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The Way Ahead to Recovery

Editorial by
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LEEDing the way of out the crisis

The role of the OECD's programme on Local Economic and Employment Development (LEED) has always been to be the pathfinder. LEED has always been an innovator – not in the sense of technological innovation, but in the sense of innovating in public policies. The LEED programme was originally created as a way to encourage locally self-reliant responses to unemployment, based on the empowerment of people, on partnership, and on spreading a culture of entrepreneurship. And that is what we have done up till now. But this crisis is different from all the crises of the past. Today we are in uncharted territory. And when you do not know where you are going, there is no use resorting to the recipes of the past. You have to find your own way. So once again our role as pathfinder comes into its own. But the pathfinder is also someone who runs the risk of burning his fingers. And that is why in order to tackle properly this crisis we must not be afraid of burning our fingers. We need to seek out new ideas that have not been tried before. Otherwise we end up with the same responses – business as usual, one-size-fits-all and so on. But we know these quick fix solutions do not work. You cannot provide a single national response with the same criteria for everywhere. In order to extol the value of diversity, we need local responses and we need innovation in those responses.

One the main lessons of the LEED programme has always been that you should not copy or simply apply in one place the experience of another. You can draw inspiration from another city – but then you have to make your own effort. There is no easy off-the-shelf solution. You have to make a big effort to adapt ideas to your own local cultural, institutional and social frameworks. Otherwise any exchange or inspiration from best practice elsewhere is doomed to fail. And that is why LEED continues to do its work today with all the more relevance. Cities may all be different, but they still have to learn and adapt ideas from each other in these difficult times.

Local governments are going to be very important as we move out of the crisis. Ordinary people see their *national* governments on television, but their *local* governments they see on the street. And local governments are taking initiatives in a number of areas that are crucial like retaining jobs, skills upgrading and so on. They can also see how important it is to give breathing space to small business.

In this special issue of CFE Insight, we have had the fortune to be able to interview David Oser, Senior Vice-President for Investment, ShoreBank of Chicago, who gave a presentation at a special session of our Governing Board, the LEED Directing Committee, on 29 May. At that session, for the first time, we gathered together our national delegates and network of partners to report on the national and local responses to the crisis and discuss policy solutions. We also had the good fortune to interview Will Hutton, Chief Executive, The Work Foundation, Jordi William Carnes, Deputy Mayor of Barcelona and Greg Clark, Chair of our Forum on Development Agencies and Investment Strategies, at a joint LEED Programme-Work Foundation conference, *Local Responses to a Global Crisis: international strategies for recovery,* in London last July. They have shared their insights on the crisis here and helped to demonstrate how the LEED approach works on the ground.

I hope you find this special issue of CFE Insight to be both an enjoyable and useful read. ■

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>>> Making the most of the crisis

Interview with Will Hutton, Chief Executive, The Work Foundation

You have stated that the world which emerges from the crisis will be very different from what went before. In what ways?

The five years from 2002 to 2007 were a very extraordinary period in national and international life. Just one statistic will give you a picture. At the beginning of that period, there were absolutely no securitised assets or collateralised debt obligations – the new financial tools. By the end of the period, growth went from 10 to 23 trillion dollars. The credit that flowed from that, and the things that happened as a result of that – these things are not going to happen again over the next five years. Looking ahead to the years from 2009 to 2014, it is clear that people's priority will be paying off their debts. That includes both households and businesses. So I think it is going to be a very constrained time. And the growth that's going to come will come from innovation.

That brings us to the next question. What will it be that brings us out of this slough of despond?

I am not sure I like being the author of a prediction about a 'slough of despond'. What we can say is that at least it's not going to be another great 'depression'. The world has been through periods like this and survived: we will get through. But in my view, what has driven the wealth generation process since the industrial revolution has been the great innovations and the spin-offs of the great innovations. And I think again that they are going to be the driver of the growth process today. I think that is where growth is going to come from.

Enlarge on that. Where exactly?

I think we will see inventions as substantial as the Internet, the internal combustion engine, the personal computer or the mobile telephone. We will see inventions which are as potent as these, escalating in number over the next 10 or 15 years. I think we will see inventions that dramatically lower the use of fossil fuels, that dramatically increase the efficiency of engines. I think we will see inventions that massively lower carbon emissions, that will allow us to store nuclear waste safely. I think we will see inventions that radically change the way people consume health – that allow pre-emptive health interventions. I think we'll see radical inventions in communications. There'll be a cascade of extraordinary invention and innovation, and all these will allow new business opportunities and create wealth and jobs.

