# A New Era for Rural Policy

## By Mark Drabenstott

small businesses are a crucial part of rural America. They certainly form the images the nation holds dear about the rural landscape—from the Chatterbox Café to Floyd's Barber Shop. But the impact of small business on the rural economy is far more than mere image. Main Streets throughout the nation have depended on the perseverance of generations of small entrepreneurs. These rural entrepreneurs have also made big contributions to the national economy through the creation of companies like Caterpillar, Gateway Computer, and Pella Windows.

Entrepreneurs may have an even bigger impact on rural America's future. Globalization has brought profound impacts to the traditional industries on which the rural economy has relied. Rural America must now turn to a new frontier of economic opportunity. Fortunately, the horizon appears rich with promise. But the promise will only be realized if a new generation of entrepreneurs seizes it—probably with both new technologies and new business models.

Public policy will play a crucial role in shaping the environment within which rural businesses start and grow. Over time, the nation has reaffirmed the importance of helping rural regions grow their economies.

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The Rural Development Act of 1972 is one clear example. Over the past 30 years, though, much has changed in the rural economy, signaling that new directions are needed for rural policy. Regardless of the direction, initiatives to help Main Streets grow more entrepreneurs will be a cornerstone of new rural policy.

This article addresses four key questions concerning the future of U.S. rural policy. First, how has the rural economy changed over the past 30 years and what are the resulting challenges? Second, what are the best economic opportunities going forward? Third, what policy goals and framing principles will help rural America seize those opportunities? And fourth, what specific program areas are likely to make the biggest contribution to successful rural policy?

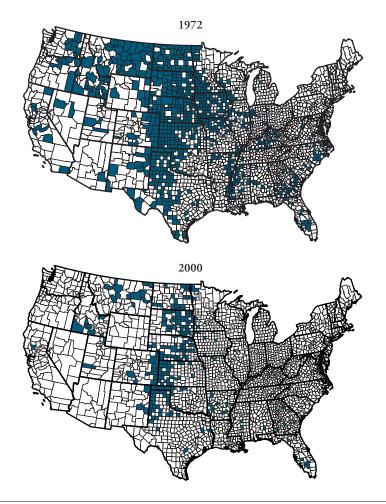
## I. CHANGES AND CHALLENGES

The Rural Development Act of 1972 was written for a very different rural America. Globalization and rapid technological change have redrawn the rural landscape, adding a number of new features. The role of agriculture has diminished, and recent trends point to some shrinkage in manufacturing. As in the rest of the nation, services have become a much bigger part of the rural economy, although rural areas have struggled to capture high-skill, high-wage service jobs. Finally, scenic amenities have never been more important in deciding which rural areas grow the fastest.

# Agriculture's shrinking role

In the past, agriculture has always been the starting point for talking about the rural economy, and rightfully so. U.S. agriculture is a food powerhouse that combines some of the world's richest natural resources with world-class technology and management. Yet that very success has dramatically changed agriculture's role in the rural economy. As farms have grown bigger and more productive, fewer rural residents have made it their living. Put simply, more and more parts of rural America rely less and less on production agriculture. In 1972, agricul-





ture was the leading source of income for roughly one in every four rural counties (Figure 1). Today, it is one in every *ten*. Today's farm-dependent counties are heavily concentrated in the Great Plains states.

Viewed another way, the performance of the nonfarm economy has become much more important to rural families. Only 6.3 percent of rural Americans now live on farms, and most farm families get most of their income *off the farm*. In 1999, 90 percent of all income to farm operator

household's came from off-farm sources. Moreover, 90 percent of rural workers have nonfarm jobs. Meanwhile, the share of the rural population that counts farming as its primary occupation has fallen to 1.8 percent.

The shift in agriculture has profound implications for public policy: Agricultural policy alone can no longer address the economic challenges facing most rural Americans.

