



Public Banking Institute White Paper

Benefits of Having a Public Bank for Cities, Municipalities & States

How Does a Public Bank Generate Non-tax Municipal Revenue?

As demonstrated by the Bank of North Dakota, a public bank makes a sizeable and reliable profit, owing to its business model which differs greatly from that of commercial banks. No branches, tellers, ATMs, outsized salaries and bonuses or broad and expensive marketing – these costs fall to the bottom line. In addition to lending according to a formula based on its capitalization and deposits, it would also have access to low cost funds through the Federal Home Loan Bank. Making its loans at market-rate¹ creates profit of which a significant portion is deposited (according to its charter) in the municipality's general fund² to help balance the operating budget without raising taxes, cutting vital programs, taking on more debt, asking for givebacks from employees or raiding pension funds.

What Role Do Public Banks Play in Sound Economic and Fiscal Policy and Providing Reliable Community Credit?

A public bank allows a municipality to direct local lending, offer below market-rate loans,³ and leverage other capital for specific public purposes such as affordable housing, neighborhood development, infrastructure, small business development, education and job creation. Dedicated loan funds can be set up in the bank's charter and it can modify mission and priorities from year to year with input from board members, local government and the public.⁴

How Does a Public Bank Reduce Public Debt and Debt Service?

A public bank can finance capital projects and bond issues at greatly lower interest than the traditional bond market, and refinance current public debt, greatly lowering debt service costs without the use of swaps and deceptive public/private partnership agreements that give away public assets to private companies without accountability. It is a stable buyer of municipal bonds. Paying non-escalating, fee free payments without the need to provide additional profits for shareholders can mean greater cost savings of between 35 to 50% that consists of interest for large infrastructure projects. And whatever interest the public bank collects is retained and returned in its profits to the municipal general fund, and not extracted and exported from the community.

How Do Public Banks Maintain Local Prosperity in Economic Crisis?

Research on public banks, whether municipal, regional, or state, shows that they function counter-cyclically, increasing credit flows and support for local small and medium businesses in times of economic downturn. This stems business losses and failures and maintains robust local employment. During the last economic downturn the largest banks severely cut their loans to local businesses.⁵

Can Public Banks Reduce Municipal Banking Costs and Maximize Returns?

Many municipalities across the United States deposit receipts and fees with large banks that are seen as providing security with collateral, something smaller community banks cannot or are not willing to do. These deposits often earn negligible interest, sometimes .49% interest or less,⁶ With a public bank, a municipality can deposit its funds in its own bank and generate far greater profits; in part by making loans, but also owing to the low overhead business model of public banks. The profit margin can support increased interest on some government accounts or on special savings accounts, such as those for seniors or pension-related accounts. Deposits in a municipal public bank are managed with direct accountability, flexibility, and full public transparency.

How Do Public Banks Eliminate Under-Productive Rainy Day Funds?

A public bank can cover a budget shortfall by making an interest-free loan to the municipality from the bank's profits. Timely disaster relief loans from a dedicated fund can preserve the municipal tax base in the event of a flood or other disaster. Annual budgets can be balanced without the need to raise expensive, high-interest capital on the open market.⁷ Meanwhile, municipal money that merely sat as cash or got negligible interest gets put to work.

How Do Public Banks Strengthen the Local Banking Industry and Increase the Tax Base?

Because a municipal public bank makes loans in partnership with community banks, credit unions, and financial institutions, the local banking and finance industry is strengthened. A public bank can enable local lenders to increase loan amounts without modifying existing underwriting standards, thus gaining a new market, and lower interest rates to help more borrowers to qualify. A public bank can offer letters of credit to enable local banks to accept municipal deposits without their pledging their reserves for collateral, provide a secondary market for mortgages and offer stock swaps to provide local banking liquidity. Community banks and credit unions are the "front office" and do the bulk of the due diligence on each loan and keep loan origination and service fees. Credit becomes local.⁸ Such arrangements facilitate the hiring of local contractors rather than large out of state companies favored by some directors of major, private banks.⁹ This "virtuous circle" increases local prosperity and the local tax base.¹⁰

Is a Public Bank More Secure Than Banking With Wall Street?

