

A State Bank for Washington: Why and How

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Where does money come from?

85% of legislators don't know, per an October 2017 UK study.



According to the Bank of England, most money is created by banks.

‘[B]anks do not act simply as intermediaries, lending out deposits that savers place with them ... Commercial banks create money, in the form of bank deposits, by making new loans... Bank deposits make up . . . 97% of the [money] currently in circulation.’

- *‘Money creation in the modern economy’, Quarterly Bulletin, 2014 Q1, Bank of England.*

Banks create the money needed to stimulate local economies. But . . .

- Wall Street is not interested.
- Local banks can't compete:
 - Insufficient capital under Basel III
 - Onerous regulatory burden—Dodd Frank and the Patriot Act

A state bank can act as a mini Fed, providing capital and liquidity.



A few politicians get this and are running with it.

Phil Murphy, elected New Jersey's governor on Nov 7, was formerly a banker at Goldman Sachs. He has made a state bank a centerpiece of his platform.



Other leading contenders – the race is on to be first!

- Sen. Bob Hasegawa has been spearheading a WA state bank since 2010.
- CA Treas. John Chiang announced Nov 7 that he is proceeding with a feasibility study -- independent of the legislature.
- Santa Fe's feasibility study is nearly done, and Oakland's is in process.

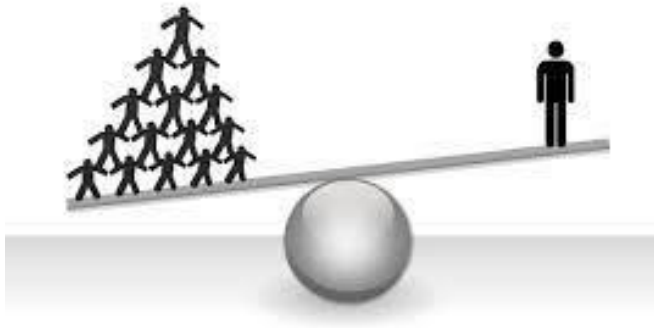


The state already has loan funds.
Why do we need a *bank*?

Answer: leverage.

Loan fund

- \$1 billion lent at 3% equals **\$30 million return**.



Depository bank

- \$1 billion in capital can generate \$9 billion in loans at 3% = \$270M. Less \$100M cost of funds (1% on the state's own deposits) = **\$170 million return**.

The high cost of private funding

- New Jersey: 10% of budget goes to finance charges.
- NYTimes 2015: “Wall Street Fees Wipe Out \$2.5 Billion in NYC Pension Gains”
- Los Angeles 2014: the city spends more on Wall Street fees than on maintaining roads.
- .California school districts are paying 300%+ on Capital Appreciation Bonds.

SF Chronicle 2016: \$1 of every \$2 spent on infrastructure bonds goes to interest.

Bay Bridge retrofit:

principal, \$6 billion;
interest, \$6 billion.

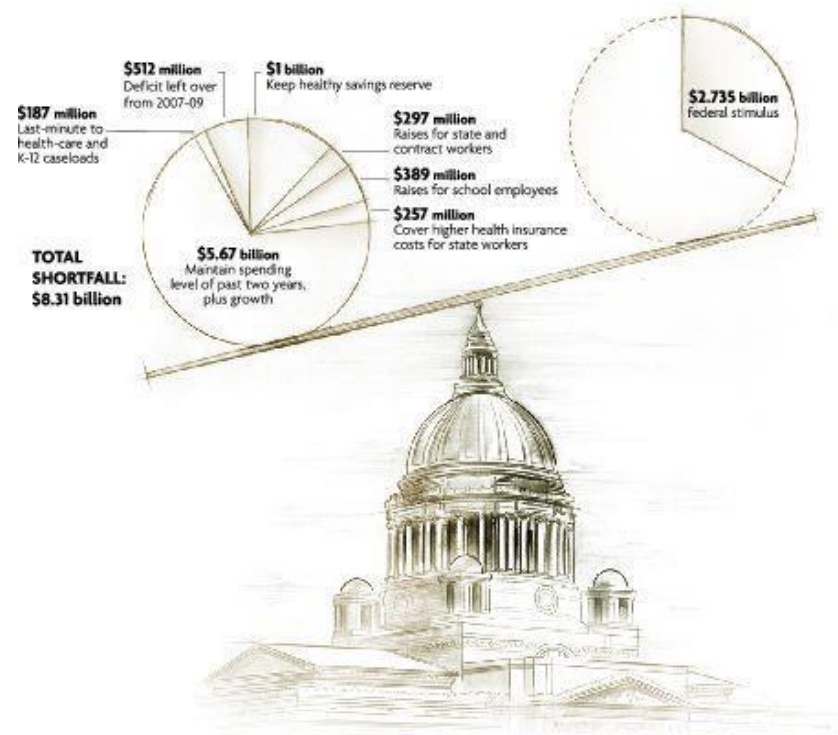
Bullet train:

