



# THE ECONOMICS OF PROSPERITY

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The Formula for National Prosperity is very simple:  
EVERYBODY WORKING  
EVERYBODY WORKING PRODUCTIVELY.

If 5% of the working population is unemployed, 5% of productive capacity is wasted. Total production, output, purchasing power and prosperity will all be reduced by 5%. That is basic mathematics. And a Welfare State will have to pay out unemployment insurance. Full employment is a First Essential.

If everybody is working, but working inefficiently and unproductively, using old machinery with poor organization, poor allocation of resources, and enforced idleness due to lack of components or spares, then again, overall production, and thus output and potential prosperity, will be reduced. This was the case throughout the old Soviet Union and its satellite countries.

We become prosperous, not just by working, but by working efficiently, constantly seeking ways to maximize productivity, to produce more output for the same or less input of labour.

Unemployment in itself reduces potential prosperity. It also has a depressing effect on productivity. Productivity, producing more and better goods and services tomorrow with less work than it took yesterday, inevitably involves reducing the work content thus putting people out of work. In times of full employment this is no problem as there are always alternative jobs. But with high unemployment, employees will oppose productivity increases for fear of becoming unemployed. Productivity creates prosperity. Opposition to productivity, is opposition to prosperity.

A prosperous nation requires full employment and continuing maximization of productivity. Full employment removes objections to labour-shedding productivity increases, and also encourages automation and more efficient use of labour.

This in turn requires

- 1) a regulatory environment which gives full rein and encouragement to individual enterprise while preventing dishonest and disruptive practices;
- 2) a sound and stable financial infrastructure to facilitate trade, saving and investment.

The first of these two requirements is already in place and reasonably effective. The second is conspicuously lacking.

Not one of the world's monetary units has any defined value and all are unstable, depreciating in real value by a minimum of 3-4% a year. The banks are privately owned and in business primarily to make a profit, which they are now doing by venturing into ever more complex financial devices which have brought, and can again at any time bring the whole system to near collapse.

Roads, bridges, piped water, electricity, telecommunications, these and many more constitute vital elements of a nation's infrastructure. But outweighing them all in importance is a properly functioning monetary system.

*Our present economic/financial system doesn't work.  
It is open to, and frequently subjected to extreme abuse,  
and fails to provide support for industry and development.  
It requires some fundamental reforms  
if it is to deliver the prosperity of which it is capable.*

1:

## THE BASICS OF BANKING

Banking is widely regarded as the world's greatest confidence trick. Does not the bank create money out of thin air with a simple stroke of the pen – or keyboard – then charge interest for its use?

The shenanigans of 2008 and onwards involving ultra high-tech gambling, bank failures, costly tax-payer bailouts and ensuing recession of historic proportions have done nothing to enhance bankers' reputation.

Yet the basic principles of banking are both sound and simple. Bankers take fixed assets (like the deeds of your house) as security and give you an equivalent in liquid assets (cash or credit, or purchasing power) in exchange for the duration of the loan. No new wealth is created. The bank simply exchanges one type of asset for another.

Banking was, and is subject to certain basic rules of conduct. The bank must at all times remain "liquid", which means that it must always hold enough cash and near-cash to satisfy the demands of depositors for withdrawals. Second, the Bank must assure itself of the true value of assets offered by borrowers in exchange for credit.

Go back thirty or forty years and banking very much reflected these ideals. High Street banks housed themselves in imposing buildings, the interior presented a mood of seriousness and solemnity. Banking was a privilege which the customer should accept with deference and respect.

Anyone wanting a loan would be ushered into the Manager's Office where, behind the privacy of frosted glass, he or she would be subjected to a procedure much resembling a bad boy's interview with a disapproving headmaster. Personal loans would be the major business, mortgages, small business loans, home improvements, all subjected to careful scrutiny.

Banks did not involve themselves in high-stakes gambling on the stock market. Purchase of stocks and shares was more of a personal, private matter, individual investors making their own choices which they would finance out of income or savings. The growth of professionally managed investment funds allowed individuals to buy into a fund or mix of funds according to the fund's focus and objectives. It all seemed to work quite well.

How, then, did a major part of the world's banking system reach a state of bankruptcy and total collapse?

2:

## THE GREAT BANKING CRISIS OF 2008+

Though it is quite natural to regard a nation's banking system as a vital, if not the most essential element of its infrastructural services and facilities, banks are in fact privately owned and as such, their primary loyalty is to their shareholders. Not only must they show a handsome profit, these days performance is monitored on a quarterly basis, and market expectations are very demanding. Hence the drive is on to find ever more new and increasingly exotic ways of maximizing profits.

Standards for the calculation of "safe" mortgage commitments have slowly declined, as banks, and in the USA especially less-than-honest mortgage brokers, allowed increasingly unsupportable mortgages. Again going back a few years, the calculation was simple: your mortgage payment shouldn't be more than a quarter of your gross income. This was also a simple calculation because few people had revolving credit or any debt other than a car payment.

In the USA by 2007, mortgage debt to income had reached into the 40-60% levels before considering any other debt and living expenses. The "safe" mortgage in the USA passed the affordability curve long before "sub-prime" (unsupportable junk mortgages) became an issue. Factor-in non-mortgage debt – for cars, domestic appliances and credit cards – and simply put: people were carrying much higher consumer debt loads than ever before, and devoting a larger share of their income to servicing that debt than ever before, all with the active encouragement of the banking and finance sector. In Britain, the situation was no better. In 1999 British households were already the fourth most indebted among the G7 economies. By 2002 Britain had taken the lead, with a debt burden equivalent to almost double disposable income, the money you have to spend after essentials are covered.

Another "old tradition" of mortgages was that the bank would lend up to 80% of the assessed value of the property, the applicant having to raise the rest. But Northern Rock – "the small bank with the big impact" – found that too limiting for its customers. Northern Rock is a relatively small British bank. Yet its spectacularly imprudent mortgage strategy caused the first run on a British bank in more than a century.

Northern Rock's first mistake was its willingness to relax normal lending criteria. It granted mortgages at six times the applicant's income, and lent up to 125% of the value of a property, despite already inflated property values.

Second, it depended on borrowing money short-term in the interbank market and lending it long-term as mortgage finance. The bank's dependence on the wholesale market – around 70 per cent of its funding came from this source – was a catastrophe waiting to happen. It was a fundamentally irresponsible strategy, which presumed an unending rise in property prices, perhaps punctuated at worst by brief 'corrective' falls of up to 5%, as well as an unending supply of short-term credit. But the UK property market was already grossly inflated, and the collapse of the sub-prime mortgage market in the US led to a cascade of bad debts throughout the banking system. Interbank lending froze, making it virtually impossible for Northern Rock to raise fresh funds as its loans fell due.

On 14 September 2007, the Bank sought and received a liquidity support facility from the Bank of England. On 22 February 2008, the Treasury was forced to rescue and then nationalise the bank to protect the wider financial system.

And that was just the start.

Property mortgages were not the only cause of economic troubles. Credit Card services of banking institutions advertise actively for business – “no credit checks, instant acceptance guaranteed”. Why such rash promises? Surely there will be defaults. Yes of course there will be. But there will also be the “poor but honest” who maximize their card debt then have to pay interest at an annual 19% plus. Encouraged by multiple credit cards, consumers committed their incomes weeks, months even years ahead – always assuming of course that their jobs and incomes would outlive their commitments. When downturn and redundancies struck, the incomes dried up, but the debts lived on. While governments desperately tried to restart their economies by encouraging consumers to “spend, spend, spend”, ordinary folk apparently knew better, devoting what money they had to running down their debts.

