State Treasurer’s Office Needs a Dose of Free Market Principles
By Kenneth M. Brown

The multimillion dollar scandal in the state Treasurer’s office opened the door to much needed reforms. The problem is not merely some sticky fingered officials, but rather the way the operation ignores some obvious lessons of economics. Incentives really do matter.

The most straightforward and obvious reform would be to make the job of treasurer appointive rather than elective. This would prevent a repeat fiasco of an indicted Treasurer who can’t be fired except by impeachment. This change would also open the job up to financial experts who don’t want to run for office. Moreover, it would make the governor share in the responsibility for any further corruption, giving him a greater incentive to oversee treasury operations.

But more reforms are needed to eliminate what was the main vehicle for corruption, namely the dependence on “consultants” who compete for the chance to collect fat commissions and hence can be pressured into giving kickbacks to the Treasurer. With kickbacks adding up into the millions of dollars, one can only imagine just how much money has been forked over in consultant fees.

Given the tremendous competition in securities markets, it is doubtful that these consultants have any profitable advice to offer. How great could these consultants be if they find it expedient to bribe their way into business deals? But even if they were honest, their advice isn’t going to be worth much.

Burton Malkiel’s classic book, *A Random Walk Down Wall Street*, explains why stock pickers almost never outperform the market, and his analysis applies in spades to the motley crew of consultants picked by shady state officials. Information flows so quickly in the stock market that any piece of valuable information almost immediately is absorbed into the price of related securities.

Much of the work of the office is simply to manage short term income and outgo of monies. Rules of operation should be established, so that when the state has, say, $20 million to invest for 30 days the rules say “buy U.S. Treasury bills.” No, or very small, commissions, no self-serving portfolio-churning tips from consultants, and a sure rate of return. Treasury securities don’t have the pizzazz of whatever the consultants have probably been pushing, but they are as safe as you can get and tend to move with inflation.

Another way to dispense with consultants is to build more expertise within the Treasurer’s office (but without a net increase in the size of the staff). Former Governor Johnson was quoted as saying that the office would do fine with half as many people. If outside advice is really needed, then sign up with one reputable nationally known company on a negotiated fee-for-service, non-commission basis.

The spirit of these reforms also applies to the state investment officer and council with a few modifications. A sizable portion of the permanent funds under their management is in long-term investments. Again, hiring a whole raft of consultants makes little sense. Rather, go with one or two big investment firms like T. Rowe Price or Vanguard, and stick to their broadly based index funds of stocks and bonds.

Above all, resist the pressure to “invest” in New Mexico firms for some nebulous goals of economic development or jobs creation. The payoff will be slim or negative. Any firm that can’t attract funding in the private market is unlikely to be a sound investment of taxpayers’ money. Moreover, such an investment strategy is a magnet for favoritism and corruption on a large scale. (And in this context, the word “invest” probably should be replaced by “spend” or “squander.”)

In summary, organize the treasurer’s office and the investment council in a way that takes out the incentives for corruption, and taxpayers will get at least a little more of the good government they deserve.