ECONOMIC DEVELOPMENT STRATEGIES IN TIMES OF MACROECONOMIC INSTABILITY

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"Advocates of the 'new economy' say the traditional economic cycle has been broken. There will be no more recessions. …. Much gives credence to those claims." McDonald, EETimes.com, March 20, 2000.

McDonald goes on to warn of a possible bursting of the bubble.

Macroeconomic Uncertainty

How did the Great Recession happen?

What will be the consequences?

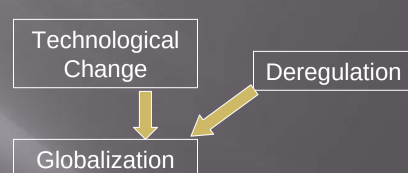
Two myths and realities

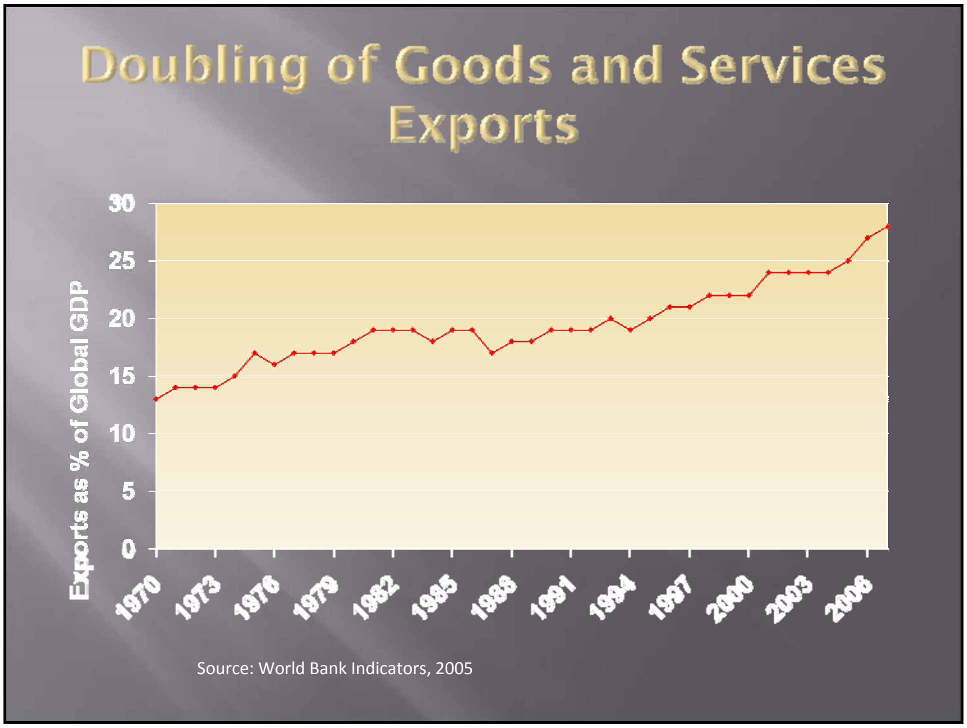
Four consequences for economic developers

