
Will the Rural Economy Rebound with the Rest of the Nation?

By Jason R. Henderson

As the U.S. economy slipped into recession in 2001, an already lackluster rural economy lost even more steam. Since 1995, job growth in rural areas has trailed growth in metro areas. But in the wake of last year's terrorist attacks, national recession and falling food demand, job rolls in many parts of rural America have not only stopped growing but contracted. Meanwhile, commodity prices, which have been slumping since 1996, have only recently begun their turnaround. As a result, farm incomes continue to rely on large government payments.

With the U.S. economy now in recession, the demand for most rural products—farm and nonfarm alike—has stalled. Many economic analysts expect the U.S. economy to turn around in 2002. But, are the prospects of a rural recovery as bright as the rest of the nation? Are both the Main Street and farm segments of the rural economy positioned to recover?

This article examines the impact of the current recession on rural growth, recaps rural performance in 2001, and explores the prospects for the year ahead. The first section examines the current recession in the Main Street economy, or nonfarm economy, and assesses its ability to recover in 2002. The Main Street economy has paced recoveries in the past, but this recession may bring different challenges. The second section focuses on the farm economy and its ability to rebound further in 2002. The farm economy has emerged from 2001 with healthy balance

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sheets and smaller supplies, but uncertainty surrounds the outlook for commodity markets due to slumping demand worldwide. Overall, rural areas seem poised to recover along with the rest of the nation in 2002, but only if demand for rural products rebounds.

I. THE MAIN STREET ECONOMY: WILL IT LEAD A RECOVERY?

The terrorist attacks of September 11 deepened the recession in the U.S. economy, and the Main Street economy followed suit. The manufacturing sector, which limped into 2001, slumped throughout the year. Service activity, while healthy, was not strong enough to keep Main Streets out of a recession. Looking ahead, the Main Street economy should rebound with the expected U.S. recovery in 2002.

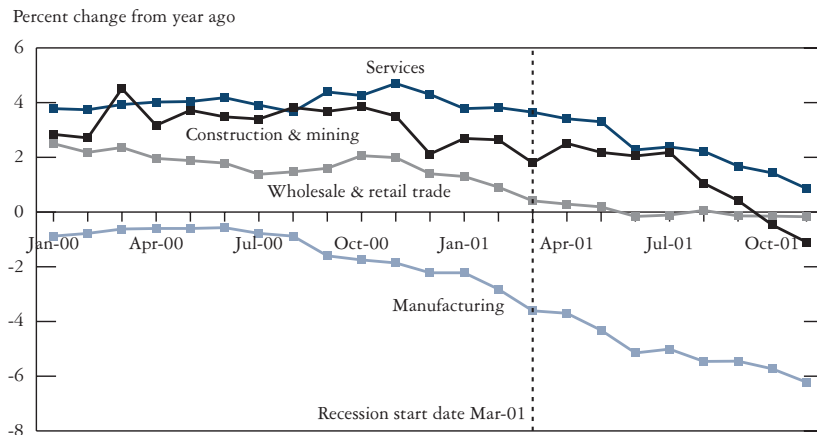
Assuming a U.S. recovery materializes, it is natural to ask if rural areas will lead the recovery as they have done in the past. Put simply, the answer is probably no. Manufacturing cuts are deeper and service sector growth is not as strong as in the past. Past engines of economic growth face unique obstacles in coping with the aftershocks of the terrorist attacks. Overall, a Main Street recovery will depend heavily on a strengthening in demand for rural products.

Main Streets slipped into recession in 2001

The combined effects of a contraction in manufacturing and a slowdown in nonmanufacturing activity spelled recession for Main Streets in 2001. Entering the year, signs of trouble were already on the horizon. Job growth was slowing. Manufacturing was the only sector to face an outright contraction in 2001. But nonmanufacturing activity, which had been sustaining the rural economy, slowed to a point where it could no longer hold back a rural recession.