In the pursuance of profits major banks, once so conservative, now take substantial risks in financial speculation on a huge scale. The history of banking provides numerous references to major banking scandals where banks have made substantial loans to dubious real estate companies, or, more recently, where banks have played the futures and foreign-currency markets using complex high-risk gearing techniques. The complete collapse in 2008 of major banking, investment and insurance institutions, though the worst to date, was only following a long-established tradition of profit-seeking risk.

Traditional banking practice is founded on “reserves”, with loans based on and secured by those reserves. But experiences in 2008 have proved conclusively that banks’ “assets” as security for their high-stakes gambling have been woefully inadequate. Reserves are in effect insurance, insurance against bad loans. But as any insurance assessor knows, insurance must be weighed against risk, and bankers’ gambles and their investment “devices” have become so complex that risk is almost impossible to estimate.

In the autumn 2008 global financial storm, UBS, Switzerland’s biggest bank, got itself into serious trouble. Not only was the bank gambling wildly, it also grossly underestimated the risks it was taking. Before the beginning of the crisis, UBS calculated its credit risk at SFr 800 million. In the event it had to write down SFr 40 *billion* – that’s 50 times more. The government had to step in and save the bank by putting in \$5.3 billion to take a 9.3 percent ownership in the bank. The “reserve of last resort”, it turns out, is the unfortunate taxpayer.

The Great New Idea of twenty-first-century banks was known as “originate and distribute.” The notion was that by packaging loans into securities that were sold to investors all over the world, the banks wouldn’t get stuck if loans went bad. Citigroup had pioneered entities called “structured investment vehicles,” or SIVs. In essence, mortgage loans were bundled together, then sliced into pieces, with some sold and others kept in these stand-alone units. The SIVs borrowed money by selling short-term IOUs on the market, making them vulnerable to a change in investor appetite for short-term lending. And SIV loans frequently were not shown on the banks’ books, but concealed from auditors as “off-balance sheet entities” in special purpose vehicles (SPVs).

Off-balance sheet financing is attractive from a risk management standpoint. When assets and liabilities are moved from one balance sheet to another, the risks associated with those assets and liabilities go with them. For example, if a firm transfers credit-risky assets to an SPV, the credit risk goes with those assets, and therefore does not need to be “covered” by insurance capital. This in turn frees up more capital thus making the operation more profitable.

In 2006, Citibank’s off-balance sheet assets amounted to \$2.1 trillion. Not only were these enormous loans hidden, but several top Fed staffers confessed later that they hadn’t even heard the term “SIV” until the end of July. Neither had some senior Fed officials – even though they were charged with being guardians of the financial system. In fact, that was typical. An astounding array of derivative products had exploded across the marketplace over the preceding few years. Even market sophisticates faced a steep learning curve to keep up with what was happening, and that included Citigroup’s own chief executive, Chuck Prince, who famously dismissed worries that his

bank and others were counting unwisely on cheap and plentiful credit to make ever bigger and riskier loans.

“When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you’ve got to get up and dance. We’re still dancing,” he told the Financial Times in early July 2007.

At the time, Citigroup, in common to a greater or lesser extent with other banks, had little or no choice. A banker who didn’t dance, who didn’t make ever more risky loans, would find his bank’s market share falling and near-term profits less impressive than his competitors’. Then the music stopped and the drama – or melodrama – took over.

And yet what might be considered honest miscalculation, however dire its results, was not to be the end of the 2008 and on-going financial disaster.

The global financial crisis, it subsequently became clear, was caused not just by the bankers’ colossal mismanagement; it was due also to the new financial complexity, offering up the opportunity for widespread, systemic fraud. That the world’s most famous investment bank, Goldman Sachs, was subject to civil charges for fraud brought by the American regulator was only one of a series of investigations into financial institutions around the world. A court-appointed examiner found that Lehman Bros, the collapsed investment bank knowingly manipulated its balance sheet to make it look stronger than it was. In Iceland a dossier assembled by its parliament on the Icelandic banks – huge lenders in Britain – was handed to its public prosecution service.

Beneath the complexity, the charges are all rooted in the same phenomenon – deception. Somebody, somewhere, was knowingly fooled by banks and bankers – sometimes governments over tax, sometimes regulators and investors over the probity of balance sheets and profits and sometimes, as the Securities and Exchange Commission (SEC) says in Goldman’s case, by creating a scheme to enrich one favoured investor at the expense of others – including, via Royal Bank of Scotland, the British taxpayer. Along the way there is a long list of so-called “entrepreneurs” and “innovators” who were offered loans that should never have been made.

Simply stated, the banks got in trouble because they gambled wildly, irresponsibly, and as it subsequently appeared, dishonestly with the resources at their disposal, bringing near-bankruptcy upon themselves, debts upon taxpayers, and serious recession upon the western economies.

Q: Are bankers Conservative or Socialist? A: Yes.

When they’re on a winning streak taking in profits on bets the complexity of which few but the young whiz kids understand, when star traders and executives are taking home bonuses in the millions, the bankers are True Blue Conservative – and “Hands Off Private Enterprise!”

But when the bets turn sour and phenomenal winnings turn into ruinous debts, suddenly they’re Socialists, standing in the lineup, their top hats held out for government welfare – and welfare on a scale which dwarfs unemployment benefits for ordinary out-of-work folks. And so the government steps in with a rescue package. For the banks, it’s a win-win situation.

Yet while traditional economists make dark threats about the dangers of governments running the banking system, the reality is that a nation’s banking and monetary system is a vital, indeed the most important element of its infrastructure, and furthermore, when it’s threatened, government is the banker of last resort.

There is thus ample justification, if not an urgent necessity, for a fundamental review of our banking and finance system, what we require from it and how best our needs for trade, and investment in commerce, industry and infrastructure can be supplied efficiently and cost-effectively.

3:

## BANKING REFORM

The Big Crash starting 2008 brought with it a widespread awareness of the extent to which banks have bent over backwards to invent ever more complex gambling devices without apparently any thought that gamblers might one day lose their (or our) shirts, awareness, too, of their gross misuse of resources at their disposal and scant regard for their status as guardians of the nation's monetary system. The complexity of the risks they were increasingly taking and their subsequent downfall became the major element in the financial troubles which shook the western world.

Solutions have been proposed. In 2009 the hot topic was the separation of banking functions. Ruth Sutherland summarized the idea in The Observer's Business & Media section dated 22.03.09:

“It doesn't take the biggest brain on the planet to divine that casinos and savings banks are very different beasts. That is why there is a growing clamour from luminaries including Bank of England governor Mervyn King and former Chancellor Nigel Lawson to look at introducing Glass-Steagall type rules. Glass-Steagall was the 1930s regulation in the US that separated banks' function as utilities from their gambling activities; it came out of their belief that banks' speculation on the stock markets with their savers' money helped cause the crash of 1929 and the Great Depression. Its repeal in 1999 by the Clinton administration was driven by powerful banking interests, a textbook case of politicians bowing to the finance industry, which had conducted a \$300m lobbying assault.”

Banks' gambling activities would then be conducted as separate, ring-fenced entities, selling properly described and monitored investment funds into which purchasers would invest knowing the precise activities undertaken and relevant risk/reward ratios. Indeed, Britain's Investment Fund industry is already highly regulated and responsibly marketed. The problem arises when complex risks and speculation are undertaken clandestinely, masquerading as simple deposit-taking banking.

