CENTER FOR THE STUDY OF RURAL AMERICA
Federal Reserve Bank of Kansas City

March 2003

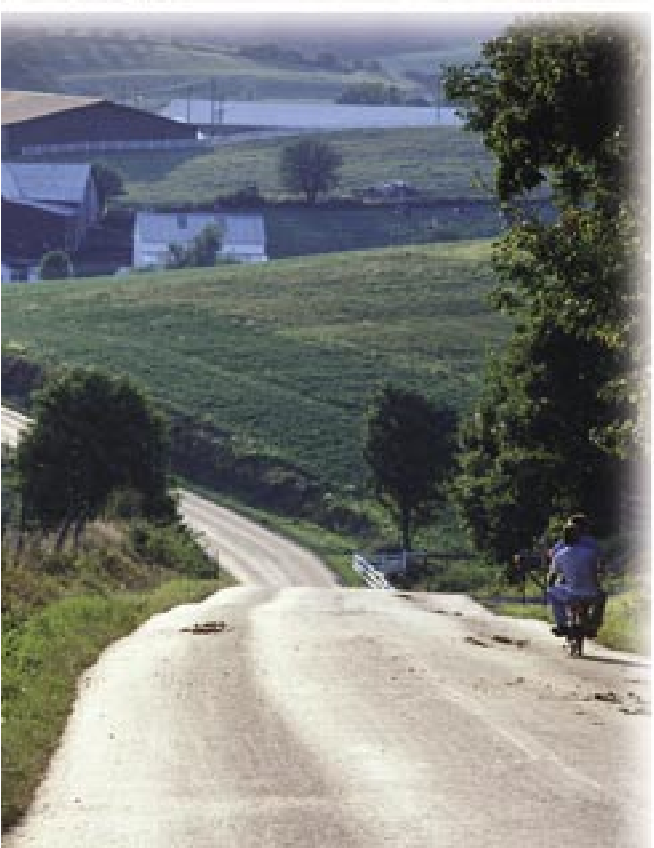
The Main Street Economist

Commentary on the rural economy

New Troubles at Rural Factories: New Implications for Rural Development

Mark Drabenstott
Vice President & Director
Center for the Study of Rural America

biggest source of income to rural families. Factory wages and benefits are often the best in the local area. But rural factories were hit hard during the recent recession and continue to struggle. While their difficulties certainly reflect cyclical factors, they may also reflect more troublesome structural factors. Many factories moved to rural America in recent decades in search of comparatively cheap 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 successful for many rural places for a long time, the strategy may be falling victim to the inexorable forces of globalization.



Put simply, rural America's claim to low-cost land and labor is being challenged by foreign locations that are even *less* expensive. This article charts the recent trends in rural manufacturing and explores what they mean for rural development strategies going forward.

Sharp weakness in rural manufacturing

By almost any measure, rural manufacturing of late has been weak. Rural manufacturing employment in 2002 fell 4.6 percent, a sharper drop than in metro areas for the second straight year (Chart 1). Job growth was positive only four months of the year, and employment shrank throughout the fourth quarter. In short, no economic rebound for rural factories is yet in sight.

The recent slump in rural manufacturing stands in sharp contrast to strong gains throughout much of the 1990s. From 1991 to 1998, rural factory jobs rose more than 3 percent, 50 percent faster than the job gains in urban factories (Chart 2). With the Asian financial crisis dampening orders, rural jobs began falling in 1998 and slid nearly 2 percent from 1998 to 2000, slightly faster than job losses in urban factories. Since 2000, however, rural factories have slashed payrolls by more than a tenth, roughly one and a half times the job cuts at metro factories.

The reasons behind the downturn are not altogether clear. The sharp contraction in rural factory jobs is too recent to have attracted in-depth study. However, a few other pieces of evidence would suggest that globalization is at least one major factor behind recent rural declines. The most telling piece of evidence is the number of plant closings in rural America. Nearly 140 factories closed their doors in rural America last year. While it is impossible to document where the factories moved, it appears likely that many sought even cheaper labor and land in foreign locations. The 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 (Chart 3).

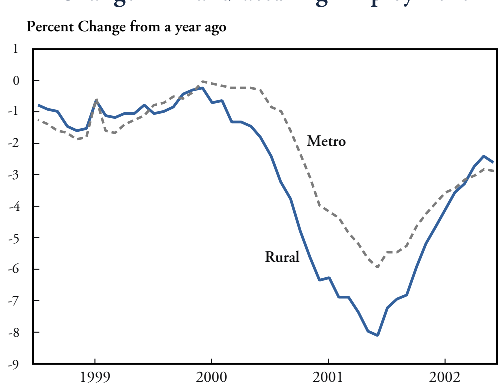
A recent study of U.S. factory closings from 1977 to 1997 examined the factors behind shutdowns (the study examined all factory closings without separately examining rural ones). Jensen and Bernard found that plants that close tend to be smaller, use comparatively more labor, and export a smaller portion of their overall production. They also tend to be newer, which the authors suggest may reflect a less-experienced work force. Given these findings, rural factories seem more likely than many metro ones to fit the "shutdown profile." Rural plants generally are smaller (in terms of production and employment) and also tend to have smaller capital investment per worker. There is no information available to identify whether rural factories are more or less likely to export than metro plants. All things considered, however, rural plants seem more likely to shut down than their metro counterparts.

