Reviving the Local Economy with Publicly-Owned Banks

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The credit crunch is getting worse on Main Street, despite a Wall Street bailout that is now in the trillions of dollars. The Federal Reserve's charts show that "base money" is rapidly expanding – meaning coins, paper money, and commercial banks' reserves with the central bank. But the money isn't making it to where it needs to go to stimulate economic growth: into the bank accounts of American businesses and consumers. The Fed has been pumping out money to the banks, and their reserves have been growing at unprecedented rates; but the money supply in the real economy has been declining.

According to Ambrose Evans-Pritchard, writing last month in the UK Telegraph, U.S. bank credit and M3 (the broadest measure of the money supply) contracted over the summer at rates comparable to the onset of the Great Depression. In the summer quarter, U.S. bank loans fell at an annual pace of almost 14 percent. "There has been nothing like this in the USA since the 1930s," said Professor Tim Congdon of International Monetary Research. "The rapid destruction of money balances is madness."

Chartered banks are allowed to create credit on their books equal to many times their deposit base, but lately they haven't been doing it. In more normal times, one dollar in base money has been fanned by the banks into $8.50 in loans. Today, one dollar in base money is producing only one dollar in loans. Although the Fed has been frantically pushing cash into the banks, it can't make them lend to consumers.

This is not because the banks are trying to be difficult. If they had prudent loans on which to turn a profit and the capital base to do it, they no doubt would. But their books have been choked with toxic assets, destroying their capital positions; and the "shadow lenders" who once took subprime loans off their books have gotten wise to the scam and gone away. Bankers who know the endangered state of their own books don't trust each other, so money is tight all around. And the Fed has already dropped interest rates as low as they can go, so it has no more leverage with which to entice borrowers.

Local Government to the Rescue?

The Fed may have played all its cards, but state and local governments still hold a few aces. Some local politicians are looking into the feasibility of opening their own publicly-owned banks, providing them with their own credit machines. A new public bank would have a clean set of books, untainted by the Wall Street addiction to gambling in complex derivatives; and its profits would go back to the local government and community, rather than being siphoned off in exorbitant salaries, bonuses and dividends. A publicly-owned bank could funnel credit where it is needed most, directly into the local economy.

One legislator who is considering a publicly-owned bank is Bruno Barreiro, County Commissioner for Miami-Dade County in Florida. In a September 23 article titled "Capital Sources: Recession Steers Banks Away from Business as Usual", The Daily Business Review reported that Miami-Dade is planning to conduct a feasibility study proposing alternatives for becoming its own depository. Said the journal:

"Barreiro notes that throughout the year, a portion of the county's $7.5 billion operating budget is deposited with outside financial institutions in return for an interest rate. However, he feels that given the instability of many banks, the county might be better off going into such a business on its own."

Brian [Bandell](), writing in The South Florida Business Journal on September 11, reported that Barreiro's concern is that bank accounts are insured by the FDIC for only up to $250,000. Some businesses have lost millions of dollars in uninsured deposits when banks failed. The county often has over $50 million in a single account. If the county were to open its own depository institution, it could safeguard against these losses.

However, said Bandell, Barreiro is not proposing to allow the institution to make loans. Rather, the state's money would be invested conservatively in Treasury bonds. The problem with that approach, said Miami banking analyst Kenneth Thomas, is that it would be a challenge to get good interest rates for the county's deposits without making loans. "There's a reason most other municipalities aren't doing it," he said.

In stopping short of making loans, the county could be missing a major business opportunity. The average interest rate on U.S. government bonds is currently 3.35%. If the funds in Miami-Dade's operating budget were deposited in the county's own bank, the money could serve as the reserves to support at least nine times that sum in loans. Assuming an average interest rate of 5% on these loans, the county could increase its revenues by over 1,000% (45% vs. 3.35%). [A fuller explanation and references are here.]