It's what you call the knowledge economy?

Yes, I call it the knowledge economy. The knowledge economy has been growing, incubating for 20 or 30 years now. The knowledge economy is the interaction between this accelerating capacity to innovate and invent, with an accelerating capacity to be an early adopter of that innovation. Rich, well-paid, discerning consumers and businesses are early adopters. So the interaction between innovation-driven supply and innovation-adopting demand is the knowledge economy. And it's going to grow more intense, and create jobs, and get us out of this recession.

You mentioned renewable energy – is that going to play a large part?

There are several difficulties about renewables. One is that wind is very variable, and tide happens twice a day — and not when you need the electricity. Also electricity can't be stored. So we need technologies that will allow us to store electricity and get the power cheaply. People think that because the tide is free and the wind is free, then the energy produced is cheap. Wrong. The energy produced is astonishingly expensive and astonishingly difficult to use in a grid. So what we need is innovation to give us the capacity to have renewables. I am sure it will happen. It's going to cost a lot of money, but it will create a lot of jobs and it will happen. But it will not happen easily.

Focussing now on the role of local government and cities: you mentioned the 'spatial' element in recovery – the idea that recovery will happen quickest in places with the right mix of elements. How does that work?

Well, the knowledge economy doesn't exist in thin air. It happens in a place, in a city. From the industrial revolution on, what drove innovation and wealth generation tended to incubate in cities. And in a particular kind of city. These were open cities. They were cities that had a matrix of what I call — following Douglas Nort, the great economic historian – 'open access institutions'. You need universities, newspapers, scientific laboratories, law courts, instruments of accountability, instruments of debate, places where people have the chance to try out ideas that might fail. That has to sit in conjunction with vibrant markets. And markets which are following the profit motive need the accountability provided by that whole network of institutions. And that all takes place in a city. I regard the knowledge city or 'ideopolis' as the locus for growth in the next 20 or 30 years. We know where they are in America. You can see them – places like New York, San Francisco. You can see them too in Europe, for example in London, Helsinki or to a lesser extent Munich, Venice, Milan. These are the kind of cities which are growth poles built around the knowledge economy. It's not just about having men in white coats running around in laboratories. It is an institutional matrix interacting with capitalism in a spatial place which is hosting the right mix of institutions. And the job of city leadership is to understand what a city's particular advantages are, and go out and build those institutions where they are lacking.

One example is banks – the loss of banking capacity could be replaced by local banks with greater involvement in the local community.

Exactly. I think the concentration of banking has now gone too far. I agree with the European Commission and the Governor of the Bank of England and other commentators who say that we cannot have banks that are 'too big to fail'. If a bank is too big to fail, it's simply too big. We have to break these banks up, or think about breaking them up. They certainly can't get any larger. And we have to introduce genuine competition. And the important point is that banks are formed in cities. So we need a kind of renaissance of city banking. It needs to have specialist skills for the knowledge economy. It needs to be locally grounded so it can build relationships and know people. We need to compete against this transactional banking in which people do not own relationships and everything is just for sale and nothing is for the long term. We need banks that are grounded in community, that understand the entrepreneurs they are lending to, understand the sectors in their area that are strong, and have a stake in the growth of that city and the companies in that city.

So is local government going to be the driver for the economic renaissance?

Yes. Local leaderships — and around them local businesses and financial elites and creative and cultural elites — are plainly going to have to lead our cities. And you cannot lead anywhere unless there is a political focal point, and that has to be the mayor or leader of the city council. Up till now city leaderships have been slightly defensive, very administrative in tone — certainly in the UK but in other OECD countries as well. What we need now are proactive, entrepreneurial leaders who take pride in city leadership. ■

How is the crisis affecting the smaller community banks? <<<

Interview with David Oser, Senior Vice-President for Investment, Shorebank of Chicago

Founded in 1972, ShoreBank describes itself as a pioneer in community development. It was originally created to help poorer groups – especially African-Americans – get access to credit for homes and businesses. ShoreBank also has an international branch operating in several countries in the developing world.

What has been the impact of the financial and economic crisis on small community banks like your own, and on the people you serve?

