The Public Bank That Wasn't: New Jersey's Excursion Into Public Banking

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In 2017, Phil Murphy, a former Goldman Sachs executive, made the establishment of a public, state-owned bank a centerpiece issue during his run for New Jersey governor. He regularly championed public banking in speeches, town halls and campaign commercials. He won the race, and the nation's second state-owned bank following the stellar model of the Bank of North Dakota (BND) appeared to be in view.

Due to the priority of other economic-policy goals, the initiative was largely kept on the back burner until November 2019. Then, in an article titled "Murphy Takes First Key Step Toward Establishing a Public Bank," the New Jersey Spotlight announced:

> Gov. Phil Murphy is planning to sign an executive order Wednesday [Nov. 13] that will create a 14-member "implementation board" to advance his goal of establishing a public bank in New Jersey.
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> The basic premise of such an institution is to hold the millions of dollars in taxpayer deposits that are normally kept in commercial banks and leverage them instead to serve some sort of public purpose. … [Emphasis added.]
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> North Dakota currently is the only state that operates a public bank wholly backed by the deposit of government funds. [Emphasis added.] Founded a century ago to help insulate farmers from predatory out-of-state lenders, the Bank of North Dakota offers residents, businesses and students low-cost services like checking accounts and loans. It has also been used to advance projects that boost infrastructure and economic

> development, and has even produced revenue for the state budget's general fund, according to the bank's promotional materials, thanks to lending operations that regularly turn a profit.

Gov. Murphy signed Executive Order 91 on Nov. 13, 2019, and the Implementation Board worked diligently for the next 3-1/2 years to advance its goals. In June of 2023, the governor signed bill S3977/A5670 into law, creating the New Jersey Social Impact Investment Fund (SIIF) along with a $20 million appropriation for seed funding. The State engaged Next Street, a mission-driven advisory firm, to create a report with guidance and input from the Public Bank Implementation Board, and on Feb. 2, 2024, Next Street submitted its "Recommendations for Implementing a Public Bank in New Jersey" to the governor.

The report did a commendable job of identifying the extensive needs for increased financing by a wide variety of interests in New Jersey, including support for small business, affordable housing, home ownership, student loans, education, better infrastructure, and many others. Also commendable were its recommendation that the Community Advisory Board be constituted of local stakeholders that could most benefit from public bank funding, and its assurance of accountability to the State and the public through transparency, detailed annual public disclosure, and an independent annual audit.

When Is a Bank Not a Bank?

Public banking advocates have serious concerns, however, about other aspects of the report. Most concerning is its apparent attempt to redefine a "public bank." The report recommends creation of a public bank as a successor to the SIIF but asserts that the public bank should not be a depository institution. This recommendation is repeated throughout the report.

Many authorities confirm that a financial institution is not a "bank" unless it takes deposits. See e.g. Investopedia:

> "A bank is a financial institution licensed to receive deposits and make loans."

See also SoFi's "Guide to Depository Institutions," stating

> "There is no difference between a bank and a depository. A bank is a type of depository institution."

And see Wikipedia:

> "A bank is a financial institution that accepts deposits … and creates a demand deposit while simultaneously making loans."

The Wikipedia definition highlights the stellar advantage of a "bank" over a "revolving fund" of the sort the Next Street report recommends: banks actually create money as deposits when they make loans. It is this authority that gives bankers their enormous power in the economy and in government, and it is a power backed by the credit of the people. It should therefore belong to the people; and as Governor Murphy recognized in 2017, it can be reclaimed by the people through their own publicly-owned banks.

The nation's sole state-owned public bank, the Bank of North Dakota, takes deposits. Taking deposits is what makes it a "bank." Being owned by the state is what makes it a "public bank." Because it is a bank, BND can create new money in the amount of the loan when it extends credit; and it is permitted to make a profit through its loans. It can convert its profits or a portion of them quickly to new capital, which can generate new loans up to 10 times the bank's capital base.