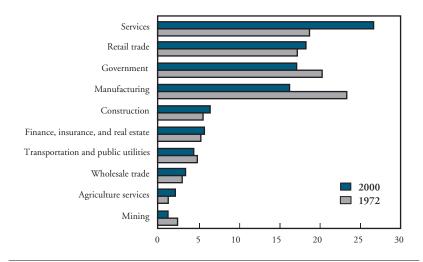
## Strains in rural manufacturing

Rural America depends heavily on manufacturing. Factories are the single biggest source of income to rural families, and often offer the highest wages in the area. But rural factories were hit hard during the recent recession and continue to struggle. While the recent difficulties reflect cyclical factors, they may also reflect more troublesome structural factors (Drabenstott 2003). Many factories moved to rural America in recent decades in search of inexpensive land, labor, and taxes. The attraction was often enhanced by generous recruitment incentives involving tax subsidies of one form or another. In fact, enticing factories to the edge of town has been the number one rural development strategy of the past half century.

While that strategy was successful for a long time, it may be falling victim to the inexorable forces of globalization. Rural America's claim to low-cost land and labor is being challenged by foreign locations that are even *less* expensive. In total, nearly 200 rural factories closed their doors last year. While it is impossible to document how many factories actually moved, or where they moved to, it appears likely that many sought even cheaper labor and land in foreign locations. Maytag, for instance, closed a Galesburg, Illinois, appliance plant that employed 1,600 workers and moved it to a foreign location. Last year's plant closings had a much bigger impact on manufacturing in rural areas than urban ones. Factory closings represented fully 45 percent of total mass layoffs at rural factories, compared with only 25 percent at metro factories.

The recent slump in rural manufacturing raises fundamental questions about industrial recruitment, the prevailing rural development strategy throughout the nation. Going forward, rural strategies will benefit from targeting incentives more carefully, encouraging new industrial clusters, and putting new emphasis on business starts and expansions.





## A surge in services?

As in the rest of the nation, services have become much more important to the rural economy over the past three decades. Service industries now employ more than a quarter of the rural workforce—the biggest slice by far, and a big jump compared with 30 years ago (Chart 1). By contrast, manufacturing's share of employment fell sharply, while government's share declined moderately. However, services provide just more than a fifth of total rural income, about the same share as manufacturing and government (Chart 2). Therein lies the challenge of a surging rural service sector—it captures lots of jobs, but not always the *high-wage* ones (Henderson).

A closer look at the data shows that rural areas lag behind in growing service industries that employ highly skilled workers. Producer services, which include communications, finance and insurance, and business professional services, have been a notable source of economic gains in the nation's cities for more than a decade. Rural areas tend to have a lower skilled workforce and thus have difficulty attracting producer service firms. Moreover, rural areas often lack the lifestyle amenities preferred by the owners and workers of producer service firms.

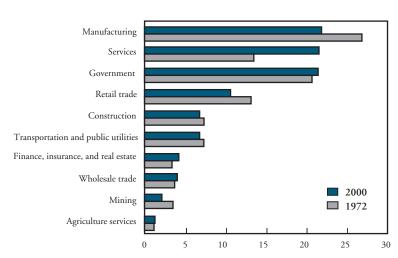


Chart 2 SHARE OF EARNINGS

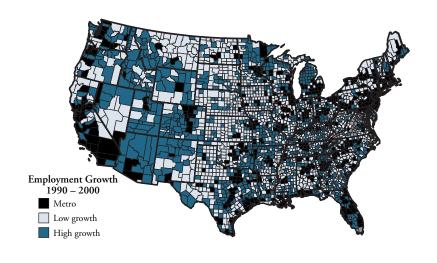
The shift to services in rural areas not only gives hope for new sources of economic growth in rural America but also points out the need to address the challenges of workforce skills and quality of life.

# The attraction of amenities

Scenery has never been more important in deciding where economic growth happens in rural America. A quick scan of the economic landscape quickly reveals a pattern in which mountains and lakes are powerful magnets of economic activity (McDaniel 2000). Throughout the past decade, the Inter-Mountain West stands out as one of the fastest growing rural regions in the nation (Figure 2). The North Woods of Minnesota and Michigan and the Ozarks of Missouri, Arkansas, and Oklahoma similarly stand out.