Maximizing the Potential of a Publicly-owned Bank

Economist Farid Khavari is a Democratic candidate for governor of Florida in 2010. He proposes a Bank of the State of Florida (BSF) that would take full advantage of the potential of a bank charter. It would not only act as a depository for the state's funds but would actually make loans to Floridians, at much lower interest rates than they are getting now. Among other benefits, the BSF could open up frozen credit markets, save homeowners many thousands of dollars in payments, produce major revenues for the state, and allow the state's own debts to be refinanced at much lower rates. All those benefits are possible, says Khavari, because of the "fractional reserve" banking system used by all banks when they make loans. As he explained in a July 29 article in Reuters:

"Using the fractional reserve regulations that govern all banks, we can earn billions per year for Florida's treasury, while saving thousands of dollars per year for Florida homeowners. . . . For $100 in deposits, a bank can create $900 in new money by making loans. So, the BSF can pay 6% for CDs, and make mortgage loans at 2%. For $6 per year in interest paid out, the BSF can earn $18 by lending $900 at 2% for mortgages.

"The BSF can be started at no cost to taxpayers, and will be a permanent engine driving Florida's economy. We can refinance state and local projects at 3%, saving taxpayers billions and balancing state and local budgets without higher taxes."

The state would earn $15,000 per $100,000 of mortgage, at a cost of about $1,700; while the homeowner would save $88,000 in interest and pay for the home 15 years sooner. "Our bank will save people about seven years of their pay over the course of 30 years, just on interest costs," Khavari said. "We should work to support ourselves and our families, not the banks. . . . What we have now . . . makes everyone work for a few greedy fat cats."

Earlier Models

This sort of healthy public competition for the private banking monopoly has earlier precedents, going back to the colony of Pennsylvania in Benjamin Franklin's day. Before Pennsylvania founded its own bank, the province was having difficulty attracting settlers, because there was a shortage of money with which to conduct trade. The settlers could get credit only by borrowing from the British bankers at a hefty 8% interest, and even those loans were hard to come by. The provincial government then got the bright idea of printing its own paper money and lending it to the farmers at 5% interest. When credit became cheaper and more freely available, the local economy flourished.

The only state that owns its own bank today is North Dakota. North Dakota is also one of only two states (along with Montana) that are on track to meet their budgets by 2010; it has the lowest unemployment rate in the country; and it has the largest budget surplus it has ever had, tallying in at $1.3 billion. Why this cold and isolated farming state should be doing so well when other states are teetering on bankruptcy has been the subject of several TV commentaries, including a spoof by Conan O'Brien on NBC's Tonight Show, which attributed it to theft by local farmers from tourists. But North Dakota's real secret seems to be that it has escaped the Wall Street credit debacle. The state has generated its own credit through its own publicly-owned bank for nearly a century.

The Bank of North Dakota (BND) was founded in 1919, when a political party called the Non Partisan League succeeded in uniting farmers suffering from an earlier credit crisis. The BND's website states that the bank was originally formed to create additional competition in the credit industry, while providing a local source of capital for state investment and development. The BND avoids opposition from other banks by partnering with them in loan projects. According to the bank's website:

"The primary deposit base of the BND is the State of North Dakota. All state funds and funds of state institutions are deposited with the bank as required by law. . . . Use of the banks' earnings are at the discretion of the state legislature. As an agent of the state it can make subsidized loans to spur development . . . . [It] underwrites municipal bonds for all of the political units in the state, and has been one of the leading banks in the nation in the number of student loans issued. The bank also serves as the state's 'Mini Fed' . . . . As a result of the banks' services, it enjoys widespread support among the public and the independent banking community."

Bringing the Model Current

The private banking system is in systemic failure, and the public is waking up to the fact. We have been fleeced by Wall Street, the banks are not providing loans, and our savings are no longer secure. The publicly-owned Bank of North Dakota has provided an alternative model that has worked remarkably well for nearly a century.

The BND has been around for so long, however, that skeptics can write off the state's remarkable success to other factors. A modern-day public bank that quickly turned its flagging local economy around could set a precedent that was irrefutable. If Florida were to establish a successful public banking model, it could blaze a trail out of the economic wilderness for local governments everywhere.

Ellen Brown developed her research skills as an attorney practicing civil litigation in Los Angeles. In Web of Debt, her latest book, 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 earlier books focused on the pharmaceutical cartel that gets its power from "the money trust." Her eleven books include Forbidden Medicine, Nature's Pharmacy (co-authored with Dr. Lynne Walker), and The Key to Ultimate Health: Non-toxic Dentistry (co-authored with Dr. Richard Hansen). Her websites are www.webofdebt.com and www.ellenbrown.com.

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