principal, \$9.95 billion;
interest, \$9.5 billion



Infrastructure costs could be cut in half if we could borrow from ourselves.

But, say legislators, the state doesn't have the money to lend. It needs its revenues to balance its budget.



Washington State actually has plenty of money—it just can't be “spent”.

The state has:

- **\$15+ billion** in its Local Government Investment Pool & Treasury/Trust Portfolio
- **\$90 billion** in public pension funds
- County and local funds
- “Money between the seat cushions everywhere” (Hasegawa)



The problems of liquidity and risk

- State revenues cannot be lent long-term through a revolving fund because they might be needed for the budget.
- But a *bank* can turn short-term deposits into long-term loans.



Solving the problem of "**liquidity mismatch**"—when borrowers and depositors come for their money at the same time.

The bank can borrow short-term to cover shortfalls:

- At 1% overnight from other banks, The Federal Home Loan Bank or the repo market
- At 1.36% for a three-month loan from the Federal Home Loan Bank



Proving the model – the Bank of North Dakota



- The only state to escape the 2008-09 credit crisis
- The nation's lowest unemployment rate
- One of the lowest foreclosure rates
- Lowest defaults on student & credit card debt

WSJ: BND is more profitable than Wall Street

Wall Street Journal, Nov 16, 2014:

“It is more profitable than [Goldman Sachs Group Inc.](#), has a better credit rating than [J.P. Morgan Chase](#) & Co. and hasn’t seen profit growth drop since 2003. Meet Bank of North Dakota, the U.S.’s lone state-owned bank, which has one branch, no automated teller machines and not a single investment banker. . . . Return on equity . . . is 18.56%, about 70% higher than those at Goldman Sachs and J.P. Morgan.”

Not due to oil:

the BND has had record profits for 15 years despite a massive oil bust.

- Spring 2017 annual report showed:
 - total assets: \$7.3 billion
 - Equity: \$876 million
 - Net income: \$136 million
 - Return on equity: 15.5%.



Why so profitable? BND has lower costs.

- No bonuses, fees, commissions.
- No high-paid CEOs.
- No private shareholders.
- No advertising.
- Massive deposit base – all state revenues.
- Local banks act as front office.
- No need for branches; no ATMs.



BND's savings are passed on to borrowers and communities.

- 2% loans for infrastructure (schools, roads, water facilities, etc.)
- Student loans 2% below federal rate
- 1% loans for startup farms and businesses
- Low-interest loans for affordable housing
- One program requires one new full-time job for every \$100,000 lent.

The magic of leverage (1):

How Washington could make a 15.5% return on a capital appropriation or pooled loan funds.

Capital: \$500M

Deposits: \$5B from Local Gov Inv Pool, Treasury or local funds x 1% = **\$50M cost of funds**

Loans (70%): \$3.5B @ 3.35% (avg BND return in 2016) = **\$117.25M return**

Securities (20%): \$1B @ 1% = **\$10M return**

Total \$127.25M return, less \$50M cost of funds = \$77.25M profit

ROE = 15.5%

The magic of leverage (2): Capitalized with a bond issue at 3%.