Certainly there is ample justification for much tighter regulation. The nation's monetary and banking system is the most systemically vital of all its infrastructural services and facilities, and as such requires optimal safeguarding against any form of abuse. Additionally, government being the banker of last resort, is fully entitled to ensure that banking operations should never again impose upon government finances to the extent where even governments are pushed to the point of near-bankruptcy.

The separation of banking functions coupled with much tighter regulation are obvious remedies against future banking collapse, as is an overall multi-card limit on personal credit-card debt and tighter mortgage regulation.

## EVERYBODY WORKING

### EVERYBODY WORKING PRODUCTIVELY:

Clearly, a dysfunctional banking system which plunges an entire nation into recession and unemployment will not contribute to either of these objectives.

However the reform and increased control of the existing banking system is not sufficient, for it lacks the capacity to generate growth: growth out of recession, growth in job-creation, growth of new industries, and growth in productivity through longterm investment in industry and infrastructure.

Everybody working, everybody working efficiently, productively. That's the key to productivity and prosperity. And a key element in facilitating this process is secure, longterm finance for industrial and commercial investment. This in turn requires an investment banking facility specifically geared for economic and commercial development in industry and infrastructure.

4:

## DEVELOPMENT BANKING – PROJECT SECURED INVESTMENT

Traditional banking practice requires pre-existing assets as security, and loans carry no long-term commitment.

Development Banking avoids these two limitations of traditional banking by securing the loan on the industrial or commercial project itself thoroughly researched and costed, rather than outside assets alone, and by making a long-term commitment based on an intimate involvement with the business or project in which it is invested.

This facilitates the creation of new business and new jobs, as well as providing secure finance with which existing business can maximize its quality and productivity. Local infrastructure can also be financed. By setting up Development Banks to operate at regional level, focusing on regional and local needs, the benefits can be spread widely and uniformly, avoiding the usual geographical pockets of non- or under-development.

The Development Banks would be established to create new business and new wealth where none previously existed, not (in the words of comedian Bob Hope) “to lend money to people who can prove they don’t need it”. The availability of investment credit has enormous potential for growth, and the Development Banks should actively be seeking to maximize the productive use of this resource.

The major distinguishing feature of the Regional Development Bank (RDB) concept is that *a total project, from design through production and management to sales, becomes the loan collateral*, rather than the personal assets of individuals.

RDBs would be authorized to create loans secured by project collateral, rather than capital or government bonds – “reserves” in the current banking sense. In the current banking tradition, a bank’s reserves are instituted as, and traditionally regarded as an insurance against losses, but in practice insurance is no better than the risks it insures. Experience in 2008-9 has shown bank assets woefully inadequate to cover bad investments and gambling risks.

The RDBs would rely for their security on thorough research of loan projects in which they are invested, on a close working and constructive partnership with the loan recipient, and a detailed follow-up of results. Security becomes “equity plus” – equity with the additional security of on-going monitoring.

Loans would be made to encourage and develop new startup enterprises large and small, to secure, expand and improve existing enterprises, and for major regional infrastructure projects, the latter in conjunction with local authorities and national planning.

In each and every case, the granting of a loan is based on a thorough and complete business plan providing full working detail, detailed use of the loan funds, and precise projections of sales, income and expenditure as appropriate for each project, as well as anticipated repayment schedule.

The RDB would maintain a register of specialist firms, contractors, business advisors and retired businesspeople who can be called upon to verify loan clients’ cost estimates and provide setup advice in forms varying from design and equipment of factory premises to promotion and accounting. Skilled commercial, architectural and technical advice would be available, either to assist existing enterprises or to promote new ones.

Once launched, the new enterprise manages itself but the Bank receives a flow of data – production, sales, outgoings, income and profits – from which the new enterprise’s progress can be monitored and compared with projections. If anything begins to go wrong, the Bank can give timely help, with advice or further finance if appropriate. *An investment loan is best secured by ensuring the success of the project in which it is invested.*

The partnership concept also assumes longterm commitment, resulting in the encouragement of secure long-range planning and productivity investment, research, and development of new-generation products and services.

In the case of larger businesses, the investing bank may well appoint a Director to the Board, as has been the practice in Germany. Careful monitoring will be to the advantage both of the investing bank and the recipient business, as well as to the regional economy: bankruptcy is not contributive to economic stability and prosperity.

With a guarantee of adequate long-term finance, the recipient business would be properly set up, equipped and maintained, able to maximize quality and productivity. Indeed the provision of finance for any business or project would be conditional upon the rigorous application of all relevant quality standards pertaining to product design and every aspect of the production process.

RDBs should be set up as not-for-profit concerns, eschewing establishment as private companies with the constant pressure to maximize profits – if necessary through risk and adventurism. A central supervisory authority would monitor individual banks’ activities, ensuring that the rules of conduct are strictly and objectively observed.

Regional Development Banks would set their own charges based on administrative costs and loan insurance. There is of course an element of risk in any investment. The more useful approach however, is to minimize risk through proper pre-investment research and positive on-going monitoring of physical production, sales, and accounting – precisely the measures which a banking-industry partnership system is able to undertake.

The banking-industry partnership would therefore be in a position to offer investment at a constant, and relatively low cost, possibly 2-3%, backed by the on-going monitoring of the recipient business ensuring safeguards for the investing bank, the recipient business and all those involved with and dependent on it.

The RDB could also provide investment finance for regional infrastructure, such loans to be repaid by the relevant local or regional government departments from their own revenues.

Thus the RDB would prove a powerful catalyst at regional level, providing finance and subsequent ongoing supervision for business and industrial development, together with investment capital for regional infrastructure.

RDBs could also be called upon to finance micro-industries in villages, small loans to open a tea-room, to provide baking facilities in the village hall, or set up a small market garden. The RDBs should be able to focus on any and all opportunities, large and small, to provide investment which will create local employment.

Individual homes could benefit too from loans to install double-glazing or roof insulation, work which itself provides further employment. Such loans would qualify as investments, being repayable from savings derived by the borrower through lower energy bills.

Regional Development Banking provides genuine, repayable investment loans, avoiding the need for deficit-increasing grants.

## REMINDER:

*Traditional banking practice is founded on “reserves”, with loans based on and secured by those reserves. But experiences in 2008 have proved conclusively that banks’ “assets” as security for their high-stakes gambling have been woefully inadequate. Reserves are in effect insurance, insurance against bad loans. But as any insurance assessor knows, insurance must be weighed against risk, and bankers’ gambles and their investment “devices” have become so complex that risk is almost impossible to estimate.*

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Banking consists of two sides, like a traditional set of scales. On one side, the assets held as security, on the other, the bank’s investments. The one is supposed to balance and guarantee the other. Recent history has shown the painful imbalance between the two, as risks far outweigh assets. Regulators are now seeking to impose higher asset ratios; they should be looking rather to an accurate assessment and limitation of risk as a better way to prevent further collapses.

Yet another variable is now entering the asset-to-investment equation. As part of their reserves, banks include government bonds, traditionally regarded as gold-plated. Now even the security of government bonds can no longer be taken for granted.

Raising the legal-minimum asset requirement by a few percentage points can never guarantee to cover the high-tech, near-incomprehensible gambling activities undertaken by the private banking sector today.

Development Banking invests in a business, thoroughly researched, and backed by an ongoing flow of performance data, so the business itself becomes the security. Asset and investment are in balance.

5:

## DEVELOPMENT BANKING HISTORY

Although Project-Secured Investment represents a major departure from the traditional Asset-Secured Investment, the concept is not new.

