

# The Rural Economic Policy Choice

*By Mark Drabenstott, Mark Henry, and Lynn Gibson*

Rural America is undergoing a serious economic adjustment. Traditional rural industries are depressed and relatively few rural communities have been able to find a new economic base from which to grow. In many parts of rural America, economic stress has raised unemployment while leaving some capital resources underutilized. Rural communities—and some predominantly rural states—are also having difficulty maintaining public infrastructure—roads, schools, and health care facilities. In short, the rural economy is struggling.

How should policymakers respond to the rural economic problems? Policymakers in Washington, state capitols, county seats, and small rural towns are grappling with this question. The difficulty in finding an answer arises from the elusive nature of rural policy. Traditionally, farm policy has been

viewed as a convenient surrogate for rural policy. While farm policy has form and function, rural policy has no clear dimensions. While farm policy undergoes systematic revision at least every four years, rural policy has no timeclock in Congress or in statehouses. It is clear, however, that policymakers will implement rural programs of one sort or another in the near future. To prevent these programs from becoming a hodgepodge that lacks effect, policymakers should first consider what type of rural policy will guide their response.

Policymakers can choose between two rural policies, or some combination of the two. One is a rural transition policy. Fundamental economic forces are encouraging people and resources to move out of rural communities into other segments of the economy. Working in harmony with these market forces, a transition policy aims to facilitate and ease the costs of resource adjustments. The other choice is a rural development policy which seeks, to some extent, to reverse market trends. With a development policy, public funds are used to subsidize rural economic development, because social value is attached to the vitality of the rural economy.

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This article outlines the factors policymakers will weigh in the decision and describes what each policy might contain. First, the rural economic problems most likely to concern policymakers are discussed. Then, a rural transition policy and a rural development policy are examined in turn. For each policy, operating objectives are posed and program alternatives to meet objectives are reviewed and evaluated.

### Emerging rural policy issues

A recent article in the *Economic Review* showed that the rural economy is in the midst of difficult economic change.<sup>1</sup> That article showed that growth in rural incomes has lagged well behind growth in metropolitan incomes for the past ten years. The gap between rural and urban wellbeing has widened most sharply since 1979. In the 1980s, economic strain has been especially evident in traditional rural counties—those depending on agriculture, mining, and manufacturing. These counties account for more than half the rural population and income. The article further concluded that the gap in rural and metropolitan economic performance does not appear to be cyclical. Rather, the gap appears related to such structural factors as international economic forces, the shift to services in the U.S. economy, deregulation, and structural change in agriculture.

The changing rural economy is giving rise to two issues that will be the focus of much policy discussion. One issue is the mounting number of displaced rural workers faced with the prospect of finding employment elsewhere. The other is

the strain beginning to show in rural public infrastructure as rural population dwindles and tax bases diminish.

### *Displaced rural workers and rural outmigration*

Unemployment is becoming a persistent problem for many rural regions. With the onset of economic woes in several basic industries in the 1980s, rural unemployment has climbed well above the levels of the 1970s to surpass urban unemployment (Chart 1). The unemployment problem is compounded by an ongoing underemployment problem. Studies indicate that a large proportion of rural workers—as many as a fourth in some cases—are in jobs below their skill levels, because no other work is available.<sup>2</sup> Furthermore, job skills of rural residents tend to be less versatile than those of urban residents and the range of employment opportunities is more limited in rural areas.

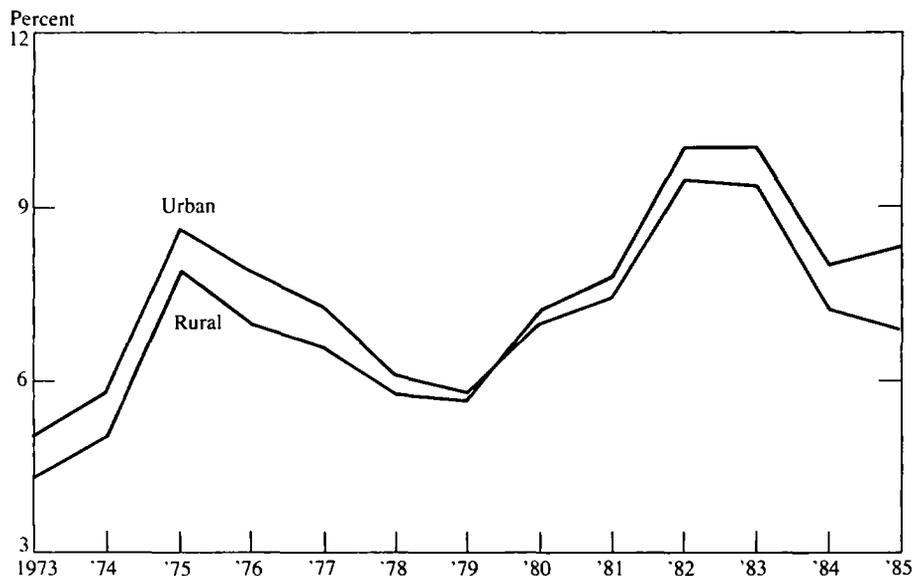
With the rural economy under stress, it seems likely that many displaced workers will leave rural communities and some rural states in coming years. Overall, rural population continues to grow slowly, but the number of regions experiencing net outmigration is increasing. In the 1950s and 1960s, more than half the nonmetropolitan counties in the United States were losing population (Chart 2). The outmigration then was generally associated with rapid job formation in metropolitan areas. In the 1970s, when the rural economy was generally prospering, the proportion of rural counties losing population fell to less than a fifth. But in the 1980s, the rural outmigration has again quickened, with nearly half the rural counties losing population between 1983 and 1985. With economic stress widely evident in rural counties depending on farming, mining, and manufacturing, many rural counties can expect further outmigration.

