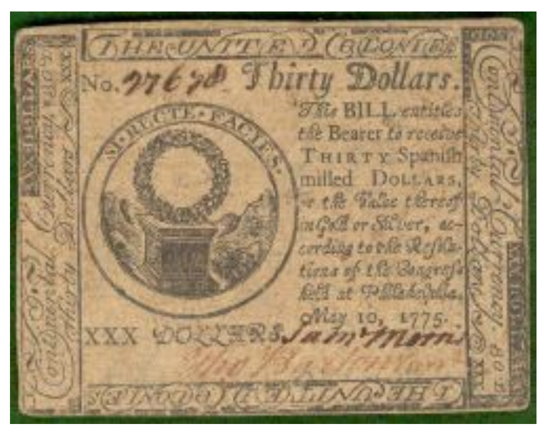
The Center for Internet and Society

The Center for Internet and Society at Stanford Law School is a leader in the study of the law and policy around the Internet and other emerging technologies.

STATE-OWNED BANKS AS A WAY TO REBUILD THE HOUSING AND REAL ESTATE MARKETS

By **Bruce B. Cahan** on August 29, 2010 at 11:05 am



The financial literacy of America has improved markedly, nearly to college level, as a result of the global recession that started in 2007. What about state-owned banks, is the time ripe to explore that part of economic history?

Americans, now economists, can fill a green chalkboard from left to right, with the familiar logic of our situation:

- our housing bubble, pumped up by loose underwriting and shadow finance, burst,
- this caused Americans' perceived real estate wealth to evaporate,
- consumers reduced spending,
- lacking demand, companies reduced employment, profitability and investments,
- the economic uncertainty increased the volatility of the stock markets,
- this caused investors to flood into the bond markets, pushing interest rates to low levels, near zero, (aided by Federal Reserve monetary policy interventions),
- all of which now threatens a cycle or syndrome of deflation and recession.

We've watched banking hearings on Capitol Hill and seen the Financial Reform Act passed and signed by President Obama. Industrial Age banks received Troubled Asset Relief Program (TARP) investments, repaid them with interest to the U.S. Treasury, restored their capacity to pay management bonuses, and are profitable again. The FDIC's list of troubled banks stands at 829, its highest level in 16 years. The FDIC has closed hundreds of community banks since the start of the recession, adding to the perception of government as partner in the mega-banks. Trustworthy, safer banks born of the Information Age have yet to emerge. We're living in an era when, for all practical purposes, virtually no new (de novo) community banks are being approved by regulators until the inventory of failed or marginally-profitable banks are merged with stronger institutions, acquired by new management/investor groups, or closed.

Still the housing and commercial real estate markets wobble in decline, with "For Rent" signs littering Main Street shops, and "For Sale by Bank" signs popping up like weeds in once flourishing, verdant neighborhoods. As of May, the Case/Schiller 20 city composite index stands at 147.33, down 28.6% from its April 2006 high of 206.5. Stockpiled foreclosed and near foreclosed housing and commercial real estate remains off-market. The Federal Home Buyer Tax Credit expired in May, pulling air out of the stimulated demand for housing.

Are housing, mortgages and banking disconnected public concerns? Should they be seen, used, negotiated and discussed in isolated boxes? Is the Internet strong or mature enough to disaggregate and clarify the banks' seminal role in Society?

What's the connection? What ideas haven't been tried? What lessons of history can we relearn, as much as frugality and mutuality of interdependence?

Our nation's financial life experience includes state-owned banks. At stateownedbanks.com, I am exploring and sharing the history of banks owned by government for their citizens in the United States and around the world. State-owned banks aren't socialism. They are precedent from our own Colonial Era, and were familiar to our own Constitutional Congress. The Bank of North America refinanced the Revolutionary War debt amassed in fighting the British for independence. Today, the Bank of North Dakota is a state-owned bank, serving the state government's needs for banking services. Ellen Brown, author of *Web of Debt* has championed this history and precedent for years.

No doubt the President and the Democrats are frustrated with the stalled recovery heading into the Fall Mid-Term Elections. Imagine that this week, President Obama calls in the nation's policymakers and asks for new ideas. What, other than federal stimulus, would jumpstart the economy, stabilize the housing and construction markets and assure state fiscal stability for years to come?

If in that room, I would stand up and say "**Mr. President, I have a plan, and here it is**:

1. The Fed Reserve is reaching the limit of how much U.S. Government Bonds it can safely/credibly buy and hold as collateral for issuing more dollars.
2. State-owned banks, like the Bank of North Dakota, have populist appeal, and have been proposed in Hawaii, Illinois, Massachusetts, Michigan, Virginia and Washington State.
3. My idea is simple: The Federal Reserve, in effect, could diversify its role, by buying bonds issued at low fixed rates for 10+ years as the seed secured position in existing or newly chartered state-owned banks.
4. The state-owned banks would more quickly and accountably lend for in-state purposes and to balance state budgets. Instead of the federal government trying to oversee and claw-back unpopular stimulus, state-owned banks would be required to use XBRL and other advanced transparency implementations of GASB/FASB transparency accounting standards so as to trace how proceeds of state-owned banks flow into the local and national economy.
5. The Federal Reserve's role as bondholder would create an instantly credible market in state-owned banks' bonds, even as an alternative form of currency, thus protecting the international exchange position

of the U.S. Dollar.

