



People cannot pay down their debts when they are unemployed.  
Nations cannot pay down their debts when they are locked in recession.

*The answer lies in jobs and growth,*  
but indebted governments cannot 'prime the pump'  
and banks will not provide credit during a recession.

Industrial Development Banking  
can generate jobs and growth  
without increasing government indebtedness.

# JOBS – GROWTH – PRODUCTIVITY – PROSPERITY

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*Roads, bridges, piped water, electricity, telecommunications  
constitute vital elements of a nation's infrastructure.  
But outweighing them all in importance is  
finance for growth and productivity.*

1:

## THE CONCEPT OF DEVELOPMENT BANKING

That western banks gambled themselves into massive debts, which in turn required equally massive taxpayer rescue packages plunging governments even deeper in debt, has become a significant episode in banking history. But if we regard the financial and banking system as an element – the most important indeed – of a nation's infrastructure, it becomes immediately apparent that our current systems fall far short of the needs of a properly functioning economy. This is a longterm structural problem which goes to the basic nature of banks and banking.

The fact is simply stated: banks are private institutions whose function is to make money for their directors and shareholders. Serving the needs of the nation's economy is not their prime concern. In fact quite the contrary. Bankers tend to shrink from involvement in an economy suffering downturn or recession. As bank loans are reduced or refused many a business has found bitter truth in the old saying that 'banks lend you an umbrella when it's sunny, and take it away when it rains'.

Napoleon III made this discovery – though he may not have been the first – when he became President and self-styled Emperor of France in December 1852. 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 focusing 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 seen as their prime role the provision of 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, guided by some formal policies establishing overall priorities. 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, and 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 with 3 million mid-sized businesses, often with fewer than 500 employees and annual sales of less than 50 million euros, yet employing more than 70 percent of German workers and contributing roughly half of the country's GDP.

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. 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 at the initiative of the World Bank, the Government of India and representatives of Indian industry, with the object of creating an industrial development institution to provide medium-term and long-term project financing for 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.

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## 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 multiple 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.

Industrial Development Banks (IDBs) would require minimal initial capitalization, since *each project, thoroughly vetted from design through production and management to sales, together with its fixed assets, becomes the loan collateral.*

IDBs 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 IDBs 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 IDB 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.

IDBs 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.

Industrial 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 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 IDB 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 IDB 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.

IDBs 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 IDBs 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.

Industrial Development Banks, through Regional Housing Corporations, can also 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 which also made a major contribution to the Great Banking Crisis.

The Housing Corporations would acquire “grey” ex-industrial, or unused agricultural land at its current price, rather than the inflated “with planning permission” price for 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, and would provide an “anchor” to slow down the next housing bubble.

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

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### SOUND BANKING PRACTICE?

Traditional banking practice is founded on “reserves”, with loans and liabilities 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.

David Wessel writes (‘In Fed We Trust’, 2008) “An astounding array of derivative products had exploded across the marketplace over the past few years. Even market sophisticates faced a steep learning curve to keep up with what was happening”. One such ‘device’ was the SIV, or Structured Investment Vehicle; “...several top Fed staffers confessed later that they hadn’t even heard the term ‘SIV’... though they were the guardians of the financial system”.

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.

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 assets. Now even the security of government bonds can no longer be taken for granted.

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

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 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 (as in the old Soviet Union), then again, overall production, and thus output and potential prosperity, will be reduced. 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.

Industrial Development Banking can create jobs and economic growth; and by requiring the highest standards of product and service quality can increase competitiveness, and the high level of productivity which alone creates real and lasting prosperity.