In December 1852, Napoleon III became Emperor and President of France. Napoleon was very much influenced by Saint-Simonianism, a French political and social movement inspired by the ideas of Claude Henri de Rouvroy, Comte de Saint-Simon (1760–1825), who predicted that imminent growth in industrialization and scientific discovery would have profound changes on society. This in turn required that banking should promote industry and infrastructure, in contrast to the existing banking system in France which was almost exclusively, and very conservatively managed under Baron James de Rothschild.

Under the direction of the Pereire brothers and the patronage of Napoleon, the newly established Crédit Foncier and Crédit Mobilier financed and promoted investment in the expansion of the textile, chemical, steel and metallurgy industries, and the modernization of agriculture. The rail network increased from 3,000 km in 1852 to 18,000 km in 1870, and the complete renovation of Paris between 1853 and 1870 was undertaken by the Seine prefect, Baron Georges-Eugène Haussmann. The addition of further large banks focused on industry ensured strong economic growth and industrial development.

The principle that banking should serve the needs of industry and the economy, as opposed to those of shareholders exclusively, was clearly established and promoted.

In Germany, the Regional Banks, or Landesbanken have traditionally provided low-interest loans to local firms, both as startup capital and as on-going investment. In fact, the regional, industry-sponsoring character of the Landesbanken goes back to their somewhat extraordinary origins.

In 1818 the Swedish government stunned Europe by offering 160,000 Taler to the German province of Westphalia as reparation for the damages incurred when Swedish and Dutch soldiers marched through the province during the Napoleonic Wars. This money was decreed the property of all Westphalia by its President, Freiherr von Vincke, and through the Westphalian Hilfskasse, or “Assistance Bank” established for the purpose, the funds were used to develop the region’s economy and pay for public-works projects, but some formal policies were needed to distribute the money. The bank played a pivotal role in developing the region’s economic potential throughout the 19th century.

Frederick William IV, king of Prussia, impressed by the advantages which the *hilfskasse* offered Westphalia, ordered that a similar bank be created in the Rhineland in 1847. Its government founded the Provinzial-Hilfskasse of the Rhineland in 1854.

Both banks became Landesbanken before the end of 19th century, which greatly increased their range of services, since *hilfskasse* banks had more restricted charters. Their new names were Landesbank für Westfalen Girozentrale, and Rheinsche Girozentrale und Provinzialbank, Düsseldorf. The two banks were instrumental in making the Rhine-Westphalia region one of the biggest and most productive industrial areas in Europe.

In the post-WW2 years, the Landesbanken played a major role in the creation of Germany’s “Economic Miracle”, in particular through the provision of secure on-going credit to the German “Mittelstand” (small and medium-sized companies) in their respective regions, now one of the enduring backbones of the German economy.

Founded in Basque Spain some 70 years ago, the now highly successful Mondragon Cooperative group likewise illustrates an ongoing relationship between investment banking and recipient business. The *Workers' Bank* serves three mutually inter-dependent functions: it provides investment as a local development bank, offers technical and financial advice for business startup, then monitors production, quality, and financial performance in a process of ongoing cooperation and partnership.

The ongoing partnership concept also assumes longterm commitment, ensuring finance for secure long-range planning and productivity investment, as well as research and development into new-generation products and services, in conjunction with apprenticeships and higher education which are also sponsored by the Cooperative.

In Bangladesh the Grameen Bank (GB) has reversed conventional banking practice by removing the need for collateral and has created a banking system based on mutual trust, accountability, participation and creativity. GB provides credit to the poorest of the poor in rural Bangladesh, without any collateral, and has succeeded in improving the lot and the prospects of thousands of the very poor.

At GB, credit is seen as a cost effective weapon to fight poverty and it serves as a catalyst in the overall development of socio-economic conditions of the poor who have been kept outside the banking orbit on the grounds that they are poor and hence not bankable. Professor Muhammad Yunus, GB's founder and Managing Director, reasoned that if financial resources can be made available to the poor people on terms and conditions that are appropriate and reasonable, "these millions of small people with their millions of small pursuits can add up to create the biggest development wonder." Grameen Bank's positive impact on its poor and formerly poor borrowers has been documented in many independent studies.

In the USA, the Bank of North Dakota (BND), the only entity of its kind in the nation, is a state-owned bank dedicated to promoting commerce, industry and agriculture. BND offers numerous low-interest loan programs in collaboration with a lead lender to meet the financing needs of any qualifying new or expanding business. Financing economic development is the BND's main focus and function. The Bank provides financing to stimulate economic development in the State for both business and agriculture.

Now India's second largest bank, ICICI Bank Limited, was incorporated in 1955 as the Industrial Credit and Investment Corporation of India Limited (ICICI) at the initiative of World Bank, the Government of India and representatives of Indian industry, with the objective of creating a development financial institution for providing medium-term and long-term project financing to Indian businesses.

The concept of loans based on, and secured by the project itself backed by continuous monitoring is basic, and simple. It can create jobs, economic expansion and productivity anywhere.

Development Banking can spread growth across the regions, creating jobs and providing the wherewithal for existing companies to increase their competitiveness. And the benefits will stretch into the future as a thriving, broadly based economy sends a positive signal to young people providing the prospect of a challenging, well-paid job as the sure reward of education.

6:

## INFRASTRUCTURE INVESTMENT and DEVELOPMENT

Regional Development Banks would also be fully equipped to identify and invest in local infrastructure and industry, investing to provide major infrastructure secured by future income, for example from an uplift in business rates.

Applying the model to four live case studies from selected British cities, a report by accountants PriceWaterhouseCooper has demonstrated that by using this approach, increases of between 50% and 80% can be achieved in housing, jobs and economic output. Note the significant factor here is that we are looking at investments, not deficit-increasing grants.

The potential benefits for many kinds of infrastructure, including transport, are considerable. Rapid cost-effective transport within regions, linking peripheral communities to the economic centre contribute to growth through enhanced mobility, in addition to environmental benefits. The combination of largely autonomous Regions established across the country each with its own Regional Development Bank empowered to make loans for industrial and infrastructural needs can provide the means to invest in new businesses, jobs, and productivity-enhancing improvements in existing industry and infrastructure.

### **Affordable housing – without the bubbles**

Regional Development Banks, through Regional Housing Corporations, can provide low-cost financing for new housing, for rental or lease “at-cost”.

A major element in the economic and financial disaster of 2008-9 has been the phenomenal rise and catastrophic fall in house prices. Banks and mortgage brokers found ways to make unaffordable mortgages (supposedly) affordable, young first-time buyers were lured into the market, demand increased, values went up, speculators jumped in buying second and third “investment” properties, and so the balloon went up, in more ways than one.

After the collapse of the housing market, as house prices began to rise again, the prevailing comment was one of unqualified relief and approval. But inflated house prices are a myth, giving an impression of wealth to home-owners which encourages second and third mortgages to finance frivolous expenditure. In reality your inflated house value is only of benefit if you’re selling up and moving into a retirement home. But if you’re selling your inflated-value home and moving to another, that too will demand an inflated price. As mortgages take ever longer to repay, the net result is that banks and financial institutions end up owning a large proportion of the nation’s housing stock, while deriving a comfortable income from it. Meanwhile first-time buyers find it a near impossible challenge to enter the market.

The Housing Corporations should acquire “grey” ex-industrial, or unused agricultural land at its current price, rather than the inflated “with planning permission” price. When owners of land currently valued at agricultural rates sell at a huge, planning-generated profit to developers, the houses they build are already on the way to becoming unaffordable. The object should be the construction of quality, environmentally attractive cluster housing, yet built using techniques of fast-track mass-production. Availability of at-cost housing would make it possible once again for young families to afford that most basic of all needs: a decent home in pleasant surroundings.

