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The next devolution

Policies for very local economics

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Thank you to Susan Kramer, Anna Sharkey and everyone else in the New Banking Project. This is the last report from that project, and we are hugely grateful for all the support also from our funders at the Joseph Rowntree Reform Trust Ltd, who made it all possible.

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Foreword

For the first months of 2014, we have been building on the work done by Susan Kramer and her team in the House of Lords, as part of the Liberal Voices project, organised by the Joseph Rowntree Reform Trust Ltd. This is the final publication from that project. It isn't in any sense a final report, but I hope it does fill a gap. If very local economic policy is the future- and I believe it is – then what policies should the political parties adopt to take us in that direction, to enable the shift to happen.

It certainly isn't exhaustive. There is a great deal of work still required, by the emerging ultra-micro economics sector and by others. But it does provide an indication of the direction of travel and I hope it informs debate in local economics circles – and for those far-sighted politicians who can see what is coming and what to find ways of facilitating the birth of an approach that might genuinely rebalancing the UK economy.

I hope it is useful.

David Boyle

Co-director, New Weather Institute

Chapter 1: Introduction

Perhaps the first attempt to explain the practicalities of helping neighbourhoods be more economically independent began with the Liberal Democrat policy proposals on local economics, set out in the document *Local Economies, Local Choice* in 2001.[1]

That was over a decade ago, and the process has moved on. We are that much more aware of the vulnerability that every neighbourhood has to the global downturns. That much was proved during the 2008 banking crash. We are that much more aware of how dependent the poorer areas are on government largesse or outside investment, neither of which seem likely at the moment.

We also know more about what the prize of an effective local economic agenda would mean. It would mean that neighbourhoods could be that much less dependent on outside supplication on the centre, if there were ways they could re-grow their economy using existing local resources. It would mean a potential answer to the great economic conundrum of the world – how to you help developing or sidelined communities, where the political and social flashpoints tend to be, to survive or thrive economically.

Solving the local economic problem will mean a potential way to underpin a genuine localism, which is not constantly undermined by the basic need for economic support, and which suddenly then becomes possible.

It is hard to overestimate the significance of solving the local economic question, if it is possible to do so – to find techniques of economic survival using local resources.

Let’s be clear about this. Nobody is claiming that existing resources – overstretched and desperate as they sometimes are – are ever going to make people wealthy. Nor are they going to be adequate for a neighbourhood to thrive. The question is: are there ways in which those non-monetary resources that everywhere with people has – wasted people, imagination, resources, buildings – can be turned into a sustainable income for local people.

The problem is, of course, that we are not there yet by any means. But compared to 2002, there is still confidence now that there is a fledgling local economics sector is clearly emerging, to wrestle with these questions. They are doing so on both sides of the Atlantic, in the shape of an emerging community banking sector, an emerging community energy sector, alongside an emerging community housing sector. There are new techniques using different kinds of money and there are techniques involving new methods of procurement and commissioning, all of which can potentially make the existing money go much further.

But there is also a gap between this emerging sector, resourceful, under-resourced and imaginative, and the mainstream world of economic policy which ignores it – unclear whether community economic techniques, the ultra-local economics sector, can ever scale up to make the impact that they need.

There may also be an element of economic snobbery about it. To economists trained in the old school, and in the conservative economic departments, ultra-local economics looks too much like plumbing. It wasn’t the high level strategic thinking the economic policy-makers imagined for themselves.

This report does not set out the case for ultra-local economics.[2] Nor does it set out the evidence for ultra-local economic techniques. That is available elsewhere.[3] Nor is it designed as an introduction to an emerging sector, which again is widely available elsewhere. What it does it to set out where the debate on policy has got to – and how it might be possible to construct a policy platform designed to revitalise local economies from the bottom up.

Chapter 2: The problem

Let's leave aside the underlying problems in the understanding of economics, which has in its mainstream form – at least as it is understood by policy-makers – tended to lag behind our understanding in other disciplines. That is for other reports. This section looks briefly at the problems which this ultra-local economics policy is attempting to tackle.

The central problem is so ubiquitous that it is hard to think of it as a solvable problem at all. It is that an increasing number of areas are dependent on central government grants and services and, when those fail to emerge, they are increasingly dependent on central government welfare. This is true in different ways all over the world. Clearly there will always be places that are poorer than others and no policy on earth seems capable of changing that. The question is whether there is anything else that can provide basic wealth, and – as far as ultra-micro economics is concerned – whether there are local assets in any given area which might be used, together with new economic techniques, to provide any area with a sustainable income.