The displacement of rural workers, then, is not a new development. Rural residents have been

<sup>1</sup> Mark Henry, Mark Drabentstott, and Lynn Gibson, "A Changing Rural America," *Economic Review*, Federal Reserve Bank of Kansas City, July/August 1986.

<sup>2</sup> For example, the underemployment problem in Nebraska was analyzed by the Nebraska Department of Economic Development and Labor in *The Nebraska Project: State of the Labor Market Economy*, Lincoln, 1985.

**CHART 1**  
**Rural and urban unemployment rates**  
 Annual average unemployment rate



moving to the city to find new employment throughout this century. The difference today is that job opportunities are much different. Rural residents that left farms and small communities in the 1950s and 1960s usually found well-paying, semi-skilled jobs in industry. Now, with the goods-producing part of the economy not performing well, most new jobs are either low-paying service jobs or well-paying jobs requiring specific technical skills. Another disturbing aspect of rural workers in transition is their apparent lack of mobility. A 1984 survey of farmers that had gone out of business in Iowa showed that more than three-fourths of them remained in the same community, but at a much lower standard of living.<sup>3</sup>

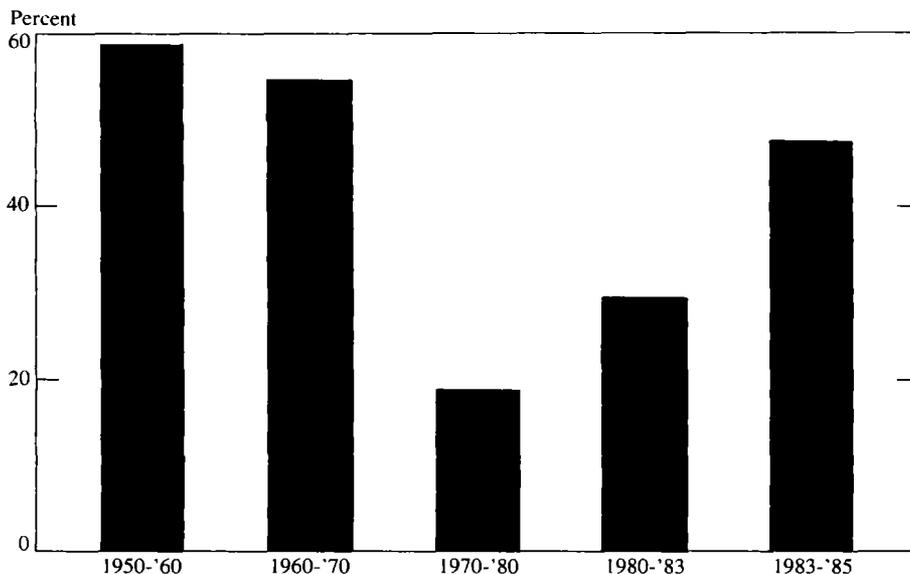
<sup>3</sup> See Daniel Otto, "Analysis of Farmers Leaving Agriculture for Financial Reasons: Summary of Survey Results from 1984," Iowa State University, 1985.

In short, one principal problem facing policy-makers is to ease the transition for displaced rural residents with skills that may not give them good job opportunities outside their local areas.

### *Strained rural infrastructure*

Rural areas increasingly face a dual infrastructure problem. On the one hand, economic stress is creating fiscal pressures that make it difficult to maintain infrastructure and public services. On the other hand, many of the same areas and communities lack sufficient infrastructure to support a successful transition to a new economic base. Thus, many rural communities and some rural states find public funds scarce while the need is great not only to meet existing demands but also to invest in the necessary infrastructure to diversify.

**CHART 2**  
**Percent of rural counties with declining populations**



As the economic viability of many rural communities starts to wane and population declines, maintaining infrastructure and public services becomes especially difficult. Adjoining small communities often find that they are simultaneously trying to maintain what have become redundant public facilities. For example, some communities may find that one hospital now can serve the needs of more than one community. Similarly, some rural counties are struggling to maintain the full complement of county government services.

The strains on rural tax bases are clearly mounting, but no comprehensive assessment has been made of the magnitude of the problem. A 1986 report by the Senate Subcommittee on Intergovernmental Relations concluded that many local rural governments face the prospect of a shrinking revenue base for the rest of this decade and longer.<sup>4</sup>

Rising tax delinquency rates in rural areas, dramatic declines in agricultural land values, and significant declines in nonfarm incomes and property values all support that conclusion. The report found that property tax delinquencies in eight selected farm-dependent regions rose from 1.5 percent in 1981 to 9.5 percent in 1986. To offset shortfalls in revenue while maintaining only essential public services, the report suggested that local rural governments would have to implement a combination of tax increases and spending cuts amounting to as much as \$200 per capita.

The fiscal strain in rural America is compounded by the revenue strains of many predominantly rural states. Table 1 shows that of

<sup>4</sup> U.S. Senate, Subcommittee on Intergovernmental Relations, "Governing the Heartland: Can Rural Communities Survive the Farm Crisis?" May 1986.

**TABLE 1**  
**Fiscal stress symptoms in rural states\***

<u>State</u>	<u>1984 Tax Capacity</u>	<u>Tax Effort Change From 1975 to 1984</u>
Arkansas	75	+11 %
Idaho	89	+4
Iowa	78	+20
Kansas	100	+12
Kentucky	77	+5
Maine	88	+2
Mississippi	70	-1
Montana	95	+10
Nebraska	93	+16
New Mexico	103	0
North Carolina	87	+4
North Dakota	106	+1
South Carolina	77	+11
South Dakota	83	-1
Vermont	95	-13
West Virginia	79	+17
Wyoming	181	+51
17 rural state average	92.7	+9
Nonrural U.S. average	102.4	+3

Source: Advisory Commission on Intergovernmental Relations, Washington, D.C.