Entering 2001, rural manufacturers were already finding it hard to maintain job levels (Chart 1). The recession started officially in March, but rural manufacturers were already facing trouble well before then. In fact, job rolls in rural factories shrank throughout the year. Prior to the

Chart 1
RURAL JOB GROWTH BY INDUSTRY



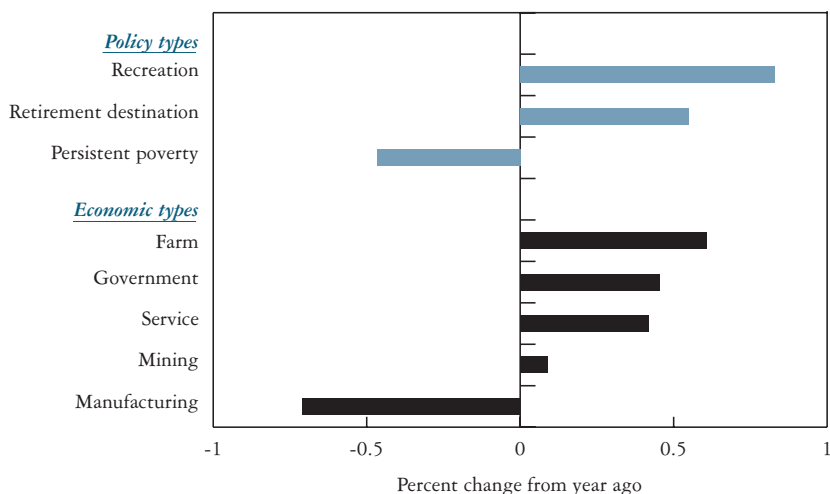
Source: Bureau of Labor Statistics

September 11 attacks, rural manufacturing jobs had already fallen 5.5 percent below a year ago. After the terrorist attacks, layoff announcements only intensified the contraction in manufacturing activity.

As rural manufacturing contracted, so did other rural economic activity. Nonmanufacturing sectors that paced growth in the previous year trended downward throughout 2001. Service industries, which account for the largest share of rural jobs, entered the year adding jobs at a 4 percent clip. By October, job growth had been cut in half. As early as April, merchants, which account for the second largest portion of rural jobs, were struggling to keep jobs at year-ago levels.

Construction activity, another bellwether sector of the rural economy, also slowed in 2001. Despite lower interest rates, the number of rural building permits during the year was well below record levels posted in 2000. Slowing activity limited gains in construction jobs throughout the year. The construction slowdown also appears to have reduced nonagricultural demand for farmland, contributing to slowing gains in farmland values in the second half of the year.

Chart 2

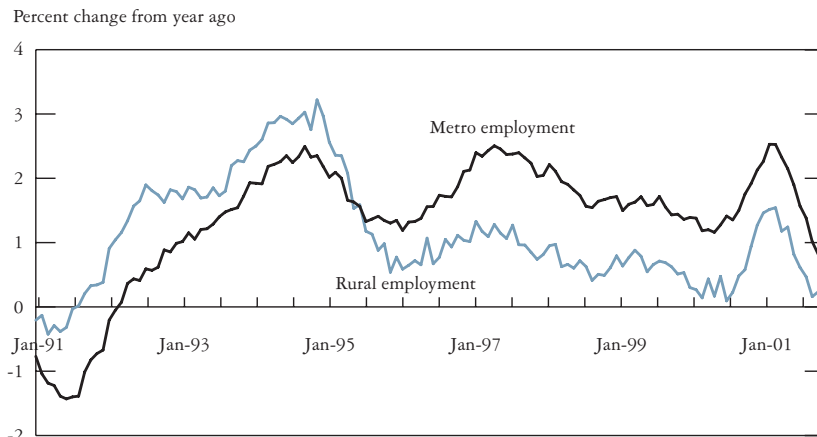
RURAL EMPLOYMENT GROWTH BY COUNTY TYPE
OCTOBER 2001

Source: Bureau of Labor Statistics and USDA

The impact of the recession was also apparent across many types of rural communities (Chart 2). The contraction in manufacturing job rolls led to widespread economic weakness in rural economies dependent on factory jobs. But other rural counties were able to keep overall employment gains positive in 2001. Employment continued to expand in service and government-based rural economies. And places that depend on recreation and retirement destination activity continued to pace rural America despite major declines in tourism following September 11. As layoff announcements mounted, the rural unemployment rate rose sharply. By October, the rural nonseasonally adjusted unemployment rate had risen more than 1 percent to 4.9 percent compared with 4.7 percent in the nation as a whole, and layoffs were continuing.¹ In short, there were many signs of a recession on Main Street.

Chart 3

RURAL AND METRO EMPLOYMENT GROWTH



Source: Bureau of Labor Statistics

Will Main Streets recover in 2002?