Scenic amenities pull in many types of economic activity. They attract recreation businesses. They often appeal to weekenders and retirees. And they frequently attract "lone eagle" businesses that use technology to locate anywhere. The strong pull of rural America's many scenic areas gives no sign of abating anytime soon.





Scenic amenities underscore the uneven pattern that now characterizes that rural economy. Economic gains are concentrated in roughly 4 of every 10 rural places—many of which enjoy considerable scenic amenities. That leaves most of rural America looking for new economic engines.

Uneven growth signals an important change for rural policy. The rural economy no longer rises on a single tide. Rather, different regions need very different economic and policy solutions.

Taken together, the four trends outlined above present a new set of policy challenges for federal, state, and local public officials. The rural economy is diverse—its economic make-up includes many key sectors, but the makeup varies widely across regions. Globalization has created strong pressures for traditional industries like agriculture and manufacturing, but new economy industries like producer services have not taken deep root in the new rural economy.

## II. A NEW HORIZON OF RURAL OPPORTUNITY

The economic challenges facing rural America can seem daunting, yet there are inviting opportunities on the horizon, too. Many of these are enabled by new technologies or new economic processes applied to old-line industries. In general, though, rural leaders must think beyond cheap land and labor and add new value to local resources. Three especially promising rural opportunities are product agriculture, tourism, and advanced manufacturing.

Product agriculture defines a broad spectrum of new businesses that go beyond traditional commodity production and processing (Drabenstott 2002). On one end of the spectrum are "near-commodities," products such as ethanol that add value to traditional commodities but still represent commodities in terms of their markets and pricing. On the other end of the spectrum are pharmaceutical crops, the opportunity to grow pharmaceutical inputs in fields instead of factories. Pharmaceutical crops are still an infant industry, with field trials only at this point. Still, the upside potential for creating new economic activity is great. For instance, one Iowa group has been trying to create a pool of 3,000 acres of specially modified corn that could spawn a \$100 million processing facility with high-skill jobs and wages. Whether that happens depends very much on regulations and production protocols that inspire the confidence of farmers, consumers, regulators, and industry. Other groups are trying to develop product agriculture through new farmer-to-grocer alliances that bring a wider variety of farm-fresh products to consumers.

Which path product agriculture takes probably depends on the region in question and the willingness of producers to go beyond their commodity traditions. Policy can play a supportive role by helping producers understand new markets and by spurring the development of new technologies essential to the new businesses, a factor especially important to pharmaceutical crops.

Still another way in which rural communities are adding new value to local resources is through tourism. As noted above, scenery and tourism are at least one reason for the strong economic growth in rural parts of the Rocky Mountains region. Tourism is no panacea, though, since it can all too often create only low-paying jobs.

Scenery is only one form of rural tourism, however. Some farmers, for instance, are discovering a "nature tourism" strategy of selling pheasant hunting experiences instead of corn and wheat. Other regions are discovering the power of combining regionally branded foods with the cultural heritage of the region. The Four Corners region is a good example. Overall, rural America still has a lot of opportunity to expand its tourism economy.

Rural manufacturers are also seeking new markets for existing product lines or new ways to improve the production process—sometimes called advanced manufacturing. Local manufacturers are learning to adopt new technologies and more flexible production processes (Drabenstott 2003). The Manufacturing Extension Partnership, created by the National Institute of Science and Technology (NIST), is using extension agents and local universities to help rural manufacturers improve production processes, identify new markets, and boost worker skills. Minnesota Technology, Inc. is an example of a completely separate manufacturing support organization. Some regions are exploring how to create new manufacturing clusters, while others are trying to build new alliances among rural manufacturers. Oklahoma's Manufacturing Alliance is one example.