That is the prize. But there are also a series of ways in which our collective failure to take on the ultra-micro economics agenda is damaging the poorest areas, and they can be summed up like this:

1. **Trickle down doesn't work**. That was a phrase of Bill Clinton's back in 1992 and it remains true today, yet mainstream policy has not yet gone beyond the idea that giving the wealthiest privileges in the system will create the wealth we need that trickle down to other

areas. It is clear to everyone except the most mainstream policy-makers that trickle down usually happens the other way around, and – if it does work geographically – it does so extremely slowly and fitfully. Our failure to face up to this basic problem, assuming that the only alternative to trickle down is some kind of welfare, has held back the most impoverished areas.

2. **Our financial institutions are the wrong shape**. They are designed to suit the biggest players and to operate at scale, but they are unable or unwilling to deal with the kind of local institutions that can make a genuine difference locally.

3. **Local government does not yet understand the local economics**. This is not true everywhere, and it is partly a result of the way local government has recruited people during the New Labour years – to follow standards and procedures and meet targets rather than to be innovative and entrepreneurial. But both the Treasury and many local authorities agree that economics is not really their business. This is extremely short-sighted and must change if we are to make places more economically independent.

4. **Poorer areas leak money faster than richer areas**. This is the central to the economic case for an ultra-micro economics, and it remains controversial in economic circles. The claim is based on research, mainly in the USA, which shows that richer and poorer areas may not necessarily differ in the money pouring in, but they do very much differ over how much money leaks out again without circulating. There is evidence that, in the poorest areas, money that is paid in via benefits tends to leak out again within 48 hours.

These are all ignored by mainstream economic policy-makers, and their failure to tackle this agenda effectively has embedded poverty as a geographical problem. It means that some places remain dependent on the centre, and are all the more so thanks to global trends. Where the coalition has made a difference is through the City Deals programmes, which encourage local economic innovation and draw down the power to carry out ambitious sustainable investment. The difficulty is that these most ambitious City Deals have had to be forced through the recalcitrant Whitehall bureaucracy, and this has encouraged cities to be less ambitious as a result.

Chapter 3: Solutions

There is now considerable evidence that ultra-local economic approaches can be effective, and that they are an important and neglected element of recovery. Most of the evidence comes from countries outside the UK, whether it is in the developing food economy of Vermont or the innovative community banking and parallel currency networks of Brazil.

There are perhaps four overarching propositions involved here:

1. There is money around, but not nearly enough institutions to invest locally and those which do exist are often too risk averse for growing local markets.

2. There are assets in communities – knowledge, skills resources, land and buildings – that can be harnessed to support local economic development.

3. There is money flowing through the local economy, but when there are few local enterprises and supply chains it tends to flow straight out again.

4. A sense of place, where all the economic levers belong and link together, underpins this approach.

Part of the problem we need to tackle is a misunderstanding at government level about scale. These solutions seem too small-scale, and they are in the sense that people doing up their own homes seemed a small-scale solution to regeneration – but it can be built up to a transformative scale. The first thing the next government needs to do is to open discussions with the ultra-local sector about how best to achieve this.

There is also a problem understanding how the various strands of ultra-local economics fit together in a practical policy. Clearly, if this is going to suit the needs of politicians, it does have to work as a coherent whole, if only to persuade voters and policy-makers that this is a serious policy, designed to shift poverty and deprivation and to rebalance the economy more effectively.

The different strands are as follows:

- Local enterprise
- Local banks
- Local energy
- Local money flows

Local enterprise

Across Europe, small and medium-sized businesses make up 99 per cent of all businesses and provide two-thirds of all private sector jobs. As many as six in ten new jobs are created by small enterprises too. Local entrepreneurs are the only people who can rebuild struggling local economies from the bottom up. Yet Whitehall's energy and imagination is more invested in the biggest businesses, and the needs of local entrepreneurs are too often ignored – and their energy wasted trying to work with public and private institutions designed to work for the biggest.

The coalition has gone further than previous governments to support small business, reducing red tape, encouraging employment and increasing competition in the banking sector. But too many institutions are still designed with big agencies or big companies in mind, which makes them hard to access for community enterprises and local entrepreneurs.

Lib Dems needs to make good on their proposal to launch a new approach called Small Business Zones (SBZs), which will set out areas where new businesses, co-ops and social enterprises are encouraged and where local spending can

kick-start a more diverse and robust local economy that will also boost local employment.