First let me say that the government has absolutely made the right decision by doing everything it can to keep the large banks in operation. Their failure would have been catastrophic for the whole world's economy. But if you start looking at the impact on real people – people who are struggling to keep their jobs, who have mortgages that are difficult for them to pay off – then that is where the smaller banks like ShoreBank come into the picture. These problems can only be resolved household by household, and that is our speciality. The problems we face are going to take a very long time to get resolved. At the end of May the delinquency statistics for the first quarter of 2009 were released. They show that in the United States at this moment, 12 percent of mortgages are either delinquent or in foreclosure. Of what are called sub-prime mortgages, the figure goes up to 25 percent. We are also in a situation where unemployment will remain on the increase. They're setting records week after week for the number of people collecting unemployment benefit. It's edging up to seven million, and the rate will continue to grow. There's been some euphoria recently with people saying we are coming to the end of the recession. Technically, that may be true – but it doesn't really help. It only means that the economy has stopped falling. But if you have a quarter where the economy loses 4 ½ percent, then another when it loses 6 ½ percent, and then it grows by 0.2 of a percent, then sure you are technically out of recession. But it doesn't help the person in the street.

Is a smaller bank like yours more or less exposed than the big institutions to the problem of delinquent mortgages?

That's a very interesting question. This crisis started as a financial crisis among the very large institutions which had bought and securitised sub-prime loans. Back in 2007 most smaller community banks like ours were saying to themselves that this was not our problem – we hadn't made these loans, so we didn't have anything to worry about. It was perfectly true that smaller banks in general did not make that kind of loan. They made responsible loans by and large, and they knew their borrowers by and large. But to say that they were not going to be affected was very short-sighted and proved to be completely untrue. The reason is that the delinquency and foreclosure of loans is a phenomenon that affects an entire neighbourhood. You personally might not have taken out a loan you couldn't afford on a house that was vastly overvalued. But if your neighbour did and if he cannot pay, and if his home is then foreclosed on, that directly affects the value of your home. Then as the housing industry slumps, more jobs are lost, and maybe you end up losing your job. And the whole situation snowballs. That's where we are now.

But on the other hand smaller banks are not getting any of the government help that the big banks are. That presumably is because you are not — as they say — too big to fail.

Exactly. I think the term 'too big to fail' is shorthand for 'too complex and too systemically important to fail'. It's not simply size. It is also because of the way the work of the big institutions is tied into the whole financial system. Again let me be clear– I am delighted that the large banks have been helped. But the fact is that we, the small banks, have not been. And the situation we face is potentially dire. Let me use an analogy. Think of the general economy of the United States as operating at a certain level. The low and middle income communities meanwhile, particularly the urban communities, also function on a pretty stable level – but that level is lower than the general level. That lower level is like a constant mild recession. Now when the general economy itself goes into a mild recession and turns down, it doesn't really affect those poorer communities because they are already there. But that is not the case today. Today there is a huge economic crisis. And this time even the lower level is being dragged down. This is what is happening to our communities.

Is there a risk of banks like yours going under?

Of course. There are risks in any bank, in any business. Any of them can fail. There are no sacred cows. ShoreBank has advantages in having a very loyal ownership structure that's committed to the work we are doing. But our delinquency rate has increased. Our problem loans have increased. We are part of the economy of our neighbourhoods, and that economy is suffering.

Can the big banks learn something from the small banks? After all, you are receiving plaudits nowadays for having kept a sense of proportion and for staying in touch with the people you serve. When a new model emerges after the crisis, will all banks look more like yours?

It would be nice to think so, but let me make one thing clear. Banks in general – small or large – simply do not have the balance-sheet to carry all the credit demand that is out there. Back in the old days everyone kept their money on deposit in banks. But that doesn't happen any more. There are money market funds, there are mutual funds of all kinds, there are all sorts of alternative investments. And people save less. What that means is that no bank can fund the full amount of credit demand that it faces. So securitisation is critical. In the US, in order to get all the mortgages funded that need to be funded, all the car loans, all the home equity loans — there has to be a vibrant securitisation market. International investors have to buy that paper. But since the crisis started, they are not. The market has dried up. The only securitisation that is getting done today is government-guaranteed. In the middle of August 2007 the market simply stopped. It was like a faucet that gets clogged up. There used to be a torrent coming through and now it's just a drop every couple of days. However that market has to come back if we are to meet the credit demand that is out there. For better or worse, what our government has said is that for the US to get back on track, people have to be able to borrow money. Now you may say: wouldn't we all be better off if we just saved as much as we could. Well, on an individual basis you are probably right. Thrift is a virtue, right? But systemically the US economy runs on consumer spending, and consumer spending runs on consumer debt. I am not making a value judgment. That is just how it works.

So you're saying that even if your model embodies all the proper values, there will always be a need for the large institutions as well.