6. Fiscally, by capitalizing the state-owned banks, this Administrations could claim, with some endorsing GAO study, that the future federal subsidy of state infrastructure and other programs can shrink, thus reducing the federal deficit.
7. Through projects funded by state-owned banks, local needs would determine how best to jumpstart and keep alive businesses and households that the "too big to fail" megabanks no longer want to fund on fair credit terms.
8. Adding a state-owned bank would bring competition to regional banking markets dominated by out-of-state megabanks, perhaps as a banker's bank, or as a regular, state-owned bank. In the San Francisco Bay Area banking market, Bank of America (30.48%), Wells Fargo (23.94%), Citibank (9.78%), Union Bank (7.39%) and Chase (4.82%) control 76.41% of all deposits, and by extension, dominate the lending choices, rates and terms available to Bay Area residents, innovators and companies."

Would a state-owned bank make a difference here in California? Suppose you are California's Treasurer, with a Pooled Money Investment Fund of $68 billion, earning 0.531% in July. A state-owned bank would avoid some of the friction of buying certificates of deposits in East Coast Banks paying less than 1% interest, and trying to negotiate the interest and other terms on which to borrow such funds back through the bond market to put them in use for California state purposes.

Most importantly, the state-owned bank could do what Californians and other homeowners and commercial mortgagors individually have had only meager success in doing: working out the underwater mortgage crisis. The state-owned bank could buy up mortgage pools secured by in-state real estate at a discount off the face amount outstanding, and re-finance the borrower at today's low long-term interest rates.

Take an example, a $350,000 face amount mortgage on a home worth $450,000 in 2005 (78% Loan-To-Value) and worth $300,000 today (117% LTV) would be sold by the mortgagee for $120,000 (66% discount) to the state-owned bank who would refinance/write down the face amount to, say 20% more, or $144,000, roughly a 59% reduction in face amount.

The benefits of this strategy include:

- At current interest rates, drastic reductions in family mortgage monthly payments.
- The mortgagee gets to declare a capital loss on the sale of the mortgage, subsidizing the capital gains tax rate amount of the discount.
- The homeowner is part of stabilizing the housing market by staying in their home.
- The state-owned bank gets to hold an affordable mortgage that stabilizes the income and economic development prospects for the city/county in the state where the home is located.
- Having state-owned banks do this means not waiting any more for the private mortgage markets to discount their under-water holdings, restoring market calm sooner.
- This bypasses the partisan debate in DC over Fannie Mae and Freddie Mac or creating more GSEs at the federal level.
- This implements the precedent of other country's state-owned banks. Rentenbank credit houses in the 1850s financed Prussia's peasants buying their land rights from landlords. Today, Rentenbank operates as a "public law institution" to refinance rural agriculture projects throughout the European Union.

These are tough, cyclically recession-prone times for our banking system and our nation. Everyday, Stanford and other communities use and are used by the banking system as we've grown to see and know it. Let's think outside the box, and perhaps learn from how others creatively used state-owned banks alongside private banks to do the people's business.

Related Topics:

banks | Case-Shiller | credit crisis | home mortgage relief | Information Age Banks | real estate | recession | state-owned banks | TARP | banking

Comments

Janko M July 19, 2011 at 3:14 am permalink

I've been thinking about his for a while as well. However, your thoughts seem to focus on one side of the problem (market, homeowners etc.) and not on the other - in your example, the bank would have to declare losses from write-downs, thus requiring capital injections all the time. These need to be funded...

Even though there seem to be many good reasons to go towards non-profit (rather than calling them state owned) banks, supporting wider good, as societal institutions, the key in my opinion remains in good management. And this is the same if you are in a state bank, profit or non-profit institution, or a private home owner.

The original sin of spending more than one has, by over-leveraging, borrowing and lending, is simply poor management of one's resources. And regardless of the ownership structure of the banking system or any other financial / societal / regulatory institution, this basic "common sense" rule remains. One can spend what one has, and not more. We will first have to tighten the belts to (spend less) for a while to get back to square, then we can talk about growth again...

reply

Add new comment

Your name

E-mail

The content of this field is kept private and will not be shown publicly.

Comment *

Disable rich-text

Notify me when new comments are posted

Once you hit Save, your comment will be held for moderation before being published. You will not see a confirmation message once you hit the Save button but please be assured your comment has been submitted and we will review it.

Image CAPTCHA

What code is in the image? *

Enter the characters shown in the image.

SAVE PREVIEW