Building State Development Banks

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America's first modern state development bank, the Bank of North Dakota, was built in 1919 when elected leaders and farmers—squeezed by banks in Minneapolis, Chicago, and New York—acted to make credit markets work for North Dakotans.

Today, leaders in several states are working to create state development banks that will reverse the sharpest fall-off in lending since 1942[1] and the massive job and revenue losses that have come with it.

State development banks team up with local banks—plus credit unions and community development financial institutions—to keep public money home where it will:

- Create new jobs and spur broader economic growth
- Increase state revenues;
- Strengthen local banks; and
- Lower debt costs for state and local government

Finally, states using big banks to handle hundred of billions of dollars in public money are helping fuel Wall Street's trading desks, massive lobbying operations, and bank bonuses.

State development banks can give states the power they need to cut down their dependence on Wall Street banks and help lower systemic risk by shifting public money from the too-big-to-fail banks.

> "Wall Street banks have cut back on small business lending [by] more than double the cutback in overall lending. The big banks pulled back on everyone, but they pulled back harder on small businesses [Small business] options just keep disappearing. If nothing changes, our economic playing field could wind up tilting against smaller businesses."
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> **—Elizabeth Warren, May 2010**[2]

"We are completely countercyclical"

The banking crisis shut down lending, destroyed jobs, shuttered banks, and blew holes in public budgets in nearly every state. But not in North Dakota. For 91 years, the state-owned Bank of North Dakota has paired with local banks to put the state's short-term money—taxes and fees paid by North Dakotans—into productive lending that creates local jobs and local revenue. The Bank also supports North Dakota's housing and student loan markets. Bank President Eric Hardmeyer: "We plow those deposits back into the state of North Dakota in the form of loans. We invest back into the state in economic development [lending]."[3]

> "The State of North Dakota does not have any funding issues at all. We in fact are dealing with the largest surplus we've ever had… [W]e look around and we say, 'Boy, that is unbelievable to see what is going on in the rest of the country and here we are completely countercyclical.'"
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> **—Bank of North Dakota CEO Eric Hardmeyer, March 2009**

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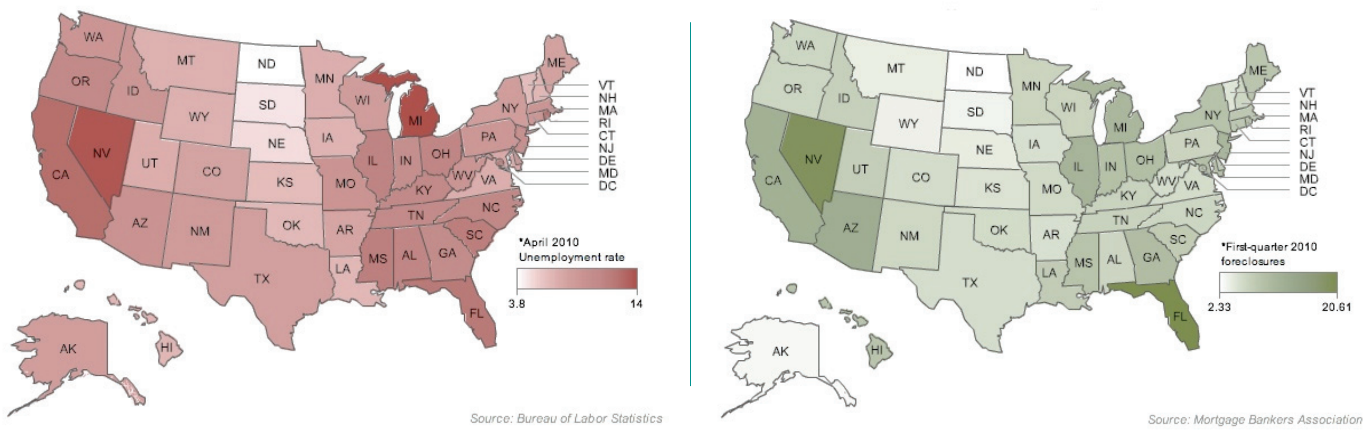
State development bank supports lowest unemployment and foreclosure rates in U.S.[4]



And the Bank does it at a profit. Over 70% of the Bank's earnings typically go straight to North Dakota's general fund. In 2009—one of the toughest years on record for U.S. banks—the Bank delivered a $30 million dividend to the state. In Michigan, for example, that's equivalent to $368 million and enough to cover 18.4% of that state's 2010 budget deficit.

