Testimony on House Bill No. 5970 (an act establishing a State of Connecticut Bank)

Submitted by Scott Shepard, Policy Director

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Good afternoon. My name is Scott Shepard. I am the Policy & Research Director for the Yankee Institute for Public Policy, Connecticut's free-market think tank. I submit this note in opposition to **House Bill 5970**.

A state-owned intervention into the financial industry carries a great deal of potential for mischief and unintended consequences. It is no accident that only one state – North Dakota – sponsors a state bank, one that it established a century ago in circumstances that could not possibly be more unlike those of Connecticut in 2019. A study of the feasibility and potential usefulness of a Bank of Connecticut might prove of some value if it were seriously and objectively to explore the questions considered below, but no other move should be made until these issues are fully vetted.

Government participation in a market for the provision of goods or services can only be justified where there is market failure. In the context of financial markets there is really only one type of market failure that could occur. That failure would be that there are fully credit-worthy potential borrowers (i.e., borrowers who can reasonably be expected to pay back their loans fully on the terms specified, which terms will bring a positive return on investment to the investor) who are for some systemic, subjective reason not being offered credit in the private financial markets despite their credit-worthiness.

Historically, various claims could have been made and studied to establish such market failure. Before the Civil Rights Acts of the mid-1960s there is little doubt that there was systemic legal discrimination that led to market-failing denials of credit. After the credit crunch beginning in the fall of 2008, there was concern that small borrowers were being pushed out of the markets for a variety of economic and regulatory reasons. Governor Malloy used this very rationale to establish the Small Business Express program, which – notably – remains active despite declared intentions to wind it up after the credit crisis ended.

Neither of these circumstances obtain today. Neither do any of the circumstances that led to the creation of the Bank of North Dakota – the only extant state-run bank in the United States – in 1919.[1] When that bank was established, North Dakota was a sparsely populated rural farm state with very little in the way of industry or extractive industries. It was about as far as anything in

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[1] *See The BND Story*, Bank of North Dakota, *available at* https://bnd.nd.gov/the-bnd-story/ (accessed Feb. 11, 2019).

the United States could be from financial resources.[2] All of this created real possibilities of market failure: simple unwillingness of the coastal and port-city banks to finance northern-plains farms in a manner reactive to and supportive of the realities of farm life and crop financing.[3] A state bank could have made sense under these circumstances, and appears since to have proven profitable.[4]

Connecticut in 2019, it need hardly be said, is not North Dakota in 1919. None of the special circumstances that plausibly justified a state bank there and then apply here and now. Connecticut is not credit starved or lacking access to financial markets. Its business culture is not one so foreign to lenders than misunderstanding might readily lead to legitimate market failures. There is no reason – absent a deep and detailed objective study demonstrating the contrary – to believe that there are systemic financial market failures in Connecticut, far less systemic failures that could coherently be addressed by a state-owned Bank of Connecticut in ways that are not already being addressed by other Connecticut state programs.

If there are no proven market failures for a Bank of Connecticut to respond to, and if it is not also demonstrated that the Bank could effectively respond to such failures in new and useful ways, then a Bank certainly should not be established. An organization that has no coherent, useful mission to achieve will necessarily take up incoherent, counterproductive ones. In the state-supported banking realm, these could take one or both of two obvious forms.

First, the Bank could support businesses that would already get market-rate support in private markets. If it provides this support at market rates then it adds nothing to the financial-services markets in Connecticut – it just crowds out private enterprise to no good purpose. Alternatively, the bank could support businesses that would already get market-rate support in private markets, but do so at *less than* the market rate. This road leads to corruption and disaster. Tax payers should not be forced to subsidize below-market lending opportunities to special, government-favored businesses. And the method of picking the specially favored businesses to get these benefits would necessarily be fraught with corruption. Meanwhile the state bank's activities would both compete with private enterprise at an unfair advantage because of the misuse of taxpayer funds to undersell the market, and also give an unfair market advantage over competitors to the state-favored borrowers who could pay less than their peers for lending services.

Second, the Bank could provide lending facilities to businesses that cannot otherwise obtain financing in private markets *because they are not sufficiently creditworthy.* As the credit crisis and housing-market collapses of 2008 and beyond demonstrate fulsomely, however, government-backed lending to parties who are objectively unlikely to be able to fulfill their obligations results in high taxpayer losses and high market volatility while at the same time destroying the capital and time that the borrowers put into their enterprise during the period during which they can service their loans. This, at its heart, would be a Bank for the recreation

[2] *See id.*
[3] *See id.*
[4] *See id.*

in miniature of the sub-prime lending crisis. Connecticut should of course venture into no such undertaking.

The general assembly might reasonably consider undertaking a study to determine whether there is systematic underservicing of fully creditworthy borrowers in Connecticut which could reasonably be redressed by a Bank of Connecticut without duplicating services that the state already offers. If all of these are reliably found, then the assembly might reasonably reconsider the possibility of creating a Bank whose role would be narrowly circumscribed to only those purposes.

It would be unwise, though, to establish such a Bank absent such a showing, and without such constraints.