In the USA, George W Bush believed that the American Dream meant that every American family should own their own home, so he provided finance for totally unqualified buyers: no job, no credit, no prospects – no problem, the loan is yours. But not the home, which was in reality owned 100% by the financiers. When disaster struck thousands of “home-owners” defaulted and were either ejected, or simply walked away, and the dream became a nightmare.

A decent home in decent surroundings is one of the foundations of a civilized society no less important than education and healthcare. A core stock of affordable, at-cost rental, rent-to-own or leasehold accommodation will serve first-time buyers, and can act as an “anchor”, a realistic cost foundation which can effectively limit the free property market from excessive inflation and over-evaluation.

### **Property prices and Prosperity**

In the general hoopla and jubilation over rising property prices, it is rarely if ever observed that rising property prices and rental costs in urban centres are economically regressive, a fact which classical economists decline to recognize.

Prosperity is more goods and services, better value, for less cost. Rising property values result in less value for greater cost. We are reducing our hard-won prosperity.

Prosperity is created by productivity, by increasing value without increasing cost. Rising land prices do just the opposite: they increase the cost of land without increasing its inherent value. And this has a similarly inflationary effect on the services using land, which become more expensive not because they are offering increased value but simply because rents are going up. “Value” in the sense of what buyers get for their money, decreases as land prices increase. This is particularly evident in major cities.

There is little or nothing in the way of goods and services which is not affected by the price of land; rising real estate prices in towns and cities affect everything from offices to retail shops, cafés, and places of entertainment. The escalation of land prices is a major contributor to the high cost of urban living. It can also cause a deterioration in urban quality of life; many of Europe’s old established city cafés which have for centuries been centres for meeting and socializing are now being forced to close as a direct result of escalating rents. Likewise the demise of urban centres in the USA came about when steadily increasing rents finally reached the point where businesses could no longer afford them and moved out instead to cheaper green field sites thus creating new suburbs.

If the city or town centre is to retain or regain and develop its function as a gathering place, it will be necessary to ensure that newly developed areas in city centres, particularly areas reclaimed from public or industrial use, should be subject to price stability so that rents are economic for those low-profit uses such as public markets and cafés which, while lacking high profit potential, provide vitality and enjoyment for the community.

This could be accomplished, for example, by vesting tenure in the hands of a locally administered Urban Trust, which would then ensure maintenance and management of the facility. Regional Development Banks can provide finance to equip public markets, the kind which exist in almost every French town and provide facilities for the exchange of locally made produce, thus in turn creating opportunities for cottage industries and rural market gardening, again financed through the RDB.

7:

## GLOBALIZATION — LOCALIZATION

Fashions come and go. Currently globalization is all the rage. But there are already signs that its days, though still many, may be numbered. Several different factors may be called in evidence.

### **1. Labour Cost.**

Why does the west import everything from clothing to electronic gadgetry from China when we can perfectly well make it ourselves? Why, likewise, do we pay Indians to fill in our insurance forms on the phone and answer customer queries when, once again it's nothing we can't do on our own doorstep?

The answer of course, is "labour cost". The wages are lower. Apart from tropical fruits which won't grow in northern climes, and those natural resources we don't have, the cost of labour is the main reason why we import so much. And will it last? Yes, for some considerable time. But it is not by any means a longterm, indefinite phenomenon.

It happened in Japan, it happened in Korea, Singapore and Indonesia: labour costs simply became uncompetitive. Already western firms with factories in China are having to move inland seeking fresh fields of cheap labour because the favoured coastal areas have become too expensive. Pay for factory workers in China increased by 69% between 2005 and 2010.

The Boston Consulting Group is increasingly advising American clients serving American customers to stay at home, not for patriotic reasons but because the economies of globalization are changing fast. Sometime around 2015, the Group believes, cost advantages of manufacturing in China will have evaporated. Add savings in transportation and the reduced need to hold high stocks, plus manufacturing and design flexibility of home-market production, and the writing's on the wall.

And as for China itself, once a nation of peasants and primitive village industries, its people constantly hovering around starvation level, it is now showing all the signs of affluent capitalism – a growing gap between rich and poor, inflation, new millionaires every day... and the wealth is spreading steadily throughout its vast country. In Europe, Canada and USA, Chinese tourists are everywhere, swarming by the busload as they spin round the major tourist sites.

India too is growing rapidly in terms of wealth, its burgeoning middle class can match the best of the west in wealth, lifestyle, home comforts, fashion and travel.

The days of cheap labour are numbered. The evidence is there, right there before our eyes, in the tourists from India and China, in everything from the world wealth tables, to the sales figures for high-end motor cars.

### **2. Our Jobs.**

The developing countries fill our shops with their goods, but they want something in exchange. The days of colonial slave labour are long gone. And here at home we need employment, otherwise we don't earn and don't spend. Every day we hear stories of jobs flying off to China, as factories and offices outsource pretty much anything they can. But once again, it's not a sustainable trend.

Europe struggles to find new sources of employment, while the United States pays for its Chinese imports with ever more paper IOUs.

We in the West need to focus our attention at home. More specifically, how we can create productive employment on a regional basis, developing local potential, seeking gaps in the market, specialist products which require a quick turnaround in response to changes in demand.

We need reliable finance for new and expanding business, and the rigorous application of standards and benchmarking to ensure that whatever we are doing, it cannot be done better. And we need to trim the excesses of capitalism. The shareholder as king of the castle, who demands outsourcing to gain a marginal price advantage – and perhaps so that a profit can be realized by selling off the domestic factory premises – must begin to share the power with other ‘stakeholders’, employees, local suppliers and the host community.

Globalization has brought about major changes in our lives. We need major responses.

### **3. The Dangers of Interdependence.**

Japanese companies are building cars in Europe and USA, but a few vital parts are produced in Japan, and with production interrupted by the Japanese earthquake/tsunami disaster of 2011, car-makers in countries not physically affected were put on short time, or factories closed. Even when natural catastrophies do not dramatically cut off supply of vital parts, many companies find by experience that more domestic production provides greater reliability both of production and delivery, as well as greater flexibility in terms of design changes.

### **4. Environmental concerns.**

Fuel is running out and the cost is going up. And as long as it lasts, burning it has a negative environmental impact. Already those with environmental concerns are calculating the environmental impact cost of items in stores which have been shipped across the globe. The time may come when we get a little more serious about carbon emissions, and wake up to the environmental impact of world trade.

### **5. The Neighbourhood Effect.**

Local farmers’ and craft markets are spreading. People are experiencing the pleasures of local produce, home-made products from cakes and jams to wild-flower wines, pottery and hand-crafted items of clothing. In the kitchens of up-market restaurants we find the chef exploring local growers, encouraging production of out-of-season or long-forgotten species of fruit and vegetables, promoting “fresh local produce” on their menus.

It’s not going to make a major impact on world trade, but it’s a trend nonetheless, and one which is proving increasingly and justifiably popular.

We need not be looking at import controls, closing our own country to the rest of the world. But the mad rush to produce anything and everything abroad needs to be counter-balanced with focused efforts to maximize employment at every local and regional level.

The alternative is unemployment and welfare, neither of which is desirable personally, socially or economically, and which in any case is a costly luxury we simply can’t afford.

### **6. Global Strategy.**

Western nations need to get themselves up to date. A basic attitude of colonialism in Europe and the USA still survives, though now more of a lingering memory. This approach assumes the West is wealthy, the rest is poor and may be favoured with trade from the West providing labour costs are kept low. But this game plan is rapidly becoming history.

