How Wisconsin Can Turn Austerity into Prosperity – Own a Bank

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As states struggle to meet their budgets, public pensions are on the chopping block; but they needn't be. States can keep their pension funds intact and leverage them into many times that sum in loans, just as Wall Street banks do. They can do this by forming their own banks, following the lead of North Dakota, the only state either to have its own bank or to have a major budget surplus.

Public workers are not going quietly into that good night of state budgets balanced at the expense of union benefits. After three weeks of protests in Wisconsin, convictions remain strong and pressure is building. Fourteen Wisconsin Democratic lawmakers said Friday that they are not deterred by threats of possible arrest and of 1,500 layoffs if they don't return to work. **President Obama has charged Wisconsin's Governor Scott Walker with attempting to bust the unions. But Walker's defense is:**

"*We're broke. Like nearly every state across the country, we don't have any more money*."

Among other concessions, Governor Walker wants to require public employees to pay a portion of the cost of their own pensions. Bemoaning a budget deficit of $3.6 billion, he says the state is too broke to afford all these benefits.

Broke Unless You Count the $67 Billion Pension Fund . . .

That's what he says, but according to Wisconsin's 2010 CAFR (Comprehensive Annual Financial Report), the state has *$67 billion* in pension and other employee benefit trust funds, invested mainly in stocks and debt securities drawing a modest return.

A recent study by the PEW Center for the States showed that Wisconsin's pension fund is almost fully funded, meaning it can meet its commitments for years to come without drawing on outside sources. It requires a contribution of only $645 million annually to meet pension payouts. Zach Carter, writing in the Huffington Post, notes that the pension program could save another $195 million annually just by cutting out its Wall Street investment managers and managing the funds in-house.

The governor is evidently eying the state's lucrative pension fund, not because the state cannot afford the pension program, but as a source of revenue for programs that are not fully funded. This tactic, however, is not going down well with state employees.

Fortunately, there is another alternative. Wisconsin could draw down the fund by the small amount needed to meet pension obligations, and put the bulk of the money to work creating jobs, helping local businesses, and increasing tax revenues for the state. It could do this by forming its own bank, following the lead of North Dakota, the only state to have its own bank — and the only state to escape the credit crisis.

This could be done without spending the pension fund money or lending it. The funds would just be shifted from one form of investment to another (equity in a bank). When a bank makes a loan, neither the bank's own capital nor its customers' demand deposits are actually lent to borrowers. As observed on the Dallas Federal Reserve's website, "*Banks actually create money when they lend it*." They simply extend accounting-entry bank credit, which is extinguished when the loan is repaid. Creating this sort of credit-money is a privilege available only to banks, but states can tap into that privilege by owning a bank.

How North Dakota Escaped the Credit Crunch

Ironically, the only state to have one of these socialist-sounding credit machines is a conservative Republican state. The state-owned Bank of North Dakota (BND) has allowed North Dakota to maintain its economic sovereignty, a conservative states-rights sort of ideal. The BND was established in 1919 in response to a wave of farm foreclosures at the hands of out-of-state Wall Street banks. Today the state not only has no debt, but it recently boasted its largest-ever *budget surplus*. The BND helps to fund not only local government but local businesses and local banks, by partnering with the banks to provide the funds to support small business lending.

The BND is also a boon to the state treasury, having contributed over $300 million to state coffers in the past decade, a notable achievement for a state with a population less than one-tenth the size of Los Angeles County. In 2008, the BND returned a *26%* dividend to the state. That beats most Wall Street investments by a country mile, at least if California's experience is any guide. California's public pension funds are down more than $150 billion – that's billion with a "b" – or close to half the funds' holdings, following the Wall Street debacle of 2008. It was, in fact, the 2008 bank collapse rather than overpaid public employees that caused the crisis that shrank state revenues and prompted the budget cuts in the first place.