\*Rural states are those where the ratio of nonmetropolitan population to metropolitan population is greater than the average for all 50 states. The unweighted average ratio in 1984 was 1.09.

Note: Tax capacity, as developed by the Advisory Commission on Intergovernmental Relations, measures the multiple resources that state governments can claim through a variety of taxes. A tax capacity greater than 100 indicates the state has more fiscal capacity than average for the 50 states. Similarly, tax effort measures a state's total tax collections relative to its total capacity.

17 states with higher than average percentages of rural population, all but four had tax capacities below the national average for nonrural states in 1984.<sup>5</sup> As farm and energy problems continued to intensify in 1985, many of the states probably experienced some additional erosion in fiscal capacity. To offset revenue shortfalls, 13 of the 17 states increased taxes between 1975 and 1984. Tax capacity and tax effort are only two of many possible indicators of fiscal pressure, but these

statistics suggest that some rural states face the same problems in supporting infrastructure and public services as many local governments.

<sup>5</sup> For an analysis of fiscal pressures facing rural governments, see James Hite and Holley Ulbrich, "Fiscal Stress in Rural America," invited paper presented at the annual meeting of the American Agricultural Economics Association, Reno, Nevada, July 1986. See also, "The Agricultural Recession, Its Impact on the Finances of State and Local Government," Advisory Commission on Intergovernmental Relations, Staff Report, June 1986.

Rural states and communities face an especially acute infrastructure problem as they try to diversify away from total dependence on a traditional economic base that is now depressed. Attracting new industry often entails putting in place new infrastructure, such as roads, industrial parks, and water and sewer facilities. The adequacy of rural infrastructure is difficult to assess, but a 1984 Farmers Home Administration survey concluded that many rural communities still lack some basic public services.<sup>6</sup> For example, only 55 percent of the rural communities in the United States were served by public water systems, and fewer than a third had wastewater treatment plants. In addition, firms considering sites for location often have special needs for infrastructure that cannot be met by rural areas without additional investment.

Thus, rural communities are left with the dual problem of trying to maintain existing services while improving their infrastructure enough to attract new industries. Growing needs and weakened capabilities to meet those needs may characterize the fiscal condition of many rural areas if current trends go unchecked.

### **The rural transition policy**

Displaced rural workers and strained infrastructure are the byproducts of structural change in the basic fabric of the rural economy. Market forces are driving down the return to rural resources and encouraging those resources to find other uses in the economy. Labor and capital resources alike probably will leave rural areas and look for more productive use in urban areas. What role should public policy play in such a transition?

One response is a rural transition policy that aims to facilitate the structural change already underway in the rural economy. Rural outmigra-

tion and reduced rural infrastructure may not be popular in rural America, but from the perspective of the whole economy, they are simply reallocations of rural resources to more productive parts of the economy.

There is sound economic justification for a rural transition policy. Put simply, rural resources are not perfectly mobile and social costs attend rural resource adjustment. When rural labor or capital resources are idled, as they now are in many places, information on other opportunities is often limited. As a result, the time that the resources are unused or underused tends to lengthen. Even when information is available, rural resources may simply lack mobility. Moreover, the social costs of adjustment—in the form of unemployment insurance and other income support programs—rise as rural unemployment rises. Thus, it is in the public interest to reduce the social costs by facilitating resource adjustments.

### *Transition objectives*

What operating objectives should guide the selection of rural transition programs? Three goals appear relevant: easing human resource adjustment, easing public infrastructure adjustment, and supplementing rural incomes.

*Easing human resource adjustment.* The easing of human adjustments appears to be the most pressing objective of rural economic policy. Economic theory suggests that labor resources gravitate toward opportunity, yet rural workers—whether displaced farmers, factory workers, or lumber workers—may lack complete information on these opportunities, the means of relocating, or the ability to acquire the skills new jobs often require. Many public programs have been aimed at keeping farmers in business, but far fewer programs have addressed what may be the more important problem of retraining displaced farmers and other rural workers for productive employment elsewhere in the economy.

<sup>6</sup> See J. Norman Reid and Patrick J. Sullivan, "Rural Infrastructure: How Much? How Good?" *Rural Development Perspectives*, U.S. Department of Agriculture, October 1984.

*Easing public infrastructure adjustment.* Funds for schools, public health facilities, and other public services are under pressure in depressed rural areas. The federal government and states may be able to assist communities that lack the funds for essential public services. Education infrastructure is especially important to meet retraining needs. Nevertheless, under a rural transition policy federal or state assistance would not be regarded as permanent. Rather, assistance would be part of an overall goal of facilitating market adjustments in rural resources.

*Supplementing rural incomes.* Incomes are low in many depressed rural areas. Temporary direct government income support to rural residents linked to retraining programs may be appropriate as a bridge to new employment elsewhere. Also, many rural communities are being left with a concentration of elderly citizens as younger workers leave to find employment in other places. For these communities, income support programs become more important.

### *Rural transition programs*

What transition programs will meet the objectives suggested above? Retraining programs, assistance to maintain public infrastructure—especially educational facilities—and assorted income maintenance programs appear to be most suited.

*Programs to ease human resource adjustment.* Retraining is the basic response to human resource adjustment problems. The federal government has long had job training programs, but the programs generally have not been directed at rural problems. Some states have recently launched programs to assist displaced rural workers.