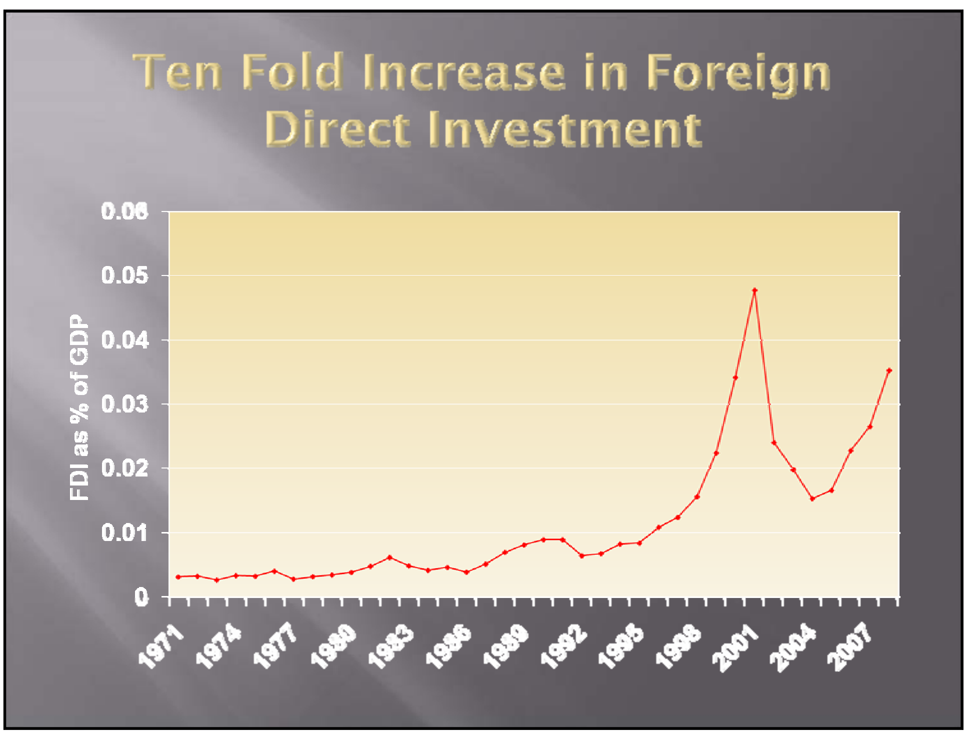
Conclusions

Overview of the recent Global Economic Crisis: How did it happen?

- Technological Change
- Deregulation
- Globalization
  - Increased trade
  - Restructuring of production
  - Rapid growth in Foreign Direct Investment (FDI)
  - Integration of the global economy

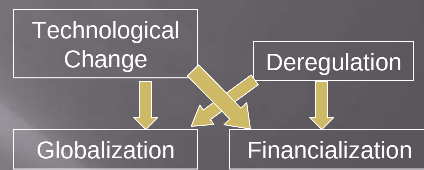



Doubling of Goods and Services Exports
Exports as % of Global GDP
0
5
10
15
20
25
30
1970
1973
1976
1979
1982
1985
1988
1991
1994
1997
2000
2003
2006
Source: World Bank Indicators, 2005

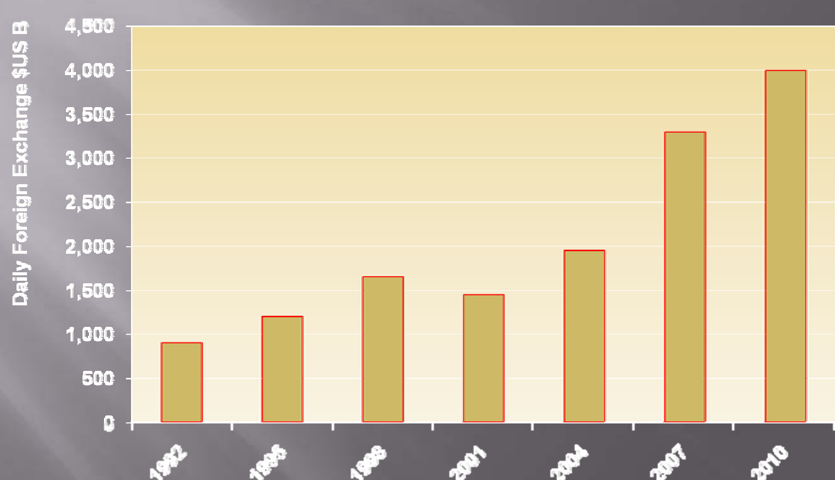

Ten Fold Increase in Foreign Direct Investment
FDI as % of GDP
0
0.01
0.02
0.03
0.04
0.05
0.06
1971
1974
1977
1980
1983
1986
1989
1992
1995
1998
2001
2004
2007

Overview of the Global Economic Crises: How did it happen?

- Financialization of the economy
  - Novel financial instruments designed to distribute and reduce risk exposure
  - Increased volumes of financial interactions
  - Low interest rates

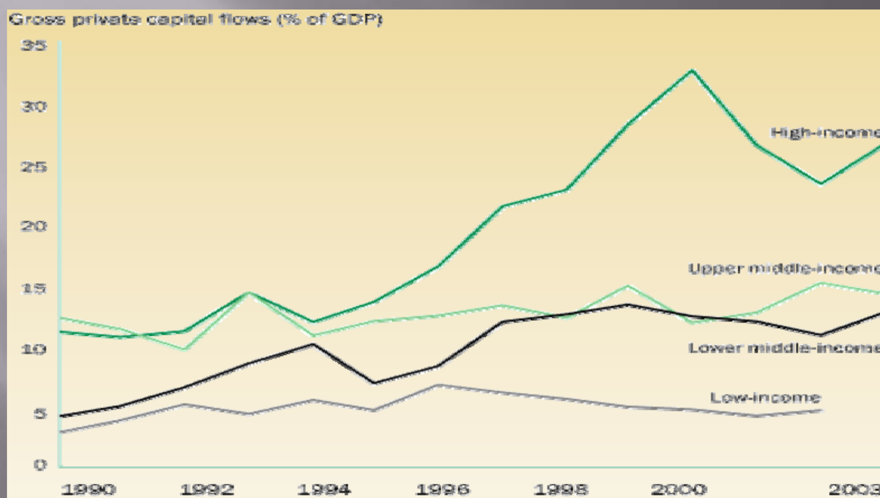


Daily Foreign Exchange Turnover, Billion $US



Source: Bank of International Settlements, Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in April, 1992 - 2010

