The Establishment of a new 'Australian Development Bank'

This submission to your commission of enquiry relates to the funding and financing mechanism of infrastructure projects.

Definition – "National Development bank - is a finance institution, created by a country's government that provides financing for the purposes of economic development of the country."[1]

This idea is the establishment of a new Government owned and managed Australian development bank is not new. It has been enacted by many governments and countries around the world. Notable development banks around the world include;

1. African development Bank[2]
2. Asian Development Bank[3]
3. Islamic Development Bank[4] and;
4. China Development Bank[5]

A development bank can be created at a federal, state level of government and affords a significant lending to be made available to industry for the conduct of national infrastructure projects, however without needing to expand the national debt to match. This is why development banks are a common feature of many developing countries.

The development bank has the ability to issue new loans, against a smaller quantity of capital held in reserve. The development bank operates as a 'force multiplier' for the initial capital deposited, making a greater quantity of lending available than that which is in deposit. This method of expansion in lending, against a smaller initial 'reserve' is known as 'fractional reserve banking'[6].

This of course has many benefits, namely the lower amount of capital raising which is needed in the Australian Government bond market, along with the lower interest rates which are applicable from fewer bond sales being required.

Benefits of an Australian Development Bank

- Large infrastructure projects able to be funded at a fraction of their actual cost;

- Government will not need to expand the national debt, to the equivalent level of spending from the projects which are funded.

- Interest payments to Australian government bond holders will be negligible for those funded projects. Only a small fraction of the reserve amount held in deposit would contain interest due to the bond holders.

- Industry and small business will have access to very low interest rate loans, spurring economic growth within the country.

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[1] *Source Wikipedia - http://en.wikipedia.org/wiki/Development_bank*
[2] *African Development Bank http://afdb.org*
[3] *Asian Development Bank http://adb.org*
[4] *Islamic Development Bank http://isdb.org*
[5] *China Development Bank http://www.cdb.cn/english/*
[6] *Source Wikipedia – Fractional Reserve Banking http://en.wikipedia.org/wiki/Fractional_reserve_banking*

- The national debt could be contained at a low level, without having to issue a large quantity of new government bonds.

- Economic activity resulting from infrastructure projects will flow through to the economy and increase the availability of employment for skilled and unskilled workers alike.

Steps required to create an Australian Development Bank;

1. Through Acts of Parliament, establish a newly created development bank, as a 100% Government owned entity. With all shares of the development bank owned by the Commonwealth of Australia;

2. Grant the new ‘development bank’ entity a banking license. This affords the ability to expand the amount of lending which is available under ‘fractional reserve banking’.

3. Implement legislative instruments that outlaw the sale or disposal /outsourcing of the development bank as an entity. This ensures the development bank remains a government asset for the benefit of the nation.

4. Government to provide a nominal issuance of currency to be held as the ‘reserve’ requirement against projects to be funded.

5. Set the Lending to Valuation Ratio(LVR) for the reserve requirement lending at a competitive rate, suggested %90 LVR, which will permit large projects to be funded;

6. Set the interest rates for any lending at a heavily discounted rate, significant enough to cover the operational costs of the development bank itself as a separate entity, but also lower than a commercially available rate.

7. Actively seek applications for lending on infrastructure, dependent upon the government of the days priorities, and then issue new investment loans at a low interest rate;

Potential capital raising methods for Infrastructure projects;

1. *<u>Consolidated revenue spending;</u>*

When purchasing infrastructure projects directly with consolidated revenue, if an outstanding deficit is in place, the government is required to raise all of the capital required through the Australian bond market. This in turn requires the payment of the equivalent market interest rate to the bond holder. Therefore the repayment of the bond holder is an additional cost that has to be factored into the infrastructure project and functions as a disincentive when deficit spending for large scale projects.

2. *Public Private Partnership (PPP)*

Under the PPP arrangement, a company seeking to construct a project on behalf of the Commonwealth needs to access funding from the private sector at a commercial interest rate. Under a PPP arrangement this means there is a large risk that is borne by both the PPP partner, the financier, and the project will need to achieve a rapid cost equalisation on commercial terms to deliver a profit into the future. This commercial aspect can be an impediment to certain types of infrastructure projects. Those projects which are not predicted to be as profitable by the private sector on commercial terms alone, may not attract the interest from the private sector.

3. *National Development Bank*

Under the model involving a national development bank, the government of the day, can set the priorities of the infrastructure that is required to be built during their term of office. The development bank can then provide access to either the government agencies, or the private sector with discounted lending, which has been made possible through the mechanism of fractional reserve banking. This will require a marginal contribution to the 'reserve' amount to be held, and allows the issuance of leveraged lending which is in excess of the 'reserve requirement'. Only the amount of the 'reserve' in this instance is required to be raised from the bond market. The amount of the lending issued is greater than the amount of bonds purchased.

Protecting the ownership of the new Development Bank from privatisation

The Australian government has previously been involved in the banking industry, through the Commonwealth Bank of Australia (CBA) and the National Australia Bank (NAB). Both these entities have since been privatised and sold as an ongoing interest. These banks are now listed on the Australian Stock Exchange, and are no longer a mechanism for the government to initiate large projects unless lending is provided on commercial terms.

Now with the consideration of a new development bank, is important that to maintain the operation of the bank in stimulating the economy delivering infrastructure projects for future generations. This requires that the development bank must remain 100% government owned. Legislation should be enacted upon creation, to prevent the sale, dissolution or disposal of the new entity the national development bank under all circumstances. This legislation should be enacted at the highest tier of legislative instruments, to ban any change of the ownership of the bank, prevent any rights from being transferred, and prevent any corporation, or private individual from gaining interest, control, operation, or proceeds of the development bank.

Recommendation

It is recommended that the Australian Government should immediately establish a new national development bank for the financing of large infrastructure projects. This will provide access to cost efficient financial lending arrangements, without having to expand the country's national debt to match.