The circulating pound

'Money is round, and it rolls away.'

Confucius

Suppose you paint a pound coin red and watch where it goes. Every time it changes hands within a community, it means income for a local person. The more times it changes hands, the better for that community. In fact, money that is re-spent in a local area is the same as attracting new money into that area. Either way, it is new money into the hands of the person who receives it.

So much for the £1 coin. Let's go up in the world and follow £100 on its journey around an area to see where it goes and what impact it makes.

Anne receives £100 and £80 immediately leaves her housing estate: swallowed up by gas and electricity bills; mortgage repayments; food from a supermarket; and a new dress from a boutique in the city. The remaining £20 stays in the local area because: £15 pays her cleaner; 50p buys an apple from the farm next door; £1.50 goes into her credit union savings scheme; and £3 buys some groceries in the corner shop.

Meanwhile Jessica receives £100. To celebrate, she asks a local baker to bake a special cake for her that costs £35. She then asks the local plumber to un-block her drains (at a cost of £45). The remaining £20 goes towards her telephone bill and so leaves the local area. In total Jessica has re-spent £80 in the local area.

Let's go round again

If you are comfortable with the idea of circulation, the next point to grasp is that it is important to look beyond the first round circulation. Above, we gave the example of Anne spending some money (£3) at the local grocer's. So in this first round, the money has stayed in the bucket. But if the grocer employed people and purchased supplies from outside the area, and lived outside the area himself, almost all that money would leak out in the second round.

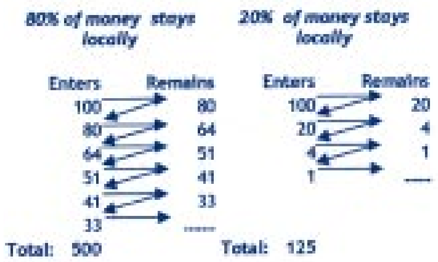
So it's not just where you spend your money that matters. It is also important where the people you give it to spend it. If you give your pound to Anne then she is likely to only re-spend 20% of it locally. But if you give it to Jessica then 80% of it might stay locally. So with Jessica the value of your pound has been multiplied several times! Understanding this so-called 'local multiplier effect' shows how important it is to look at all the economic impacts of expenditure, not solely the direct impacts.

Here are two practical examples. A study of tourism in Tayside showed that although tourists in hotels spent 70% more than those in B and B accommodation, the total income generated locally was in fact higher for B and Bs. This was because most of the money spent in hotels leaked immediately out of the local economy: non-local staff and owners, legal services provided by London firms, and so on.

The second example comes from a small district in Baltimore, USA. This district is predominantly black and predominantly unemployed after the steel and rail industries declined. Locals estimate that the 'local multiplier effect' is exactly 1.0. Practically all money comes in as social security and is immediately spent outside the community at discount food stores. There is no re-circulation; no multiplier effect to benefit the local economy. The community development corporation has now set a target circulation of 8, which they believe is the average for a predominantly white predominantly employed suburb in the US.

The local multiplier effect

How do we measure this 'local multiplier effect' then? The following table illustrates how it works – showing the spending patterns of Jessica and Anne:



The starting point in each situation is that £100 enters the local economy. If 80% of each £1 spent stays in the local economy, the total amount of spending that that £100 will generate is about £500 - a multiplier of 5 (500 divided by 100). If only 20% of each £1 spent stays in the local economy, the total spending is only £125. This gives a multiplier of only 1.25 (125 divided by 100).

If a business has a multiplier of 1, then it is re-spending none of the money it's earning in the local area. The higher the multiplier is above 1, the better the business is for the local economy, because more money is being re-spent locally. So the multiplier effect allows you to judge the impact of different economic activities on your area.

Don't worry if you don't understand the mathematics. The important thing is to understand the underlying principle – that if money is re-spent locally then it helps to strengthen the local economy.

As a practical illustration, we recently compared the multiplier effects of shopping for fruit and vegetables in a supermarket and from a local organic 'box scheme' (for the uninitiated, it's a fixed-price box of fruit and vegetables delivered to subscribers' doorsteps each week). The results showed that every £10 spent with the box scheme was worth £25 for the local area, compared with just £14 when the same amount was spent in a supermarket.

That sounds simple enough, though in order to reach these figures, local resident Tim Boyde spent two months tracking the finances of a Cornish vegetable box scheme, Cusgarne Organics, based near Truro. He followed the box scheme's expenditure to see exactly where it was spent; in particular how much of it was spent within a 15-mile radius of the business. He then also monitored where that money was spent at the next level of spending and so on. He discovered that the organic box scheme spent significantly more money locally than the supermarket and that this extra income to the area was then reinvested many times over by the other people who received it in the area.

Evaluating bids, tenders and inward investment

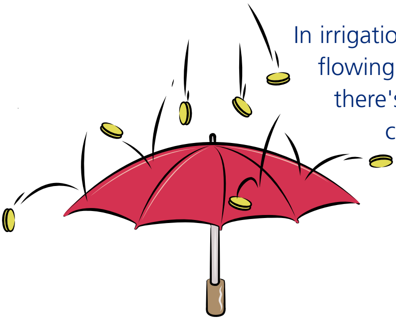
NEF has developed a tool that estimates the local multiplier effect of different types of initiatives. The tool shows how different initiatives (such as tenders for contracts or bids for funding or incentives for inward investors) compare with one another in terms of cost and local economic impact. Perhaps the most useful aspect of the tool's application is that it rewards those companies who do more local sourcing by giving them a higher result. This then frequently spurs them on to look for ways that they can increase their result further by doing even more local sourcing!

