

Bank of the State of Maryland Testimony – House Bill 1066/Senate Bill 789 – March 8, 2011

Testimony of Sam Munger, Center for State Innovation

Thank you for the opportunity to submit testimony regarding Senate Bill 1066, creating a commission to evaluate the creation of a Maryland State Bank. My name is Sam Munger. I am the Managing Director of the Center for State Innovation, an independent state policy think tank based at the University of Wisconsin-Madison. As part of our policy work on state financial systems, we conducted analyses of the effects of a state bank in a number of states. This analysis was essentially an examination of the Bank of North Dakota—which as you’ve probably heard by now is the only state bank currently in operation—its relationship to North Dakota banks and effects on lending in North Dakota, and an attempt to extrapolate that relationship and effects to another state’s banking industry. That analysis, along with an FAQ describing the functions and structure of a state bank, is attached to this testimony and I invite you to take a look at them.

The basic results of the analysis were as follows:

- 1) First, the Bank of North Dakota seems to have had a positive effect on the banking industry in North Dakota, which outperforms similarly-situated states on a number of key indicators, including various measures of lending, number of banks and bank offices, less bank industry concentration, and fewer loans in default. We also tried to take some account for economic variables such as the strength of North Dakota’s extractive industry and the relative stability of its real estate market and concluded that the strength of the state’s banking industry did not seem to be linked, or not only linked, to those factors.
- 2) Second, if we extrapolate the effect the Bank of North Dakota has had on that state’s banking industry to another state—in our most recent analysis Washington, but the same would hold in general terms for most states including Maryland—basically assuming that bank here would have roughly the same relationship to Maryland banks that the Bank of North Dakota has to North Dakota banks, it would result in:
 - Increased lending. A state bank facilitates this in a variety of ways, some of the principle ones being participation loans and buying down interest rates with private community banks, loan guarantees, and letters of credit. This is especially the case during recession and times of tight credit.
 - This would result in credit being more easily available to small businesses in this state.

- Increased lending to small business would lead to job creation by those businesses. We are currently working on an analysis modeling a state bank in Maryland, but in Washington, a state with a GSP roughly equivalent to Maryland, we estimated job creation due to a state bank to be between 7,400 and 10,700 new or retained jobs at small businesses alone. This figure does not include jobs created in other sectors or indirect or induced job creation due to increased lending. We would presume that job effects in Maryland would be relatively similar in magnitude.
 - In addition, a state bank can return money to the state—either to a rainy day fund or to the general fund—and still be financially viable. The Bank of North Dakota has returned over \$300 million to that state over the past decade and remained profitable in real terms. In our Washington analysis, assuming that a state bank there returned roughly the same percentage of profits to the state general fund over time, we estimated that a bank capitalized with \$100 million in state money and conservatively run could return about \$71 million to the state over 10 years, and over \$200 million in 20.
 - Obviously the magnitude of the numbers I've just given is very dependent on the inputs—the amount of capital, how the bank is run, the leverage ratio, etc. and we play out some of those possibilities in our report.
- 3) There are costs associated with establishment of a bank like this, including:
- Increased risk to state monies, though the experience of North Dakota would seem to indicate that this risk can be managed effectively (see our attached FAQ).
 - The opportunity cost (or debt service cost) of capital to capitalize the bank
 - Lost interest and tax revenue, overhead and other incidentals

However, it is important to note that we find that the bank would be profitable in a real sense even when all costs, including lost tax revenue, lost interest on state deposits, and the cost of start-up capital, for instance debt service on a bond—are accounted for.

In short, our analysis indicates that the creation of a state bank would have some beneficial effects on the state's economy by making credit more available in the state, would add stability to the state banking industry particularly in times of recession, and could do this in a revenue-positive way.

I invite you to look at our full report, which I will submit into the record along with my written testimony, and a short FAQ on state banks that may be helpful in understanding some of the particulars

of the concept. Thank you again for the opportunity to submit this testimony. I'd be more than happy to answer any follow-up questions the Committee may have, and are also willing to be a resource for the commission should it be created.