The “de-coupling” of the far-eastern economies from the West has already happened: when the US sneezes, the far east, once dependent entirely on US largesse, barely notices. China, the Far East, and to a growing extent India, are increasingly generating their own consumer demand to keep their domestic production rolling. And let’s face it, there is little or nothing the West can do for Asia that Asia can’t do for itself, more cheaply and probably better.

China particularly is moving into a position of much greater world influence. Its “rare earth” policy provides a glimpse into the future and China’s view of itself in the world. Rare earths are used extensively in high-tech products, and China accounts for 97% of current production. It is using

this position to induce foreign technology companies to set up in China by restricting exports, a strategic threat to high-tech companies worldwide.

The European Union might be described as “globalization in miniature” with its insistence on free trade and open borders among member states. But when, in July 2011, the British government awarded a major transport contract, not to Bombardier’s factory in Britain, but to a German rival thus depriving Britain of 1,400 jobs, the old familiar question returned: should local jobs be sacrificed in order to get the lowest bid and thus best value for consumers, or in this case tax-payers. As the Railworkers’ Union saw it, Britain colluded with the EU to “wipe out train building in the nation that gave railways to the world”. The right answer is for domestic industry to offer a better, cheaper product than the foreign competition, then both parties are satisfied. This in turn requires guaranteed longterm investment of sufficient substance to provide the necessary research, development, equipment and premises to ensure products and production of the highest quality at competitive price.

Globalization has its up-side, but every up-side has a down-side. Globalization works. But it should always be combined with localization, the full realization of regional creative and industrial potential across the nation – which brings us back to the nation’s financial facilities and Development Banking in particular.

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A nation’s banking system is a vital – *the most* vital part of its infrastructure. Yet we dispose of sewage more efficiently.

The first and essential reform must be the complete segregation of **Utility Banking**, so that conservatively managed, strictly controlled basic banking facilities can be relied upon.

The longterm investment needs of trade and industry, large and small, need a new facility: **Development Banking** serving and supporting its clients through a longterm commitment to, and secured by, the business itself. This can best be done on a regional basis. Autonomous regions each based around a core city, each with its own development bank, can maximize their own resources and functionality, each making its own individual contribution to a productive and prospering nation.

The great Euro crisis of 2011 came about as a result of government profligacy, as member countries such as Greece spent more than they earned in revenue as a result of unaffordable benefits, an over-weighted bureaucracy and uncompetitive economy. The Greeks would have to tighten their national belt, the government must spend less and take in more revenue – thus spake the European Union as a pre-condition for a financial bailout. But this kind of austerity at once plunges a country into recession, and recession lowers tax receipts while increasing social security costs, thus worsening, not improving the government deficit.

A well-established Development Banking institution could provide finance for much-needed growth without increasing the deficit.

Once again – the Formula for National Prosperity is very simple:  
EVERYBODY WORKING  
EVERYBODY WORKING PRODUCTIVELY.

Development Banking can provide the catalyst to increase both employment and productivity.

But there are hidden barriers along the road to the ultimate objective of Everybody Working, Everybody working productively – barriers which within our present concept of money and value cannot be overcome.

In other words, we can increase, **but never maximize** either employment or productivity.

8:

## GROWTH VERSUS INFLATION

The ability to channel investment into areas of un- or under-employment offers the potential to expand the productive capacity of the economy to its maximum potential, that is to say, full employment.

Full employment has a number of advantages. A job is fundamental to life itself. Without a job little else can be achieved. Without a foot on the ladder, there is no hope of mounting. Unemployment also puts demands on those who do have jobs, since they must pay taxes to finance welfare benefits for the unemployed. At the national level, unemployment represents a waste of productive potential. 5% unemployment is an immediate 5% reduction in potential production. And unemployment discourages labour-shedding productivity improvements, since those with jobs are afraid of losing them.

When the London Underground system decided to replace ticket sellers and collectors with automated ticketing and barriers, Trades Unions opposed and blocked this labour-saving move for several years, fearing unemployment of their members. At the same time and in contrast, the tramway administration in Zurich, Switzerland, decided to replace conductors with automatic ticket machines. The changeover took place smoothly as planned with no opposition. On the last day of conductor operation, there were tables set up outside the tram depot by firms seeking employees. Switzerland at that time enjoyed not only full employment, but a shortage of labour.

Some economists have suggested that a degree of unemployment is essential, since a tight labour market can hold back economic development; on the contrary, employers and managers at a Japanese labour conference in 1991, when the Japanese economy was still buoyant, were unanimous that the shortage of labour at that time had forced them into increased labour-saving productivity and automation.

A substantial degree of hardcore unemployment, on the other hand, causes employees to oppose labour-shedding productivity improvements for fear of losing their jobs and being unable to find alternative employment. This is much worse than it sounds. Prosperity is created and increased through advances in productivity, making better goods tomorrow with less labour than today. When workers oppose productivity, they are opposing prosperity.

Despite the clear disadvantages of unemployment, and the desirability of full productive use of all economic resources, the ability to expand an economy to full capacity cannot presently be realized, for as the economy expands to near-full employment, the danger of inflation causes the Central Bank to put the brakes on by raising interest rates.

The problem is that our money has no defined value. Surely that cannot be true. The Pound Sterling or Euro or Dollar has a value in terms of... gold? No, gold is subject to volatile speculation and its value is never constant. So how about the Pound Sterling's value in terms of... Swiss Francs? Certainly the SFr is one of the world's more stable currencies, but for that very reason it becomes a currency of refuge during uncertain times, thus raising its exchange value against other currencies. The plain fact is that our money, whichever currency we use, really has no defined value. It can be defined against gold or other currencies, but not one of these has a defined value either.

But wait. Money does have a value, real value. It has real value in terms of what you earn (wages), and what you can buy with what you earn (prices). But again, both wages and prices are open to on-going dispute and lack any form of definition or stability. None of our national currencies has any stable, clearly defined value, and all are subject to a continuous upward pressure known as inflation. This in turn prevents economic expansion to full employment, sentencing the world's economies to the waste and human distress of substantial and permanent unemployment.

And the existence of inflation as a permanent feature of every world currency is a denial of one of the basic purposes of money known to every first-year economics student from the first day: money should act as a store of value. Yet a currency which loses – at the very best – 3% of its value every year is not much use as store of value. It's about as practical as storing water in a bucket with a hole in it.

So what is inflation? What causes the upward pressure on our currency units, and their consequent decline in real purchasing power?

Inflation is not the complex esoteric phenomenon economists would have us believe as they attempt to explain it with long equations and newly-invented symbols. Inflation is simply a matter of human greed – our natural desire to get more reward for the same work. Inflation is an increase in price without a corresponding increase in value. If the price goes up for a better product that costs more to make, that is not inflation. But if a producer asks more tomorrow for the same product he sold for less yesterday, that is inflation.

Similarly with wages. More money for more or harder work is not inflation. Inflation is more money tomorrow for doing exactly the same work you did yesterday.

In today's economies, the level of overall economic activity directly affects inflation.

Take this in slow motion.

The economy is in recession. Producers and retailers find difficulty in moving their goods; so they respond by offering price reductions, incentives and special offers. Meanwhile the Government and/or the Central Bank seeks to expand the economy by lowering interest rates, making it easier for both producers and consumers to borrow money to finance production and consumption. So the economy picks up.

As the economy expands and consumer demand expands, producers and retailers can increase their prices without damaging sales. So the "sale" signs and special offers disappear, and prices can be nudged upwards without risking lower sales.

