

Economic Development in the Nation's Heartland: Issues and Strategies

By Tim R. Smith

Problems in agriculture, energy, and basic manufacturing have slowed the recent growth rate in the nation's Heartland—a 13-state area including Arkansas, Colorado, Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska, New Mexico, North Dakota, Oklahoma, South Dakota, and Wyoming. Slower growth in these states than in the nation as a whole has focused attention on opportunities to improve the economic prospects for these states.

How can the region improve its economic fortunes? To help answer that question, the Federal Reserve Bank of Kansas City sponsored a conference on "Economic Development in the Nation's Heartland: Issues and Strategies" at Kansas City, Missouri, on November 16, 1987. Participants of the conference agreed that sharply increased cooperation among educators, bankers, business leaders and policymakers at local, state and regional levels is essential to the region's economic development.

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This article summarizes the presentations made at the conference. The article follows the order of the conference's agenda shown in the box on page 9. The first section considers the prospects for growth in the Heartland. The second examines what can be done, at the national and regional level, to make the Heartland more competitive in the global economy. The third section explores specific strategies for economic development from the standpoint of key participants in the development process.

Prospects for growth: the strengths and weaknesses of the Heartland

The success of economic development efforts in the Heartland depends partly on reckoning with the region's outlook and on identifying the relative advantages and disadvantages the region has with respect to specific economic activities. These activities include such traditional activities as agriculture and energy and such emerging activities as high-technology manufacturing. Despite some formidable obstacles, a regional approach to economic development seems to hold promise.

The Heartland's economic outlook

Roger Brinner gave his outlook for the region and the nation. Although the natural resource-based economy of the Heartland would be hard hit by a national recession, Brinner contended that the possibility of a recession in 1988 was remote. He argued that the October 1987 stock market crash probably would not cause consumers to panic and cut their spending. He predicted, however, that the nation's economy was likely to slow considerably in 1988 and that employment growth in the Heartland would remain below the national rate.

Brinner identified the region's dependence on slow-growing industries as one of the factors causing its growth to be slower than growth in the nation as a whole. The lagging growth in regional employment could be attributed to its mix of economic sectors. The farm and energy sectors were particularly heavy drags on economic growth from 1984 to 1986, and both are important sectors in most of the Heartland states. Brinner foresaw sluggish growth in the Heartland's ten most important industries through 1991.¹ Several of these ten industries relate to energy and agriculture.

A second factor is that industries employing the largest numbers of workers have grown slower in the region than in the nation. These industries include retail and wholesale trade and services—all industries that tend to follow growth of the region's primary industries, such as agriculture and energy. Brinner predicted that the Heartland's ten largest industries would grow more slowly in the region than in the nation through 1991.

¹ The ten district industries with the highest employment concentration relative to the nation are: primary lead; iron and ferroalloy ores mining; greeting card publishing; food grains; feed grains and grass seed; metal ores mining (not elsewhere classified); other ordnance and accessories; livestock; small arms ammunition; and poultry and egg processing.

Still another cause of the region's slower growth is its lack of fast-growing industries. Concentration of the nation's fastest growing industries, such as many high-technology industries, is comparatively low in the Heartland. Not only are these industries relatively less important in the region, but Brinner projected growth of these industries to be slower in the region than in the rest of the country for the next several years.

What policy variables might affect future employment growth in the Heartland? While many factors influence regional growth, Brinner identified some policy variables that appear to be statistically important for the Heartland. He suggested that more competitive business and personal taxes might improve the prospects for growth in these 13 states. Policies regarding unions also appear to be important because labor costs affect firms' location and expansion decisions. And to improve growth prospects, more attention may need to be given to education in the region.

The Heartland's strengths and weaknesses: traditional and emerging industries

Jerry Jordan, in a paper on the strengths and weaknesses of the region, characterized the nation's economy as a reciprocating engine with many cylinders. In this characterization, he equated individual states with cylinders of an engine. At any given time, some cylinders are up and some are down. So while the national economy may be running smoothly, the performance of the states can vary significantly.

