

**HB0794**

**Public Banking Institutions – Authorization and Task Force**

**Testimony before the Maryland House of Delegates Economic Matters Committee**

**By Stacy Mitchell, Institute for Local Self-Reliance**

**February 24, 2016**

Thank you, Delegate Davis and members of the committee, for this opportunity to testify in support of HB0794. My name is Stacy Mitchell. I am co-director of the Institute for Local Self-Reliance (ILSR), a 41-year-old national nonprofit policy research organization. In addition to being co-director, I run ILSR's Community Banking Initiative.

Our banking system has become dramatically more consolidated in recent years. Here in Maryland, the number of local community banks has been cut in half over the last ten years.<sup>1</sup> The market share of local community banks is now down to just 20 percent, which is lower than the national average.<sup>2</sup> Meanwhile a handful of large national banks now control about two-thirds of deposits in Maryland.<sup>3</sup>

This loss of local control of banking has significant consequences for the state. Most Maryland mortgages, for example, are now held out-of-state, meaning the substantial interest payments homeowners make on these loans are leaving the state rather than working here in the state's economy. Maryland cities and towns are also more dependent than ever on Wall Street banks to handle their financial needs, often with more risk and higher fees than is warranted.

Perhaps most concerning of all, new and growing small businesses, which have historically been a major source of net job creation, are now struggling to get the financing they need to expand. Last month, ILSR conducted a national survey of over 3,200 small businesses. One in three of those that had sought financing to grow in the last two years reported being unable to secure a loan. This figure rose to 54 percent among minority-owned businesses.<sup>4</sup> (The responses from Maryland closely tracked the national results, with one-third of businesses seeking loans coming up short.)

Federal data further illustrate the problem. Since 2000, bank loans to large businesses have grown 33 percent, while loans to small businesses have fallen 14 percent, including a 36 percent drop in the smallest business loans, those under \$100,000.<sup>5</sup> According to a recent

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<sup>1</sup> Federal Deposit Insurance Corporation statistics.

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

<sup>4</sup> Institute for Local Self-Reliance, *2016 Independent Business Survey*.

<sup>5</sup> ILSR analysis of Federal Reserve data.

analysis in the *Wall Street Journal*, this credit crisis has forced small businesses to rely on high-cost credit cards or high-cost loans from alternative lenders, or to give up on the growth plan altogether.<sup>6</sup>

Needless to say, this is bad news for Maryland's economy and the state's ability to create new jobs.

Banking consolidation is the primary reason for the sharp drop in small business lending. Local community banks have always and will continue to be the primary source of small business loans. Although they control only 24 percent of the nation's banking assets, community banks and credit unions provide 60 percent of all small business lending.<sup>7</sup> These local institutions do so much more small business lending than their large competitors because they know their borrowers and their local markets intimately. This kind of soft information, which big banks lack, is essential to judging risk and making small business loans successfully.<sup>8</sup>

Although the consolidation of the banking industry was largely driven by federal policy changes in the 1990s, Maryland does not need to wait for Congress to address the problems that consolidation has caused in the state's economy. **Maryland can act on its own to cultivate a banking system that is more diversified, locally controlled, and responsive to the needs of the state's communities and its businesses. Passing HB0795 would give the state the opportunity to study a viable and effective solution — a public partnership bank.**

As you may know, North Dakota has a public partnership bank. Established in 1919, the Bank of North Dakota functions mainly as a “banker’s bank” — meaning that most of its lending is done in partnership with local banks and credit unions. By participating in loans originated by local privately held banks and credit unions, BND expands the lending capacity of North Dakota’s local financial institutions, giving them added strength and capacity.

Thanks in large part to BND, community banks are much more numerous and robust in North Dakota than in other states. North Dakota has more banks and credit unions per capita than any other state. In fact, it has nearly *six times* as many local financial institutions per person as the country overall. In North Dakota, local banks and credit unions hold over 80 percent of deposits, compared to just 20 percent here in Maryland.<sup>9</sup>

BND's lending portfolio has three main components:

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<sup>6</sup> Ruth Simon, "Big Banks Cut Back on Loans to Small Business," *The Wall Street Journal*, Nov. 26, 2015.

<sup>7</sup> Institute for Local Self-Reliance, "Small Business Lending by Size of Institution, 2014," Apr. 20, 2015; Online at [www.ilsr.org](http://www.ilsr.org).

<sup>8</sup> Institute for Local Self-Reliance, "Understanding the Small Business Credit Crunch," Apr. 16, 2014. Online at [www.ilsr.org](http://www.ilsr.org).

<sup>9</sup> Bank of North Dakota, annual reports; Federal Deposit Insurance Corporation statistics.

- About half of BND's \$3.9 billion loan portfolio consists of business and agricultural loans that are originated by a local financial institution and funded in part by BND. As a result of this added capacity and the strength of the state's local banks, North Dakota's banks averaged an astonishing 434 percent more small business lending per capita over the last decade than the national average.<sup>10</sup>
- Another segment of BND's portfolio is comprised of mortgages. About 20 years ago, the bank began buying home loans made by local banks and credit unions. This gives local banks a way to move mortgage loans off their books, thus freeing them up to make new loans. This also benefits borrowers. First, BND services the mortgages it buys, ensuring that North Dakota homeowners continue to have in-state servicing for their loans. Second, it ensures that the mortgage interest homeowners pay each month stays in the state rather than flowing to Wall Street. Between BND's mortgages and those held by local banks and credit unions, roughly 20-25 percent of the state's mortgage debt is held and serviced within North Dakota.<sup>11</sup>
- The final component of BND's loan portfolio consists of student loans. This is the only area of lending in which the bank works directly with borrowers. BND offers loans to state residents enrolled in schools located anywhere, as well as to out-of-state residents attending schools in North Dakota or any adjacent state. Its interest rates are widely regarded as some of the lowest in the country. In early 2015, the bank's rates were about 2 percent for a variable-rate loan and 5 percent for a fixed-rate — substantially lower than the 10-15 percent rates typical of private student loans.<sup>12</sup>

The Bank of North Dakota is extremely popular — with local bankers, residents, and members of both political parties.

In addition to serving the state's economy, BND also reduces the tax burden. Over the last 21 years, BND has generated almost \$1 billion in profit. Nearly \$400 million of that, or about \$3,300 per household, has been transferred into the state's general fund, providing support for education and other public services, while reducing the tax burden on residents and businesses.<sup>13</sup>

Thank you again for this opportunity to testify. I urge you to support HB0794, which would give the state an opportunity to explore how a public partnership bank could work here.

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<sup>10</sup> For additional details and sourcing, see ILSR's backgrounder, "Public Banks: Bank of North Dakota," July 2015, available at <https://ilsr.org/rule/bank-of-north-dakota-2/>.

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

<sup>13</sup> Ibid.