Similarly with wages. Employees are naturally reluctant to demand more money, or threaten strike action, in a time of high unemployment with a lineup of job applicants outside the door. But when the economy approaches near-full employment and staff are hard to find, now's the time to demand that raise you've been wanting!

So wages go up, prices go up. Inflation sets in.

When near-capacity is reached in the more prosperous regions and inflation begins to rise, the Central Bank attempts to control inflation by slowing down the economy with increased interest rates, thereby reducing the economy to a state of mild recession and a degree of unemployment.

*In a free market economy, wages and prices increase in times of economic expansion and can only be held in check by creating a degree of recession.*

The combination of zero inflation with stable money, and full employment with full productive use of resources in a free-market economy is an economic and financial impossibility. Getting a job becomes a challenge. For every hundred job-seekers, there are only at best ninety-five jobs. Similarly producers will be competing to sell their goods to a market which has insufficient credit to purchase them.

Recession or inflation? Our economic managers have two choices. Expand the economy to full employment and we get inflation. Or reduce inflation, by slowing down economic activity, creating

unemployment and recession. The art of economic management as currently practiced lies in attempting to compromise between the two.

Apart from fiscal dishonesty and irresponsibility (printing money to gold-plate the presidential palace), inflation is not a monetary, but a social factor. In hard times people behave themselves. But when things get easier, producers put prices up for the same product or service, and employees demand more money for the same amount of work.

That is not an economic factor, to be explained with complex formulas and obscure economic jargon. It's simple human nature. Or to put it a little more plainly, it's simple human greed.

The underlying economic factor which makes this situation possible is that pay and prices are settled by a form of disputation. The price is as much as the producer can get, or as little as the consumer is willing to pay. Similarly, the wage is as much as the employee can get, or as little as the employer can get away with.

This process is commonly known as *free collective bargaining*. But it is inherently unstable and subject to continuous upward pressure fuelled by the simple human desire for more. While the desire for more wealth and prosperity both personally and nationally is a very reasonable one, an economy and its participants should seek to increase their personal and collective prosperity by becoming more productive, not by demanding more money for the same work or the same product.

The process of establishing pay, profits and prices by disputation results in friction, industrial disputes, loss of productivity, inflation, and permanent under-employment. It represents a facet of anarchy, in that it is a process of settling differences by unregulated dispute rather than by a system of debated and agreed guidelines and regulation. And it ensures that we can never achieve and maintain full employment.

9:

## STABILIZING VALUE

Free Collective Bargaining on the wage, or pay side, combined with totally unregulated market pricing is the key factor which prevents expansion to full employment. What, if any, are the alternative options?

A potential solution to this problem already exists, and needs only to be applied on a standardized national scale in order to bring stability – and justice, that essential pre-condition of stability – to the economy.

For many years, a number of government agencies and corporations large and small, have been using a system of *job evaluation* to evaluate the work each employee contributes. Each job is analyzed, its essential characteristics and demands, such as training, responsibility, working conditions and physical/mental effort involved, are measured on a series of common scales. The job “value” is then directly related to remuneration. In this way, pay is fair, both in relation to the work done, and in relation to the pay and the work of others.

Currently there are several such systems in use, well tried and working successfully. It would not be difficult to analyze and compare their different features in order to establish a single standard. This would become in effect a national standard of value for measuring the work element contained in a product or service, so that pay becomes a true reflection of the work required of a job. Society already measures apples and gasoline; it could hardly get along otherwise. Yet of all the things traded every day, work is the most important, and work is the one commodity we do not measure.

A national standard would provide a point of reference, of justice indeed. Everyone would know how much they should get for the work they do, without hassle or argument or strike.

Job evaluation can be reflected directly in wage evaluation thus ensuring wage stabilization. This process can be carried through to price stabilization.

A factory's, or a business's total costs consist of three elements. First, the cost of bought-in raw materials and components; second, the direct labour added in the factory; and third, the costs of capital write-off, overheads and finance.

These are the costs of making a product, of supplying a service. From these costs a Unit Production Cost can be calculated for each product or service supplied. If this Unit Production Cost then becomes the Selling Price, there would be a direct and fair relationship between cost and price, and therefore between pay and purchasing power.

But the Unit Production Cost is not normally equated with the Selling Price. The difference between the two is commonly referred to as the net profit. How is the net profit currently disposed of?

The prior destination for profits has traditionally been the investors, or shareholders. But today this is changing, reflecting in turn a new perception of the need to create a greater sense of teamwork.

Investment is vital, as also is the equipment it provides; but the machine is no longer the exclusive source of productivity and indeed its operation can be rendered useless without the intelligent participation of the workforce. The reality today, becoming ever more widely recognized, is that the people who work in an enterprise are equally vital: their inventiveness, their enterprise and initiative, their attention to the job in hand, their commitment to quality, their extra thought and effort... these are the factors which if encouraged and harnessed can turn investment into

productivity and prosperity, and which can turn a company's fortunes. Thus an annual workforce bonus reflecting performance of the company may also be included.

Apart from investor dividends and employee bonuses, the other major destination for the disposal of company profit is re-investment, either in research and equipment or increased working capital. The advantage is that in-house or self-generated investment comes without future servicing cost or commitment to repay.

There is one more claimant to a share in the profits, and that is the customer. Profits have to come from somewhere – or someone. In fact it is the customer who pays the price and generates the profit; with this view a further claim on profits would come from the consumer, demanding lower prices.

The stabilization of prices would require the establishment of public policy for profit distribution. This could take the practical form, first, of an overall profit ceiling.

Of the profit made, broad percentage bands could be established and gradually stabilized, distributing profit according to a pre-set formula as between co-workers at all levels, investors, and the internal needs of capital for reserves and re-investment.

As they do today, government revenue departments would continue to require that companies prepare in timely fashion properly audited annual accounts. Company profits would be examined in order to ensure that they are within overall agreed limits, and apportioned according to a consensus formula which respects the claims and contributions of consumers, investors, co-workers, and the future security of the business itself.

It should be noted that price stabilization effected in this way, through annual account regulation, would permit the same degree of latitude in pricing “deals” and special offers. But the profit ceiling would ensure an ultimate price stability.

Pay and price evaluation and stabilization would provide guidelines ensuring fair exchange between employer and employee, as well as between producer and consumer, without the need to argue or strike. More importantly, stable pay and prices would permit economic expansion to full employment without inflation.

Guidelines for remuneration/pay evaluation coupled with profit limitations would replace dispute with rules, and would move to stabilize pay and prices even in times of economic expansion. In such circumstances it would be possible to expand the economy steadily to full employment and hold it there indefinitely without fear of inflation. The results would be seen in full employment, monetary stability, and a high level of productive efficiency and thus prosperity.

“A fair day's pay for a fair day's work” – a fine-sounding slogan but hardly a reality today. The vast majority of working people slog away in factories and offices for the best part of their lives with nothing but a meager pension at the end of it – and even that may be in doubt. At the other end of the scale, the “fat cats” walk away with millions for having done little but preside over a company's decline – or worse still, an entire banking system's demise.

Is inequality a problem? No, not if it is the result of hard work, of training and education, acceptance of responsibility and simple success at what you do. But inequality of remuneration and consequent living standards IS a problem when it is widely perceived that there is no just and fair relationship between work and reward, and when the wealth gap keeps on growing.

### **The uncounted cost of income disparity**

Put a thousand people on an island and they'll soon sort themselves out. Some will assume command while others do their bidding. Over time, the “commanders” will gradually assume

privileges, in accommodation perhaps, or food. Spread that trend over centuries and you have landowners and peasants, factory owners and workers, riches and poverty.