He was critical of the proposition that diversification might be the answer to fluctuations in regional economies. Some types of diversification tend to make the amplitude of economic fluctuations more uniform, he said, but others accentuate the amplitude. For example, diversification into high-technology manufacturing was expected to offset some of the regional effects of downturns

in other sectors. But high technology was also in a slump during the recent downturns in agriculture and energy.

Jordan also identified the government sector as a potential problem during regional economic downturns. He said states of the Heartland have what is called "the small population state problem." State and local government employment is larger relative to the private sector in small states. The problem can be particularly acute in areas that depend primarily on natural resources. The government sector grows during natural resource booms to support overall employment growth in the area. Then when a downturn comes, the private sector shrinks faster than the government sector. Since the government sector is supported by taxes, the state and local government sector accentuates the downturn by becoming a larger burden on the shrinking private sector.

If neither diversification nor government is the answer, where can the Heartland turn to improve its outlook? Jordan focused on two factors that can influence regional growth. One is a healthy financial sector. The other is the quality of educational institutions. Jordan blamed restrictive banking laws for what he considered a weak financial sector in the Heartland. Although he said the Heartland has some fine educational institutions, he did not think the region spends its education dollars efficiently. Educational institutions are almost always a factor in economic development. But the benefits are diluted, he said, if the funds for education are spread over too many autonomous and comprehensive institutions.

Jordan pointed out that several factors affect a region's comparative advantage. The Heartland's comparative advantage could change with changes in international exchange rates, energy prices, grain prices, or technologies. Although he said it might be difficult to identify specific industries that will be important in shaping the economic future of the Heartland, he offered some suggestions. Traditional industries such as agri-

culture and food processing are likely to remain important, but emerging industries also hold promise for economic growth. Emerging industries include health care, tourism, and education—all industries that can be expected to grow as incomes rise.

Economic development: a regional challenge for the Heartland

Scott Fosler stressed regional cooperation among Heartland states as a foundation for economic development.² He pointed to successful cooperation among states in other regions but said that, compared with other regions, the Heartland did not have a strong regional identity or a set of regional institutions. This lack of regional ties suggests that the 13 Heartland states may face formidable obstacles to improving regional cooperation and regional prospects for economic development.

Fosler first identified factors favoring a regional approach to economic development, based on successful cooperation in other regions. One factor is the continued restructuring of the U.S. economy and the changes it has brought to the Heartland. For example, recent restructuring in response to problems in agriculture, energy, and traditional manufacturing has affected much of the region. Another factor favoring regional economic development is the increase in the responsibility of the states under the Reagan administration, the "New Federalism." Another factor is that states can directly control several important policy variables, such as education and infrastructure, that contribute to regional economic growth. Finally, increased awareness of regional potential and recent improvements in understanding regional economic development

² Fosler's paper is reprinted in this issue of the *Economic Review* beginning on page 10.

favor cooperation among Heartland states as they attempt to find solutions to their economic woes.

Fosler admitted, however, that while many factors favor regional cooperation, there are also significant obstacles to cooperation. First, economic geography and political boundaries do not match. States are the main regional governments in the country, and their boundaries seldom coincide with economic geography. Second, regions overlap. States of the Heartland border other regions and are represented by many overlapping regional institutions. Third, the region has no clear focus. The Heartland does not have a single regional institution that includes most of its states. States turn their efforts to their own economies with little awareness of common regional goals. And fourth, the region has many economic decisionmakers and few institutional links to bring them together.

Although the factors favoring and hindering regional cooperation are difficult to weigh, Fosler suggested seven possible actions to be taken. First, every Heartland state should develop an effective economic development strategy as a first step toward general improvement of the region. Second, competition among states should be limited and cooperation encouraged. Third, states should pay particular attention to issues that involve bordering states. Fourth, states should exploit economies of scale by pooling resources for research on common problems. Fifth, states should frame a common regional strategy, even if the strategy only helps individual states develop their own strategies. Sixth, states should identify and negotiate specific targets of mutual opportunity, such as centers of excellence in higher education and the strengthening of regional financial institutions. And seventh, states should develop their regional institutional infrastructure.