A public bank provides a safe and secure vehicle for the deposit and investment of funds from the general budget and sometimes municipal pension funds.¹¹ Many city and town CAFRs (Consolidated Annual Financial Reports) reveal investments in hedge or equity funds and other risky vehicles.¹² Because the Systemically Important Financial Institutions (SIFIs) that hold many of the sizeable municipal deposits also invest heavily in derivatives, municipal treasurers have cause for being concerned about the possible confiscation, or "bail in" of these funds in the event of the next Wall Street crash. Legally, derivatives have "super-priority" in the case of bankruptcy and the FDIC (where applicable) only has enough to pay pennies on the dollar.¹³ The next mega bank failure could exhaust the FDIC.

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End Notes:

¹ The Bank of North Dakota (BND), our country's oldest public bank, shares its headquarters with the state economic development agency from which it sometimes receives supplemental funds that allow it to make below market-rate loans to startups that create local jobs in areas with unemployment.

² Founded in 1919, the BND has averaged more than 25% return on equity over the past 16 years. Since 2008, BND's annual return on investment has been between 17 and 26%. Financials are at: http://banknd.nd.gov/financials_and_compliance/annual_reports.html. Since 1945, BND has deposited its profits in the State's general fund. In the past decade, BND has returned over \$300M to the general fund. BND's high profits are possible because the public bank is not a retail bank. Only 2% of its deposits are private. It concentrates on investing and managing the government revenues it receives by law. It has no need of local branches or high-salaried or extensive staff. BND is also not required to contribute to FDIC insurance because it is not a retail bank and it is backed by the full faith and credit of the State and people of North Dakota. This and its partnership arrangements with local banks lower its operating costs considerably.

³ On job creating business loans, the bank uses the PACE fund to buy down interest rates by from 1% to 5%. Similar funds are available for entrepreneurs and agricultural loans. See <http://ilsr.org/rule/bank-of-north-dakota-2/>, p. 3.

⁴ A process like participatory budgeting already used in cities such as New York and Chicago, allows for public input as to the priority of areas and needs to be invested in without designating specific investments, something done by professional bankers or lending officers.

⁵ Most of the studies of counter cyclical lending to local businesses by public banks is of foreign banks. Germany and the BRICs banks are 40% public, including Germany's network of local, cooperative banks. Studies have been done of both Latin American public banks (such as Chile's Banco Estado that has a counter-cyclical strategy for business lending) and European public banks. Most studies seem to be of larger national, regional, and state public banks, but a similar counter-cyclical benefit could also be had by a municipal, public bank. Direct investment in public assets such as education, healthcare, land acquisition, renewable energy, green infrastructure (water/wastewater etc.), and transportation can function counter-cyclically and generate additional revenue. According to studies, the interest paid to private banks can represent between 30 to 50% of most public projects. Low-cost loans from a public bank provide an alternative.

⁶ For example in 2013, Bank of America paid Boston .49% on over \$2 billion of deposits.

⁷ One year, the Bank of North Dakota bailed out the State government when its budget experienced a shortfall. Finance arrangements with its public bank could make rainy day funds such as Boston's \$130 million "free cash" fund unnecessary. Instead such funds may be used to capitalize a public bank, which working in partnership with its community banks, could generate a steady profit after three years of operation.

⁸ Local bank capacity to make loans can also be increased by the public bank's buying partnership banks' loans on the secondary market and increasing their capitalization by buying their bank stock.

