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Opening Remarks

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We meet at an extraordinary time. This year's collapse of financial markets around the world has pushed the global economy to the brink of the abyss. For the first time in my lifetime, people are tempted to use the "D word" in a contemporary way and not just in the historical. The downdraft created by the financial crisis has spawned massive efforts by governments and central banks to stop the downward spiral. The Federal Reserve is now in markets for commercial paper, insurance, student loans, credit cards, not to mention its usual and customary focus on preventing disorderly bank failures. Citigroup, one of the world's largest banks, is the most recent target of large Fed action.

I grew up on a farm, with parents and grandparents who had vivid memories of the Great Depression. My father would tell me about attending farm foreclosure auctions as a teenager in the 1930s, when all the neighbors would show up with pitch forks and discourage anyone from bidding save the farmer going broke. My grandfather remembered long lines snaking around the corner as people tried to get their money out of banks. With that memory etched in his memory, his whole life he kept a few spare 20 dollar bills under the canned peaches in the cellar.

Yes, the times are different today, but there are disturbing echoes of the one my Grandfather knew. Confidence is in short supply. A decade of economic euphoria and wealth creation has given way to gloom and evaporating net worth. The numbers on the amount of wealth lost are staggering. Since the start of this year, more than $21 trillion in wealth has disappeared on global stock exchanges, nearly $6 trillion in the US alone. That drop is matched by another $6 trillion loss of real estate wealth in the US, with even more around the globe.

Governments are pulling out all the stops—and some they did not even know existed—in a frantic bid to prevent the global economy from sliding deeper into recession and/or deflation. Huge stimulus packages are taking wing in our respective capitals. In the United States, this package corresponds, of course, with the arrival of our new president. No one knows the full extent of the stimulus package, but some current estimates top $600 billion. If such projections hold true, the size of this package could eclipse what the US spent on WWII, even in inflation-adjusted terms.

As an economist, I can only describe this current policy era as Lord Maynard Keynes risen from the dead. I spent many hours in graduate school studying his famous text, *The*

General Theory. Though his work fell out of favor for a time, the world will now be conducting far more fiscal policy experiments and far bigger ones than he could ever have imagined.

The financial crisis shines a powerful light on the work of this committee, and comes at an especially propitious time in our life. For many years now, we have worked hard to show that central governments can spark stronger economic growth with fewer public dollars, euros, or yen if they invest in helping every region of their nation seize its unique economic potential. We have worked equally hard to help policymakers understand that this focus will not come easy, requiring as it does to relinquish a long legacy of single-minded emphasis on sectors and subsidies. While this policy battle is still quite young, we have made surprising strides, with a rich panoply of regional policy experiments to point to around the world. Even more encouraging, emerging economies like China are eager to learn more about this fresh approach to economic progress, a point underscored yesterday in a fascinating review of China's rural policy.

Today's financial crisis is an awful time for our friends, our families, and our neighbors the world over. But it also represents a golden moment for this committee to seize. We are headed into one of the biggest periods of fiscal stimulus any of us will ever see. The dollars, the euros, the yen, the yuan, the pesos—they will all be spent, quickly and massively. The question before is not how much will be spent, not when it will be spent, but *how* it will be spent. We have an incredible opportunity to inform the answer to this critical question.

Last week, president-elect Obama held news conferences three straight days announcing his new economic team. I believe he chose a superb team, including a public servant that I hold in the highest esteem from my career at the Federal Reserve—Paul Volcker. During one of those news events, Mr. Obama was asked what his priorities will be in the new fiscal stimulus package. His answer was so prescient that I wrote it down: *We will have a new way of doing business. We will invest in projects that have the biggest bang for the buck in the American economy.*

His words define the incredible opportunity now facing the TDPC. We have an opportunity to help identify which public investments will best power our national economies. This is an opportunity we must not let pass.

Which public investments will have the biggest bang? This question brings new focus to preparations for the March Ministerial meeting we will discuss today. It also challenges us with new urgency to bring forward fresh advice on the overriding economic question of our day, drawing on our rich reservoir of prior achievement and augmenting it where necessary.

In my opinion, there are four critical issues on which we must marshal our best policy advice in weeks and months to come:

- *Prioritizing public investments across regions*. We must put high priority on the discussions we began in Rome in mid-2007 on this topic. We already have a firm grasp on the types of tools necessary to craft sound strategies founded on regional competitiveness. We must be more clear, however, on just how important such strategies are in producing an even more powerful result for public policy—priorities for public investment, region by region. We all know that creating such priorities from the bottom up will yield the biggest payoff for taxpayers. Yet the urgency of the financial crisis is such that we run the very real risk of seeing huge public spending programs that are one-size-fits-all, and not aligned with the competitive advantage of respective regions. We must have both a sound argument and a ready arsenal of tools to analyze investment priorities if we are to seize this opportunity. We have the argument, though it can be stated more forcefully, I think. We have begun work on the investment analysis tools, but we must go further, and faster. How we best do this should be an item of serious discussion among the bureau and the committee over the next two days.