Cost of capital: \$500M @ 3% = **\$15M**

Cost of deposits: \$5B x 1% = **\$50M**

Loans (70%): \$3.5B @ 3.35% = \$117.25M return

Securities (20%): \$1B @ 1% = \$10M return

Total \$127.25M return

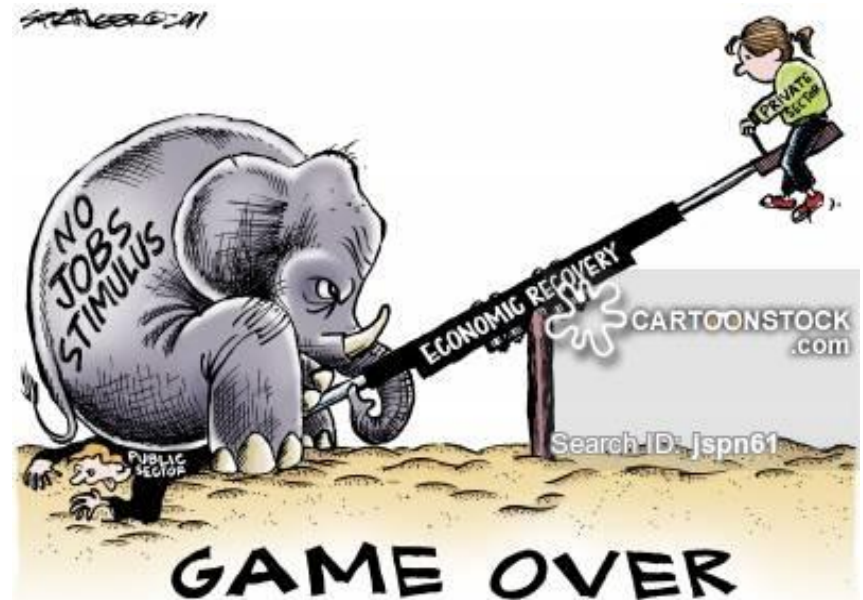
less \$65M cost of funds = \$62.25M profit

ROE = 12.5%



Compare the JOBS Act

- Crowdfunding for local business, but risky and illiquid, and many businesses don't want to share equity.
- Bonds to capitalize a public bank are liquid and safe – better for pension funds and local investors.



Compare Roosevelt's Reconstruction Finance Corp.

- \$500 million capitalization
- Loaned or invested over \$40 billion from 1932 to 1957
- Issued bonds, mostly bought by the Treasury
- Not in the federal budget
- Funded the New Deal and World War II
- Net profit to the government: \$690 million



Other models:

25% of banks globally are publicly-owned, including the world's largest banks –

- The two largest banks by market capitalization (ICBC and China Construction Bank)
- The largest bank by deposits (Japan Post Bank)
- The largest bank by number of branches (State Bank of India)
- The largest development bank (China Development Bank).
- The world's seven *safest* banks are also publicly-owned, leading with KfW, Germany's public development bank.

Recent studies show that public banks are:

- Safer.
- Less corrupt.
- More efficient and more profitable for local governments and local economies.
- Avert banking crises by lending countercyclically.



Keeping the bank honest – how to avoid corruption

- New digital cryptographic systems allow full transparency and accountability
- Targeted lending, strict underwriting standards
- No speculation
- No bonuses, fees, commissions—no incentive to gamble





Finanzgruppe

Sparkassenstiftung für internationale Kooperation

The Stellar Performance of German Savings Banks (Sparkassen)



2015 report comparing private German commercial banks with public savings banks (Sparkassen), regional banks and credit unions:

Total deposits and loans are about the same. Yet private banks are less profitable and pay less than half the taxes.

German Sparkassen & green energy



- Half of German banking assets are in the public sector.
- German public savings banks (Sparkassen) -- a network of 15,600 branches financing local economies.
- Germany has been called “the world's first major energy economy”: renewables generated 41% of its electricity in 2017, up from 6% in 2000.
- Public banks provided over 72% of the financing and were instrumental in the transition – both as lenders and as facilitators, coordinating stakeholders and setting up renewable energy cooperatives.

China's remarkable infrastructure

- 12,000 miles of high-speed rail built in a decade
- World's largest dam and power station
- How funded? The government owns 80% of the banks.





For more information –
PublicBankingInstitute.org
EllenBrown.com

