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While bank bailouts fatten Wall Street, states continue to battle the credit crisis. In the search for innovative solutions, some political candidates are proposing that states generate their own credit by setting up their own banks.

State budgets for 2010 face the largest shortfalls on record, totaling $194 billion or 28 percent of state budgets; and 2011 is expected to be worse. Unemployment has already officially hit 10 percent, and many economists expect it to rise higher. Continued high unemployment will keep state income tax receipts at low levels and increase demand for Medicaid and other essential services states provide. The existing alternatives are spending cuts or tax increases, but both will just serve to make the downturn deeper. When states cut spending, they lay off employees, cancel contracts with vendors, eliminate or lower payments to businesses and nonprofit organizations that provide direct services, and cut benefit payments to individuals. The result is a reduction in overall demand. Tax increases also remove demand, by reducing the amount of money people have to spend.

Amanda Paulson , writing in The Christian Science Monitor, quotes Arturo Pérez, fiscal analyst with the National Conference of State Legislatures, which released its survey of state budget situations in December:

“Unless you’re North Dakota, you’re probably a state that has had some degree of difficulty or crisis involving finances. It’s the worst situation states have faced in decades, perhaps going as far back as the Great Depression in some states.”

“Unless you’re North Dakota ” – a state with a sizeable budget surplus, and the only state that is adding jobs when other states are losing them. A poll reported on February 13 ranked that weather-challenged state first in the country for citizen satisfaction with their standard of living. North Dakota’s affluence has been attributed to oil, but other states with oil are in deep financial trouble. The big drop in oil and natural gas prices propelled Oklahoma into a budget gap that is 18.5% of its general-fund budget. California is also resource-rich, with a $2 trillion economy; yet it has a worse credit rating than Greece. So what is so special about North Dakota? The answer seems to be that it is the only state in the union that owns its own bank. It doesn't have to rely on a recalcitrant Wall Street for credit. It makes its own.

Candidates Across the Political Spectrum Pick Up on the Public Bank Model

In the quest to find ways to divorce the well-being of their states from the financial sector, a growing number of candidates are picking up on the public bank alternative. Florida, Illinois, Oregon, Massachusetts, Idaho and California all have candidates whose platforms contain this proposed solution to the credit crisis.

A publicly-owned bank has also been proposed on the federal level. Nationalizing the Federal Reserve (which is not actually federal but is owned by a consortium of private banks) was advocated by 2008 Presidential candidates Dennis Kucinich , a Democrat, and Cynthia McKinney , the Green Party candidate. In 2009, Nobel laureate Joseph Stiglitz said the government would have been better off funding a federally-owned bank than doling out trillions of dollars to private investment banks and CEOs who speculated their way into bankruptcy. Speaking at the New York Society for Ethical Culture on March 6, 2009, he said:

"If we had used the $700 billion to create a new financial institution, allowed it to lever 10 to 1, which is very modest compared to the 30 to 1 that we were doing, 10 to 1 would have generated $7 trillion of new lending capacity, far in excess of what our country needs. So the issue here is not about lending. It's really about saving the bankers. And what we confused was saving the banks versus saving the bankers and their shareholders."

But nationalizing the Federal Reserve faces powerful opponents in Congress. Meanwhile, on the state level the public bank concept is gaining ground, attracting proponents across the political spectrum, including Democrats, Republicans and Greens. The issue transcends party lines. In North Dakota, a Republican state, the state-owned bank was inaugurated by a political party appropriately called the "Non-Partisan League."

Oregon: The Bankers' Bank Model

In Oregon, Bill Bradbury has included a state bank platform in his bid for governor. Bradbury, a Democrat, was formerly secretary of state and has been endorsed by former Vice President Al Gore. His website declares:

“It is time to put Oregonians back to work. It is also time to declare economic sovereignty from the multi-national banks that in large part are responsible for much of our current economic crisis. We can achieve these two goals by creating our own bank.”

The Oregonian, Oregon’s largest newspaper, reported that Bradbury plans to deposit tax revenues in the public-interest bank, keeping Oregon’s money in Oregon. The bank would then lend the money to get the economy going again, targeting small and medium-sized businesses. Interest would be poured back into the state through more loans to start-up businesses, agriculture, and other key sectors. Currently, Oregon deposits hundreds of millions of dollars in tax revenues into large out-of-state banks, siphoning the money off from productive in-state uses. Many of these banks are the very banks needing federal bailouts to keep from failing in 2008, after years of handing out risky mortgage loans. These banks have now grown tight-fisted with Main Street borrowers, making Bradbury’s plan to get money flowing again especially appealing to Oregonian voters.