At the federal level, the existing comprehensive job training program was created under the Job Training Partnership Act in 1983 to replace the Comprehensive Employment and Training Act (CETA). The program's chief objective is still

to provide job training to unskilled workers and disadvantaged workers, whether rural or urban. The new act seeks to link training with the opportunities in local job markets by placing more of the administrative responsibility at the local and state level. This added flexibility does allow the program to address the problems of rural displaced workers. But the program does not appear to have been used widely enough to ease career transitions for significant numbers of displaced rural workers. Criticisms of the program include its failure to use community colleges and existing local training efforts and its failure to link training programs with local economic development programs.<sup>7</sup>

State efforts to address rural worker adjustments are relatively recent in origin. Just in the last two years, many midwestern states, including Kansas and South Dakota, have initiated retraining programs for farmers and other rural residents out of work. Most of the programs provide tuition credits for classes at local colleges, universities, or vocational schools, as well as opportunities for on-the-job training. A few programs offer relocation benefits when the training is completed, in some cases, including relocation from the state.

The state programs are too new for any comprehensive evaluation of their effectiveness. On the whole, the programs appear well guided. In many cases, public funds may be better spent on retraining than on efforts to keep financially ailing farms or rural businesses from failing. However, program budgets often fall short of meeting projected needs. In Kansas, for example, the Rural Employment Assistance Program (REAP) had a 1986 budget of \$1.2 million, enough to reach about 600 workers. An estimated 7,000 Kansas farmers

<sup>7</sup> See Ted K. Bradshaw, "Economic Development in Rural America: The Hard Case," *Looking Ahead*, The National Planning Association, Vol. IX, No. 2, Spring 1986, and Sigurd Nilsen and Frank A. Fratoe, "Job Training Partnership Act, CETA, and Rural Communities," *Rural Development Perspectives*, U.S. Department of Agriculture, October 1984.

left farming in 1986, with another 9,000 under severe financial stress. Thus, only a small percentage of the target group can benefit from the retraining program. The same is true in many other rural states.

Some predominantly rural states face a social and financial dilemma when they undertake retraining programs. States that do not have a realistic prospect of developing a new economic base may face the unpleasant likelihood of declines in population. Workers that are retrained, largely if not totally at state expense, may find employment only in other states. Thus, the state that bears the cost of training may not reap its benefits. Yet without the retraining programs, many displaced workers might remain tied to state welfare programs.

The solution to this dilemma may lie in regional and federal cooperation. Neighboring states might reduce costs by sharing retraining programs, with each state furnishing the training it is best suited to furnish. There also appears to be a role for the federal government in sharing retraining costs when the budget of an economically depressed rural state is stretched and the state has little prospect of recouping human capital investments in its own economic development.

Overall, no federal program is in place specifically to retrain displaced rural workers. The Job Training Partnership Act can be used for rural workers, but its use remains fairly limited. Fine tuning that program—adding a clearer rural emphasis and linking training to available rural education programs—might be sufficient direct federal involvement in easing human adjustment in rural areas. Much of the retraining task will fall to the states in conjunction with local communities. State programs are just now emerging, but the budgets of many rural states are seriously strained. The rural displaced worker problem is national and retrained rural workers promise dividends to the national economy. Thus, a fairly strong case can be made for the federal govern-

ment sharing in the cost of state administered programs.

*Programs to ease public infrastructure adjustment.* The basic program for meeting the need for infrastructure adjustment is grants-in-aid linked to maintaining essential services in declining rural communities. Neither federal nor state programs of this type are now in place. Although the federal government will spend nearly \$8 billion on rural infrastructure in 1986, funds will go to economic development, not transition assistance to maintain rural infrastructure. The principle behind transition infrastructure programs is to assist communities in such a way that services are provided for a sufficient transition period, but not in such a way as to subsidize communities permanently. The challenge, therefore, is to craft programs that effectively channel funds to communities that need them while allowing structural changes to continue.

The greatest rural public infrastructure need for the near future is schools and universities. Rural communities and some rural states will have great difficulty maintaining high-quality education because of scarce resources and dwindling enrollments. Programs will be needed to maintain those facilities for two purposes: first, to keep overall education standards high for resident elementary, secondary, and college students, and second, to provide adequate facilities for retraining displaced workers. An appropriate federal program might be to provide grants to universities in rural states. The grants could be linked to the establishment of quality retraining programs and then be phased out over a period of years.

States may want to consider programs to encourage the pooling of rural infrastructure. For example, two neighboring communities may find that they lack the resources or population to support two hospitals but may be unable or unwilling to address the problem. Rather than further dissipate public funds, state grants-in-aid could be linked to community agreements to share

responsibility for essential public services, such as health care. In doing so, states encourage the market flow of resources while increasing the efficiency of public spending at both state and local levels. A similar approach could be used to encourage neighboring counties to combine public services. That issue remains controversial, but some states are beginning to consider such combinations.<sup>8</sup>

*Programs to supplement rural incomes.* Farm programs and other income transfer programs have been the two main approaches to supplementing rural incomes. Both approaches simply direct government transfer payments to rural residents. The programs continue to receive support, though they are not long-run solutions to the gap between rural and urban incomes.

Federal farm commodity programs have mushroomed into large income transfer programs in the 1980s. Designed originally to stabilize farm prices and farm incomes, the programs have become a mechanism in recent years for large federal infusions into a depressed industry. The 1985 Farm Bill moves agriculture to greater market orientation but provides substantial income protection as the transition occurs. As a result, farm program spending has increased dramatically. Between 1971 and 1975, net outlays for farm commodity programs—both Commodity Credit Corporation (CCC) loans and deficiency payments—averaged only \$2.4 billion a year. Between 1981 and 1985, outlays increased to an annual average of \$11.9 billion. Program costs swelled to \$26.0 billion in 1986.