Creating new state development banks

Lawmakers and state leaders in Oregon, Washington, Michigan, and other states are building the case for state banks that keep public money at home to:

1. **Create new jobs** and spur economic growth. State development banks are participation lenders—they partner with local banks by sharing risk and buying down interest rates to drive lending to small businesses. That means more lending and more new jobs.[5]

   Targeted lending programs allow local banks to back promising start-ups and clean energy projects, for example. And to make sure public money is creating jobs, the Bank of North Dakota writes accountability measures into their economic development loans.

   A new Center for State Innovation analysis shows that an Oregon state bank's support for local banks could have helped to create or save 6,700 Oregon small business jobs in 2009 alone.[6]

2. **Generate new revenue for states** with job growth, Bank dividends, and by bringing home money that states are sending to Wall Street. Here are projected long-term dividends—based on the Bank of North Dakota's 2009 dividend payment to the state's General Fund—from state development banks in several states:

> "I travel all over the country and I see small businesses that are ready to grow, but they need working capital… We know that banks are starved for capital to give to good businesses."
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> **—Karen Mills, Administrator of the Small Business Administration, August 2010**

	Projected net 2009 revenue	Percentage of 2010 deficit[7]
North Dakota	$30 m.	[In surplus]
California	$1,775 m.	9.9%
Hawaii	$61 m.	10.3%
Maine	$48 m.	5.1%
Maryland	$263 m.	13.1%
Massachusetts	$351 m.	13.0%
Michigan	$368 m.	18.4%
New Hampshire	$58 m.	15.8%
New Mexico	$77 m.	23.1%
Ohio	$453 m.	15.1%
Oregon	$155 m.	7.4%
Pennsylvania	$532 m.	13.0%
Vermont	$24 m.	7.2%
Washington	$310 m.	14.8%

Source: Center for State Innovation

3. **Strengthen local banks** and even out credit cycles with participation loans and other services. There have been no bank failures in North Dakota in the financial crisis, and the Bank's charter is clear that it must "be helpful to and to assist in the development of [North Dakota banks]… and not, in any manner, to destroy or to be harmful to existing financial institutions."[8]

   Instead of 'crowding out' private funding and jobs, the Bank of North Dakota's support for local banks has a 'crowding in' effect—keeping them liquid, lending to local businesses, and fueling economic growth when big banks were cutting off credit in much of the rest of the country.

   State development banks can also help the state's banks navigate the new regulatory waters, and even act as an incubator for strong local financial institutions in an era of massive consolidation.

   Finally, the North Dakota Bankers Association strongly supports the Bank of North Dakota. The Bank also has wide, bi-partisan support in North Dakota, and the state's conservative Republican governor John Hoeven—who is backed by both the Independent Community Bankers Association and the American Bankers Association[9]—was CEO of the Bank of North Dakota from 1993-2000.

4. **Lower public debt costs** for local governments. The Bank of North Dakota can borrow at the Federal Reserve's discount window. State development banks can use this power to lend directly to local governments at below-market interest rates, cutting out the notoriously corrupt Wall Street municipal bond market.[10] State development banks can also provide credit support—letters of credit—for tax-exempt bonds at lower interest rates, and participate with local banks on take-out loans. All three functions allow states and local governments to free up capital for important infrastructure and other growth projects.[11]

> "We're a fairly conservative lot up here in the upper Midwest… [W]e have the ability to get into the derivatives markets and put on swaps and callers and caps and credit default swaps and just chose not to do it."[13]
>
> **—Bank of North Dakota CEO Eric Hardmeyer, March 2009**

"We're a fairly conservative lot"

North Dakota also shows us how states can bring transparency and strong governance structures to their states' bank relationships. North Dakota's independent Industrial Commission, the Bank's Advisory Board, and regular external audits keep the Bank behaving like a bank—its Return on Equity is an impressive 27%—even as it helps drive North Dakota's ambitious economic development goals.[12]