These new zones will be set up by partnerships between public institutions, such as local authorities, universities and hospitals. They will agree to transition part of the procurement budgets of the partners into regenerating the local economy, and commissioning some services from new local co-operatives, employing local people, by using powers in the Public Services (Social Value) Act 2012.

An effective local enterprise policy must also:

- Remove mandatory size limits for bids for public service contracts, and cancel local authority preferred supply lists for social care.

- Trial a new kind of institution that brings small business expertise together, with enterprise coaching, local mentoring and advice, and attached to local financial institutions and CDFIs, and with access also to small-scale, low rent business space.

- Make sure regeneration and other institutions are geared to dealing with small, local ventures (why should a community energy scheme pay the same £35,000 for planning permission as a big one?)

- Encourage LEPs to find more representation from people who understand the needs of smaller companies, locally owned companies and companies which have demonstrated a commitment to the local area through their supply chains and employment practices.

- Create a £100m community finance loan facility via the British Business Bank, to be lent on at low cost by credit unions and CDFIs to SMEs, social enterprises

and individual consumers denied access to mainstream credit and finance services.

- Agree an urgent national variation to the Basel lending regulations so that SME lending does not cost banks more than other lending.

Local banks

There is no doubt that the coalition has made progress making the big banks safer and to increase competition between them. But the UK's competitors and trading partners have powerful and diverse local banking systems that support small-scale enterprise, which the UK still lacks. Research also shows that co-operative and savings banks reduce the drain of capital from urban centres and foster regional equality because of their ability to lend to SMEs.[4]

The truth is that the big banks no longer want to fulfil the role of lending to small business or manufacturing directly. The truth is that increasing competition between the big banks, as proposed by Ed Miliband, will not in itself increase the diversity of the UK banking system. The lack of this effective local lending infrastructure puts our economy at a disadvantage, and makes our cities and regions too dependent on London.

An effective local policy must therefore build a new, diverse local banking system, including community banks and community development finance institutions (CDFIs). It must also explain how this will be done, which is that it must be funded by the big banks – as it is in the USA – setting out a basis under which they will pay for the infrastructure to lend in places and sectors where they are unable to lend themselves, based on their geographical lending data.

An effective local economics policy would also:

- Impose a duty on banking regulators to promote a diverse banking system in the UK, and a new market in alternative sources of finance for enterprise.

- Carve three more regional banks out of the struggling lending infrastructure of RBS, but keeping RBS in existence as a co-ordinating body.

- Provide a £100m community finance loan facility via the British Business Bank, to be lent on at low cost by credit unions and CDFIs to SMEs, social enterprises and individual consumers denied access to mainstream credit and finance services.

- Make available an off-the-peg basic regulatory and IT package to encourage new community banks, and a legal structure for co-operative banks, as there are in most European countries (the UK's Co-operative Bank was owned by a mutual but was not itself mutual).

- Set up a simple system of resolution to allow small banks to collapse safely if they take wrong decisions.

Local energy

As much as 99 per cent of UK energy is generated by just six companies. In itself, that explains some of the sclerosis in the energy market, and the stand-off between those who want green energy installations locally and those who don't. Why should they when the big generators get all the benefits?

The coalition's community energy strategy is an important step forward, but we are still a long way from the vision where every home, every building – even every lamp-post and road – generates its own energy, backed up by a grid – was set out in 2005 by Greenpeace UK.[5] One important way to achieve this is by making sure local people have an ownership stake in the way energy is generated – and can create an income stream out of that, which can have an important local

economic impact, providing a sustainable income for every area which generates energy.

Other northern European countries have been experimenting successfully with a different approach. Germany produces over 20 per cent of its electricity from renewable sources, with communities generating about a quarter of this. In the UK, less than one per cent of renewable electricity is generated by communities.[6]

But they are beginning to grow faster, in projects like Brixton Energy and Community Energy Warwick. Community financial institutions, like Wessex Home Improvement, Street UK and the London Rebuilding Society, have also developed a retrofit energy-saving package for lenders specialising in housing repair.

These provide a source of income and economic activity in rural areas, allowing young people to stay living there and working there. They allow smaller companies and local authorities to work together for local benefit in the future. They allow small investors to benefit, rather than continuing profits going to the Big Six, and for poorer neighbourhoods to get a continuing income. The UK co-op Baywind channels profits into an energy conservation trust for local residents.[7]

These developments are slow in the UK partly because the business of setting up the right co-operative or community institutions is slow and complicated, which means that huge experience and expertise is needed to get each project off the ground. It is partly because energy regulations have rarely been written with community energy in mind, adding huge complications to local generation, though – thanks to the coalition – this is changing. It is partly also because of the need for institutions capable of dealing with small investments, though the emergence of websites which make

this possible – like Abundance and MicroGenius – has begun to make a difference.