Tourism, advanced manufacturing, and product agriculture are just three of the exciting new economic opportunities that we see emerging in rural America today. These new businesses, however, also demand a new way of doing business. Rural America has a rich heritage of rugged independence. Many of the new business horizons, on the other hand, seem best suited to a more interdependent business model, whether that be an alliance of 200 farmers of pharmaceuticals or the Four Corners tourism cluster. Finding ways to encourage and support more regional partnerships is one of the defining challenges for rural policy in the new century.

## III. FRAMING NEW RURAL POLICY

The Rural Development Act of 1972 was a moment of clarity for rural policy. The nation agreed that there should be public policy "to foster a balanced national development that provides opportunities for increased numbers of the people of the United States to work and enjoy a high quality of life dispersed throughout [the] nation by providing the

essential knowledge necessary for successful program of rural development." (Public Law 92-419). The act did lead to some new rural programs, notably programs to help communities plan economic development. However, funding for the programs outlined in the act has remained relatively small over the years, especially compared with the funding for other farm programs.

As already shown, however, a lot has changed in rural America since the act was passed. The fundamental question for policy officials today is plain: What policies are best suited to helping rural America seize the opportunities of the 21st century?

The answer begins by acknowledging that past policies, by themselves, will not lead to a new rural economy. Agricultural policy was rural policy throughout the 20th century. There may be good reasons to continue agricultural policy (a safe and abundant food supply, for instance), but it can no longer serve as the primary policy for helping the rural economy. Even in farm-dependent areas, large farm payments are not supporting widespread economic gains. In fact, sluggish economic growth and population exodus characterize much of the Great Plains, where farm-dependent communities are concentrated.

The next step is defining goals for new rural policies. Such goals are not in place yet, but there is emerging consensus on the importance of one goal: helping rural regions build new sources of competitive advantage in a global marketplace. In a global economy, no imperative is greater (Porter). The quest for new economic engines is, in fact, ubiquitous the world over. Rural regions in other countries face the same imperative (OECD).

An informed dialogue on rural policy goals would be very useful. A case can be made that the Rural Development Act of 1972, and reaffirmed in 1980, was the last time the nation stated its goals for rural America. Given all the changes of the past 30 years, the goals need to be clarified anew.

Clear goals will be extremely useful, but they must be paired with a well-defined justification for policy intervention. In the past, policies for rural America have been largely predicated on the uniqueness of agriculture, and the social contract between urban consumers and rural food growers. Today, with so few rural residents employed in agriculture, new reasons for rural policy will be required.

Justifying public policy for rural regions might rest on three broad issues. First, in the wake of the September 11 attacks, the nation may want to improve national security through a more diffused pattern of economic activity and population settlement. Ironically, there are echoes of this concern in the 1972 act. Second, with 60 percent of the nation's population now living in suburbs, there may be a collective desire to avoid the costs of greater congestion in burgeoning metropolitan areas. Finally, the nation may want to renew its commitment to the future stewardship of rural natural resources, recognizing that the rural landscape is where the nation goes for recreation.

If the goal is helping rural regions build new competitive advantage, two principles are likely to frame any new rural policy efforts.

Rural policy should shift from a traditional focus on sectors to a greater emphasis on regions. Agricultural policy and factory recruitment have been the two legs of rural development policy for the past half century. Both provide benefits to individual farmers and firms, but neither is helping rural regions enhance their competitive position in global markets. Moreover, given the diverse character of the 21st century rural economy, there is no longer a single sector "tide" that can lift all rural communities.

Instead, rural policy must recognize that one size no longer fits all. If globalization is creating an economy of regions, then public policy must be flexible in its response. It can no longer focus on one sector, nor on policies applied equally to many different regions. What is best for the rural Southeast no longer works in the Midwest. Indeed, what works in southeast Iowa no longer works in northwest Iowa.

Thus, "region" becomes a useful policy frame for rural areas characterized by small communities and small firms (Isserman). For much of rural America, region is probably defined as a multicounty, multicommunity geographic area. Since county lines were mostly drawn to reflect 18th and 19th century economies, this is not necessarily easy.