Gross Private Capital Flows (% of GDP)



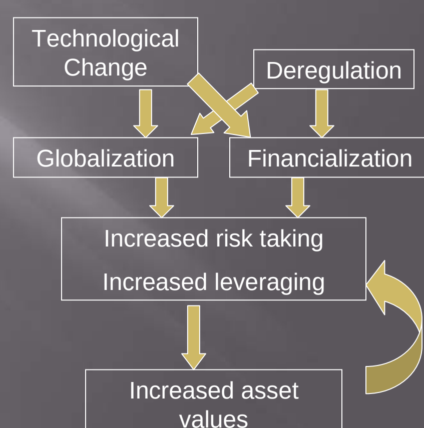
Source: World Development Indicators, 2005

Overview of the Global Economic Crises: How did it happen?

Consequences
- Growing appetite for risk
- Increased leveraging
- Increasing asset values based on expectations of asset appreciation
- Self reinforcing process

But unsustainable!

A classic bubble



Aftermath of Recession

- Private Sector
  - High unemployment
  - Stagnant or declining income
  - Reduced appetite for risk
- Public Sector
  - Reduced public revenues in the short and medium-run
  - High levels of public debt
  - Increases in short and medium-run demands for public expenditures
  - Increased levels of regulation

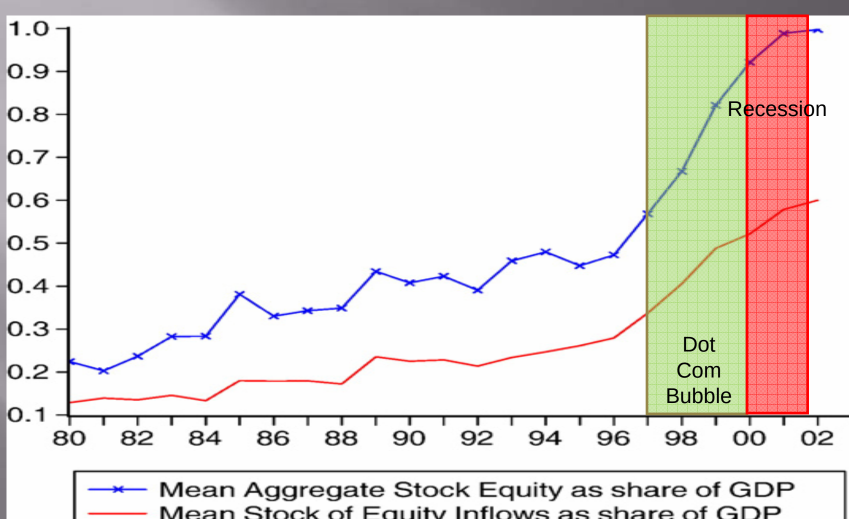
What have we learned from history?

- Savings & Loans bubble of the 1970s
- Commercial real estate bubble of the 1980s
- Farmland price bubble of the 1980s

What have we learned from history?

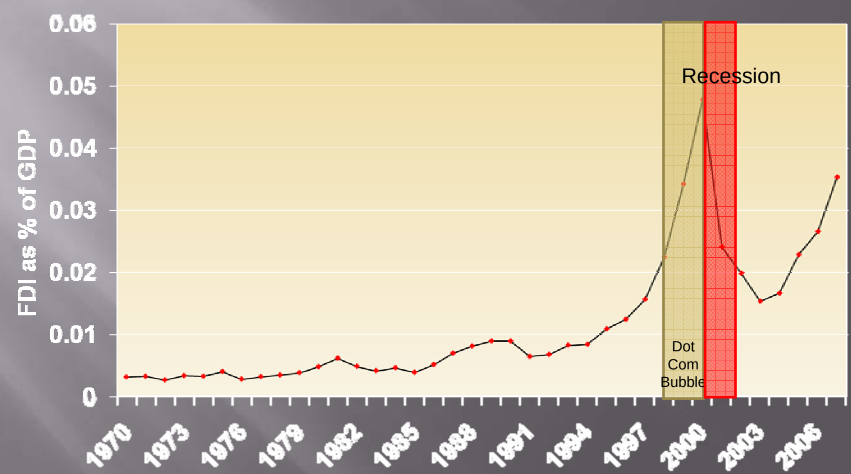
- Dot-com bubble is dated from about the beginning of 1997 to March 2000
- This was followed by a relatively short recession in 2000-2001
- Housing bubble of the early 2000's led to the Great Recession (December 2007 to mid-2009)