Read Ellen Brown's two chapters in *The Global Economic Crisis*

Seven States Are Now Considering Setting Up Public Banks

Faced with federal inaction and growing local budget crises, an increasing number of states are exploring the possibility of setting up their own state-owned banks, following the North Dakota model. On January 11, 2011, a bill to establish a state-owned bank was introduced in the Oregon State legislature; on January 13, a similar bill was introduced in Washington State; on January 20, a bill for a state bank was filed in Massachusetts (following a 2010 bill that had lapsed); and on February 4, a bill was introduced in the Maryland legislature for a feasibility study looking into the possibilities. They join Illinois, Virginia, and Hawaii, which introduced similar bills in 2010, bringing the total number of states with such bills to seven.

If Governor Walker wanted to explore this possibility for his state, he could drop in on the Center for State Innovation (CSI), which is located down the street in his capitol city of Madison, Wisconsin. The CSI has done detailed cost/benefit analyses of the Oregon and Washington state bank initiatives, which show substantial projected benefits based on the BND precedent. See reports here and here.

For Washington State, with an economy not much larger than Wisconsin's, the CSI report estimates that after an initial startup period, establishing a state-owned bank would create new or retained jobs of between 7,400 and 10,700 a year at small businesses alone, while at the same time returning a profit to the state.

A Bank of Wisconsin Could Generate "Bank Credit"

Many Times the Size of the Budget Deficit

Economists looking at the CSI reports have called their conclusions conservative. The CSI made its projections without relying on state pension funds for bank capital, although it acknowledged that this could be a potential source of capitalization.

If the Bank of Wisconsin *were* to use state pension funds, it could have a capitalization of more than $57 billion – nearly as large as that of Goldman Sachs. At an 8% capital requirement, $8 in capital can support $100 in loans, or a potential lending capacity of over $500 billion. The bank would need deposits to clear the checks, but the credit-generating potential could still be huge.

Banks can create all the bank credit they want, limited only by (a) the availability of creditworthy borrowers, (b) the lending limits imposed by bank capital requirements, and (c) the availability of "liquidity" to clear outgoing checks. Liquidity can be acquired either from the deposits of the bank's own customers or by borrowing from other banks or the money market. If borrowed, the cost of funds is a factor; but at today's very low Fed funds rate of 0.2%, that cost is minimal. Again, however, only banks can tap into these very low rates. States are reduced to borrowing at about 5% — unless they own their own banks; or, better yet, unless they *are* banks. The BND is set up as "North Dakota *doing business as* the Bank of North Dakota."

That means that technically, all of North Dakota's assets are the assets of the bank. The BND also has its deposit needs covered. It has a massive, captive deposit base, since all of the state's revenues are deposited in the bank by law. The bank also takes other deposits, but the bulk of its deposits are government funds. The BND is careful not to compete with local banks for consumer deposits, which account for less than 2% of the total. The BND reports that it has deposits of $2.7 billion and outstanding loans of $2.6 billion. With a population of 647,000, that works out to about $4,000 per capita in deposits, backing roughly the same amount in loans.

Wisconsin has a population that is nine times the size of North Dakota's. Other factors being equal, Wisconsin might be able to amass over $24 billion in deposits and generate an equivalent sum in loans – over six times the deficit complained of by the state's governor. That lending capacity could be used for many purposes, depending on the will of the legislature and state law. Possibilities include (a) partnering with local banks, on the North Dakota model, strengthening their capital bases to allow credit to flow to small businesses and homeowners, where it is sorely needed today; (b) funding infrastructure virtually interest-free (since the state would own the bank and would get back any interest paid out); and (c) refinancing state deficits nearly interest-free.

Why Give Wisconsin's Enormous Credit-generating Power Away?

The budget woes of Wisconsin and other states were caused, not by overspending on employee benefits, but by a credit crisis on Wall Street. The "cure" is to get credit flowing again in the local economy, and this can be done by using state assets to capitalize state-owned banks.

Against the modest cost of establishing a publicly-owned bank, state legislators need to weigh the much greater costs of the alternatives – slashing essential public services, laying off workers, raising taxes on constituents who are already over-taxed, and selling off public assets. Given the cost of continuing business as usual, states can hardly afford *not* to consider the public bank option. When state and local governments invest their capital in out-of-state money center banks and deposit their revenues there, they are giving their enormous credit-generating power away to Wall Street.

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