The Public Option in Banking: How We Can Beat Wall Street at Its Own Game

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President Obama has repeated his call for a public option in health care, in order to create some competition for the insurance companies and keep them honest. We the people need to call for a public option in banking, in order to create some competition for the private banks and keep them honest.

In Wall Street's latest affront to the public trust, the nine mega-banks graced with $125 billion in taxpayer bailout money under the Troubled Asset Relief Program (TARP) were reported last week to be paying out billions of dollars in bonuses to their executives. At least 4,793 bankers and traders received more than $1 million each in bonus payments, *although it was one of Wall Street's worst years on record*. After months of investigating banker compensation, New York Attorney General Andrew Cuomo said on July 30, "The repeated explanation from bank executives that bonuses are tied to performance in a manner designed to promote (national economic) growth does not appear to be accurate."

To say that it was an understatement would be an understatement. The bonuses paid to executives not only were not tied to national economic growth but were not even tied to some reasonable percentage of company profits. In fact they were generally *greater* than the *net income* of the banks. Morgan Stanley, for example, had $1.7 billion in earnings and paid $4.475 billion in bonuses. Goldman Sachs had $2.3 billion in earnings and paid $4.8 billion in bonuses. JP Morgan Chase had $5.6 billion in earnings and paid $8.69 billion in bonuses. JP Morgan's largesse involved showering 1,626 of its favorite execs and traders with bonuses of $1 million or more. For most people, a "bonus" is a few hundred dollars at Christmastime. A million dollars is what you work a lifetime to try to save, and few people reach that goal. Even Citigroup and Merrill Lynch, which have been called zombie banks, paid $5.33 billion and $3.6 billion in bonuses, respectively — although they *lost* more than $27 billion each in earnings. The bar for merit is apparently so low that you're entitled to a bonus if your zombie bank simply keeps breathing!

These blatantly inflated bonuses are just the last in a litany of abuses by those same profligate banks that nearly destroyed our economic system. If the derivatives on their books were "marked to market" (valued at what they would fetch on the market), the banks would be bankrupt, and their employees would be out of a job. Instead, they have been allowed to inflate the value of their "toxic" assets – and sell them to the U.S. government at the inflated value. Then they have taken the money they got from the government at these inflated prices and paid back the TARP money they received – allowing them to post inflated earnings and reward themselves with inflated bonuses! Many people feel that these bankers are thieves stealing from the public till who should be looking at jail time. But who is there to stop their parade of outrages? No one in Congress, the White House, or the news media is calling them on the carpet for it. As Senator Dick Durbin said recently, Wall Street owns Congress; and that is also true of the major media.

We may not be able to stop them, but we can join them. We the people need to play the bankers' game ourselves. Even corporate giants such as General Motors and WalMart have now gotten into the banking game and are easing their credit problems by forming their own banks. The U.S. public sector is late to the party. States, counties, public universities could take the lucrative system the private banking industry has created for itself and turn it to productive use in the public interest.

Keeping the Banks Honest with Some Public Competition

In President Obama's July 17 weekly address, he repeated his call for a public option in health care, in order to "increase competition and keep insurance companies honest" and to "put an end to the worst practices of the insurance industry." The same call needs to be made for a public option in banking. In some countries, publicly-owned banks have operated alongside privately-owned banks for decades; and in those countries, the current crisis has served to show that public banks generally do a better job of serving the people and protecting their interests than their private counterparts.

In Canada, the trendsetter in public banking is the province of Alberta. Alberta's publicly-owned banking system, called Alberta Treasury Branches or ATB, was initiated during the Great Depression to give the private banks a run for the public's money. According to a government publication titled "These Are the Facts: An Authentic Record of Alberta's Progress, 1935-1948":

"The Treasury Branch system enables the people to pool their financial resources and to use these resources for their mutual benefit thereby enabling them to progressively free themselves from the stranglehold of the existing financial monopoly. These Treasury Branches provide effective competition for chartered banks thereby ensuring banking services at reasonable rates."