Rural policy must shift from relying on subsidies, which thwart business innovation, to public and private investments in new engines of growth. New rural economic engines will require legions of rural entrepreneurs. Yet many segments of the rural economy have become more dependent on government subsidies and incentives than on growing new businesses. The nation now spends huge sums on agricultural subsidies that tie farmers to growing the same commodities year after year, even when

the most exciting opportunities in agriculture are now found in growing new agricultural products, not commodities. Agricultural policy actually stifles the innovation that could grow product markets. Similarly, industrial recruitment subsidies have left many rural communities tied to one factory, with no place to turn if it closes down.

Rural America's business focus must shift beyond commodity businesses. While traditional industries like commodity agriculture and basic manufacturing will continue for the foreseeable future, knowledge-based industries must become more important parts of the rural economy if economic growth is to quicken throughout the countryside. The knowledge industries in which rural regions can thrive will probably only be discovered through the trial and error of new entrepreneurs.

In short, rural policy for the 21st century will probably require a big shift in thinking from the 20th century. The prior focus on commodity subsidies is likely to give way to a new focus on growing more rural entrepreneurs. And the national, one-sector approach may give way to efforts to leverage new regional opportunities.

## IV. NEW DIRECTIONS FOR RURAL POLICY

Clearly stated goals and well-defined framing principles are essential starting points for rural policy. But what program directions might rural policy take? The choices are wide, of course, but it may be useful to highlight a few directions that appear to hold the greatest promise in boosting rural economic performance in the period ahead. Four program directions seem promising: spurring regional partnerships, growing more entrepreneurs, boosting investment in new technology and research, and redefining roles for higher education.

Spurring new regional partnerships. A daunting challenge for most rural regions in building new competitive advantage is reaching critical mass. The emerging evidence suggests that regions that form vibrant networks of cooperation or clusters of businesses have greater economic success than those that do not (Rosenfeld). Thinking regionally, however, is not an underlying feature of rural culture. Quite to the contrary, most rural communities are accustomed to competing with the neighboring town, whether on the football field, basketball court, or economic race. The deeply rooted penchant for industrial recruitment does not help.

Yet rural America's economic winners in the new century are discovering the power of regional cooperation. A number of rural regions are emerging, mostly multi-county economic development efforts (McDaniel 2003). Ironically, many of the new regional development efforts are forming in spite of public policy, not because of it.

Policymakers, therefore, may want to examine the possibility of providing new incentives for regional collaboration. Such an approach is gaining acceptance in many other countries, Italy and Mexico being two examples (Barca; Drabenstott and Sheaff). Economic development funds might be made available to rural regions, but only if there is clear demonstration of a regional strategy. Such an approach has the advantage of encouraging each region to pursue its own unique competitive advantage.

Incentives that spur regional cooperative have the additional advantage of recognizing a market test for individual communities. Rural policy will not, and should not, guarantee the economic future of rural communities. In a market economy, there will always be an ebb and flow of economic fortune among communities. Focusing on regions acknowledges this market maxim and allows communities to rise and fall on their own merits.

Growing more entrepreneurs. Entrepreneurship is the cornerstone of new rural policy. That was the consensus of 200 rural policy experts who participated in a national conference our Bank sponsored earlier this year (Abraham and others). Making entrepreneurs the focus of rural policy will not be easy, however. Entrepreneurship cannot offer a quick fix to rural regions looking for new economic engines, since businesses take time to grow, and many public programs expect results in the short run. Existing entrepreneurship programs do not offer a systematic approach to future business innovation and may need to be overhauled; yet there is still much information needed on which programs work best in which region. Many rural entrepreneurs lack sufficient equity capital, but there is little consensus on what policy can do to fill the gap.