Main Street following the rest of the nation into recession is certainly not a new phenomenon. The current downturn follows a history of rural economies traveling the same path as the rest of the nation. With many analysts expecting a recovery in the U.S. economy sometime in 2002, Main Street should also recover in 2002, if history is a reliable guide.

While rural employment growth has slipped relative to metro growth over the past decade, rural and metro growth rates still tend to move in the same general direction (Chart 3). After falling during the 1991 recession, employment grew in both rural and metro areas through 1994. Growth rates softened in 1995, rebounded in 1996, and then trended downward. After a strong bounce in 2000, employment gains fell steeply last year. The correlation between rural and metro employment growth over the past 30 years is quite high—about 80 percent. Thus, it seems safe to say that changes in the U.S. economy are a fair predictor of changes in the rural economy.

Table 1

U.S. RECESSION EMPLOYMENT GROWTH

Pre-trough growth (Percent)			Post-trough growth (Percent)			
<u>Year</u>	<u>Metro</u>	<u>Rural</u>	<u>Trough</u>	<u>Metro</u>	<u>Rural</u>	<u>Year</u>
1970	-.20	1.13	Nov. 1970	2.71	3.02	1971
1974	-1.83	-1.22	Mar. 1975	2.48	4.25	1975
1979	.56	-.64	Jul. 1980	1.00	.20	1980
1982	.95	.27	Nov. 1982	5.00	3.16	1983
1990	-1.49	-.15	Mar. 1991	.35	1.73	1991

Sources: BEA, Dept. of Commerce

Most economic analysts forecast an end to the recession in the first half of the year. A consensus survey of economic forecasters reported that the annual rate of growth in GDP would turn positive in the first quarter of 2002 and continue to grow.² Over 90 percent of these same forecasters expect the recession to end by June 2002. By January, the stock market returned to pre-September 11 levels pointing to a recovery sometime in 2002.

Can Main Streets lead a recovery?

Assuming the nation's recovery materializes, can rural areas actually lead a recovery by growing faster than the rest of the nation? Contrary to expectations, rural economies have rebounded faster than the nation in three of the last five recoveries since 1970 (Table 1). But that tendency may not hold in the current recession. The forces that propelled rural economies into a leadership role in the past do not appear to be in place this time around.

Rural areas paced the nation in recovering from the two recessions of the 1970s, a decade some rural economists labeled a "Rural Renaissance." Job growth was faster in rural areas than their metro counterparts after both the 1971 and 1975 recessions. Stronger rural growth was spirited by smaller job cuts in rural factories and by larger job gains in service firms. For example, during the 1971 recovery, rural manufac-

Table 2

RURAL AND METRO JOB GROWTH
AFTER THE 1990–91 RECESSION

(Annual percent change)

	<u>Metro areas</u>	<u>Rural</u>
Manufacturing		
March 1991 (trough)	-4.6	-3.6
March 1992	-2.6	1.0
October 2001	-3.8	-5.7
Services		
March 1991 (trough)	.7	2.8
March 1992	2.0	4.9
October 2001	1.1	1.4
Trade		
March 1991 (trough)	-2.0	.3
March 1992	-2.0	.3
October 2001	.3	-.1

Source: BLS

turing jobs only fell 1 percent compared to a 5 percent cut in metro factories. Meanwhile, rural service jobs rose more than 3 percent as metro service jobs rose less than 2 percent.

Rural places again rebounded faster after the 1991 recession. Declines in manufacturing activity were smaller and growth in non-manufacturing industries was stronger in rural areas than metro areas (Table 2). At the trough of the 1991 recession (March 1991), rural manufacturers experienced smaller cuts in job rolls than their metro counterparts, -3.6 percent versus -4.6 percent. A year later, metro manufacturers were still losing jobs, while rural manufacturers were adding jobs. Meanwhile, rural service businesses boosted job rolls a full 2 percent more than their metro counterparts—both before and after the trough.