The real problem is that the Green Investment Bank and other initiatives have been designed only with giant energy projects in mind. They are very difficult to navigate for community organisations. And even if they do navigate them, they get a lower return than the big players would for the same project – because they have to distribute via the Big Six rather than selling direct to the market. Up to a third less, in fact. It is a perverse incentive against doing things small.

This imbalance extends to the Green Deal because of the shortage of low cost finance, which is a problem for all projects under the Green Deal but especially for community energy projects. The German government is financing green retrofit of all their housing at rates of 2.5 per cent. The UK is making finance available through the Green Deal at rates of 7 per cent, despite the very low interest rates available through the Bank of England.

An effective policy would include commitments to:

- Provide low-cost finance to boost the sector. The UK needs to learn from the German approach, and the approach used by the New Deal in the USA, setting up institutions capable of lending money for community energy at affordable rates. So far, the UK community development finance institutions (CDFIs) have invested about £100 million in low-cost home improvement loans and have no bad debt, even though they are lending to some of the poorest homeowners.[8] They have proved themselves in this area and need to be able to funnel investment to green energy as well. As well as low cost finance, we need proven business models that will generate income streams into communities.

- Use community energy as the basis for local economy regeneration. The new investment arms, like the Green Investment Bank and the Big Society Bank, need to help communities, local authorities and co-ops to find ways that community energy can be used to ripple economic benefits through an impoverished community, including a loan guarantee fund for community energy projects, so that banks and investors – who are otherwise unfamiliar with this kind of project risk – can lend money at scale.

- Build community enterprises capable of profiting from reducing demand and energy efficiency. The neighbourhood level is the most effective scale for these, but the need long-term planning, and effective models do not yet exist in a scaled-down form so that community enterprises can extract an income stream from their success – especially now that grant-funding is fast disappearing. Some of the best models seem to be NeighborWorks America, working in 4,400 urban and rural communities across the USA, providing advice to homeowners about disrepair problems and the available packaged solutions, surveying work, home improvement scheduling and access to grant assistance, and so on.[9] This model has been adapted in a series of successful link-ups between CDFIs in the UK and local authorities.[10]

- Develop a co-operative energy sector. Denmark pioneered this approach in the 1980s, developing Co-operative Wind Guilds and federating them together to stand up to the power of the big commercial operators, and it provides a powerful organisational form to maximise involvement.

Local money flows

This is a more controversial area of the emerging local economics. In fact, the heart of our approach is an economic argument, based on a study of how money flows around a local economy. How many times money circulates in an area is just as important as the amount of money flowing into it, into cities and the high streets that make them up.

Local money flows analysis shows that some high streets may have the same amount of money coming in, but in one of them it gets spent in the supermarket and then it leaves the area straight away. But in another place, the income gets passed on from local business to local business, over and over again. It is the same money, but every time it changes hands, it creates local wealth.

It is not the total amount of money that is important here. It is the diverse ecosystem of businesses, and maybe even the diversity of people that matters – because they can keep money circulating:

- Our original research on the local multiplier effect showed that every £10 spent with the organic vegetable box scheme was worth £25 for the local area, compared with just £14 when the same amount was spent in a supermarket.[11]
- A study in a Chicago neighbourhood showed that a dollar spent at a local restaurant yielded a 25 per cent greater economic multiplier effect than at a chain restaurant.[12]
- An LM3 study of the Brixton pound shows that a pound spent locally is worth £1.73 for the local economy.[13]

The implications of this for local economies are profound. It means that sustainable economic success requires a diverse range of locally-owned businesses which trade with each other. Outside investment is important, but only when it

supports that local business – not when it corrodes it by taking local spending away from the area.

It means that local policy must encourage more enterprise and, in the poorest places, to make it more inter-dependent. That means keeping local money circulating locally. Monoculture economies are extremely vulnerable, and they require a healthy proportion of locally owned businesses trading with each other.

The central task for those responsible is not only to attract outside investment, but to shape local economies like a good landlord – encouraging key businesses to open, making sure they genuinely anchor the surrounding business (many grocery chains actively undercut them), finding ways to help local entrepreneurs to start businesses, creating stepping stones for them.[14]

In retail policy, it may mean forcing developers to prove their impact on local money flows. One major reason why so many of our local economies have been hollowed out is that so many cities have been using wealth destroyers as anchor stores. American cities are leading the way in fighting back.

