Public Banking – A Tool For Fixing The Economy And The Means to Achieve It

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The terrible twins of Wall Street and Washington are the agents and facilitators of the economic crisis, and expecting them to solve it is unrealistic. So if not them – who?

The answer is us. The power to fix the economy rests directly in the hands of individual states, their local governments and citizens. Our solution does not require any new laws or systems, only a recognition of the elements that contribute to economic vitality and the means by which we can achieve it ourselves without the help of, or interference from, Washington or Wall Street.

Where Does Money Come From?

At the heart of economic vitality in any community, state or country, rests the availability and free circulation of money. If money is abundantly available, the economy tends to be vibrant and healthy. If money is scarce, the economy slows.

So, how is money injected into the economy? Most people assume that money comes from the government, but the reality is that the federal government only accounts for an estimated 3% of all the dollars in circulation.

Banks actually create money with each new loan they issue.[1] They are the source of approximately 97% of the money in our economy. If banks are making loans, more money is being pumped into the economy. When they stop lending, the money dries up. Banks have stopped lending, and even though there are sound reasons why that is the case, without lending, our economy cannot recover. So we need to get lending flowing again.

How Do Banks Work?

The key to understanding how lies in understanding what banks need in order to lend. Even though they are allowed to create money, there are limits to how much they can create. Those limits are directly tied to the amount and quality of the assets (capital) owned by the bank. International banking convention[2] categorizes the kinds of assets a bank may own on the basis of their liquidity (cash and fixed assets like buildings). The more liquid an asset, the greater the amount of loans that the bank may create.

For example, banks are allowed to create approximately $25 in loans for every $1 in cash held by the bank in its own money (as opposed to depositors' money). Assets like buildings can only be multiplied 5 to 8 times. The ideal translates into a weighted average of all assets that would yield total loans equal to approximately 12 ½ times the combined assets of the bank. Banks that exceed that multiple in loans are considered unsafe and regulators demand those banks obtain more capital and/or discontinue lending.

A large number of banks find themselves in that condition today, primarily because of one overarching factor driving down the value of the assets of all banks – the collapsing values in real estate. Loans are

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[1] It should be self evident that banks would prefer that the public not know that they have this unique ability to create money. However, occasionally that reality is disclosed to the public, as exampled by the following. Robert B. Anderson, Secretary of the Treasury under Eisenhower, said in an interview reported in the August 31, 1959 issue of *U.S. News and World Report:* [W]hen a bank makes a loan, it simply adds to the borrower's deposit account in the bank by the amount of the loan. *The money is not taken from anyone else's deposit; it was not previously paid in to the bank by anyone. It's new money, created by the bank for the use of the borrower.*

[2] http://en.wikipedia.org/wiki/Basel_II

considered part of the collective assets of the bank (thus are part of the asset formula for the maximum amount of loans) and if the value of those loans goes down, so does the lending ability of the bank. The drop in real estate values is plunging the value of bank loan portfolios. That is why they cannot lend and the situation is projected to worsen. And almost nobody wants to invest in banks to fix their asset problems, that is, unless the bank is too big to fail. Then the federal government hands them our tax dollars with virtually no strings attached. All others are on their own.

The Public Asset Solution

Since assets are the key to unlocking lending, where can we find sufficient assets to address this problem? That answer lies in our own back yards. We citizens have been accruing literally trillions of dollars in assets by virtue of our tax dollars that have formed the basis for the very substantial amount of accumulated assets (call it investment) we have in our public entities – our state and local governments and other government entities like school districts, airports and utility districts.

Those assets range from huge amounts of cash to buildings, land, parks, roads and bridges and more. Even tapping a very tiny percentage of those accumulated assets would free up massive amounts of new lending potential, generated by leveraging banking laws and systems. And since banks don't use up (liquidate) their assets in the process of creating loans, government entities would not have to sell or dispose of their assets in order to leverage them into new credit money for their states and communities. This is at the heart of what we call public banking – using public resources as the foundation for creating money for society through banking. The question is how to capitalize on those assets.