That's right. What we are able to do works very well on a local scale. It is the right way to work on a local scale – really knowing the people you do business with, really knowing your borrowers, really knowing the community, really working to revitalise the community. In our case we work in low and middle income communities. But it applies everywhere – even the most affluent communities need banks that understand them. However looking systemically at the US as a whole, the securitisation market is absolutely critical.

ShoreBank has interests and experience around the world. What has the crisis taught you about how banking needs to develop globally?

It is a huge question. Right now every financial institution is saying to itself: when this is over we are going to sit down and figure out what went wrong, what we should have done differently, what we should have known ahead of time, and what were the things we didn't see. Whenever something bad like this happens, we are like turtles: we want to pull our heads in and stick to the things we know. We don't want to try new things that could get us into trouble. But I don't think that is the long-term answer. You've got to keep experimenting, trying new things. For us, and for many other institutions, learning lessons about how to operate in the future will be an interesting and critical piece of work. It will cause many institutions to change — at least for a while. But the task of learning those lessons will be slow. The picture needs to clarify. My own feeling is that if we are able to start drawing conclusions in 2010, we'll be lucky. ■

Emerging successfully from the crisis: <<< how to learn from each other

Interview with Jordi William Carrnes, Deputy Mayor of Barcelona

The theme of this seminar is how regions and cities can emerge successfully from the economic crisis. How badly hit has Barcelona been?

It is true that the crisis is affecting most cities and in Spain it has been pretty bad, especially in those areas which were heavily involved in real estate. However Barcelona did not have a big boom in real estate during the so-called 'glory' days of the Spanish property market. So in that sense we have not suffered quite as much as other parts of Spain. We have a more diversified economy and we never had as much actual land to offer to the real estate developers. So I would say we are three or four points lower than other cities in Spain in terms of the negative impact on employment. We are working on a more diversified basis.

What are you concentrating on now as you try to steer a way clear of the downturn?

We are focussing a lot on services, education, health and so on. Also there is a certain amount of industry: the food sector, chemistry and cars, with the move to the new electric vehicles. And tourism and retail. These are the main areas. In terms of Barcelona's gross domestic product, real estate was just five percent, so it was not much in comparison with other areas. So we are coping relatively well.

What can cities like Barcelona teach other cities, or indeed learn from other cities. And how does the LEED programe help that process of exchange?

The LEED programme is a good platform above all because there is no requirement to come to any formal kind of resolution. When institutions or governments come together to seek that kind of formal resolution, it is always complicated. Because realities are very different. Each country and each territory knows better than the others what it needs and what it can offer to its citizens. In Barcelona, we are working on three main dimensions: economic dynamism – in other words trying to encourage all the economic projects and processes that the city contains. Then secondly, social cohesion – in other words, we do not want to leave parts of territory to be abandoned or to fall behind the rest. We need to work in education, work in healthcare. And third, permanent urban transformation – improving and implementing new projects that will lead Barcelona to an outstanding position in terms of all the necessary infrastructure, the port and airport and so on.

How does working with the LEED programme help?

I would say quite a lot. With LEED we exchange experiences with UK cities or with South African or Canadian or Asian cities. We are in a global market so hearing experiences from other cultures and linguistic backgrounds and institutional frameworks – it all helps. There is perhaps always a tendency for a local government to think that its system is the best. But then you share that experience with an administration from Italy or the UK – and it is useful because you realise that there are other ways of tackling youth unemployment or the recovery or whatever. If we went through a formal institution like the European Commission or the European Parliament, I won't say we would get lost, but so much time is used up trying to reach a formal resolution. And in the end you can't come to a formal resolution because cities are different, each city is proud of itself, and it needs its own strategy. You can share, you can understand, you can explain, but in the end you have to do it on your own.

Is there a sort of 'tool-kit' out of which local governments can choose solutions.

Everyone is talking about the crisis, and the credit crunch and what financial systems have to do. But in the end the crisis affects citizens and it affects territories. And each territory is going to adopt a solution according to its possibilities. So knowing your strengths and weaknesses is a vital exercise. It's not a question of being hyper-critical, but of knowing what you can do and how you can improve — and the LEED programme provides a lot of help to achieve just that. ■

>>> The role of local government in helping to achieve global recovery

Interview with Greg Clark, Advisor at the UK Department of Communities and Local Government and Chair of the OECD LEED Forum on Development Agencies and Investment Strategies

What would you say is going to be the role of local government in bringing the world out of the current economic impasse?