The question must be asked whether farm programs meet an objective of supplementing rural incomes. Federal farm programs do keep farm incomes high and, thereby, improve business activity in areas dependent on farming. But only

a fourth of the nation's 2,400-odd rural counties—and less than 12 percent of the rural population—depend primarily on agriculture. Meanwhile, counties depending on manufacturing and mining—the other traditional rural counties—also have experienced downturns in the 1980s, and nearly half the rural population lives in these counties. Moreover, farm programs increasingly benefit a relatively small number of larger farms. In 1985, for instance, the 27,000 farms with annual sales greater than \$500,000 represented only 1.2 percent of all farms but received 13.3 percent of direct farm program payments. These large farms, which had an average net farm income of \$647,037 in 1985, received an average of \$38,000 in direct government payments and also held an average of \$113,200 in nonrecourse CCC loans. Farm income programs, then, may be too narrowly focused to meet broad rural objectives.

A host of federal and state income transfer programs, ranging from social security to food stamps also have significant effects on rural incomes. Social security has become especially important to many rural counties. Counties with depressed economies often lose large portions of their younger population and are left with a much larger concentration of elderly people. Social security, then, becomes an even more important source of income to such rural counties. Not only does the program meet an objective of improving incomes of the elderly, it also helps soften a region's downward economic adjustment.

Overall, direct income transfer programs probably meet fairly limited policy objectives. Most economists and policymakers agree that programs which encourage economic growth offer a better long-run solution than programs that create dependency on government assistance. Nevertheless, with the ongoing stress expected to confront many rural communities in the next few years, some existing direct income transfer programs will serve a short-run objective of easing rural economic adjustment. Farm income support

<sup>8</sup> In the fall of 1985, the Iowa legislature briefly discussed the possible need to consolidate the state's 99 counties into fewer counties that would be more fiscally sound.

programs, the traditional channel to raise rural incomes, probably are too narrow to meet truly rural objectives.

### *Summary*

A rural transition policy aims to facilitate the difficult structural change underway in the rural economy and to ease the costs of the change. The most urgent need will be retraining programs to ameliorate the adjustment of displaced rural workers. The Job Training Partnership Act could be refined to target rural workers more specifically. In addition, the federal government should consider partially funding the retraining programs of rural states where budgets are stretched and the states are unlikely to keep retrained workers. State retraining programs are beginning to emerge, but greater emphasis on these programs will be needed. Both federal and state assistance could be used to maintain public services while encouraging the adjustment of rural infrastructure to new market realities. Finally, income transfer programs likely will serve a useful purpose while the rural economy is in transition, but questions must be raised whether farm income programs meet broader rural needs.

### **The rural development policy**

A rural development policy would be a much different response to current rural economic problems. Rural transition policy is a short-run commitment to ease the costs of resources adjusting to market trends already at work. Rural development policy, on the other hand, is a long-run commitment to stimulate economic development in rural areas, even though such development may run counter to current fundamental economic trends.

Adopting a rural development policy may not preclude a rural transition policy. Rural economic development policy logically includes a transition

component for the parts of the rural economy that are unlikely to recover from current depressed conditions. Thus, a rural development policy can be regarded as a two-pronged response: on the one hand, an effort to ease resource adjustment in areas with little likelihood of economic revival and, on the other hand, an effort to stimulate economic activity in areas that offer more promise for future growth. The difficulty with this dual policy is that it forces policymakers to decide which rural areas fall into which category. The first step becomes a sort of triage, a determination of the rural areas that are not likely to grow, the areas with some growth potential, and the areas most likely to grow. What remains unclear is whether policymakers have sufficient information, knowledge, or discipline to make such decisions.

### *Justification for rural development*

Rural transition policy can be justified on solid economic grounds, but the justification for rural development policy lies apart from economics. Two reasons can be given for rural development policy: the social value of the rural lifestyle and the past history of U.S. rural development policy.

The United States has attached social value to rural living from the founding of the republic. Thomas Jefferson was a leading exponent of rural virtue.

Cultivators of the earth are the most valuable citizens. They are the most vigorous, the most independent, the most virtuous, and they are tied to their country, and wedded to its liberty and interests, by the most lasting bonds. As long, therefore, as they can find employment in this line, I would not convert them to . . . anything else.<sup>9</sup>

<sup>9</sup> Saul K. Padover, *Thomas Jefferson on Democracy*, Mentor 1939, p. 68. Quoted from a letter Jefferson sent to John Jay in 1785.

From Jeffersonian roots, an economically strong rural population soon came to be regarded as a national asset. Such thinking resulted in congressional action, like the Homestead Act of 1862, which encouraged widespread ownership of rural resources.

Public opinion still supports rural causes. This support is frequently expressed in public backing of farm policy. A wide majority of voters continue to support farm policy.<sup>10</sup> Voters may be treating farm policy as a surrogate for rural policy, though that is unclear. As the public becomes more aware that farm programs benefit large, well-capitalized farmers more than small farmers, farm programs may be redirected, possibly to reflect rural goals more closely.