The twin forces that allowed rural areas to pace a U.S. recovery a decade ago—stronger service-based activity and a softer manufacturing slowdown—are currently missing. The absence of these forces limits the ability of Main Streets to build economic momentum in the year ahead. In today's recession, rural manufacturers and service firms are posting weaker job gains than a decade ago. Job cuts have been deeper for rural

manufacturers. Rural service firms are still adding jobs, but the gains are not as strong as in the last recession and may not be able to overcome job losses in manufacturing. Moreover, in the U.S. recessions since 1970, the metro or rural economies that were posting stronger growth prior to the recession trough led the way to economic recovery. Prior to September 11, rural places were lagging metro places in job growth, making it less likely that they could pace a recovery.

Whether service activity in rural areas can continue to outpace metro areas is also open to question. Traditional engines of rural service growth face unique challenges in the current recession. Over the past decade, rural locations rich in natural amenities—particularly lakes, streams, and mountain vistas—have paced rural employment growth. These recreation and retirement destinations continue to enjoy the fastest rate of employment growth in the new millennium. By depending more on tourist dollars than other rural areas, a slowdown in travel limits their overall economic activity. These locations face serious difficulties in the current recession since recreation and retirement areas posted the sharpest declines of all rural areas in the third quarter of 2001, losing 1.3 percent of their total employment. If the aftershocks of the terrorist attacks continue to hinder travel and alter vacation plans next year, these rural areas face increasing economic difficulties.

Main Street in the year ahead

The Main Street economy enters 2002 with a contracting manufacturing sector and a sluggish service sector. If the recession deepens in the first part of the year, the result could be persistent losses in manufacturing jobs and a continued slide in service-based activity. In this case, nonmanufacturing activity will not be strong enough to stop shrinking job rolls in many rural areas. And unemployment will continue to rise.

The new year, however, is expected to bring new opportunities to rural America. The U.S. economy is expected to recover sometime in 2002, bringing renewed demand for rural products and services. Generally speaking, the Main Street economy should move in parallel with the U.S. economy and rebound in 2002. But, it is the strength in demand that will determine how fast rural areas recover.

II. THE FARM ECONOMY: POISED FOR A REBOUND?

While the Main Street economy faced recession in 2001, the farm economy was shaking off its recent slump. Agriculture appears poised for further rebound in 2002. Another round of government emergency payments and higher market receipts for livestock and crops boosted farm incomes in 2001, improving the farm balance sheet. Heading into 2002, food supplies are expected to shrink, positioning commodity markets for a potential price rally. The strength of the rally depends heavily on the U.S. and global economies emerging from recession to boost food and agricultural product demand.

A healthier farm economy in 2001

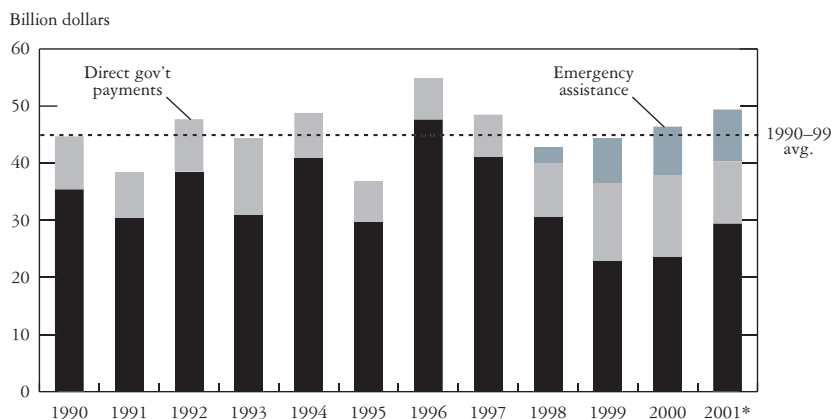
The U.S. farm economy continued to emerge from its three-year slump in 2001. Another round of emergency government payments coupled with rising farm cash receipts boosted U.S. farm incomes, which quickly translated into gains in farmland values. The rise in income came in spite of the first U.S. recession in a decade, which led to softer demand in commodity markets. When the final numbers were tallied, the farm balance sheet was healthy heading into 2002.

With higher market-based incomes and Congress boosting payments again in 2001, farm income rose to its highest level in five years. USDA expects net cash farm income, a cash flow gauge that measures the difference between receipts and expenditures, to reach \$60.8 billion in 2001, up 6 percent from the previous year. U.S. net farm income, a broader measure that accounts for inventory swings and depreciation, is expected to rise 6.5 percent to \$49.4 billion in 2001, its highest levels since the banner year of 1996 (Chart 4). Unlike 1996, however, more than a third of net farm income in 2001 came from government payments. Congress passed another round of emergency payments bringing the total to \$9.1 billion, slightly higher than the \$8.5 billion in 2000. The rise in emergency payments offset a decline in farm bill payments emerging from the 1996 farm bill.