Thanks to the Bank, North Dakota was 'off-the-grid' when the lights went off on Wall Street in 2008 and the state's economy and financial sector is stronger for it. Compare the results from Vermont—a state with comparable demographics, budget, and state loan portfolio that employs a traditional economic development loan model—to North Dakota's hard-nosed focus on local lending and strong support for community banks:

	Vermont	North Dakota
Population	622,000	647,000
General Fund budgets[14] (2009)	$1.1 b.	$1.56 b.
Unemployment (%, 2010)	6.2	3.2
Budget deficit[15]	($24 m.)	$400 m.
Banks (2009)	22	102
Deposits held by out-of-state banks[16] (%, 2009)	65	24
Total state loan portfolio[17] (2009)	$3,100 m.	$2,619 m.
Commercial/Econ. Development lending[18] (2009)	$102 m.	$1,333 m.
Net state banking revenue[19] (2009)	($21 m.)	$30 m.

Next Steps

The state leaders who are building state banks learned three big lessons in the financial crisis and the recession it created.

One, states need to begin breaking the big banks' grip on their finances. Interest rate swaps and rigged municipal bond markets are but two ways in which Wall Street has cheated state and governments.

Two, powerful stimulus policies at the state level—policies that drive strong job growth and revenue growth at the same time—are hard to craft.

Three, small businesses and the banks that support them cannot be left swinging in the wind of the global credit market.

All three lessons point to the need for state development banks and credit markets that keep public money at home where it works for the people, not the big banks.

For help in building state-specific state development banks strategies, contact:

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Other reading:

- BND 2009 Annual Report, [1920 Policy of the Bank, pge 5] http://www.bankdnd.nd.gov/financials_and_compliance/pdfs/annualreport09.pdf
- BND FAQs http://www.bankdnd.nd.gov/about_BND/pdfs/faqs.pdf
- Mother Jones BND story http://motherjones.com/mojo/2009/03/how-nation's-only-state-owned-bank-became-envy-wall-street

[1] WSJ, "Lending Falls at Epic Pace", Feb. 24, 2010

[2] Chair of the TARP Congressional Oversight Panel, May 13, 2010 video introduction of COP "Small Business Credit Crunch" report, http://www.youtube.com/watch?v=l6suIQs7Wx0

[3] http://motherjones.com/mojo/2009/03/how-nation's-only-state-owned-bank-became-envy-wall-street

[4] http://money.cnn.com/news/storysupplement/economy/gapmap/index.htm

[5] http://motherjones.com/mojo/2009/03/how-nation's-only-state-owned-bank-became-envy-wall-street

[6] *Oregon State Development Bank Analysis*, Center for State Innovation, September 2010

[7] http://www.cbpp.org/files/9-8-08sfp.pdf

[8] BND Policy of the Bank, 1920

[9] http://query.nictusa.com/cgi-bin/can_give/2009_S0ND00093

[10] http://www.bloomberg.com/news/2010-07-30/u-s-predicts-more-indictments-in-municipal-bond-bid-rigging-investigation.html

[11] http://www.vermonttiger.com/file-downloads/jan10/Vermont%20State%20Bank%20Testimony.pdf

[12] http://motherjones.com/mojo/2009/03/how-nation's-only-state-owned-bank-became-envy-wall-street

[13] Ibid.

[14] Calculated from the FY 2009-2011 Biennial budget, see http://www.nd.gov/fiscal/docs/budget/appropbook2009-11.pdf ., http://sunshinereview.org/index.php/Vermont_state_budget

[15] State surplus is $800 m. over two-year budget cycle: http://www.bismarcktribune.com/news/local/govt-and-politics/article_e86f8ba0-88b2-11df-ad0b-001cc4c002e0.html

[16] *FDIC-Insured Institutions Deposit Market Share Report*, June 30, 2009

[17] Cairn Cross, Jan. 22, 2010 Vermont Statehouse report, Combining Vermont Student Assistance Corporation, Vermont Economic Development Authority, and Vermont Housing Finance Agency; VT leg report, http://www.leg.state.vt.us/jfo/Issue%20Briefs%20&%20Memos/Bank_of_North_Dakota_Model_In_VT.pdf

[18] Ibid.

[19] Ibid.