Brinner, Jordan, and Fosler brought together views that generally support a case for a regional approach to economic development. But in their views, the benefits of such an approach will not

come easy. Against a backdrop of slow potential economic growth, some significant obstacles must be overcome for the region to exploit its comparative advantages and improve its economic prospects.

*Economic development: think globally,
act locally*

In the conference luncheon address, Richard Lamm put the issues of regional economic development in a broader context. He saw the Heartland as part of a nation increasingly in need of broadbased changes to improve its international competitiveness. Lamm blamed many institutions for putting the United States in the backseat to the rest of the world.

He put some of the blame on the government. Expensive federal spending programs, such as defense, have added to the tax burden of U.S. corporations and raised their production costs. Meanwhile, infrastructure has been allowed to deteriorate, raising the cost of doing business in the United States. This suggests that a reallocation of federal spending from defense to infrastructure may be an effective way to improve economic development prospects for the nation and its component regions.

In Lamm's view, the country is also handicapped by societal problems. These include a complex and burdensome legal system, illiteracy, costly health care and a high crime rate. He suggested evaluation of the nation's legal and educational systems, its health care, and correctional facilities, with aims to make them more efficient.

Education makes a good example. Lamm was of the opinion that a country that is second-best educationally will be second-best economically. He stressed the importance of reducing the size of higher education in the United States while improving its quality. Particularly important is the need to improve the commercialization of university research.

In addition to pointing out governmental and societal problems, Lamm suggested that the nation could improve its competitiveness by streamlining its corporations. Many corporations are top-heavy and inefficient, he said. Moreover, the employment benefits corporations routinely offer have placed the country at a cost disadvantage to other countries.

Economic development strategies for the Heartland

A panel discussion by representatives of institutions with key roles in economic development highlighted the parts played by universities, financial institutions and the business community. The need for cooperation among these players emerged as an important theme, along with the need for cooperation across state lines.

Kenneth Keller raised the question of how universities can be responsive to economic changes, such as the weakening of agriculture, mining, and other traditional sources of economic activity. In the absence of a national university system, the nation and its regions must depend on a fragmented regional system of public and private universities for basic research and an educated workforce. The importance of universities to economic development cannot be overestimated. Two-thirds of the nation's basic research is done at universities.

The contributions universities make to regional economic development depend to a large extent on the quality of the institutions. All the universities in the Heartland cannot be treated equally. No university can be all things to all people. Keller expressed the belief that not only should university missions be differentiated across universities in the same states but that there should also be collaboration in research and teaching across state lines. He emphasized the importance of regionalism in defining the missions of universities, pointing out that there is often not a perfect

match between university programs and the needs of the state where the university is located. An efficient solution might be for a state to turn to universities in neighboring states for some programs.

The potential for universities in economic development depends importantly on the transfer of technology. In Keller's opinion, attention should be given to improving the links between university faculty and the business community. Care should be taken, however, that the sense of university identity is not lost. Keller pointed out, for example, that the comparative advantage of universities in agricultural research lies in basic research—in identifying chemical components, for instance—rather than in product development or market research.

Why are universities in the Heartland not doing a better job in fostering economic development? Keller cited two main barriers to expansion of the universities' role in economic development. One is the generally low per-student state funding for higher education in Heartland states. The other is the decline in federal support for university infrastructure and graduate studies. The contribution of universities to economic development may depend not only on the reallocation of resources among universities and their programs but also on increasing support for Heartland universities relative to those in other regions.

Richard Kirk gave his views on financing Heartland development. He began by noting the importance of commercial banks in financing economic activity in the region, but pointed out that problems in energy, agriculture, and real estate—the mainstays of Heartland banking—may have made some bankers too conservative. He saw the region's low loan-to-deposit ratios as evidence of bankers pulling back from some types of lending that might be needed. Some increases in "safe, aggressive lending" might improve economic prospects in some areas.

