing accounts and corporate stock portfolios. The only income that must be reported in government budgets is that from taxes, fines and fees; but the investments of government entities can be found in official annual reports (CAFRs), which must be filed with the federal government by local, county and state governments. These annual reports show that virtually every U.S. city, county, and state has vast amounts of money stashed away in surplus funds. Burien maintains that these slush funds have been kept concealed from taxpayers, even as taxes are being raised and citizens are being told to expect fewer government services.

Burien was originally alerted to this information by Lt. Col. Gerald Klatt, who evidently died in 2004 under mysterious circumstances, adding fuel to claims of conspiracy and cover-up. Klatt was a an Air Force auditor and federal accountant, and it's not impossible that he may have gotten too close to some military stash being used for nefarious ends. But it is hard to envision how all the municipal governments hording their excess money in separate funds could be complicit in a massive government conspiracy. Still, if that is not what is going on, why such an inefficient use of public monies?

A Simpler Explanation

I got a chance to ask that question in April, when I was invited to speak at a conference of Government Finance Officers in Missouri. The friendly public servants at the conference explained that maintaining large "rainy day" funds is simply how local governments must operate. Unlike private businesses, which have bank credit lines they can draw on if they miscalculate their expenses, local governments are required by law to balance their budgets; and if they come up short, public services and government payrolls may be frozen until the voters get around to approving a new bond issue. This has actually happened, bringing local government to a standstill. In emergencies, government officials can try to borrow short-term through "certificates of participation" or tax participation loans, but the interest rates are prohibitively high; and in today's tight credit market, finding willing lenders is difficult.

To avoid those unpredictable contingencies, municipal governments will keep a cushion of from 20% to 75% more than their budgets actually require. This money is invested, but not necessarily lucratively. One finance officer, for example, said that her city had just bid out $2 million as a 30-day certificate of deposit (CD) to two large banks at a meager annual interest of 0.11%. It was a nice spread for the banks, which could leverage the money into loans at 6% or so; but it was a pretty sparse deal for the city.

Meanwhile, Back in California

That was in Missouri, but the figures I was particularly interested were for my own state of California, which was struggling with a budget deficit of $26.3 billion as of April 2010. Yet the State Treasurer's website says that he manages a Pooled Money Investment Account (PMIA) tallying in at nearly $71 billion as of the same date, including a Local Agency Investment Fund (LAIF) of $24 billion. Why isn't this money being used toward the state's deficit? The Treasurer's answer to this question, which he evidently gets frequently, is that legislation forbids it. His website states:

> "Can the State borrow LAIF dollars to resolve the budget deficit?
>
> "No. California Government Code 16429.3 states that monies placed with the Treasurer for deposit in the LAIF by cities, counties, special districts, nonprofit corporations, or qualified quasi-governmental agencies shall not be subject to either of the following:
> "(a) Transfer or loan pursuant to Sections 16310, 16312, or 16313.
> "(b) Impoundment or seizure by any state official or state agency."

The non-LAIF money in the pool can't be spent either. It can be borrowed, but it has to be paid back. When Governor Schwarzenegger tried to raid the Public Transportation Account for the state budget, the California Transit Association took him to court and won. The Third District Court of Appeals ruled in June 2009 that diversions from the Public Transportation Account to fill non-transit holes in the General Fund violated a series of statutory and constitutional amendments enacted by voters via four statewide initiatives dating back to 1990.

In short, the use of these funds for the state budget has been blocked by the voters themselves. Bond issues are approved for particular purposes. When excess funds are collected, they are not handed over to the State toward next year's budget. They just sit idly in an earmarked fund, drawing a modest interest.

What's Wrong with This Picture?

California's budget problems have caused its credit rating to be downgraded to just above that of Greece, driving the state's interest tab skyward.  In November 2009, the state sold 30-year taxable securities carrying an interest rate of 7.26%.  Yet California has never defaulted on its bonds.  Meanwhile, the too-big-to-fail banks, which would have defaulted on hundreds of billions of dollars of debt if they had not been bailed out by the states and their citizens, are able to borrow from each other at the extremely low federal funds rate, currently set at 0 to .25% (one quarter of one percent).  The banks are also paying the states quite minimal rates for the use of their public monies, and turning around and relending this money, leveraged many times over, to the states and their citizens at much higher rates.  That is assuming they lend at all, something they are increasingly reluctant to do, since speculating with the money is more lucrative, and investing it in federal securities is more secure.

Private banks clearly have the upper hand in this game.  Local governments have been forced to horde funds in very inefficient ways, building excessive reserves while slashing services, because they do not have the extensive credit lines available to the private banking system.  States cannot easily incur new debt without voter approval, a process that is cumbersome, time-consuming and uncertain.  Banks, on the other hand, need to keep only the slimmest of reserves, because they are backstopped by a central bank with the power to create all the reserves necessary for its member banks, as well as by Congress and the taxpayers themselves, who have been arm-twisted into repeated bailouts of the Wall Street behemoths.