Stifling of Stock Values

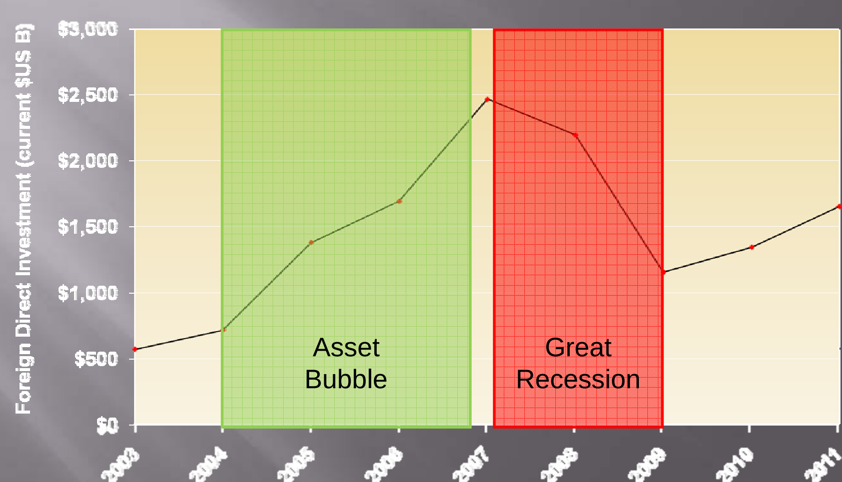


Source: Vo and Daly, Global Finance Journal,2007

Decline in Foreign Direct Investment

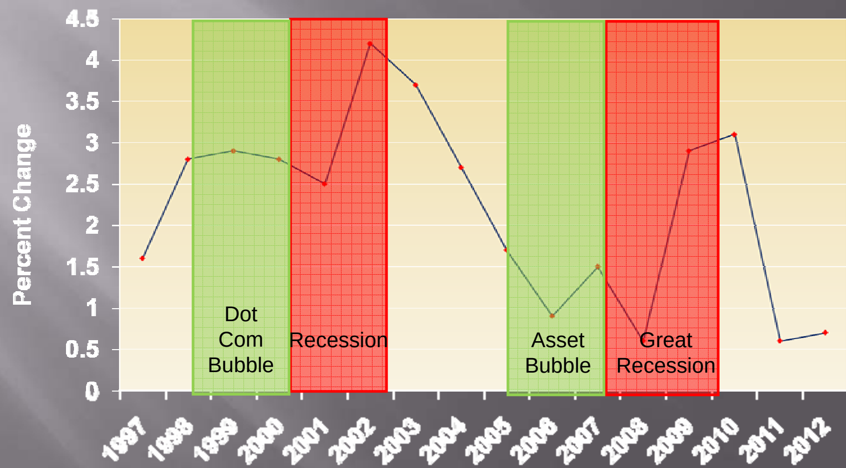


Global Foreign Direct Investment



Source: World Bank Indicators, 2013

Annual Percent Change in Non-farm Business Productivity, 1997 - 2012



Common Myths about Recessions

1. Recessions are temporary and reversible situations
2. Consumer spending will bounce back to pre-recession patterns when unemployment falls, and income levels and asset values recover

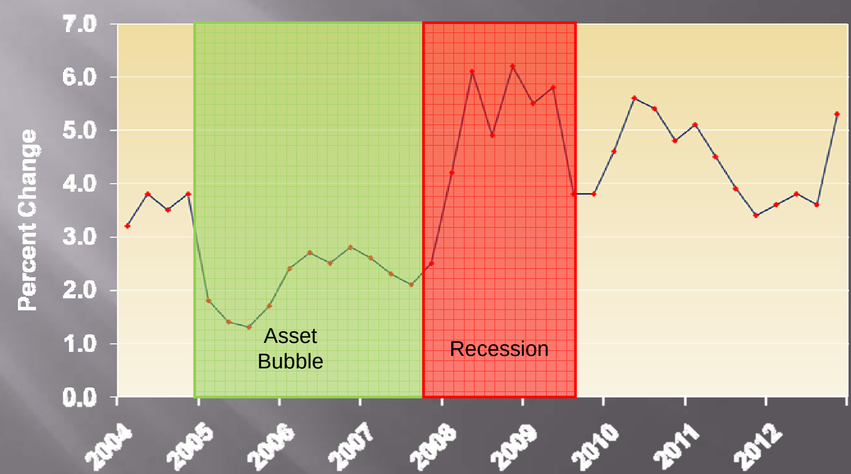
1. Reality: Deep Recessions Cause Irreversible change

