The International Economic Crisis: A Community Development Perspective

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This fall marks the five-year anniversary of the financial crisis that brought on the “Great Recession”, so named to indicate that -- so far -- it is not as severe as the Great Depression, but almost. The Great Recession is best thought of as a “Balance Sheet” recession (see Richard C. Koo, Nomura Research Institute, “The world in balance sheet recession: causes, cure, and politics”, Real-world Economic Review, Issue 58, 1 December 2011). As Koo explains, this is “no ordinary recession.”

In an ordinary recession, the tools of monetary and fiscal policy, plus the regenerative powers of a capitalist economy, eventually work to restore forward economic momentum. In a balance sheet recession, households, businesses, and banks have an overhang of debt issued against assets that have lost much or all of their value. Regardless of how much liquidity the Federal Reserve feeds to the economy, or how low interest rates fall (and the yield on the six month Treasury bill has been lower than 0.5% for the past three years), it won’t work to stimulate business or residential investment.

Weak fiscal policy is a big part of the problem. Koo shows that there has been a massive shift in the US private sector (households and businesses) toward greater savings and debt reduction, without a commensurate shift in the public sector toward greater investment and borrowing. This is only prolonging the recession, suppressing income growth, and, ultimately, increasing the size of future public deficits.

One way for the savings in the private sector to get mobilized for economic stimulus is for governments to invest. In the US, this process has to be led by the federal government, since it alone has the ability to run deficits and it is recognized globally as a strong borrower. Another way to mobilize private savings is through banks and capital markets. But this channel isn’t working either, either because of unwillingness to borrow and invest, or unwillingness to lend and invest by private sector businesses, households, and financial institutions.

At the same time that savings and liquidity is accumulating in the business and banking sectors of the US economy, concrete opportunities to invest in community assets and human capital go unexploited. The international economic crisis has had a devastating “trickle down” impact on working class communities across the globe.

In the US, it has destroyed jobs and housing wealth, placing stress on the budgets of cities and local school districts that provide essential public goods, notably public safety and public education. These communities were not the cause of the crisis but they are least able to sustain the economic losses it has wrought.

The way forward could and should start with sustained reinvestment in community development. Community development is about organic, integrated investment in the people, housing, built environment, and institutions in low and moderate income neighborhoods. The returns from community development take the form of better educational and employment outcomes, better health, safer neighborhoods, and stronger local businesses as housing costs are aligned with household incomes. All of these “returns” ultimately accrue not only, even though most importantly, to the residents of these communities, but also to businesses, the health care system, and local, state, and federal governments. Yet where will the investment come from?

Clearly, we need institutional innovation in the saving-investment mechanism—just as happened in the 1930s with the organization of new institutions such as the Home Owners’ Loan Corporation and the Reconstruction Finance Corporation, but tailored to the demands of our times. This is where President Obama’s 2010 proposal for a national infrastructure bank to finance large-scale transportation and energy projects comes into play. On the local scale, third-sector, mission-driven institutions such as community land trusts, community development financial institutions, and community development corporations have the potential to play an important complementary role in re-igniting a cycle of investment, income generation, and saving growth. These institutions need to be “scaled up” to have real impact, using a blend of public and private sector resources for their capitalization.