Bradbury uses the Bank of North Dakota (BND) as his model. Like the BND, the Bank of Oregon would return a dividend to the state based on its earnings, while creating jobs and stimulating the economy through lending. The state bank would not replace private banking institutions but would partner with them, particularly with community banks, providing them with new customers and helping them provide new services. To assure the state bank’s independence from existing financial powers, Bradbury proposes that a board of directors appointed by Oregon’s Senate should govern the bank, while taking advice from an advisory committee of experts.

Idaho: Keeping State Assets in the State

In Idaho, James Stivers , a Republican candidate for the State Senate, has also proposed a state bank to fill state coffers and protect the local economy. In the first indication of a political shift among grassroots Republicans, Stivers swept a closed-ballot preference poll at the GOP District 2 Central Committee meeting in Coeur d’Alene on February 13, winning the non-binding poll 10-0. Stivers declares:

“An important part of sovereignty is the monetary authority. Currently, banks are allowed to multiply many times over the tax receipts deposited in their institutions. This special privilege is partly responsible for the ‘sucking sound’ in our local economies, as regional banks send their assets to central banks that are playing the derivatives markets of the world.

“A state bank would restore this privilege to the people in a public trust and would give us the opportunity to back our deposits with the wealth from our public lands.”

Stivers sees the bank as a way to facilitate small business startups, end the ability of private banks to cream profits from the public treasury, protect key budget items, and stave off excessive influence from the federal government. He suggests the novel approach of expanding the role of Idaho’s Bond Bank authority into a full-fledged state bank. The current banking system, he says, causes inflation, one of the “greatest detriments to a living wage”:

“Inflation is caused by the secret tax of the banking industry in which lenders use the multiplier effect to the benefit of their cronies. This secret tax takes the form of a decline in the value of the dollar and results in higher prices. Wages never keep up with this process because its very purpose is to extract wealth from the wage earner to support the privileged classes who curry the favor of lenders. A state bank would restore this privilege to the people in a public trust and would give us the opportunity to back our deposits with the wealth from our public lands.”

Illinois: Using a State-owned Bank to Fund Infrastructure

In Illinois, Green Party gubernatorial candidate Rich Whitney has other ideas for a state-owned bank. Illinois is listed by the Pew Center for the States as one of nine states confronting historic budget problems. In a recent response to the governor’s State of the State Address, Whitney said:

“I am the only candidate in this race who proposes to fund public improvements, and promote economic health, without any further tax increases, through the establishment of a state bank, a progressive idea that North Dakota adopted years ago, and that has helped keep that state debt-free even in these troubled economic times. Instead of going into more and more debt, to further enrich private banks, we should be using our tax revenue to further invest in our own State and its people, for the enrichment of our own economy."

The bank would use tax revenues and pension contributions as the financial base to expand credit where it is most needed. Illinois' bank would borrow from the Federal Reserve at the same 1 percent rate as commercial banks. Once the budget was balanced, Whitney's top priorities would be to use the new money to modernize energy infrastructure and promote solar and wind power. To achieve this, property owners of land where wind and solar generators could be located would be lent money through the state bank at a minimal 1 percent interest rate. To secure repayment, Whitney would require utilities to buy power from the solar and wind-based producers at a premium rate. One option would then be to require part of this premium to be paid to the state bank until the loan is returned. This arrangement, says Whitney, would create a win-win situation:

"The bank is paid back. The homeowner, farmer or business investing in solar or wind generation realizes immediate savings on energy costs and in many cases will go from being a net consumer to a net producer of energy. Their greater income will further stimulate the economy. The utilities will have to pay the cost of the premium rate but in the long run will realize the benefits of having a greater, stable, more diversified and decentralized energy grid, ultimately cheaper in the face of rising fossil fuel prices. As economies of scale are realized in wind and solar power generation, the costs will fall, as will the necessary premium rate. And we all benefit from the reduction in greenhouse gas emissions."