Market-based farm income rose to \$29.4 billion, paced by a rebound in livestock markets during the first half of the year. The dairy industry led the way as rising milk prices contributed to a sharp gain in

Chart 4

U.S. NET FARM INCOME



*Forecast

Source: USDA

dairy receipts. Smaller supplies of cattle, hogs, and poultry at the beginning of 2001 boosted prices and led to rising cash receipts. By the second half of the year, however, bigger supplies and weaker demand led to a broad slump in livestock prices.

Though not as strong as livestock, crop receipts managed a 3 percent gain to \$97 billion in 2001. A surge in soybean receipts due to strong export activity paced the crop side of farm receipts. Cash receipts for corn and wheat rose somewhat less as smaller carryover stocks supported relatively stable crop prices throughout the year. Crop prices edged up throughout the summer as USDA continued to cut production forecasts. Prices quickly reversed course, though, when the fall harvest proved bountiful. Still, the fall bounty was not sufficient to raise carryover stocks, and by yearend prices had found a bottom.

Bigger government payments and larger farm cash receipts supported rising land values in 2001. A quarterly survey of farm bankers in the Kansas City Federal Reserve District (Colorado, Kansas, western Missouri, Nebraska, northern New Mexico, Oklahoma, and Wyoming) reported a buoyant 4 percent gain in land values during the year ending

in September (Center for the Study of Rural America). The Chicago Federal Reserve District (northern Illinois, northern Indiana, Iowa, Michigan, and southern Wisconsin) reported a solid 5 percent gain during the same time period. Land value gains in the Kansas City district appeared to slow throughout the year, though, declining from a 4.3 percent annual gain in the first quarter. The weaker growth rate may be driven by diminished nonfarm demand for agricultural land due to the recession. For instance, land value gains slowed more in the mountain states and other scenic areas of the Kansas City district, where nonfarm demand contributed to substantial land value gains in recent years.

Rising land values and farm income led to a healthy farm balance sheet as farmers used income gains to pay off existing debt. Farm business assets rose almost 3 percent in 2001, paced by a 3 percent growth in farm real estate assets. Cheaper borrowing costs due to lower interest rates and tax incentives to convert nondeductible personal property to farm business property pushed farm debt up 4.8 percent in 2001. In response, the farm sector debt-to-asset ratio edged up in 2001 but remained well below historical levels. Higher farm incomes are allowing producers to remain current on loan repayments for machinery and farm real estate loans. After declining in the first half of the year, loan repayment rates rose as renewals and extensions declined.

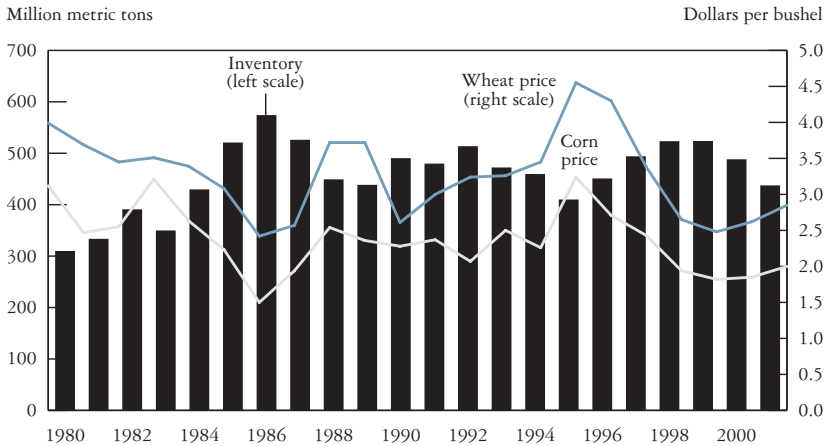
Overall, higher commodity prices and increased government payments have produced financial stability in the farm economy. Debt-to-asset ratios remain low as rising incomes from slightly higher commodity prices and government payments boosted land values. By the end of the year, higher supplies and waning demand from the economic recession weighed heavily on farm commodity prices. Both smaller supplies and a recovery in food demand will probably be needed to boost prices in 2002.

