Mother Jones

How the Nation’s Only State-Owned Bank Became the Envy of Wall Street

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The Bank of North Dakota is the only state-owned bank in America—what Republicans might call an idiosyncratic bastion of socialism. It also earned a record profit last year even as its private-sector corollaries lost billions. To be sure, it owes some of its unusual success to North Dakota’s well-insulated economy, which is heavy on agricultural staples and light on housing speculation. But that hasn't stopped out-of-state politicos from beating a path to chilly Bismarck in search of advice. Could opening state-owned banks across America get us out of the financial crisis? It certainly might help, says Ellen Brown, author of the book, Web of Debt [1], who writes that the Bank of North Dakota, with its $4 billion under management, has avoided the credit freeze by "creating its own credit, leading the nation in establishing state economic sovereignty." *Mother Jones* spoke with the Bank of North Dakota's president, Eric Hardmeyer.

Mother Jones: How was the bank formed?

Eric Hardmeyer: It was created 90 years ago, in 1919, as a populist movement swept the northern plains. Basically it was a very angry movement by a large group of the agrarian sector that was upset by decisions that were being made in the eastern markets, the money markets maybe in Minneapolis, New York, deciding who got credit and how to market their goods. So it swept the northern plains. In North Dakota the movement was called the Nonpartisan League, and they actually took control of the legislature and created what was called an industrial program, which created both the Bank of North Dakota as a financing arm and a state-owned mill and elevator to market and buy the grain from the farmer. And we're both in existence today doing exactly what we were created for 90 years ago. Only we've morphed a little bit and found other niches and ways to promote the state of North Dakota.

MJ: What makes your bank unique today?

EH: Our funding model, our deposit model is really what is unique as the engine that drives that bank. And that is we are the depository for all state tax collections and fees. And so we have a captive deposit base, we pay a competitive rate to the state treasurer. And I would bet that that would be one of the most difficult things to wrestle away from the private sector—those opportunities to bid on public funds. But that's only one portion of it. We take those funds and then, really what separates us is that 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 type of activities. We grow our state through that mechanism.

MJ: Clearly other banks also invest their deposits. Is the difference that you are investing a larger portion of that money into the state's own economy?

EH: Yeah, absolutely. But we have specifically designed programs to spur certain elements of the economy. Whether it's agriculture or economic development programs that are deemed necessary in the state or energy, which now seems to be a huge play in the state. And education—we do a lot of student loan financing. So that's our model. We have a specific mission that was given to us when we were created 90 years ago and it guides us throughout our history.

MJ: Are there areas that you invest in that other banks avoid?

EH: We made the first federally-insured student loan in the country back in 1967. So that's been a big part of what we do. It's become almost a mission-critical thing.

I don't know if you have been following the student loan industry lately, but it's been very, very interesting as many have decided to leave. We will not though.

MJ: So you are able to invest in certain areas because they provide a public good.

EH: Yeah, or a direction, whether it's energy or primary sector type of businesses. We have specific loan programs that are designed at very low interest rates to encourage activity along certain lines. Here's another thing: We're gearing up for a significant flood in one of the communities here in North Dakota called Fargo. We've experienced one of those in another community about 12 years ago which prior to Katrina was the largest single evacuation of any community in the United States. And so the Bank of North Dakota, once the flood had receded and there were business needs, we developed a disaster loan program to assist businesses. So we can move quite quickly to aid with different types of scenarios. Whether it's encouraging different economies to grow or dealing with a disaster.

MJ: What do private banks think of you?

EH: The interesting thing about the bank is we understand that we walk a fine line between competing and partnering with the private sector. We were designed and set up to partner with them and not compete with them. So most of the lending that we do is participatory in nature. It's originated by a local bank and we come in and participate in the loan and use some of our programs to share risk, buy down the interest rate. We even provide guarantees similar to SBA to encourage certain activity for entrepreneurial startups. Aside from that, we also act as a bankers' bank or a wholesale bank. So we provide services to banks, whether it's check clearing, liquidity, or bond accounting safekeeping. There's probably 20 other bankers' banks across the country. So we act in that capacity as kind of a little mini-fed actually. And so we service 104 banks and provide liquidity to them and clear their checks and also we buy loans from them when they have a need to overline, whether it's beyond their legal lending limit or they just want to share risk, we'll do that. We're a secondary market for residential loans, so we have a portfolio of $500 to $600 million of residential loans that we buy.