Another factor behind the recent downturn at rural factories is the industrial mix of rural plants. Food, textiles, lumber, furniture, and paper all represent a much bigger share of rural manufacturing earnings than in metro areas (a total of 39 percent vs. 16 percent). These are all intensely competitive industries where production is expanding in many regions around the world. On the other hand, more technology-intensive industries such as chemicals, metal, equipment, and instruments account for much less of rural manufacturing earnings than at urban factories (55 percent versus 70 percent). These industries face competitive pressures, to be sure, but U.S. technology often gives such products a bigger competitive edge in global markets. Simply put, rural factories appear to be more heavily weighted in categories feeling the greatest competitive pressure.

Revisiting industrial recruiting

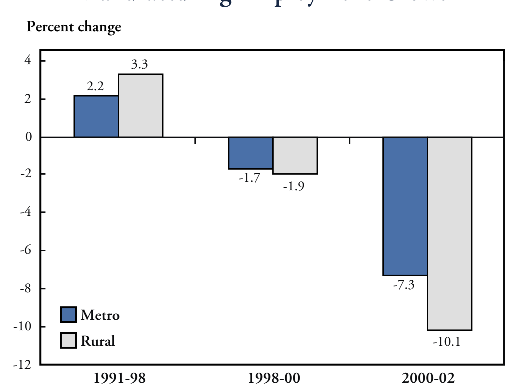
If recent trends do, in fact, reflect more than a cyclical downturn for rural factories, then the implications for rural economic officials are profound. A whole generation of rural economic developers has vigor-

Chart 1
Change in Manufacturing Employment



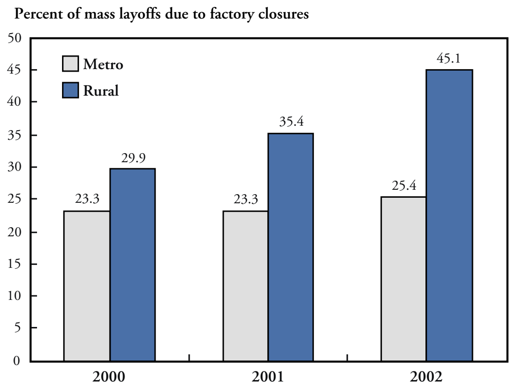
Source: Bureau of Labor Statistics

Chart 2
Manufacturing Employment Growth



Source: Calculation based on Bureau of Labor Statistics data

Chart 3
Manufacturing Job Losses



Source: Calculation based on Bureau of Labor Statistics data

ously pursued a focused strategy of offering recruitment incentives to bring factories to rural areas. This strategy was especially pronounced in the rural South, where manufacturing plants became the engine for newfound growth. In general, industrial recruitment has been very tempting to rural developers simply because the menu of development options in many rural places is often very short.

While the strategy has been widespread, its total cost is unknown. No aggregate data are available on the overall cost of manufacturing recruitment incentives. Some analysts assert, however, that each year the total cost of economic development incentives—for urban and rural places—runs well into the billions of dollars (Minneapolis Federal Reserve).Without such tracking data, the benefits and costs cannot be weighed.

Even before the recent downturn in rural manufacturing, however, development experts were cautioning that industrial recruiting has pitfalls as a development strategy. State and local governments can find themselves in bidding wars to lure factories, with the ante often measured in the millions of dollars. Alabama gave Mercedes-Benz more than $250 million in incentives to bring an assembly plant to the state. One analyst estimates that, nationwide, incentives now average $4,000 per job created (Bartik). Sometimes, the ante is much higher. Michigan granted Blue Water Fibre $80 million to locate its paper recycling mill in the state—an incentive worth $2.4 million for each of the plants 34 workers (Farrell).

The recent trends in rural employment and plant closings raise fresh doubts about the long-term validity of emphasizing factory recruitment as the primary rural development strategy. How might economic development officials adjust their strategy? Three shifts are worth considering: targeting recruitment incentives; encouraging industrial clusters; and putting new emphasis on business starts and retention.

Targeting recruitment incentives. All too often, rural development success has been measured by ribbon-cutting when a factory opened. Given the pressures of globalization, it is much less clear how long any particular factory will remain open. Thus, recruiting incentives must be measured against the willingness of firms to make investments, add jobs, and create wealth in the local area.