Social conscience has long attempted to eradicate some of the extreme injustices and poverty, but it was with the advent of Socialism at the beginning of the 1900s that the “underprivileged” would strike back.

The word “disparity” derives from Latin and simply means “unequal”. Most people would accept that those who train hard and work hard should be more substantially rewarded than the idle and indolent. Not so acceptable is “disparity” in the form of an absence of relationship between work and reward, where some are paid little for arduous work, while others are highly rewarded without appearing to contribute anything useful to society.

Despite the near collapse of the banking system from 2008 onwards, bankers and financiers drew huge bonuses as what appeared to be the reward for the near-destruction of our entire economic structure. Indeed under the surface, the reality is that in the USA the top 0.1% earn 80 times more than the rest. That is not in itself the problem, rather the clear perception that they do not appear to be working 80 times as hard, nor contributing 80 times as much consumable value to the overall economy.

Socialism made no attempt to address this problem, choosing rather to rob the rich to pay the poor. Thus the perceived injustices remain, and the lower paid become recipients of charity.

This leads to another, quite separate result of our growing income disparity: governance has become less concerned with law-making, and increasingly occupied with income-redistribution. The process of taking from the rich and giving to the poor is highly complex and costly both in terms of administration and of fraud. In the US budget of 2011 welfare costs amounted to 40% of the federal budget. Nor of course does the total apportionment for welfare equate with the total paid out in welfare: the administration costs of income redistribution have been variously estimated at anything up to 30%.

Gross income disparity and the growing wealth gap also has a serious and substantial effect on the overall health of society, from violence and illiteracy to mental illness and life expectancy. Such a claim may sound a bit far-fetched, but authors Wilkinson and Pickett have brought together such a huge, varied and incontrovertible weight of evidence in their highly acclaimed book “The Spirit Level” (Penguin Books 2010) as simply cannot be ignored. Their conclusion is that societies with a bigger income gap between rich and poor are bad for everyone – including the well-off.

Social Security in its widest possible sense is the goal of every well-governed society, and the only true “Social Security” is that utopian condition in which there is a rewarding job for everyone who wants one, with the guarantee of a fair day’s pay for a fair day’s work.

Ultimately the bottom line is that a fair and accurate relationship between work and reward across the spectrum is an essential element in any society aspiring to basic social justice. It also gives definition and stability to the monetary unit and facilitates consistent full employment.

10:

## INFLATION OR DEFLATION

Inflation is a depreciation of a currency, where it buys less each year. The longterm effect of price stability combined with productivity maximization creates the opposite of inflation – your money buys, not less, but more every year. This becomes a completely normal, natural process. As productivity increases, the labour-content decreases, goods and services are produced more cheaply and offered at lower prices, thus progressively lowering the cost of living.

“Negative inflation”, where your money buys more with time, not less, has already happened in the field of computers and other electronics. Buy a computer today, and it is almost guaranteed that in three months’ time the price will be lower, for a faster machine with more storage space on its hard drive.

This in turn means that as we get older we can look forward to increased purchasing power for our savings. A wild dream? No. This is as it should be, the normal course of events. We should be steadily increasing productivity, producing more and better at less cost. And with a stable monetary unit, increased productivity involving less labour is reflected in lower prices. Currently we are forced to rely on private pension schemes defined in terms of inflating currency, and government pension schemes which are already heading for deep deficit.

So we seek other ways of protecting our money, prompting a proliferation of investment schemes, many of which consist of sound investments in soundly managed companies, while others gamble investors’ funds using dubious models of financial manipulation.

And we console ourselves with inflating home prices, ignoring the warnings that bust can follow boom.

Money which increases in value over the years... surely an ideal which most “ordinary folks” with ordinary common sense would heartily applaud.

And yet our economists regard deflation with absolute horror. Do they know something the rest of us don’t?

There are two issues which need to be addressed.

The first is that economists are contradicting themselves. Check the first chapter, indeed the first few lines of any first year economics textbook, and there it is: “money is useful as a medium of exchange, **and as a store of value.**” And yet no one, economist, financial advisor, banker... indeed no one at all would ever suggest putting currency coins and notes under the mattress and hoping that by the time you retire they’ll be worth anything. We can all remember “how things used to be”, and the older you get, the more you see the rapidity with which money – the economists’ store of value remember – is losing its value.

In fact the word “inflation” is hardly an appropriate term. “Depreciation” would be a lot more accurate. Instead of talking of “3% inflation this year”, it would be more realistic to speak of “a 3% depreciation in the purchasing power of our currency”. But no government or central bank would dare lay bare the failures of the nation’s money so clearly. Inflation is a word with a good connotation; it means “bigger”, and that in turn has to be good. But “depreciation” reflects reality: our currency is slowly deteriorating in real value – and by the time you need to spend your pension savings, your money will only be worth half what it is now, at best. Inflation is a depreciation in value and purchasing power; likewise “deflation” represents an “appreciation” in the value and purchasing power of the currency.

So once again, why do economists dread deflation?

The answer is simple: inflation reduces the value of debts. If you owe £1,000 and pay it back in three years, its value will have fallen. It will be easier for you as the debtor to pay it back because your wages/salary will (hopefully) have increased.

This is particularly significant – and useful – for debt-ridden governments, which issue five-year bonds happy in the knowledge that with a currency deteriorating in value by 3-5% a year the real debt will be that much lower when repayment time comes round.

Inflation – a depreciating currency which steadily loses purchasing power – is an incentive to spend now, pay back later. It encourages indebtedness. But indebtedness, once considered a limitless privilege for governments (and some individuals too), reached a dramatic “full stop” in 2010-11 as Greece, Portugal, Spain and others – not to mention the USA – were dramatically forced to confront the “wages of sin” as their debt ratings sank and borrowing costs sky-rocketed.

Conversely deflation – an appreciating currency which gains in purchasing power – encourages saving, which in turn has a number of spin-off consequences. A nation which saves has more money available for investment. And when people can be confident that their money is naturally increasing in value, they will be less inclined to seek refuge in dubious investment practices.

The choice is simple: do we craft a monetary system to favour people and governments which save, or those who spend now and (hope they can) repay later? Financial prudence would favour the savers over the profligate.

And the good commonsense of ordinary people would favour a currency which appreciates in value, not depreciates.

But deeply indebted governments have their own agenda. In the words of John Stuart Mill:

“When governments create paper debts, they have a direct interest in lowering the value of the currency, because it is the medium in which their own debts are computed.”

The Euro Crisis of 2011 in which several Euro currency governments reached the verge of total insolvency has proved a rude reminder that indebtedness cannot go on for ever. The USA is likewise being forced to rein in its growing indebtedness.

Ultimately the prosperity of a nation and its citizens individually can best be guaranteed by full employment, fair remuneration, and increasing productivity in a stable economy. And this in turn requires that the nation’s credit flow, its most vital resource, be given stability of value, protected from abuse, and directed specifically towards releasing full productive potential.

Development Banking has the potential to *increase* employment and productivity across the nation. And with the addition of a stable currency we can *maximize* employment, and thus also productivity, without inflation and the inevitable resort to putting on the economic brakes.

And the icing on the cake: the money you put under the mattress increases in purchasing power every year.

Roads, bridges, piped water, electricity, telecommunications,  
these and many more constitute vital elements of a nation’s infrastructure.  
But outweighing them all in importance is  
a properly functioning monetary system.

*Only with fundamental reform  
will our monetary system  
deliver the prosperity  
of which it and we are capable.*