Developing a more systematic approach to supporting the unique needs of rural entrepreneurs will be an extremely valuable program direction. The fact is that rural regions lag well behind metro areas in fostering high-growth entrepreneurs. Support programs need to be regional in scope and systematic in approach. Successful entrepreneurs need a core set of skills, yet they start with different skill levels. A new system that

would diagnose skills and then connect business owners with service providers that specialize in "coaching" them and developing skills is gaining attention. This approach is now being tested in Kentucky, North Carolina, and West Virginia (Lyons).

Equity capital is another useful focal point for helping rural entrepreneurs become more successful. Entrepreneurs and small businesses in rural areas simply do not have similar access to equity capital and support services as their urban counterparts (Barkley). The federal government is not likely to solve the equity capital needs of rural entrepreneurs. However, it might lead a new initiative aimed at understanding and forming a richer web of equity capital institutions. Such a web may include private funds, public/private funds, and some funds operated by the states.

Boosting investments in research and technology. Many of rural America's new economic engines will be built by innovations in research in technology. This raises new questions about the role of public policy in funding the research and development of those technologies. Two examples illustrate the issues ahead.

Pharmaceutical crops offer one of the most exciting new opportunities for U.S. commodity growers. Whether that potential is developed, however, depends heavily on research on new crops and new production protocols. While the crop research is likely to proceed in the private sector, developing the economic opportunity may suggest public research in production protocols and scalable processing techniques suited to rural locations. Currently, the industry is at something of a standstill, since production protocols have not been developed to inspire the confidence of regulators, food companies, and consumers. Public research might fill that void.

Broadband technology offers another clear example. Broadband will be crucial infrastructure for many rural communities to build new economic engines. Yet there remains a patchwork of broadband solutions, with yawning gaps in coverage across the countryside. Closing these digital divides remains a rural policy issue that has not been fully addressed.

Redefining roles for higher education. If rural America is to become a more knowledge-based economy, its institutions of higher learning will play a pivotal role. Yet the role these institutions will play remains unclear in many instances.

Land grant universities have been the traditional source of research, teaching, and outreach for rural regions. While rural regions now need many types of support, the college of agriculture is often the source of this support. Understandably, the resulting programs frequently have an agricultural focus.

Land grants might take on several new roles. They might be catalysts in convening regional dialogues on rural development. They might provide expertise in helping regions identify competitive niches. They could expand efforts to transfer technology beyond agriculture; Purdue University's planned Discovery Parks throughout Indiana are an excellent example of a productive new initiative. They might provide resources to foster more small and mid-sized businesses. They might help galvanize business networks and clusters. And they might help raise the skills of local and regional economic development officials.

Another promising education initiative is to enhance the role of community colleges and regional universities in building the new rural economy (Rosenfeld and Sheaff). Often, regional community colleges and universities are uniquely positioned to provide the spark to create new regional economic development efforts. For instance, in northeast Minnesota—still heavily dependent on timber and iron ore—the region has reorganized its community colleges to make them more effective engines for new growth. New incentives for such institutional innovation may be worth exploring.

## VI. SUMMARY

A lot has changed in rural America since the Rural Development Act of 1972 was signed into law. While the rural economy is more diverse today, it remains heavily tied to commodities, whether industrial or agricultural. The main exception are regions with scenic amenities, or those where economic activity is spilling over from nearby metropolitan areas. Feeling the press of globalization, most rural regions are looking for new sources of competitive advantage. Fortunately, there are exciting economic opportunities on the horizon, including product agriculture and advanced manufacturing.

Seizing these new opportunities will take fresh policy directions, however. Rural policy can no longer afford to focus on sectors and subsidies. Rather, the focus needs to shift to the unique needs of regions and the investments that will spur new sources of competitive advantage.

Four directions appear especially promising for rural policy. New incentives for communities and counties to think regionally will help them find new niches and a threshold level of critical mass. New programs to foster rural entrepreneurs promises long-term dividends and the prospect of helping rural regions catch up with metro areas in creating local wealth and attractive jobs. New investments in research and technology will help rural regions build a larger knowledge-based economy. And if their roles are redefined, higher education institutions may lend valuable assistance to rural leaders and businesses alike.

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