The California city of San Diego forces grocery superstores over 90,000 square feet to get a Site Development Permit (SDP). These permits will only be issued if the developer can show that their new project will not increase neighbourhood blight, adversely affect the city's small businesses. The new National Planning Framework in the UK hints at similar powers, but local authorities need to grasp them in practice.

It means that town centres need to be centres of production as well as consumption, of energy generation and training. As Woking has showed, town centres can be net generators of local energy. As Ludlow has showed, high streets can also be centres of production, showcasing local food. As Liverpool has showed, food waste can be used as compost for growing more

food, and for generating electricity. The new recycling and repair economy is also emerging, which can also process waste as raw materials for the new local economy.

A robust set of policies that might encourage local money flows to stay put for longer in the poorer places – clearly this is not a problem for wealthier places – will mean objectives that will:

- End preferred supplier lists at local level.
- Reduce the size of procurement contracts to encourage a wider range of bidders, including local ones.
- Set up new local financial institutions, capable of building and supporting local business (see local banks).
- Use innovative new approaches, like coaching, to encourage local entrepreneurs (see local enterprise).

Chapter 4: Opportunities

These are the immediate next steps that could be developed, to grow local economies from the bottom up, and which could be put into place immediately.

The first involves **using a small part of Big Society Capital to catalyse change.**

The UK has a fine tradition of local enterprise. We have the potential to lead Europe as an enterprise pioneer, driving innovation across new markets such as energy, resource re-cycling and IT which offer a new, sustainable model for growth. Yet a significant number of small enterprises, and the individuals behind them, can't access the financial services they need on fair and affordable terms. This drives up indebtedness, stunts economic growth and blights local communities.

The gap between the finance and credit needs of UK's citizens and provision of traditional financial services, is growing. New CDFA research exposes the size of this gap at between £5.75-£6.25 bn. The costs to society - and to government - of inaction are all too obvious: increased unemployment, growing welfare expenditure, stifling of local enterprise. Failure to address this gap will corrode UK's market position, require costly crisis management and will compound the wealth divide.

Traditional finance providers do not have the business models or infrastructure to fill this gap. Yet there is a viable and potentially robust means to fill the gap – community finance, a sector made up of credit unions, community development

finance institutions, social investment finance intermediaries, mission driven banks, crowd funding and peer-to-peer platforms. In total, the sector offers over 500 retail outlets embedded in the very communities experiencing this gap.

With sufficient capitalisation and infrastructure support, they offer a viable and established means of filling that gap.

But provision, delivery and impact remain uneven. Scaling to this level requires a shift in the financial services industry, where availability of financial services to underserved communities becomes the foundation for a new partnership with banks and other mainstream investors. How? Through ***using £10m of Big Society Capital's £600m, as a development fund, able to catalyse this change by a strengthened community finance infrastructure***, diversifying the product range and leveraging private sector investment.

Also through incentivising banks to partner the community finance sector, by accelerating policy initiatives already underway such as aggregated disclosure of lending data, alignment of tax incentives, infrastructure investment, an HMT seed fund for new product development and developing EFG as an industry-wide cover scheme

The second proposal involves **increasing the local economic impact of services.**

The future of local public services, including who delivers them and how we reduce demand on them are key to the 'double-benefit' approach. The UK government is committed to public service reform, which advances choice and promotes plurality in delivery types, where social, private and various partnerships and collaborations play a greater role.

But so far this has focused on efficiency savings. Of course these efficiencies are vital, but we also must consider the greater prize, where we make inroads into reducing or

eliminating demand on public services in the first place. We need new forms of local social/public and commercial/public collaborations - creating innovations in service delivery.

Local spending and how it is 'bent' and 'sweated' is a vital component of this advancement. Wherever, possible public spend should 'ripple' through local areas, encouraging new forms of delivery models, supporting local economies and increasing economic health, through contracts for local enterprise, business and community and voluntary sectors. For us, this is a key means of creating effective services, improving choice, service quality and reducing public service demand.

Much work by many of us, local studies and individual local authority activity has demonstrated the significant value that a bend in local spend can bring. Indeed, some local authorities do carefully monitor spend and its 'ripple effects' upon local economies. But the picture is patchy, and is all too often bogged down in perceived difficulties around procurement.

Therefore, as a key starting point, we believe ***there needs to be a more comprehensive understanding and disclosure at a national and local government about the geographies and beneficiaries of public spend***. It is only from this full picture that we can advance a holistic approach to place, local economies and a reduction in demand on public services.

Endnotes

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