- Development is a process of "creative destruction" (Schumpeter)
- Creative destruction is accelerated by the business cycle
- Destruction occurs during the down turn
- Creation occurs during the recovery

1. Reality: Deep Recessions Cause Irreversible change

- Productivity rises during and after recessions
- New entrepreneurs, new firms, new products, new jobs
- Fixed assets are freed-up and released to higher uses

Annual Percent Change in Non-farm Business Productivity, 1997 - 2012



1. Reality: Deep Recessions Cause Irreversible change

- Rising productivity is increasing the competitiveness of US industry, especially
  - those that demand high-skilled labor
  - Those that involve innovative products
- Economy is irreversibly changed!

2. Reality: Consumers May not Consume the Same Post-Recession

- There is a sense that consumerism is waning in the US (see for example, "Generation Y And Consumerism: Waning Interest In Car Ownership A Sign Of A Deeper Shift." Huffington Post, January 18, 2013.

2. Reality: Consumers May not Consume the Same After the Recession

- "In the 1990s and early 2000s…multi-family building accounted for about 10% to 20% of new building; today that number is at 60%" New Jersey Future.

- http://www.njfuture.org/2013/03/26/forum-housing/#sthash.oPrx7pAx.dpuf

2. Reality: Consumers May not Consume the Same After the Recession

- Savings rates have increased significantly even as income and assets have fallen, and despite very low interest rates.
- Local foods movement and home gardening rising
- Reducing carbon footprint a growing concern

Challenges for Economic Developers

A fundamental irony of macroeconomics is that what is good for the economy in the short-run is often bad for the economy in the long-run.

- Short-run:
  - Goal is to maintain or increase aggregate demand
  - Savings reduces demand
  - Consumption expands short-term growth

Challenges for Economic Developers

A fundamental irony of macroeconomics is that what is good for the economy in the short-run is often bad for the economy in the long-run.

- Long-run:
  - Goal is to increase productivity and productive capacity
  - High levels of consumption displace productive investment
  - Savings allows investment which creates long-term sustained economic growth.

Challenges for Economic Developers

1. To find pro-development, counter-cyclical strategies

- Short term economic goal is stability: stable demand (consumptions and investment)
- Long term goal is economic development: increased productivity and growing productive capacity

- Is it possible to do both?

Challenges for Economic Developers

- Pro-development counter-cyclical economic policy
  - Job creation should be the goal when unemployment is higher than structural equilibrium
  - Wealth creation should be the goal at all times
  - Economic slow-downs should be viewed as opportunities for productivity gains

Challenges for Economic Developers

- Pro-development counter-cyclical economic policy
  1. Automatic counter-cyclical mechanisms including predetermined lists of prioritized investments during economic slow-downs
  2. Stimulate demand with needed infrastructure, skills development, higher education, and research and development.
  3. Public spending should go down when revenues are strong and up as they weaken, leading to frequent budget surpluses.

Challenges for the Public Sector

2. To find new economic development strategies
   1. Entrepreneurship development and support
   2. Work force development (education and training)
   3. Wealth creation and retention
   4. Balance need for regulation and tax revenues with need for sound foundations and incentives for private investment

Challenges for the Public Sector

3. New fiscal foundations

- Old sources of revenue are unreliable
  - Sales taxes unstable and unfair
  - Internet sales often untaxed
  - Services untaxed
  - Property taxes unstable

Challenges for the Public Sector

3. New fiscal foundations

- Possible new revenues sources
  1. Internet and e-commerce taxation
  2. Expansion of taxes to services
  3. More use of instruments such as carbon taxes
  4. Public-private partnerships

Challenges for the Public Sector

4. New Types of Public Investments

- Expansion and improvement of new infrastructure (telecommunication, public transportation, research and education)
- Protection and maintenance of old infrastructure
- Investment in more resilience, adaptive infrastructure
- Place-based research and development

Conclusions
Challenges for Economic Developers

1. Economic development policy must be more strategic in the timing, types and location of public investments
2. Public revenues and expenditures systems must become pro-development and counter-cyclical
3. Policy assessment systems must replace jobs as its key metric with growth in productivity and wealth creation.

THANK YOU