A potential price rally in 2002?

Heading into 2002, food inventories are comparatively small. World grain consumption outpaced production in 2001, leaving smaller world carryover stocks heading into 2002. Moreover, meat production is also projected to drop in the first half of 2002. Thus, small food supplies leave the agricultural commodity markets poised for a potential

Chart 5

WORLD GRAIN INVENTORIES AND U.S. CROP PRICES



Source: USDA

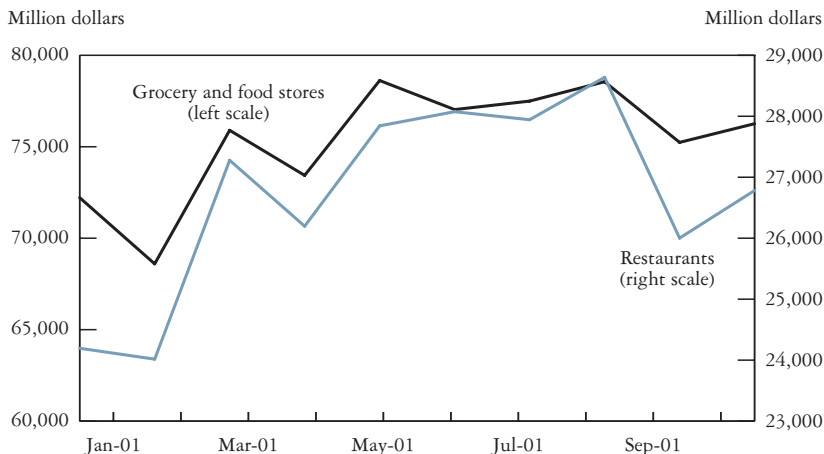
price rally. But the extent of that rally will depend on how quickly the U.S. and global economies emerge from recession—and how quickly new markets for farm products develop.

Smaller Food Supplies for 2002. World grain inventories have now fallen for two straight years (Chart 5). World grain consumption has trended higher, while world production has stabilized and is now 3 percent below world consumption. As a result, world grain inventories dropped 10 percent in 2001. By comparison, U.S. grain stocks dropped 19 percent.

Meat supplies are also forecast to decline due to smaller livestock supplies. Pork production is expected to drop 4 percent in the first half of 2002, as smaller numbers of hogs are ready for market. Beef production is also expected to drop almost 4 percent during the first half the year.

Will Food Demand Return to Boost Prices? Smaller food supplies have positioned commodity markets for a potential price rally. Yet, a number of crosscurrents in global food demand make higher prices uncertain in the near future. Following September 11, restaurant demand plummeted and has yet to recover. Export activity has declined with the

Chart 6
FOOD RETAIL SALES



Source: Advanced Monthly Retail Sales, U.S. Census Bureau

growing global recession. Moreover, lingering fears about Mad Cow disease among Japanese consumers raise concerns about the traditional seasonal bounce in meat demand heading into 2002. For demand to recover significantly in 2002, agriculture may need a boost from new markets. Ethanol is one potential spark that could lift demand.

The terrorist attacks and subsequent economic recession slowed the demand for food, both domestically and globally. The immediate impact of the terrorist attacks on the agricultural economy was the stoppage of airline travel that brought about a dramatic decline in restaurant sales. Businesses cut back on corporate travel and families stayed at home, glued to their televisions to watch the latest developments of America’s response to the terrorist attacks—what some people have called the “CNN effect.” As a result, restaurant sales plummeted 9.2 percent in September (Chart 6).³ In addition, USDA estimates that expenditures spent on food away from home in September fell to \$29.3 billion, 11 percent below August levels. Although restaurant sales have rebounded somewhat, they have failed to return to pre-attack levels.

The decline in restaurant sales slowed the demand for food, especially high-end meats. The falling demand placed downward pressure on livestock prices at a time when the industry was already working off a large supply of cattle being sent to market. A slow recovery in restaurant sales, whether from changing business travel patterns or a slowing economy, could limit price rallies, especially in the livestock and high-end meat markets.

In addition to falling domestic demand for food, U.S. food exports have slowed with the current economic recession. Since the second quarter of 2001, export growth has slowed dramatically, collapsing to just 1 percent above year-earlier levels in the third quarter. For the year, exports are still expected to manage a 5 percent rise.