Changes in the regulatory environment could

help banks in the Heartland become more responsive to the region's economic needs. States in the Heartland have been slow to liberalize branching and interstate banking restrictions. Although small independent banks meet a need in the region, Kirk suggested that larger banking organizations meet some needs that would otherwise go unmet.

While admitting the importance of traditional bank lending, Kirk pointed to the need to diversify sources of funding for economic development. Innovative sources of venture capital would facilitate entrepreneurial activity. Venture capital could be provided by banks and other private firms, state and local governments, or public-private partnerships. He suggested the further possibility of an economic development fund anchored by a large regional bank. Other major corporations, small banks, insurance companies, and pension funds could contribute to the fund.

Also important to improving the region's economic development prospects, according to Kirk, is diversification of industries and the products they sell. While it is important not to ignore existing firms and their potential for expansion, Kirk said that incentives should be improved to attract new companies to the region and that universities can play an important role in seeding new companies.

Charles M. "Mike" Harper addressed the challenge of improving the business climate in the Heartland. He focused on the prospects for fostering private enterprise in the region. In his opinion, one of the best ways of attracting firms would be to improve their potential profits.

One incentive Harper singled out as a major factor in business decisions regarding location and

expansion is tax abatement. Reduction in state taxes has been suggested as a means of attracting businesses to many Heartland states. The cost of doing business in Nebraska, for example, has been reduced significantly by lowering capital gains and other business taxes.

Harper foresaw a positive future for business in the Heartland. Contributing to his optimistic view was his faith in entrepreneurs and—though he emphasized that policymakers must adopt an aggressive development posture and provide incentives to businesses—a sense that policymakers were changing their attitudes toward economic development.

Summary

Participants in the conference agreed that economic growth in the Heartland was likely to continue lagging behind growth in other regions. The region will continue being subject to cyclical swings because many of its main industries depend on natural resources. But as the region's comparative advantage changes with economic events, new industries will emerge with new potentials for growth.

Participants also agreed that individual states should take steps to improve their economic outlooks. The most urgent broad steps to be taken were identified as improving the business climate in the region, boosting the quality of education, and making capital more accessible. Educators, bankers, business leaders, and policymakers will need to cooperate to reach effective solutions. And maybe more important, cooperation needs to reach across state boundaries.

**Economic Development in the Nation's Heartland:
Issues and Strategies**

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Prospects for Growth: The Strengths and Weaknesses of the Heartland

Mark Drabenstott, Assistant Vice President and Economist, Federal Reserve Bank of Kansas City, moderator

The Heartland's Economic Outlook, Roger E. Brinner, Group Vice President and Chief Economist, Data Resources, Inc.

The Heartland's Strengths and Weaknesses: Traditional and Emerging Industries, Jerry L. Jordan, Senior Vice President and Chief Economist, First Interstate Bancorp

Economic Development: A Regional Challenge for the Heartland, R. Scott Fosler, Vice President and Director of Government Studies, Committee for Economic Development

Session Discussants, Tucker Hart Adams, Vice President, Economics and Planning, United Banks of Colorado; Charles Krider, Director, Institute for Public Policy and Business Research, University of Kansas

Economic Development: Think Globally, Act Locally, Richard D. Lamm, Professor and Director of the Center for Public Policy and Contemporary Issues, University of Denver

**Economic Development Strategies for the Heartland:
A Panel Discussion**

Marvin Duncan, Member of the Board, Farm Credit Administration, moderator

A Regional Approach to Education and Research, Kenneth H. Keller, President, University of Minnesota

Financing Heartland Development, Richard A. Kirk, Chairman of the Board and Chief Executive Officer, United Bank of Denver

Improving the Heartland's Business Climate, Charles M. "Mike" Harper, Chairman of the Board and Chief Executive Officer, ConAgra, Inc.