- *Re-designing the fiscal policy architecture*. The resurrection of Keynes could give new impetus to viewing economic policy as captive of our federal capitals. Yet we all know that economic policy is most robust when it is firmly rooted in the new balance between federal capitals and regional centers. This is a time when we must make the case for coordination between the two, not top-down spending with no regard for a vastly uneven regional landscape. It is also the time when we must make the case that the current economic downturn is the perfect time to invest in the capacity of regions to guide future investments. Sadly, we do not have the regional governance in our nations to provide quick answers to Mr. Obama's principle. Put another way, many regions do not know their public investment "ask." We need to make the case that such capacity is essential to sustained economic growth, and we must also bring forward sound and fresh ways of building this capacity. We have an incredibly rich base of experiments and knowledge on which to draw. But we must synthesize those findings into a cogent narrative that will compel the uninitiated. The Ministerial is a perfect platform to do this, but it may be too late. More on that in a moment.

- *Re-regulating financial markets*. Fiscal stimulus will be the priority for coming months. But sooner or later, attention will pivot to financial market re-regulation. Elected officials and the public will want their pound of flesh from what they perceive as the culprit for the current mess. When that regulatory moment comes, we will be tempted to stay on the sidelines because we have not made financial markets a focus of our work. That would be a mistake in my opinion. A broad conclusion one could draw at this point of the crisis is that financial markets got too far removed from the economic activity they were financing. That is, derivatives markets developed in which it was possible to slice and dice an underlying financial asset into ever smaller pieces, and ship those pieces further and further away from the underlying asset. In the future, we will return to what we always knew but lost along the way: *financial markets work best when the linkage between financial institutions and the economic activity they fund is strong, direct, and transparent.*

At the regional level, there are at least three things we could bring to the looming regulatory discussion. First, regions need a mix of financial institutions, but at least some need to be owned within the region to encourage both risk-taking and local wealth creation. Second, in all regions, there will need to be good channels to bigger capital flows from financial markets. And third, in a more innovative, entrepreneurial economy, equity capital takes on much greater importance. This is a big challenge since regulatory and development policy have given preference to banks and other debt financing institutions for more than a century. These financial topics are not part of our current or prior work. We must think seriously about how to remedy this.

- *Placing a clear policy marker on regional innovation*. Fiscal stimulus mania has its place, especially compared with the alternative of sliding into the abyss. But we must help federal officials from themselves. We must gently remind that federal programs have a way of becoming firmly entrenched in our respective capitals. Everything we know about regional economic growth is that it is increasingly driven by innovation, the very opposite of central government ministries. Thus, we can and should be prepared to bring forward the critical importance of investing in regional innovation systems in this period of central government spending. If our respective nations want sustained economic gains, then the mechanisms that connect R&D with business growth will never be more important. We must draw on our budding knowledge of how regional innovation happens to propose a sound new set of programs aimed at creating fertile environments for innovation. We have made a lot of progress over the past year on this front, but we have much more work to do.

Finally, let me say a few words on the urgency of our contribution to an OECD wide initiative on the financial crisis. Under Deputy Secretary General Paduan's leadership, the OECD is crafting a new plan to help OECD countries identify best practice in responding to the financial crisis. Until yesterday, that plan was devoid of regional perspective. I'm happy to report both good news and bad news. The good news is that we held a very productive meeting with Mr. Paduan to make the case that fiscal stimulus, innovation, and financial regulation all have critical regional dimensions. He readily agreed with our arguments. The bad news is that he then immediately asked, "How soon can you do this?" We have some work to do.

In closing, the financial crisis has taken the wind out of many sails. But let it not be so for the TDPC. In an ironic way, the financial turmoil provides the perfect opportunity for us to tell the compelling story of regional policy and the dividends it pays to national economic growth and prosperity. We have done amazing work over the past nine years. The newfound interest in Keynesian stimulus shines a new light on the story we have to tell. The fact that our Ministerial meeting was already planned is surely serendipity. But our quest is about more than just serendipity. The Romans had the best phrase to describe where we find ourselves today. And recalling our very successful discussion begun in Rome 18 months ago on public investment priorities, I offer it to you in closing: *Carpe Diem!*