⁹ Because local banks in North Dakota are supported by a public bank, they are able to make a greater proportion of small business loans than banks in other states. Ellen Brown writes:

Over the last ten years, the amount of lending per capita by small community banks (those under \$1 billion in assets) in North Dakota has averaged about \$12,000, compared to \$9,000 in South Dakota and \$3,000 nationally. The gap is even greater for small business lending. North Dakota community banks averaged 49 percent more lending for small businesses over the last decade than those in South Dakota and 434

percent more than the national average. In other states, increased regulatory compliance costs are putting small banks out of business. [The number of small banks in the US has shrunk](#) by 9.5% just since the Dodd-Frank Act was passed in 2010, and their share of US banking assets has shrunk by 18.6%. But that is not the case in North Dakota, which has 35 percent more banks per capita than its nearest neighbor South Dakota, and four times as many as the national average. The resilience of North Dakota's local banks is largely due to their amicable partnership with the innovative state-owned Bank of North Dakota. See: "[Why Do Banks Want Our Deposits? Hint: It's Not to Make Loans](#)", Oct. 26, 2014 at: <http://www.globalresearch.ca/why-do-banks-want-our-deposits-hint-its-not-to-make-loans/5410125.d>

¹⁰ In 2010, the Center for State Innovation published a study analyzing the effects of moving Massachusetts State funds from big banks (assets greater than 100B) to medium banks (assets 1-10B) and small banks (assets less than 1B). This complex study included bank limits to absorb deposits and the willingness of differently sized banks. Tellingly, the study found that for each 10M moved small banks created between 4.50 and 7.23 jobs and medium banks created between 4.67 and 5.75 jobs. This was simply the result of moving deposits. With a public bank, the entire lending system is refocused to create local jobs with likely far more significant results. This is because small partnership banks do not have to hold and collateralize deposits but merely obtain letters of credit from the public bank to lend additional capital. Local banks tend to fund local, small businesses where the bulk of job creation takes place. Large banks, in general, are no longer interested in making loans below 5 million dollars and even higher thresholds. *By a municipal public bank strengthening local, community banks, the chance of their being consolidated by larger banks is also reduced. Communities can more likely keep their local banks and bank officers.*

It is instructive to compare the financial statements of community banks in North Dakota with similarly capitalized and sized community banks in Massachusetts. Those that work in partnership with the State public bank appear much more profitable. See <https://www2.fdic.gov/idasp/main.asp> and <http://www.bankingencyclopedia.com>. The Massachusetts Bankers Association is funded by major international banks who tell community banks that a public bank would be competition despite its nature as a non-depository institution. Through research, our group hopes to highlight the opposite. We hope to also document instances where the same major banks that lobby against public banks take over then loan servicing, the lion's share of fees, and eventually the clients of the smaller community banks with which they partner. They often obtain information about local banks and buy them out.

¹¹ Public banks do not necessarily invest a municipality's pension funds. However, proposals to do so are being considered for preserving principal, consistent returns, and tax purposes. Some cities are exploring using pension funds to launch public banks that then invest operating profits to both buy back municipal bonds and fund their pensions.

¹² ***Private Equity at Work; When Wall St. Manages Main St.***, a May 2014 book by Eileen Appelbaum and Rosemary Batt examines equity funds to find that the returns of only 25% have beaten a stock market index fund each year since 2005. The problem is that different funds exceed that benchmark in each year. The book is a balanced expose of hedge and equity funds revealing that they work for only 2% of the companies that the funds buy, generally small businesses that are helped to scale up and for whom bank capital is not available. Most other companies are looted within three to five years and about half end up bankrupt. Both the profit figures and the jobs created statistics are detailed as to the ways in which the equity companies manipulate them.

¹³ For a dramatic presentation of the safety of public deposits in the age of derivatives, see the YouTube presentation, <https://www.youtube.com/watch?v=jPsOopzp7e4>. See also these articles: "[Winner Takes All: The Super Priority Status of Derivatives](#)," Ellen Brown, Web of Debt Blog, April 10, 2013; "[The Armageddon Looting Machine: The Looming Mass Destruction From Derivatives](#)", Ellen Brown, Web of Debt Blog, September 18, 2013; and "[The SEC Finally Takes an Interest in Collateralized Loan Obligations](#)", Yves Smith, Naked Capitalism Blog, March 25, 2014; and this study: *Derivatives: Innovation in the Era of Financial Regulation*, Wallace C. Turbeville, Financial Pipeline Series, Americans for Financial Reform, Washington, DC, June 13, 2013 and Americans for Financial Reform reporting on Derivatives bills before the US Congress.