Let me start by saying that there are four things that local government can do as a rule. One, it represents local people; two, it provides local services; three, it regulates the local environment. And fourthly – and this one is not often thought about – it is in charge of the *future* of the place. This fourth dimension is about investment, it's about development, it's about the economy, and it is about vision. The difference between these four roles is that the first three are provided for, and with, *citizens* inside a defined geography. The fourth one involves working with all sorts of other actors — with businesses, institutions, investors, higher tiers of government. It involves being in markets, not just providing services. And it's *that* role of local government that is really going to grow as a result of this crisis and this recession. The reason is this: in the last cycle lots of local economies began to copy each other as a way of seeking economic success, there was a race to the centre, where many local strategies began to look rather similar. All of them began to develop, for example, new hotels in the same location, or city centre living, or the same kinds of retailers. But in the next cycle what is going to matter is local *distinctiveness*, not similarity. New distinctive economic roles, distinctive economic strategies at the local level – these are required as a result of the crisis and they are things that cannot be provided by national government. They have to be provided by local government, bringing the various strands and stakeholders together. So I think the role of local government coming out of this crisis will be to make localities more different and distinctive— not to make them the same. Local economies have to focus on fashioning unique futures and identities in order to make and attract investment.

Have you noticed this "distinctiveness" already apparent in the ways local governments are coping with the immediate effects of the crisis?

As I mentioned, in the last cycle just before the big bust, local governments began to copy each other in terms of what they tried to attract – which explains why we had this 'same town' problem going on. But now, what local governments have realised is that because, for example, financial services are not going to be the same big employer that they used to be, and because access to mortgage capital will not work in exactly the same way to support the housing market, and because generic expansion in the public sector is not going to go on for ever (and indeed a sharp cut in public investment will happen in some countries) – because of all these reasons, local and regional governments have got to focus on the things that constitute their unique competitive advantages. So local leaders have to begin to understand and appreciate different factors – such as the history of their place, their unique assets and entrepreneurs, and the talents that they have. And they have to build around what they have got, and not around what a national economy or a global economy is going to deliver them. And that is exactly what is happening right now. In the 41 places we've reviewed for the OECD LEED Report on the Crisis, local leaders are already saying to themselves — look , in the future we cannot rely on a rising tide to raise all of the ships; we have to make sure that our boat has its own engine. And they are focussed very much on this.

So it's not just a question of publicising programmes that work and of these being copied from city to city – it's a different kind of learning process?

Well, that is a good way of putting it. It is about *learning* and not *copying*. Copying doesn't work because the unique assets and opportunities, and the institutional frameworks and local dynamics vary from one place to another. We must focus on local innovation just as much as we focus on national policy, and we should judge national policy by whether or not it promotes local difference, local distinctiveness and innovation. We should use other places to inspire us, not just to give us ready-made answers. And I think that encouraging all of this is very much the role of OECD LEED.

One of your ten recommendations for local leaderships: 'The Barcelona Principles*' is: don't waste the crisis. Because you can see it in a positive light as well.

Absolutely, and you may be surprised to discover that many local leaders are already seeing it in a positive way. Let me say why that is. I think there are three reasons. On the one hand, local governments and local economies suffer right now from terrible *coordination failures*: too many bodies doing too many things in too many different ways, duplication, gaps, a lack or prioritisation, and everything else. The crisis provides a very compelling rationale to change the way they are organised to make it more efficient, simple and effective. So I do foresee institutional reform happening at the local level.

The second point is that local economies also suffer from *market* failures. We know that. Coordination failures are always attended by *market failures*. So the current moment is an opportunity for local authorities to start talking differently to business, to start thinking about what are the real incentives for investment, for employment, for talent to come to them, and to generate strategies that are really focussed on correcting market failures — in other words not just falling blindly in with the market, which was what happened in the last period.