Knowsley Metropolitan Borough Council in Merseyside used NEF's multiplier tool to assess the local economic impacts of some of their construction contracts. It was estimated that just 8% of the Council's expenditure reaches local businesses, a situation the Council was keen to improve. The Council evaluated two contracts for their local multiplier effects. Contract A was let to a firm situated just outside the local area, and contract B was let to a local firm. The Council therefore thought that Contract B would have a greater overall local impact. However, interestingly, the study showed that the non-local firm had a higher impact on the local economy, with 16% of the contract income being re-spent locally compared to 11% for the local firm. This might not sound like a significant difference, but with each contract being worth in excess of £1 million, the numbers soon stack up. The reason for the different local economy effects between the two firms is that the 'non-local' firm in fact hired more local staff than did the locally owned firm!

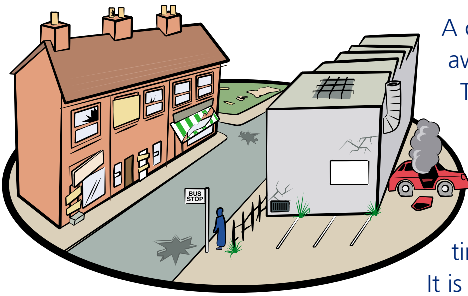
Funnels and umbrellas

'This regeneration grant that we were awarded is not a new deal for our deprived area at all. It is a new deal for the rich people in the area over there.'

Local resident, Bradford New Deal for Communities project



In irrigation, the side channels are no use if there's no water flowing into them. And the multiplier effect only works if there's something there to multiply. For many poorer communities, that should include regeneration funding – flowing into a community, through its mini-channels, into its farthest corners. But sometimes it seems like there is an umbrella held over the poor community. The money flows off the edge of the umbrella into the richer surrounding areas.



A consistently observed example of this is in the awarding of contracts for housing improvement. The contracts almost always go to external contractors, because they have the experience of delivering to high standards, tight timescales and so on. It is entirely understandable why time-stretched regeneration staff choose to award contracts in this way – it gives them a much greater guarantee of success at meeting that specific target to a high quality in the short-term.

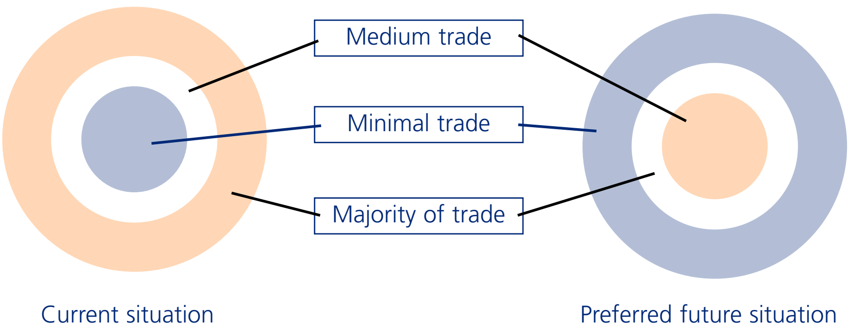
A better approach for the local economy would be to create a funnel for the funding so that more of it could stay in the community. In practical terms this would mean undertaking the work more slowly, gradually supporting the strengthening of capacity inside the community so that they are able to undertake their own development. For example, a scheme could be created to strengthen relevant building skills in the first couple of years of a regeneration programme. Then those trainees could form

the basis for local tenders for contracts in subsequent years – though clearly they will need to win such contracts on the basis of open competition. Alternatively, administrative support might be offered to existing local traders to help them to organise themselves into a contracting co-operative.

Admittedly, this approach does take longer. It also takes a lot more effort from the regeneration staff. And there is greater short-term risk involved. However, it is the only way to make sure that the money does not leak away in the short-term – and of course it also increases the capacity of the poorer community to hold on to future money.

Spending circles

Imagine your area as the centre of a series of circles, with the outside one representing the whole of the UK and beyond. In the two diagrams below, the darker the shading, the more is spent there. The circles on the left represent the current situation: not much is spent locally, and most of the trading is from far away. A stronger local economy would be one where quite a lot of trading happens locally, most comes from quite nearby, and some, but not much, comes from far away.



Reinvigorating the local economy means looking at some of the things you source from further away and seeing if there are steps that you could take to supply them more locally. A key part of this would be looking at things that currently leave your area to be processed elsewhere, before re-entering your area. Could you 'add more value' locally? Much of this 'middle man' role is marketing – could this be done more locally? For example, the vast majority of the fish caught in Torbay is transported straight out again. According to local economist Owen Nankivell, there is a huge opportunity to add value by opening fish restaurants or processing the fish before it leaves Torbay.

In the Brecon Beacons, locals began to realise that tourism was probably as important a source of money in-flow to the area as farming. They surveyed tourists and tourism establishments to identify ways to increase the impact of each tourism pound. As a result they decided to link local restaurants with local farmers and set up a youth-run marketing company that was locally based. 'All previous activity in this area', says Duncan Fisher, 'had been done by people from outside the area.'

Are you feeling a bit cynical about what you have read so far? Does it all seem too simple – perhaps even simple-minded? Would you be persuaded if we linked these ideas to a growing body of evidence produced by the United Nations Conference on Trade and Development? If so, take some time out to read *Appendix 2: The regeneration game*. It will particularly appeal if you are currently working to attract inward investment or to deliver a regeneration programme.

As we have moved from village hall to board-room, and training centre to dining-room table, we have found that the ideas outlined in this chapter have generated debate between people who have not previously come together to discuss their local economy. These people from different backgrounds and perspectives have then used this common language to decide on the future of their local economy. What follows is a detailed guide to taking it forward into action.