The second justification for rural development policy stems from historical fact. The United States has had a rural development policy of one form or another for nearly 100 years and is likely to continue having such a policy. Table 2 shows that from the Country Life Commission under Theodore Roosevelt to the Agricultural Adjustment Acts, Resettlement Administration, and Rural Electrification Administration under Franklin Roosevelt, federal rural development policy grew into a diverse set of programs.<sup>11</sup>

Current rural policy derives from the Rural Development Act of 1980.<sup>12</sup> The act established a framework for implementing rural development policy. The act requires the Secretary of Agriculture to review the nation's rural development strategy every year and to identify federal involvement in meeting the rural objectives stated by Con-

gress.<sup>13</sup> In practice, however, the Rural Development Act does not serve as the motivating force behind most federal spending for rural development. Diverse federal programs, most unrelated to rural policy objectives—or to each other—continue federal spending on rural projects (Table 3).

The United States, then, has a national rural development strategy. But the strategy is only a loose guide to rural policy, not a policy blueprint. The Secretary of Agriculture facilitates rural development policy and implements a few discretionary programs within the Department of Agriculture. But the strategy falls short of being a comprehensive policy statement that clearly marks objectives and programs. Most federal spending in rural areas happens apart from any such rural policy blueprint.

### *Rural development objective*

If the United States does want to encourage rural development, it should work from a comprehensive policy that guides the selection of specific programs. The first step toward a comprehensive policy is identifying primary policy objectives. Easing the transition from narrower traditional economic bases to new, more diversified rural economies appears appropriate as the major objective of a federal rural development policy. A diversified economy is no guarantee against economic stress, but diversification helps buffer the wide economic swing many rural areas have experienced in the 1980s.

<sup>10</sup> Recent public opinion polls reveal that two out of three U.S. citizens support farm programs.

<sup>11</sup> For a discussion of rural development policy history, see Wayne D. Rasmussen, "90 Years of Rural Development Programs," *Rural Development Perspectives*, U.S. Department of Agriculture, October 1985.

<sup>12</sup> PL96-355, the Rural Development Act of 1980, was enacted September 23, 1980. The act extended the Rural Development Act of 1972.

<sup>13</sup> Harking back to traditional goals, the act identified five rural objectives: to raise rural incomes, to improve rural business and employment opportunities, to improve the management capabilities of rural governments, to "strengthen the family farm system," and to maintain and protect the environment and natural resources of rural areas. See "Rural Development Strategy: 1985 Update," Office of Rural Development Policy, U.S. Department of Agriculture, and "Rural Communities and the American Farm: A Partnership for Progress," U.S. Department of Agriculture, Office of Rural Development Policy, July 1984.

**TABLE 2**  
**Summary of federal rural development programs**

<b>Year</b>	<b>Rural Characteristics</b>	<b>Major Developments</b>	<b>Goals</b>
1908	33% of population live on farms, 54% of population live in rural areas	Country Life Commission appointed	Major report on needs of rural population
1920	30% of population (32 million) live on farms		
1935	35% of farms electrified	Rural Electrification Administration organized  Resettlement Administration organized	Bring electricity to farms  Resettle farm laborers and disadvantaged rural residents in part-time farming communities
1940	23% of population (30.5 million) live on farms, 43% of population live in rural areas		
1955		Rural Development Committees organized	Aid local communities in establishing new training programs and other activities Coordinate federal efforts in rural development
1960	8% of population (15.6 million) live on farms		
1965		Housing and Urban Development Act passed  Rural Community Development Service replaces Office of Rural Areas  Development Interagency Task Force on Agricultural and Rural Life established	Improve rural and urban housing  Coordinate USDA's rural activities  Recommend legislation to improve rural life

TABLE 2 (continued)

Year	Rural Characteristics	Major Developments	Goals
1966		National Advisory Commission on Rural Poverty	Develop major program for attacking rural poverty
1970	26% of population lives in rural areas	Rural Community Development Service transferred to USDA Rural Development Committee	Coordinate USDA rural development programs
		USDA Committee for Rural Development set up in each state	Coordinate USDA programs for rural development within states
1972	5% of population lives on farms	Rural Development Act	Broad authority for rural development programs
1978		White House rural development initiatives on health, water, sewers, communications, energy, transportation	Secure cooperation in solving these problems
1980		Rural Development Policy Act passed	Extend authorizations for appropriations
		USDA establishes National Advisory Council on Small Community and Rural Development	Give groups opportunity to participate in policy and program planning
1982	3% of population lives on farms	National Advisory Council on Rural Development established	Identify rural problems and support rural development policies

Source: Wayne D. Rasmussen, "90 Years of Rural Development Programs," *Rural Development Perspectives*, October 1985, pp. 6-7.

### *Rural development programs*

Three program approaches can be taken to facilitate rural economic diversification: infrastructure investment, business development, and information dissemination. The federal role might best be confined mainly to infrastructure. State

and local governments might best bear responsibility for the other two approaches.

*Infrastructure investment programs.* Investing in rural infrastructure and then allowing market forces to determine the location of business activity is a long-standing tradition in federal rural development policy. Infrastructure investment

**TABLE 3**  
**Administration's proposed fiscal 1986 budget for**  
**selected rural development programs**

<u>Development programs</u>	<u>Nonmetro share</u> <u>(millions of dollars)</u>
Community and infrastructure development	
Spending programs	7,554
Credit programs	881
	<hr/> 8,435
Business and government economic assistance	
Spending programs	1,014
Housing and credit assistance	
Spending programs	120
Credit programs	4,660
	<hr/> 4,780
Other selected programs	
Spending programs	2,180
Credit programs	3,596
	<hr/> 5,776
Total selected programs	
Spending programs	10,868
Credit programs	9,137
	<hr/> 20,005

Source: U.S. Department of Agriculture, Office of Rural Development Policy.

appears to be the main program area where the federal government can still play a role in rural development. Two major program areas in infrastructure development have been evident in the past.<sup>14</sup> The one is Economic Overhead Capital (EOC), which consists of public works, such as power systems, sewer and water utilities, and highways and other transportation facilities. The other is Social Overhead Capital (SOC), which is comprised of such human resource development

programs as education, public health, and rural housing. Federal policymakers might appropriately view SOC as part of a rural transition policy.