Public Banking – Two Approaches

Attorney Ellen Brown in her book, *Web of Debt*[3] and her many articles on public banking, including *Cut Wall Street out! How states can finance their own recovery*,[4] builds on the model of the Bank of North Dakota,[5] formed and owned exclusively by the state of North Dakota. Other states and even counties, cities and a host of other governmental entities could likewise form their own wholly owned banks. That concept is gaining momentum nationwide, as described in this article[6] by Ellen.

The major problem with this approach is the time and difficulty involved in getting a government entity to first agree (think legislation) on establishing its own bank, let alone proceed to implementation. Creating a new bank from scratch is a very time-consuming and complicated process even for private business interests, let alone for a government. This approach also means that each government goes it alone and there is much potential duplication of effort and a lack of collaboration. There is clear value in the idea, it is just difficult to move forward on this path.

As a consequence, Commonwealth Group has developed an alternative. This approach entails a collaborative effort between governments and various other public interest groups like non-profits, foundations, pension funds, unions and private banks, through the vehicle of a commonly held bank holding company.[7]

A greatly simplified structure allows all participants to benefit from a common effort, which saves time and duplication. These parties collaborate through the vehicle of the bank holding company formed to serve the public good. Rather than each of them having to form a bank from scratch, the participants can

[3] http://www.webofdebt.com/articles
[4] http://www.webofdebt.com/articles/cut-wallstreet.php
[5] http://en.wikipedia.org/wiki/Bank_of_north_dakota
[6] http://www.huffingtonpost.com/ellen-brown/growing-number-of-candida_b_470411.html
[7] http://en.wikipedia.org/wiki/Bank_holding_companies

collectively engage in banking with that bank holding company through one or more of the following means:

1. Establishing a bank used by all.
2. Buying an existing bank.
3. Investing in existing banks.

With this approach, most governments can get engaged very quickly, even if to a limited extent at first, without having to first get buy-in from a lot of other stakeholders. In many cases the decision-making may well rest with the chief financial officer of that government entity (like a state treasurer), under the guidelines of their existing mandate to manage the assets of that government, including investments. See *A Common Bank Holding Company For States, Counties & Cities: A Solution for Our Economic Problems*[8] and *Public Banking and L3Cs*.[9]

What Can Be Achieved Through Public Banking?

In addition to general economic development, governments may have an interest in seeing certain kinds of economic activity being advanced in the interest of society, rather than the pure pursuit of profit, as would be the case for private banking interests.

Fortunately, unlike private business interests, governments can prioritize concepts that don't necessarily emphasize maximum profit as the goal of the banking effort, but rather aim at some social, economic and/or environmental objective. They also can tailor terms to facilitate those goals, including longer terms and lower rates than those available from commercial alternatives, if they are available at all.

A state for example, may feel very motivated to encourage the development and utilization of renewable energy sources and therefore may wish to craft a loan program that incentivizes that objective. Likewise it may be determined that higher education is a priority and therefore student loans could be emphasized. The same applies to state and local infrastructure such as energy generation projects and mass transit systems like monorail (the greenest, lowest-cost alternative available), low-income housing, farming, reduction in home foreclosures, manufacturing, small business development and any number of other objectives. Many conventional banks never touch many of these types of loans.

Owning and/or controlling a bank allows these government entities to establish programs which directly facilitate and support those kinds of objectives. However, even owning a bank is not a necessity. For example, investments made in existing banks can come with conditions that would produce this same result, and the presence of a government partner(s) can enhance the bank's overall health in its other lending areas, thereby producing the general effect of increasing overall prosperity.

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[8] http://www.commonwealthgroup.net/docs/CommonBankHoldingCompany.pdf
[9] http://www.commonwealthgroup.net/docs/PublicBankingAndL3Cs.pdf