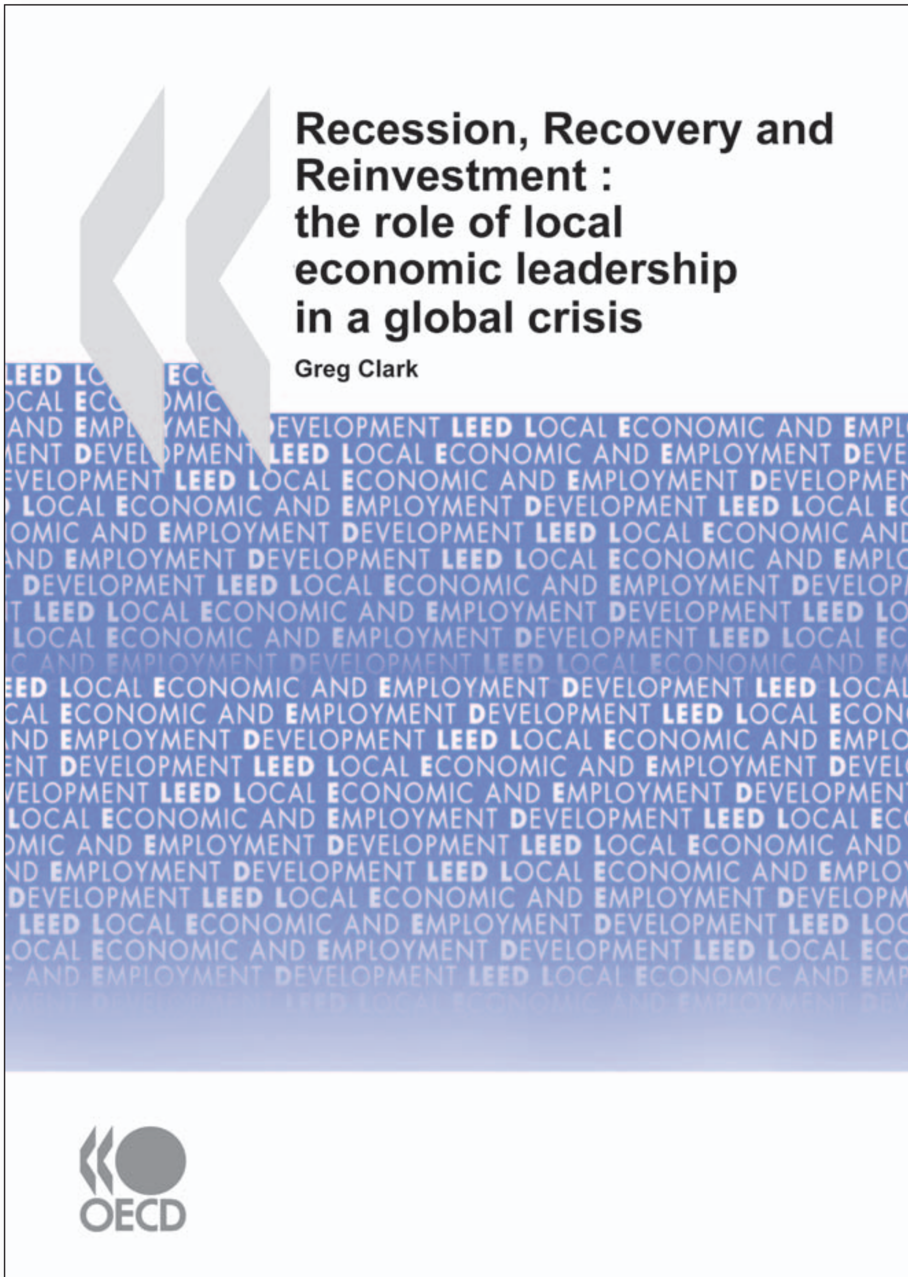
And then I think the third area is about giving more authority and more freedom to local government. The crisis provides compelling reasons for national governments to loosen up a little bit, and to appreciate that if they want this mosaic of locally distinctive economies – that is not going to come unless there is more freedom for local government to act. So in those three very important ways, it is essential not to waste this crisis. It is essential to say that although the last cycle was good, it was not *all* good — and we have got to make sure that the next cycle is better.

The crisis, in this sense, represents an opportunity for local government leaders to secure changes and take opportunities, that it might be difficult to achieve at any other time. ■

* Please see next page.

This report discusses the actions that forty one localities throughout the world have taken in response to the crisis, ranging from shorter-term concerns like unemployment and home repossessions to the longer-term concerns of securing more resilient local economies by analysing future patterns of trade and innovation. The report concludes with the ten "Barcelona Principles" drawn up at a workshop in Barcelona in March 2009 as a guide to local leaders that want to address economic performance by focusing attention back on the long-term drivers of prosperity and sustainability and the need to embrace innovation in local development. The Principles were endorsed by the 35 governments that sit on the LEED Directing Committee. The report and the Principles were launched at an international conference in London, Local Responses to a Global Crisis: international strategies for recover, in July 2009 in partnership with The Work Foundation.

The report can be downloaded at www.oecd.org/cfe/leed. ■



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