How the CAFR Money Could Be Used Without Spending It

California, then, is in the anomalous position of being $26 billion in the red and plunging toward bankruptcy, while it has over $70 billion stashed away in an investment pool that it cannot touch.  Those are just the funds managed by the Treasurer.  According to California's latest CAFR, the California Public Employees' Retirement Fund (CalPERS) has total investments of $360 billion, including nearly $144 billion in "equity securities" and $37 billion in "private equity."  See the State of California Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2009, pages 83-84.

This money cannot be spent, but it can be invested — and it can be invested not just in conservative federal securities but in equity, or stocks.  Rather than turning this hidden gold mine over to Wall Street banks to earn a very meager interest, California could leverage its excess funds itself, turning the money into much-needed low-interest credit for its own use.  How?  It could do this by owning its own bank.

Only one state currently does this — North Dakota.  North Dakota is also the only state projected to have a budget surplus by 2011.  It has not fallen into the Wall Street debt trap afflicting other states, because it has been able to generate its own credit through its own state-owned Bank of North Dakota (BND).

An investment in the State Bank of California would not be at risk unless the bank became insolvent, a highly unlikely result since the state has the power to tax.  In North Dakota, the BND is a dba of the state itself: it is set up as "the State of North Dakota doing business as the Bank of North Dakota."  That means the bank cannot go bankrupt unless the state goes bankrupt.

The capital requirement for bank loans is a complicated matter, but it generally works out to be about 7%. (According to Standard & Poor's, the worldwide average risk-adjusted capital ratio stood at 6.7 per cent as of June 30, 2009; but for some major U.S. banks it was much lower: Citigroup's was 2.1 per cent; Bank of America's was 5.8 per cent.) At 7%, $7 of capital can back $100 in loans. Thus if $7 billion in CAFR funds were invested as capital in a California state development bank, the bank could generate $100 billion in loans.

This $100 billion credit line would allow California to finance its $26 billion deficit at very minimal interest rates, with $74 billion left over for infrastructure and other sorely needed projects. Studies have shown that eliminating the interest burden can cut the cost of public projects in half. The loans could be repaid from the profits generated by the projects themselves. Public transportation, low-cost housing, alternative energy sources and the like all generate fees. Meanwhile, the jobs created by these projects would produce additional taxes and stimulate the economy. Commercial loans could also be made, generating interest income that would return to state coffers.

Building a Deposit Base

To start a bank requires not just capital but deposits. Banks can create all the loans they can find creditworthy borrowers for, up to the limit of their capital base; but when the loans leave the bank as checks, the bank needs to replace the deposits taken from its reserve pool in order for the checks to clear. Where would a state-owned bank get the deposits necessary for this purpose?

In North Dakota, all the state's revenues are deposited in the BND by law. Compare California, which has expected revenues for 2010-11 of $89 billion. The Treasurer's website reports that as of June 30, 2009, the state held over $18 billion on deposit as demand accounts and demand NOW accounts (basically demand accounts carrying a very small interest). These deposits were held in seven commercial banks, most of them Wall Street banks: Bank of America, Union Bank, Bank of the West, U.S. Bank, Wells Fargo Bank, Westamerica Bank, and Citibank. Besides these deposits, the $64 billion or so left in the Treasurer's investment pool could be invested in State Bank of California CDs. Again, most of the bank CDs in which these funds are now invested are Wall Street or foreign banks. Many private depositors would no doubt choose to bank at the State Bank of California as well, keeping California's money in California. There is already a movement afoot to transfer funds out of Wall Street banks into local banks.

While the new state-owned bank is waiting to accumulate sufficient deposits to clear its outgoing checks, it can do what other startup banks do – borrow deposits from the interbank lending market at the very modest federal funds rate (0 to .25%).

To avoid hurting California's local banks, any state monies held on deposit with local banks could remain there, since the State Bank of California should have plenty of potential deposits without these funds. In North Dakota, local banks are not only not threatened by the BND but are actually served by it, since the BND partners with them, engaging in "participation loans" that help local banks with their capital requirements.

Taking Back the Money Power

We have too long delegated the power to create our money and our credit to private profiteers, who have plundered and exploited the privilege in ways that are increasingly being exposed in the media.  Wall Street may own Congress, but it does not yet own the states.  We can take the money power back at the state level, by setting up our own publicly-owned banks.  We can "spend" our money while conserving it, by leveraging it into the credit urgently needed to get the wheels of local production turning once again.

*Ellen Brown developed her research skills as an attorney practicing civil litigation in Los Angeles. In Web of Debt, her latest of eleven books, she turns those skills to an analysis of the Federal Reserve and "the money trust." She shows how this private cartel has usurped the power to create money from the people themselves, and how we the people can get it back. Her websites are www.webofdebt.com, www.ellenbrown.com, and www.public-banking.com.*

*Thanks to Carl Herman for discovering the CalPERS figures.*