Dabson argues that development incentives can be made more effective in the future if state and local governments pursue three directives:

- Full public disclosure should be required of all recruitment incentives to strengthen their accountability. Disclosure should be followed by rigorous benchmarking of local economic benefits provided by the project over time.
- Incentives should be deployed in strategic, "custom-fit" situations, not merely a "copy-cat" reply to incentives offered to the firm by another place. Public officials thus must choose which goal they are intent on achieving—overall job creation, job growth in slower growing areas, diversifying the local economy, or another goal. Clawback provisions—requiring that incentives be repaid if the firm leaves before agreed dates—are especially useful in ensuring incentives for the firm and benefits to the community are tied.
- Especially in a time of tight state and local budgets, officials should select incentives that provide the broadest benefit to the local economy. For example, job training subsidies provide a wider benefit than tax incentives that go to one firm. In fact, officials may want to link recruitment incentives to employment programs, such as "first source agreements" to ensure the local labor market is improved. Such agreements require firms that receive incentives to hire workers provided through a public or nonprofit job referral program.

Encouraging industrial clusters. While recruitment incentives are likely to continue, rural development officials might consider a wholly different tack in thinking about industrial development. A growing number of economic experts now believe that clusters provide a unique way for small rural factories to compete effectively in the global economy. If true, then rural developers might consider abandoning the traditional strategy of trying to land one big fish, and instead assemble a cluster of small but similar firms that can form synergies, especially when related to technology.

North Carolina's hosiery industry provides a compelling example of the cluster approach. About 60 percent of the nation's socks are made in rural North Carolina. The industry employs about 35,000 workers, but at very small firms. The typical firm employs fewer than 75 workers. The industry is concentrated in rural communities in the state's Catawba Valley. On the surface, this industry seems especially vulnerable to globalization pressures.

Quite to the contrary, North Carolina's hosiery industry has been generally prosperous in its rural location. The key has been building new synergies among the small firms through clusters. Feeling the effects of mounting global competition, the industry created the Hosiery Technology Center in 1989 at Catawba Valley Community College. The Center became a focal point for testing and adapting new technologies that none of the small firms could test or adopt on their own. The Center also provided new training to industry workers to make more effective use of new technologies. The result has been steady investment in new technology, more productive workers, and a highly competitive industry. More recently, the industry has pushed aggressively to establish rigorous quality certification programs and to take advantage of e-commerce methods for purchasing inputs and marketing its products *(www.legsource.com).*

One key to cluster efforts in the future appears to be a formal organization that can forge partnerships among firms. The Hosiery Technology Center played that role in this case. While rural America has a strong history of cooperatives, especially in agriculture and utilities, there are relatively few examples of multifirm clusters like the one in North Carolina. Thus, public officials may want to consider ways to help create the institutional setting in which clusters might form and flourish.

Putting new emphasis on business starts and retentions. Critics of industrial recruitment incentives frequently point out that putting too much emphasis on recruiting factories can leave too few resources to support businesses that are new or expanding. Given recent trends, this may be a good time for rural development officials to revisit their programs aimed at retention and expansion. Another reason this approach may find new support is its relatively low cost. The National Business Incubation Association estimates that fostering jobs at new businesses costs about a quarter of what is typically spent on recruitment incentives.

Recent evidence suggests that while rural America has similar rates of business starts as metro areas, high-growth new businesses are more rare in rural areas. In simple terms, finding business and technical assistance and obtaining equity capital appear to be more difficult in rural areas. These factors are especially important to firms that are moving from start-up to the growth phases of their business.

Thus some rural areas are giving new attention to becoming "entrepreneurial regions." The Appalachian portion of Ohio is one such case, and the state of Maine is another. The former represents a new coalition of stakeholders committed to improving the support network for rural business owners. This coalition includes a regional philanthropic organization, Ohio University, and the Extension Service. In Maine, the focus on entrepreneurship was championed by the governor's office.

Conclusions

Rural America has long counted on its factories to stoke the rural economy. Accordingly, recruiting factories to the edge of rural communities has been the principal rural development strategy of the past half century. Recent trends suggest that rural manufacturing is struggling to emerge from the recent recession. While some of the difficulty no doubt stems from cyclical factors, a recent rash of plant closings may also reflect the pressures of globalization. Factories have often moved to rural locations in search of inexpensive land and labor—many plants may be finding even lower costs abroad.

In this changing industrial landscape, rural developers may want to revisit their singular focus on industrial recruitment. Going forward, rural strategies will benefit from targeting incentives more carefully, encouraging new industrial clusters, and putting new emphasis on business starts and expansions.

References

Bartik, Timothy J. 1996. "Eight Issues for Policy Toward Economic Development Incentives," Federal Reserve Bank of Minneapolis, *The Region*, June.

Bernard, Andrew, and J. Bradford Jensen. 2002. "The Deaths of Manufacturing Plants," Working paper, June.

Burstein, Melvin L., and Arthur J. Rolnick. 1994. "Congress Should End the Economic War Among the States," Federal Reserve Bank of Minneapolis, *Annual Report.*

Dabson, Brian, Carl Rist, and William Schweke. 1996. "Business Climate and the Role of Development Incentives," *The Economic War Among the States.* Proceedings of a conference sponsored by Federal Reserve Bank of Minneapolis.

Farrell, Chris. 1996. "The Economic War Among the States: An Overview," Federal Reserve Bank of Minneapolis, *The Region,* June.

United States Department of Agriculture. 2001. "Cultivating Successful Rural Economies: Benchmark Practices at Community and Technical Colleges," *Benchmark Practices.*