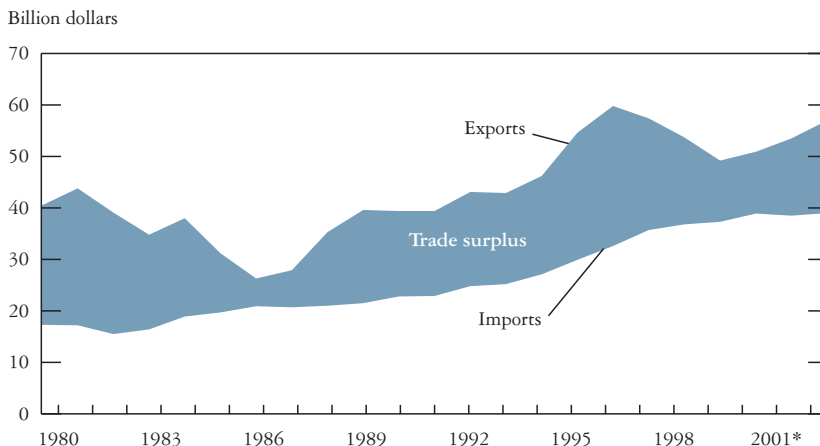
The fourth quarter may provide some clues on whether U.S. agricultural exports will rebound in 2002. Traditionally, the fourth quarter is a seasonal boom period for U.S. exports. For example, export numbers jumped 17 and 18 percent, respectively, in the fourth quarters in 1999 and 2000. In 2001, though, slowing export activity at the end of the third quarter, forecasts of weaker global economies and the Mad Cow scare in Japan led many agriculture analysts to project limited gains in exports in the fourth quarter.

The current U.S. recession is also being felt globally, especially in Asia. After rising 4.6 percent in 2000, world gross domestic product is expected to grow more slowly in 2001 and 2002. The Japanese economy is especially weak. After meager GDP growth for Japan in 2000 (1.5 percent), many economic analysts expect Japanese GDP growth to turn negative in 2001 and 2002. Forecasts for other Asian economies are also bleak. After rising faster than 6.0 percent in 2000, GDP growth for Hong Kong, Korea, Singapore, and Taiwan is expected to drop in 2001 and remain weak through 2002.

Slower growth in foreign economies, especially Asian markets, could limit the demand for U.S. agricultural products in the year ahead. Asian economies account for roughly 40 percent of U.S. agricultural exports. Japan is the largest market for U.S. agricultural exports, with just over a sixth of U.S. export sales. During the Asian financial crisis, agricultural exports to Asia fell 14.2 percent between 1997 and 1999, resulting in a dramatic decline in overall U.S. exports (Chart 7). During the current recession, agricultural exports to Asia are following a similar trend. Agri-

Chart 7

U.S. AGRICULTURAL TRADE BALANCE



*Forecast

Source: USDA, Economic Research Service

cultural exports to Asia, which were rising 7.3 percent above year-ago levels in the first quarter of 2001, reversed course, falling to 3.5 percent below year-ago levels by the third quarter. Continued weakness in the Asian economies raises some concerns about U.S. export opportunities.

Mad Cow disease findings in Japan are also hindering the prospects for stronger U.S. export activity. As of December, four cases of Mad Cow disease had been documented in Japan since September. In response, Japanese consumption of beef has dropped sharply. The U.S. Meat Export Federation reported that Japanese beef consumption dropped between 50 and 80 percent. Declining Japanese beef consumption poses problems for the U.S. livestock market, since the Japanese market consumes roughly half of the U.S. beef exports. In fact, beef exports to Japan fell 7.5 percent in October. It has also been reported that the Mad Cow situation in Japan has reduced cattle prices approximately \$2.50 per hundredweight, roughly 3.5 percent.

While an expected recovery in the U.S. economy will help farms recover, new sources of demand for agricultural products may be needed to boost markets in 2002. The first crop of pharmaceutical corn in Iowa was harvested this fall. And a sharp expansion in ethanol production may point to rising nonfood demand.

Ethanol production received a boost in 2001 after the EPA rejected California's request to be waived from federal standard on oxygenates in gasoline. The rejection opened up a whole new market for ethanol oxygenates, which some analysts estimated at 580 million gallons per year. A new wave of ethanol plant expansions and openings in 2001 boosted ethanol capacity 41 percent (Chart 8). By 2005 ethanol capacity is expected to double, spawning a host of new plants. An additional 1 billion bushels of corn may be needed to accommodate the new capacity. Obviously, the increased corn demand will help support corn prices.