A New Jersey public bank on this model would be able to grow quickly, eventually reaching the size needed to fully fund the state's large unmet needs. See for reference "Why a Sovereign State Bank Is Good for Tennessee" by Prof. Richard Werner, who proposes initial capitalization of $500 million for a Tennessee state-owned bank. A $20 million revolving fund would be barely sufficient to cover New Jersey's startup costs. The Next Street proposal is to leverage this fund with private capital, but that approach has repeatedly been shown to be inadequate to fund infrastructure and other major public projects. In many states it is unlawful for a lending institution that does not take deposits to call itself a "bank." Public banking advocates contend that such misuse of the term "bank" confuses public officials and the public and hinders the public banking movement. The Public Banking Institute definition of "public banks" is "banks with a depository bank charter (or equivalent direct license) that the public owns through their representative government and that work to benefit local communities." The PBI website also features an infographic distinguishing various types of financial institutions, titled "U.S. Public Banks, Banks, and NonBanks At-A-Glance: How Public Banks Excel."

A Bank Is Not a Charitable Revolving Fund

Among other concerns are the Next Street presumption that the New Jersey public bank would be making risky, unprofitable loans (e.g. loans to uncreditworthy businesses otherwise unable to get affordable credit), and the recommendation that the bank could be majority privately owned and operated. The BND is more profitable than some of the largest Wall Street banks; and to be a public bank, the institution must by definition be either majority or 100% publicly owned and operated.

On the BND model, the New Jersey bank would be run by professional bankers who prioritize safe lending. BND has been safely operated for 105 years, despite a majority of its board occasionally shifting political parties. Experienced bankers make its loans free from board or political influence and from conflicts of interest. BND's principal depositor, the state of North Dakota, by law must keep its funds in the bank, thus protecting BND from a run on its deposits. The Standard & Poor's credit rating for the BND is A+/stable. The S&P report states, "BND has one of the highest risk-adjusted capital (RAC) ratios for rated U.S. banks."

BND's profitability has helped strengthen community banks and credit unions in North Dakota by making loans in partnership rather than in competition with them. In the Great Recession, it also bought loans from stressed local banks to prevent bank failures and keep the economy running smoothly. BND operates with very low overhead and stresses productive and local lending rather than lending to buy existing assets. The latter is the sort of speculative, nonproductive, bubble-creating lending engaged in by the giant commercial banks from which Gov. Murphy originally sought to divest. North Dakota's revenues are safer in its own bank than in the largest Wall Street banks, which "insure" their capital with interconnected derivatives backed by rehypothecated collateral, a practice that the Office of the Comptroller of the Currency has declared to be "unsafe and unsound."

A Litany of Contrary Studies

In contrast to the conclusions of the Next Street report, other detailed studies have recommended establishing true public depository banks and have demonstrated that this can be done safely, profitably and sustainably. Here are a few:

Exploring a Public Bank for New Jersey: Economic Impact and Implementation Issues by Prof. Deb Figart (2018). "Figart estimates that every $10 million in new credit or lending by a state bank would yield between $15 million and almost $21 million in gross state output and between $3.5 million and $5.2 million in state earnings. Between 60 and 93 new jobs would be created."

Public Bank East Bay Viability Study (2022). "This Study and the accompanying financial projections show that the PBEB [Public Bank East Bay, California] can achieve [its] goals while operating in a conservative and secure way, minimizing the financial risk to its sponsor governments."

White Paper: Public Banking in the Northeast and Midwest States. This 2019 report by The Northeast-Midwest Institute "recommends that all NEMW states adopt a public bank and do so with close attention to their circumstances and needs, tailoring the bank's specifics to the nuances of the state."

Why a Sovereign State Bank is Good for Tennessee (2023). Prof. Werner states, "Banking is one of the most profitable industries. The State Bank of Tennessee will be profitable and constitutes a sound investment for the State of Tennessee. However, the benefits abound and go beyond merely commercial attractiveness. The establishment of the State Bank of Tennessee is a crucial step that can be built upon in a variety of ways in order to be able to counter future possible threats to financial and economic stability and economic and political autonomy and freedoms."

Whether the final stage of New Jersey's efforts will be a true public bank, as advocated by Gov. Murphy in 2017, remains to be seen. Meanwhile other states and cities are making impressive progress toward that goal. For updates, see the Public Banking Institute newsletter.

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The Public Banking Institute team contributed to this article, which was first posted on ScheerPost.

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