MJ: So what's the advantage of a publicly owned "bankers' bank" instead of a privately owned one?

EH: Our model is we use our deposit base to help [other banks] with funding their loans, even providing fed funds lines with our excess liquidity—we buy and sell fed funds and act as a clearinghouse for check clearing activity. That would be the benefit or different model. We're a depository bank and can bring that to bear.

MJ: If other states had a bank like yours, do you think they would have been more insulated from the credit crisis?

EH: It all gets down the management and management philosophy. We're a fairly conservative lot up here in the upper Midwest and we didn't do any subprime lending and we 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, really chose a Warren Buffett mentality—if we don't understand it, we're not going to jump into it. And so we've avoided all those pitfalls. That's not to say that we're completely immune to everything, certainly we've bought some mortgage-backed securities and we're working through some of those issues, but nothing that would cause us to be concerned.

MJ: Would states with your model have any new tools to get out of the credit crisis?

EH: Let me put it to you another way and tell you another thing that we do. We also provide a dividend back to the state. Probably this year we'll make somewhere north of $60 million, and we will turn over about half of our profits back to the state general fund. And so over the last 10, 12 years, we've turned back a third of a billion dollars just to the general fund to offset taxes or to aid in funding public sector types of needs.

MJ: Not bad for a state with a population of 600,000.

EH: Right. And here's another thing: Back in 2001, 2002, when we went through the dot com bust, all the states suffered some sort of budget shortfall, including the state of North Dakota. At that time our budget shortfall was fairly insignificant--$40 some million. And so it was quite easy to overcome that. The governor just simply said alright, we're going to turn back 1 percent of all general fund agencies, and the Bank of North Dakota, you will declare another dividend to make up the balance. And so we did that. Our capital was in a fine position to go ahead and do that. So in some cases we've acted as a rainy day fund.

MJ: And now the current downturn seems to have bypassed you.

EH: 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. So our concern is how do we spend it wisely and make sure we save it for the future.

MJ: It's not a bad problem to have.

EH: Yeah. We're a little bit of an island here, and so we 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.

MJ: Are other states interested in your model?

EH: In my stint here as president, which as been about

9 years now, I've had a lot of inquiries from other states about how this works, could it work for them. And my predecessor, who is now the governor of the state of North Dakota, has in fact testified at a couple of other state legislatures in terms of setting up the same model. Up until a year or two ago I would have bet that it would never happen.

MJ: It's funny, because North Dakota is traditionally a red state and yet you have these institutions—some people might say they're socialist.

EH: Yeah, I've had that thrown at me many times.

MJ: But is seems like they are very popular in the state.

EH: Yeah, and of course the socialism theme has become in vogue lately, been thrown about a bit.

MJ: Aside from political opposition from bank interests, do you think it could be viable for other states to implement your model?

EH: So much of what is going on right now is a knee-jerk reaction to some things that have happened, where regulations and accounting practices weren't where they should be. So my advice is everybody take a deep breath and we're going to get through this and we are going to exit this as a stronger industry than when we went into it, with controls in places that are absolutely necessary, with banks understanding the risks they are taking. For all states to look at North Dakota's model and say this would be the panacea to all those things, I don't see that happening.

MJ: It’s clearly not the only solution, but I’m curious whether it could be part of it.

EH: Possibly. It just depends on what they want to do with it. We’re using this to spur economic growth for our state, to provide niches where others aren’t comfortable, whether it’s in-state financing of residential loans or making student loans. Every state has their own particular needs. We’ve carved out a pretty good niche here and I think are well-respected by our peers in the banking industry. They look at us as partners and not competitors. That would be the key if you were to do this in any other state is to replicate that part of our model. That’s where you really open yourself up for criticism, is state-owned businesses competing with the private sector.

MJ: Could a bank like yours be set up without sucking deposits out of private banks in the short term?

EH: I imagine you could do some sort of bond issue where you would use that as your funding source.

MJ: After seeing the credit crisis unfold, has it changed your opinion of what you do?

EH: It just reinforced what we do, and that is you stick to what you understand, you do it well, you know your customers. We've never been a bank that tries to hit home runs. That's not what we're all about. We have a specific mission which is more important. Most corporations and banks, their top priority is to maximize shareholder return. And that is a nice byproduct for us because we do have a nice return—an NROA [return on net operating assets] of 2, a ROE [return on equity] of 25, 26 percent. But really where we take the most satisfaction is making sure we meet the needs of the state and finance those types of things that make our state go forward.

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