GOVERNMENTAL BODIES CAN OBTAIN INTEREST FREE LOANS

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Government officials should learn that there are ways for governmental bodies to borrow the funds they need without being required to pay interest charges for those funds. A small service fee would have to be paid to cover the cost of servicing the loans, but that is not an interest charge.

So long as those making the loans do not have to pay interest on the funds they loan out, they do not have to charge interest from the borrowers. Commercial banks do not pay interest on the bank credit they loan out. They only pay interest on their reserves and on any cash they may loan out. The Federal Reserve Banks do not pay interest for the bank credit loans they make. They do not even have any reserves for the checks they issue. Their checks are redeemed with bank credit, on which they pay no interest.

All of us, especially government officials, will benefit if we learn of the actions taken by the people in the state of North Dakota. In the latter part of the 1800s and the early part of the 1900s they were not happy with the conditions under which they had to borrow money. Over the years, they organized politically in what was called Populist Movements. In the election of 1918, the Non-Partisan League gained control of the State government. In 1919 the State Legislature passed the laws which established the Bank of North Dakota for the purpose of “Encouraging and promoting Agriculture, Commerce, and Industry.” With headquarters at Bismarck it is the only bank of its kind in the United States.

From its beginning the North Dakota Bank did not intend to compete with the existing privately owned banks, but rather to cooperate with them to best serve the needs of the people. That policy still exists. The Bank makes no loans to private corporations or individuals, with the exception of loans under VA (Veteran Administration), FHA (Federal Housing Administration), and FISL (Federal Insured Student Loans).

A State Industrial Commission composed of the Governor, who acts as chairman, the Attorney General, and the Commissioner of Agriculture, operates the Bank. Mr. H. L. Thorndal, the president, has stated that the Bank of North Dakota is able to loan to the
political subdivisions all the funds they need. But the Bank usually insists that every issue of notes or bonds over $150,000 be put up for public sale and the Bank of North Dakota bids on the issue. On issues of less than $150,000, the Bank will negotiate directly with the political subdivisions for the rates and terms.

The Bank charges interest for its loans and after paying its expenses, the remainder, the profit, is turned over to the general fund of the State. In 1974 the Bank made a net profit of $9,268,770.41.

The above is what the Bank does. However, because the Bank is a government agency operating to perform a public service, it is not necessary that it make a profit for the State. Of course it should not incur a loss either.

As a public service, a policy could be adopted that the profits would be returned to the governmental bodies concerned in the borrowing, instead of being paid to the State. The borrowers who paid the interest then really could say, “we are paying the interest to ourselves.” The result would be the same as if no interest were paid.

The people of North Dakota could go one step further. They could operate the Bank of North Dakota on a 100% bank credit system in a manner similar to the Federal Reserve Banks operation. The Bank could adopt the policy that it would not receive or pay out any cash. It would make loans to governmental bodies by issuing checks on itself and it would receive payments only in checks. It would be a completely cashless bank. Let us illustrate with an example:

Let us say the City of Fargo wishes to borrow $1,000,000 from the Bank of North Dakota. The City will issue $1,000,000 worth of bonds payable to the Bank of North Dakota over a period of five years, with $200,000 worth of the loan to be paid back annually. No interest will be charged, only a service fee sufficient to cover the cost of making and servicing the loan. Let us say a total flat fee of 1% ($10,000), or an annual fee of $2000 will be charged and payable, also, at the end of each of the five years.

The City of Fargo, on its part, must levy an irrevocable tax of $202,000 for each of those five years in order to make the payments. The Bank will then issue a check of $1,000,000 payable to the City of Fargo. The City will deposit the check in its demand deposit account at the Fargo Local Bank and receive $1,000,000 worth of bank credit. The Fargo Local Bank will then send the check back to the Bank of North Dakota and receive $1,000,000 worth of bank credit in its account there.
The City of Fargo then can issue checks against its account up to $1,000,000. The persons receiving the checks can deposit in any bank and receive credit in their accounts. They in turn can write checks against their accounts. Thus by everyone using checks in lieu of cash as their medium of exchange, buying and selling can take place in the usual manner.

When taxpaying time arrives, the people can pay their taxes with checks to the City of Fargo. The City of Fargo will deposit those checks in its Fargo Local Bank and receive credit for them.

At the end of each year when the payments on the bonds are due, the City of Fargo will issue a check for the amount due and send it to the Bank of North Dakota. The Bank will credit the City for the amount paid and debit the Fargo Local Bank for that amount and return the endorsed check to the Fargo Local Bank which will debit the City of Fargo's account and return the cancelled check to the City Treasurer.

That procedure will be repeated at the end of each of the five years at which time the principal will be repaid without any interest charges. The bank's cost of operations will be taken care of by the $2000 annual fee.

The reason it will not be necessary for the Bank to charge any interest on its loans is because it will not use any of its own cash and it will not have to borrow cash from anyone or pay interest to anyone. The only income the Bank will need is the amount necessary to pay the total cost of its services, i.e. the annual fee of $2000.

The reason the Bank of North Dakota can issue checks without having any cash on hand is because the Fargo Local Bank and 167 of the 170 banks in the state maintain an account with it and it acts as the clearing bank for those banks. That is the same reason that Federal Reserve Banks can write out checks with no cash needed to cash them.

If an annual interest rate of 6% were paid on that $1,000,000 loan, it would amount to $60,000 for the first year, $48,000 for the second year, $36,000 for the third year, $24,000 for the fourth year, and $12,000 for the fifth year. A total of $180,000! Whereas, the total service fee would be only $10,000.

Conclusion: The problems caused by the interest bearing debts of governmental bodies are almost overwhelming. Is it not time that some efforts be made to devise a means of freeing ourselves from the burden of those huge interest payments?
Surely, we and our government officials should at least want to benefit from the experience of the people in North Dakota. Even though the Bank of North Dakota does charge interest on the loans it makes to governmental bodies, it turns much of that interest into the general fund of the State, thus reducing by that amount, the need for levy of state taxes. North Dakota has made a good start. Let us carry on from there.