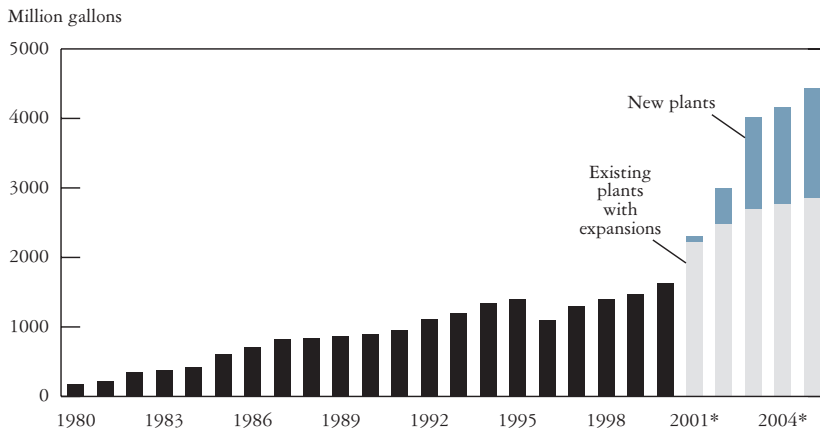
The farm economy in the year ahead

Overall, farm finances are healthy heading into 2002, thanks to government payments and first half profits in the livestock industry. Entering the year, the debt-to-asset ratio rests near its historical low. Despite a reduction in demand from the economic recession, cash receipts are rising and being transformed into land value gains. On balance, farmers start the year with improved financial footing.

If demand recovers, farmers are positioned to exploit a potential price rally in 2002 from smaller food supplies. Grain and meat supplies are expected to shrink heading into 2002. USDA forecasts an 8 percent rise in grain prices and at least a \$10 per head gain in fed cattle and live hog markets. But, the expected rise depends critically on a recovery in demand, both domestically and globally. If demand recovers and prices rally, farm cash receipts should rise as USDA forecasts.

Farm income in 2002 will still depend on the size of government payments. Congress did not act in 2001 on a proposed new farm bill that would have added \$73.5 billion to the farm bill baseline over the next ten years. With no new farm bill, government payments in 2002 will probably follow the pattern of the past four years, when large ad hoc payments supplemented farm payments paid out under the 1996 farm bill. With the current farm bill set to expire in 2002, Congress

Chart 8
U.S. ETHANOL PRODUCTION



*Forecast

Source: Renewable Fuels Association

could pass a new farm bill quickly. Both the Senate and House proposals currently on the table would push most of the additional farm bill dollars into commodity payment programs.

III. CONCLUSION

The U.S. recession spread to a weak rural economy in 2001, where shrinking demand for rural products caused a contraction in rural manufacturing activity. Demand for service activity has not been strong enough to boost overall job rolls on Main Street. If recent cutbacks in travel translate into reduced vacationing this year, the demand for rural areas as recreational and tourist destinations could stall.

Falling demand for farm products limited a rebound in the farm economy. Despite the recession, the financial footing of farmers improved in 2001 due to improved market earnings and big government payments. With stable farm balance sheets, shrinking food supplies have poised agriculture for a rebound in 2002. The rebound, however, will depend on a recovery in food demand and new outlets for agricultural

products beyond traditional food markets. Product-based opportunities such as ethanol production should help focus attention on new sources of agricultural demand that could strengthen a farm recovery.

Together, the Main Street and farm economies appear ready to support a rural economic recovery. Service activity is weathering the current recession and the farm economy is slowly emerging from its recent slump. If a U.S. recovery materializes to lift demand, rural America should recover with the rest of the nation.

ENDNOTES

¹ These rates stand in contrast to the more widely followed seasonally adjusted rate which stood at 5.4 percent for the nation in October.

² GDP forecasts in this article are based on the *Blue Chip Economic Indicators*, January 10, 2002.

³ Sales at grocery and food stores fell 4.2 percent in September, but do not include food sales at discount merchandisers such as Wal-Mart or Target, where anecdotal evidence suggests that sales were somewhat stronger in September.

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