Federal spending on rural infrastructure most often has been for loans or grants for improving water and sewer systems and developing highways into isolated regions.<sup>15</sup> Federal rural development

<sup>14</sup> See, for example, Niles Hansen, "Development Pole Theory in a Regional Context," *Kyklos*, Vol. XX, 1967, pp. 709-725.

<sup>15</sup> For an overview of government and private agencies involved in rural development, see Judith M. Richards, *Rural Economic Development*, Southern Rural Development Center, Mississippi State University, Spring 1984. The Economic Development Ad-

policy continues to emphasize the public works aspects of infrastructure development. More than \$8 billion was budgeted for spending on community and infrastructure development in fiscal 1986 (Table 3). Many of these programs are intended to make plant sites in rural areas more attractive and accessible to new businesses.

Federal infrastructure programs do appear to have stimulated income growth in rural counties. Counties receiving Economic Development Administration (EDA) aid have consistently grown more rapidly than counties without aid. Furthermore, EDA investments in infrastructure have been more successful in boosting rural economic growth than have direct EDA loans to businesses.<sup>16</sup>

The success of the Appalachian Regional Commission in bringing rural parts of its constituent states into the mainstream of the U.S. economy may offer a paradigm for other federal investment in rural infrastructure. Increased growth in the Appalachian region can be attributed largely to public investment in the area's transportation network. The programs also appear to have facilitated the outmigration of labor to urban areas. Thus, EOC infrastructure development can serve both transition and development objectives in rural areas by enhancing the attractiveness of the area's resource base while making rural resources more mobile.

The future success of federal investment in rural infrastructure will depend on carefully targeting funds. Public investment in EOC seems warranted where funds are targeted to communities that

already have characteristics that will attract private investment. Such characteristics might include low-cost energy, a favorable location relative to existing transportation, a pool of adaptable labor—possibly associated with declining rural industries—and availability of a natural resource base. Under such conditions public investment in EOC serves as the catalyst for private investment in the rural area rather than merely accommodating private investment. Increased EOC investment in lagging rural communities, however, is not likely to be effective in promoting sustained growth in areas lacking other growth potential characteristics.

*Business development.* Programs to develop local business are almost entirely the province of state and local governments. Federal funds might be directed to investment in infrastructure, but it falls to state and local governments to stimulate further development. Business development programs take essentially one form, a subsidy to entice business investment.

Many rural communities and states continue to emphasize various forms of investor subsidies to attract industry. Common forms of local investor subsidies in rural areas include tax abatement, interest subsidies through industrial development bonds, and subsidized production inputs.<sup>17</sup> Since such subsidies are a cost to local communities, do they pay off in terms of new jobs and income to local residents?

Investor subsidies appear to have only limited effect on industrial location for two reasons. First, companies select a general region in which to locate on the basis of market potential or resource availability. For example, a manufacturer of textile products might first consider locating in the South because of the availability of experienced

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ministration (EDA), U.S. Department of Commerce, and the Farmers Home Administration, U.S. Department of Agriculture are two important sources of federal funds for public works projects in rural areas.

<sup>16</sup> For analysis of infrastructure programs, see Randolph C. Martin and R. E. Graham, "The Impact of Economic Development Administration Programs: Some Empirical Evidence," *The Review of Economics and Statistics*, February 1980, pp. 42-52, and Randolph C. Martin, "Federal Development Programs and U.S. Problem Areas," *Journal of Regional Science*, May 1985, pp. 157-170.

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<sup>17</sup> For an exhaustive guide to incentives, see *Directory of Incentives for Business Investment and Development in the United States: A State by State Guide*, Urban Institute Press, Washington, D.C., 1983.

labor and relatively cheap land. Local subsidies have little or no influence on the decision, because the subsidies are often a small part of the cost differentials between regions. Second, nearly all communities offer new plants some sort of subsidy. The general availability of subsidies reduces their locational pull. Accordingly, investors are not likely to locate in an area solely on the basis of local subsidies.

Industrial revenue bonds illustrate the relative ineffectiveness of investor subsidies. First introduced in Mississippi in 1935, industrial revenue bonds are tax-exempt municipal bonds issued by local public agencies on the behalf of private firms. They were originally intended to attract new businesses to areas with little indigenous capital, but evidence suggests that they are now widely used and available to existing local businesses as well as new business interests. As such, they have little effect on location decisions. Rather, they serve as a general subsidy for new investment, with the costs borne by the federal Treasury, since municipal bonds are exempt from federal income tax.<sup>18</sup> Moreover, the recently passed federal tax reform further restricts the use of industrial revenue bonds.

Tax abatements and subsidizing production inputs, such as manpower training, also have drawbacks as development tools. There is some evidence that location decisions—the choice, say, between neighboring states or counties—are influenced by special tax abatements or offers of subsidized inputs.<sup>19</sup> However, the value of subsidies varies greatly with the capital needs, marginal tax structure, and resource requirements of potential investors. Accordingly, rural develop-

ment agencies would do well to provide an array of incentives that can be tailored to the needs of potential investors in rural areas.<sup>20</sup> It should also be emphasized that the locational advantages of tax abatement could be offset if lower tax bills result in poor public services. Finally, states that want to direct new development to lagging rural areas will need to provide special state incentives for location in those areas since investor subsidies are generally available in all areas of a state, whether urban or rural.

