

## RESPONSE TO NEW ENGLAND PUBLIC POLICY CENTER'S REPORT: THE BANK OF NORTH DAKOTA: A MODEL FOR MASSACHUSETTS AND OTHER STATES?

Executive Office of Housing and Economic Development  
One Ashburton Place, Room 2101  
Boston, MA 02108

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Dear Massachusetts policymakers,

Last year, Massachusetts joined a vanguard of states determined to find new tools to improve their local economies. Nearly a dozen states have taken up the same questions as Massachusetts' state bank study commission and are responding with modern Partnership Bank proposals that put their state deposits to more productive uses, as the 92 year-old Bank of North Dakota (BND) does. With Oregon leading the way, states are embracing the policy as scalable, flexible, and capable of winning support from businesses, farmers, and community banks alike.

A new report from the Federal Reserve Bank of Boston's outside policy research arm contributes new data to the conversation about the development of Partnership Banks modeled on the Bank of North Dakota.

The New England Public Policy Center (NEPPC) affirms a number of things that advocates have been saying about Partnership Banks, including that:

- The Bank of North Dakota enjoys a largely favorable reputation in North Dakota.
- BND's most important role currently is serving as a lending partner for North Dakota's numerous small banks. The existence of BND enhances the viability of small banks in North Dakota and expands the state's credit markets.
- During the financial crisis and economic downturn of 2007–09, BND increased its loans and letters of credit to North Dakota banks, helping local banks weather the recent banking crisis.
- North Dakota saw no bank failures.
- The state of North Dakota has been able to use revenues from BND to help balance its budget given shortfalls in other sources.

But given the Federal Reserve Bank's privileged access to data on lending and economic impacts, the report is surprisingly selective and incomplete.

The NEPPC's paper ignores key measures of the BND's success, drawing conclusions that appear designed to pre-empt and re-direct the work of Massachusetts' 'state bank' commission. In short, the report forgoes a rigorous discussion of the potential impacts of a bank and concludes that a modern Partnership Bank isn't needed, wouldn't work, and is too risky for Massachusetts.

The accompanying response is intended to help policymakers and legislators in Massachusetts and other states develop a more complete and objective picture of the Partnership Bank policy options available to them. Here are a few of the key topics the report skates over or fails completely to address:

**Missing Employment Figures.** The NEPPC report makes no effort to quantify the job-creating effects—arguably the most important measure of success—of the small business lending supported by the Bank of North Dakota. This omission is striking given the detailed modeling of Partnership Bank job impacts by the Center for State Innovation. For example, the December 2010 ‘Oregon State Bank Analysis’, available at <http://www.stateinnovation.org/State-Banks-Materials/CSI-Oregon-State-Bank-Analysis-020411.aspx>.

**Defense of the Large Bank Status Quo.** The report instead directs Massachusetts policymakers interested in spurring new lending and job growth to the state’s biggest banks. The report refers repeatedly to the capacity of these banks to meet Massachusetts’ credit needs, but fails to present the most relevant data to support such a claim: their lending records.

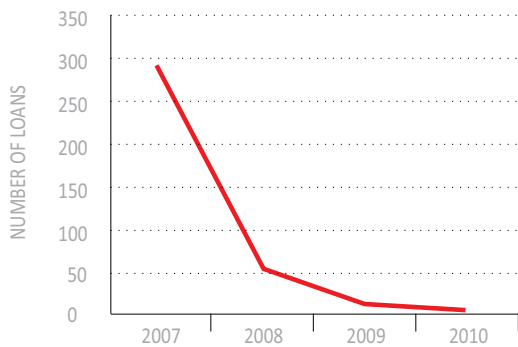
Freedom of Information Act requests to the Small Business Association (SBA) reveal that small business lending by the four largest retail banks in the state—as measured by the number of loans made through the SBA’s flagship 7(a) loan program—fell by 74 percent between 2007 and 2010.

**NUMBER OF SBA 7(A) LOANS IN MASSACHUSETTS BY BANK, 2007-2010**

	2007	2008	2009	2010	Change (%) 2007-10
Bank of America	286	54	11	6	- 98%
Citizens/RBS	384	257	130	121	- 68%
Sovereign	182	182	128	69	- 62%
TD Banknorth	130	87	35	56	- 57%

**SOURCE:** FOIA request to the Small Business Administration

**BANK OF AMERICA SBA 7(A) LENDING IN MASSACHUSETTS**



**SOURCE:** FOIA request to the Small Business Administration

While the 7(a) program is not the only avenue for small business lending, it is the best available standard measure, as well one of the best-performing and most advantageous programs available to business borrowers. The alternatives, including Express Loans and business credit cards, suffer from high default rates and high interest rates. To credibly dismiss the need for more local business lending, the NEPPC report should have presented more evidence. The report should have both acknowledged the scale of the collapse in small business lending at the large banks it touts as capable of lending, and looked for evidence that Boston and other credit markets dominated by these banks are rebuilding their traditional small business lending portfolios to pre-crisis levels.

The report also points policymakers to private “bankers’ banks” as an alternative to Partnership Banks but offers no analysis of their stability, capacity, and lending records in Massachusetts’ credit markets.

A cursory look at these factors in the accompanying response reveals a decidedly mixed record. Missing, too, in the NEPPC report is a discussion of the opportunity costs for Massachusetts and

other states of leaving public money in large out-of-state banks with no obligation to invest these dollars in the state's economy.

**Defense of Inadequate Federal Programs.** Similarly, the report highlights existing federal lending programs—some of them created in response to the financial crisis—as an alternative to creating a flexible, long-term solution accountable to Massachusetts. The paper is unable to provide any evidence that the programs are achieving the goal of spurring lending to the small businesses, farms, and entrepreneurs that make state economies go. Importantly, the report also fails to consider that these limited federal programs are unlikely to continue.

**Incomplete Assessment of Design Options.** On key questions such as capitalization costs, coordination with economic development programs, and new revenue for Massachusetts, the report's conclusions suggest dire consequences and ignore existing evidence and programs from other states.

The BND example, recent legislation in other states, and other, more thorough independent policy analyses demonstrate that Massachusetts policymakers have many good options in designing an institution that matches its needs.

**Large Bank Self-Interest?** Finally, the NEPPC reports that “existing private sector banks would likely view a new public bank as an undesired competitor rather than a welcome partner.”

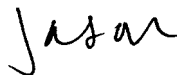
This cursory conclusion contradicts the NEPPC report's own finding that the Bank of North Dakota does not compete with private banks and the strong support that North Dakota's own banks show for the state's public bank. It also reveals a conflict inherent in a study funded by the Federal Reserve Bank, which is dominated by large out-of-state banks. That Wall Street banks might not support a Partnership Bank for Massachusetts—however structured—is not a good reason for policymakers to discount the potential for Massachusetts' economy.

The detailed response that follows makes clear that the NEPPC paper is incomplete and misleading. We hope that it will provide Massachusetts policymakers with a surer and more complete analysis of their policy options for bringing the state's deposits home and putting them to work creating jobs in Massachusetts.



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Heather McGhee  
Director, Washington D.C.  
Office, Dēmos



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Jason Judd  
Consultant,  
Dēmos



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Sam Munger  
Managing Director,  
Center for State Innovation

## CONTACT

**Dēmos**.org

**DĒMOS MEDIA**  
Tim Rusch,  
Communications Director  
trusch@demos.org  
(212)-389-1407

Center for State  
**innovation**

**CENTER FOR STATE INNOVATION**  
Monica Wedgewood,  
Policy Analyst  
monica@stateinnovation.org  
(608)263-0819