Florida: The Commercial Bank Model

Economist and author Farid Khavari , a Democratic gubernatorial candidate in Florida, proposes a state-owned bank that would lend directly to borrowers. The Bank of North Dakota usually uses a "lead lender" such as a bank, savings and loan company, or credit union rather than doing commercial lending directly. Dr. Khavari maintains that the Bank of the State of Florida could be launched at no cost to taxpayers by using the state's assets as the reserves for making loans, employing the same fractional reserve lending rules used by private banks today. In this way, he says, the bank could drive an "economic miracle" in Florida, instigating massive job creation, cutting costs in half or more, providing low interest financing to homeowners and businesses, and improving teacher salaries and care for veterans and the elderly, while at the same reducing taxes. He explains :

“The economy is collapsing due to lack of demand. The economy needs money, but the banks are cutting credit, and then sucking all the cash out of the economy by raising interest rates to make sure no one has any cash left at the end of the month. The cost of interest is built into the cost of everything. People already work ten years of their lives just to pay interest in one form or another. The Bank of the State of Florida will end that for Floridians. And this model will work for every state. . . .

“We can pay 6% interest on savings. Using the same fractional reserve rules as all banks, we can create $900 of new money through loans for every $100 in deposits. We can loan that $900 in the form of 2% fixed rate 15-year mortgages, for example, and the state can earn $12 every year for every $100 in deposits. That means Floridians can save tens of billions of dollars per year while the state earns billions making it possible for them.

“State and local government budgets will balance without higher taxes when the BSF cuts interest costs. 6% BSF credit cards will save people billions per month, money that stays in Florida instead of going to the big banks—and the state will make huge profits on that, too. Saving billions in interest costs will create millions of jobs without subsidies just by keeping those billions circulating in Florida. Eventually the state will earn enough to reduce and eliminate state and local taxes while every Floridian has economic security in a recession-proof Florida.”

The Federal Reserve states on its website that the banking system as a whole leverages $100 in deposits into $900 in loans, but whether a single bank can do it alone has been challenged. Critics say that while banks do create money as loans, they have to replace the deposits when the checks leave the bank in order for the checks to clear. How this all works is a bit complicated and will be the subject of another article, but suffice it to say here in response that if a bank does not have the deposits to cover its outgoing checks, it borrows from the interbank lending market at very low rates, or issues commercial paper or CDs; and the state bank could do the same thing. It would not be fighting with the other banks for old deposits. Loans create new deposits, which can be borrowed back from the pool of “excess deposits” thereby created. Ninety-seven percent of the money supply has been created by commercial banks by turning loans into deposits, but that credit machine has frozen up. A state bank could get it flowing again.

California: Catching the Wave

California leads the nation in the sheer size of its budget gap. It too now has a gubernatorial candidate proposing to alleviate the state's credit woes with a state-owned bank. Running on the Green Party ticket, Laura Wells is a former financial analyst who received 420,000 votes in her 2002 bid for State Controller, more than any other Green Party candidate has earned in a partisan statewide race. According to her website:

“Rather than drowning in debt and begging Wall Street for loans, California can institute a State Bank that invests in California's infrastructure, and future generations.”

She stated in a comment, “A state bank for California is part of my platform as a candidate for the Green Party nomination for Governor. I ran for State Controller to ‘Follow the Money.’ Now, we need to Fix the Money. A state bank would keep California's wealth in the state. Rather than invest in Wall Street (we've hit the wall on that one) we can invest in our infrastructure and our future generations.”

Legislative Proposals

It is not just political hopefuls who are exploring the public bank option. Therese Murray currently presides over the Massachusetts State Senate. She has introduced legislation that would study the formation of a state-owned bank with the principal aim of boosting job creation in the state. Massachusetts now faces a 9.4 percent unemployment rate. “It wouldn't be in competition with our small community banks,” she says. “We've got to free up some credit, and mortgage companies and banks have got to do a better job of allowing people to redo their mortgages.”

In Virginia, Congressman Bob Marshall , a Republican, introduced a bill in January to study whether to establish a bank that was owned, run, and controlled by the state. However, the plan was tabled in committee.

On February 16, the front page of the Huffington Post featured an article on the Bank of North Dakota and the precedent it sets for financially-strapped states. Besides political candidates promoting this option, it noted that a Washington State legislator and a Vermont House committee were exploring it.

North Dakota hit the Wall Street wall in 1919, when the Bank of North Dakota was established by the state legislature specifically to free farmers and small businessmen from the clutches of out-of-state bankers. For over 90 years, it has demonstrated the success of the public banking model. Other credit-choked states are finally taking notice and devising their own variations on the theme.

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