From 1929 to 1933, the average annual income in Alberta had fallen from $548 to $212, a staggering 61 percent drop. Interest payments continued to bleed the farmers of cash, and taxes had increased. In 1935, Albertans decided they wanted a change and swept the Alberta Social Credit Party into power. In 1938, the system of Alberta Treasury Branches was set up literally as a branch of the provincial government. The stated goal of the ATB was to "provide the people with alternative facilities for gaining access to their credit resources." Bankers initially scoffed at Alberta's attempts to establish a competing economic system, but Albertans had high hopes and rushed to deposit their meager savings in the Treasury Branches. The government invested in the ATB only once, contributing $200,000 in 1938. That was all that was necessary, as the system was self-funding after that. By 1946, the ATB was turning an annual profit of $65,000. According to a booklet titled "Albertans Investing in Alberta 1938-1998," by 1998 the ATB had remitted $68 million to the provincial government.

In India, public sector banks also operate alongside private sector banks. Privatization has made significant inroads into India's banking system, but fully 80 percent of the country's banks are still government-owned. Before the current crisis, neoliberals criticized India's public banks for being oriented more toward serving the customer than turning a profit; but studies showed that the public sector banks were out-performing the private sector banks in terms of customer satisfaction. Today, when the credit crisis has hit the aggressive private international banks particularly hard, customers are fleeing into the safety of India's public sector banks, which have emerged largely unscathed from the credit debacle. The public banks have been credited with keeping the country's financial industry robust at a time when the private international banks are suffering their worst crisis since the 1930s.

In China, private-sector banking has also made some inroads; but state-owned banks still predominate. In a June 2009 article titled "The Chinese Puzzle: Why Is China Growing When Other Export Powerhouses Aren't?", Brad Setser noted that nearly all countries relying heavily on exports for growth have experienced major downturns and remain in the doldrums — except for China. When China's external markets fell off, the government turned its credit machine inward to domestic development. Its state-owned banks engaged in a huge increase in lending, with local governments and state enterprises borrowing on a large scale. The result was to create a real fiscal stimulus that put workers to work and got money circulating again in the economy.

In the United States, the trendsetter in public banking is the state of North Dakota, which has owned its own bank for nearly a century. North Dakota is one of only two states (along with Montana) that are currently not facing budget shortfalls. Ever since 1919, North Dakota's revenues have been deposited in the state-owned Bank of North Dakota (BND). Under the "fractional reserve" lending scheme open to all banks, these deposits are then available for leveraging many times over as loans. Other banks in the state do not see the BND as a threat because it partners with them and backstops them, serving as a sort of central bank for the state. BND's loans are not insured by the Federal Deposit Insurance Corporation (FDIC) but are guaranteed by the state. North Dakota has plenty of money for student loans, makes 1% loans to startup farms, has the lowest unemployment rate in the country, and is generally not feeling the pinch of the credit crisis at all.

Theory and Practice: The Proof Is in the Pudding

A bank charter brings with it the privilege of creating "credit" simply as an accounting entry on the bank's books. The flaw in the private banking scheme is that banks create the principal portion of their loans but not the interest, which is continually drawn off the top as profit. New borrowers must continually be found to take out new loans to create this extra profit, making private banking effectively a pyramid scheme; and like any pyramid scheme, it has mathematical limits. Today, those limits appear to have been reached. Personal and national debts have gotten so large relative to incomes that it is no longer possible to maintain the fiction of solvency. We soon won't have the money even to pay the interest on our existing debts, let alone to incur new ones. Public banking does not suffer from that flaw, because interest is not drawn out of the system but is returned to the public coffers. Public banking is thus mathematically sound and sustainable.

That is the theory, but there is nothing so persuasive as putting it to the test. Like with the public option in health care, we need to pit the public banking option against the private banking option and see which works best. My money is on the public option.

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