Many rural areas likely will find recruiting industry more difficult in the future. Recent evidence suggests two reasons for this outlook. First, low-wage, labor-intensive jobs increasingly are going to foreign countries with outright comparative advantage. Second, many of the new jobs in manufacturing are being directed toward the more diversified labor pool and more highly developed infrastructure found in larger cities.<sup>21</sup> As a result, some states are proposing to stimulate local business formation through training and seed capital programs. Examples of such approaches are to use colleges and technical schools as centers for small business development and to provide local development agencies with technical assistance to broaden their perspective. The effectiveness of seed capital programs remains unclear.

*Information dissemination programs.* Federal, state, and local governments all have past experience in providing information on development opportunities. The basic aim of the information programs is to promote rural communities as places to invest or to promote the goods rural communities produce.

<sup>18</sup> Matthew Marlin, "Industrial Revenue Bonds: Evolution of a Subsidy," *Growth and Change*, Vol. 16, No. 1, January 1985, pp. 30-35.

<sup>19</sup> W. Warren McHone, "State Industrial Development Incentives and Employment Growth in Multistate SMSA's," *Growth and Change*, October 1984, pp. 8-15.

<sup>20</sup> See D. Rasmussen, M. Bendick, and L. Ledebur, "A Methodology for Selecting Economic Development Incentives," *Growth and Change*, January 1984, pp. 18-25.

<sup>21</sup> For example, see MDC Panel on Rural Economic Development, "Shadows in the Sunbelt," MDC Inc., Chapel Hill, N.C., May 1986.

The federal government has a long history in stimulating foreign demand for goods produced in rural areas through information dissemination and export promotion. The federal government has dozens of programs for facilitating export expansion, such as the International Trade Administration, the Export-Import Bank, the Small Business Administration, the U.S. Trade and Development Program, and perhaps of greatest significance to many rural areas, the Foreign Agricultural Service (FAS) of the U.S. Department of Agriculture.<sup>22</sup> These programs are not specifically targeted at rural products, but they have considerable influence on the rural economy and probably serve a useful purpose in rural development.

States are taking several steps to stimulate rural exports, both to the rest of the U.S. economy and to foreign buyers. Many states are trying to provide rural communities with technical assistance to expand their exports out of the region. Accordingly, many state universities have community and rural development personnel to help small communities identify development goals and attract industry. States are also becoming more involved in promoting export goods from their states through programs that seek market niches for locally produced goods.<sup>23</sup> To be successful, programs that promote local processing of raw goods need to be based on products that offer comparative cost advantages over competing regions. Products based on traditional local raw materials and processing activities will not necessarily offer a comparative advantage in the changing market. For example, the cotton-producing states of the Southeast may no longer have an advantage in tex-

tile production. On the other hand, the Mississippi catfish industry is an example where state programs have been coupled with comparative cost advantages to develop a rural industry.

Local governments tend to specialize in providing information about communities through local chambers of commerce or county industrial recruiting offices. No comprehensive evaluation of the effect of such programs on economic development is available, but the low cost of such efforts and the perceived need to match the recruiting efforts of neighboring counties and states ensure that the policy will continue to be popular with local leaders.<sup>24</sup>

### Summary

In sum, rural development policy involves a long-run commitment to stimulating economic growth in rural areas. Such policy would aim to reverse, at least to some degree, structural changes now at work in the rural economy. This approach is justified by social goals, not economic ones. The federal role in rural development appears to be investing in rural economic infrastructure. States can play a part by providing special business development incentives and information programs to enhance markets for goods produced in rural areas. Rural policymakers should set clear priorities for infrastructure investment. Scarce public funds should be spent only when there is a reasonable likelihood they will spur private economic activity. Local communities will be left with the greatest rural development task—that of attracting businesses to rural locations. Local communities will offer a variety of investor subsidies, but the results of these efforts may fall short of expectations.

<sup>22</sup> For a description of specific programs, see International Trade Commission, *The Export Trading Company Guidebook*, U.S. Department of Commerce, March 1984, pp. 77-80.

<sup>23</sup> See Judi Hackett, "Agriculture and Rural Development," mimeo, Center for Agriculture and Rural Development, Council of State Governments, Lexington, Ky.

<sup>24</sup> For a discussion of program effects, see Charles Leven, "Regional Development Analysis and Policy," *Journal of Regional Science*, Vol. 25, No. 4, November 1985, p. 574.

## Conclusions

The rural economy is undergoing fundamental change. The effects of this structural change are showing up in an increasing number of displaced rural workers and mounting strains on the public infrastructure of rural communities and states. Policymakers are just now beginning in earnest to decide how they will respond to rural economic problems. Before going further, policymakers need to decide whether a rural transition policy, a rural development policy, or some combination of the two will guide their responses.

Rural transition policy is the logical starting point for responding to rural economic stress. The structural change unfolding in rural America is creating resource adjustment strains that policy can effectively address. Retraining programs for displaced rural workers and programs that maintain essential public services and encourage the pooling of rural infrastructure can facilitate rural economic change while holding social costs to a

minimum. States will carry the principal responsibility for administering many of these programs, but the federal government likely will play a role in funding the programs.

Whether the United States goes beyond transition policy and pursues a rural development policy depends on the social value attached to the economic growth of rural areas. The United States has explicitly pursued rural development goals for more than a hundred years. If those goals are still considered worthy, a comprehensive policy needs to be formulated to guide rural development programs. Infrastructure, business development, and information dissemination programs should be targeted to rural communities that have a reasonable likelihood of attracting private investment. Finally, policymakers should decide if farm programs, currently the primary policy link to the rural economy, may be too narrowly focused to meet rural objectives. If so, some of the public funds now going to farm programs may need to be redirected to rural programs.