



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

October 1999

The Main Street --- Economist

Commentary on the rural economy



Rural America in a New Century

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Rural America is undergoing enormous change as the 21st century dawns. The farm economy is in a deep slump, even as agriculture undergoes a sea change in the way it does business. The ebb and flow of rural America's many other industries has left a deeply divided rural economy. Rural boomtowns wonder how to manage high rates of growth without eroding their quality of life. Declining rural communities wonder how they can find new engines of economic growth when traditional sources seem to be sputtering.

Helping all of rural America unlock its economic potential will be a tall order for public policy, which remains tightly focused on just the farm economy. In this inaugural issue of *The Main Street Economist*, our new monthly newsletter, we review the major economic challenges facing rural, or nonmetropolitan, communities across America as the new century begins.



The best and worst of rural times

A vital slice of the nation—home to a quarter of its people and more than half its banks—rural America is a striking combination of the best and worst of times. While some parts of rural America have fully participated in the nation's long-running expansion, many others have simply been left behind. Employment growth, one broad yardstick of economic growth, paints a clear picture of economic fits and starts across the nation. On the surface, the 1990s have been a strong rural economic rebound, with job gains nearly matching the "rural renaissance" rate of the 1970s.

Yet those gains have not been widely shared. Four in every ten rural counties have captured nearly all the growth. These rural growth havens generally have three key traits. Some are next to major cities and are being "suburbanized." Others have striking scenic amenities, such as mountains or lakes. Still others are emerging hubs of rural commerce, providing retail, financial, and health services to an ever-widening rural area.

The biggest rural economic gains, therefore, are flowing to regions like the intermountain west, the Ozarks, and rural counties that benefit from market access, such as the counties along I-80 in Nebraska or the ones next to the Kansas City metro area (Figure 1). Meanwhile, a large swath of the Heartland has struggled with modest economic gains at best. In the main, these counties remain heavily tied to traditional rural economic bases, including agriculture. In many cases, the economic problems in lagging counties are compounded by a shrinking population.

In short, it is both the best and worst

of times in rural communities across America. That diversity reflects the wide range of economic bases, but it also poses serious questions about the future for rural people and their communities.

A new farm crisis?

Rural America's most visible economic challenge currently may be the sharp slump in the farm economy. Prices for major commodities have fallen sharply, pushing down farm incomes. Through August, prices for corn, wheat, and soybeans in 1999 are all down about a third from the average of the past three years. Livestock prices are also relatively weak, especially for hogs.

Farm prices are low for three main reasons. Crop supplies are big due to favorable weather throughout much of the Farm Belt and large plantings worldwide. Global demand is weak in the wake of the Asian crisis, although early signs show demand could begin growing again. And the U.S. dollar has been strong against many currencies, making U.S. farm exports more difficult, especially compared with Latin American competitors such as Brazil.

another \$7.4 billion dollars (if the aid were patterned after the recently passed Senate bill). If enacted, it is unclear how much of the extra aid would actually reach farmers this year. Assuming that at least a major portion is issued in the final months of this year, however, farm income may well top the average for 1990 to 1998 (\$54.7 billion). Put simply, agriculture is shaping up to have a good income year, with government payments making up what the market would otherwise take away.

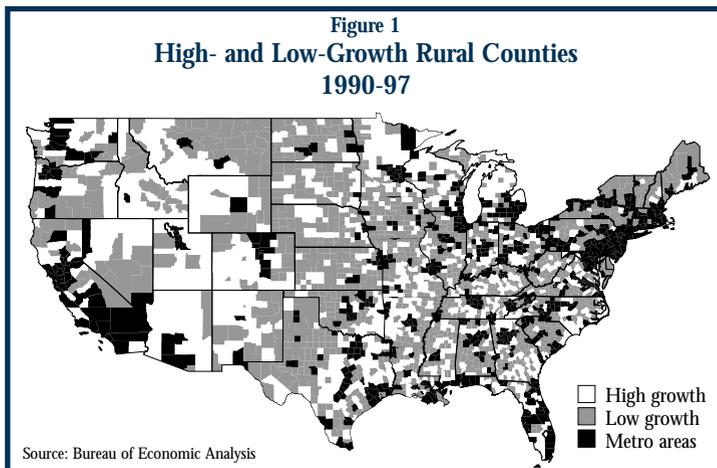
Thus far, the farm slump has not turned into a financial crisis that approaches the turmoil of the mid-1980s. Farm balance sheets remain relatively strong, and loan portfolios and capital reserves of most farm lenders are strong. A major factor in keeping farm balance sheets healthy has been generally buoyant farmland values, which have stayed remarkably resilient despite low commodity prices. In the seven Heartland states of the 10th Federal Reserve District, for example, land values are down only 1 percent over the past four quarters.

The big question going forward, of course, is whether protracted weakness in farm cash flows could lead to lower land values, eroding balance sheets, and widespread farm loan problems. This situation certainly bears watching. The outcome will depend on how quickly commodity markets rebound and if government payments remain large until they do.

A supply chain revolution for rural America

The current slump in agriculture is generating a lot of public interest, yet viewed from a longer perspective, the changes now under way in the structure of agriculture—a trend many now refer to as supply chains—will be much more important to rural America. In short, a new tidal wave of change in the structure of agriculture will be a defining force in the rural America of the 21st century, while also defining who will remain in the new farming industry.

Agriculture is redefining the way it



Low farm prices have hurt farm incomes, though not nearly as much as expected. Net cash farm income is projected at \$53.7 billion this year, down only slightly from last year due to an estimated \$16.6 billion in direct government payments. Moreover, Congress is considering extra farm assistance that could add

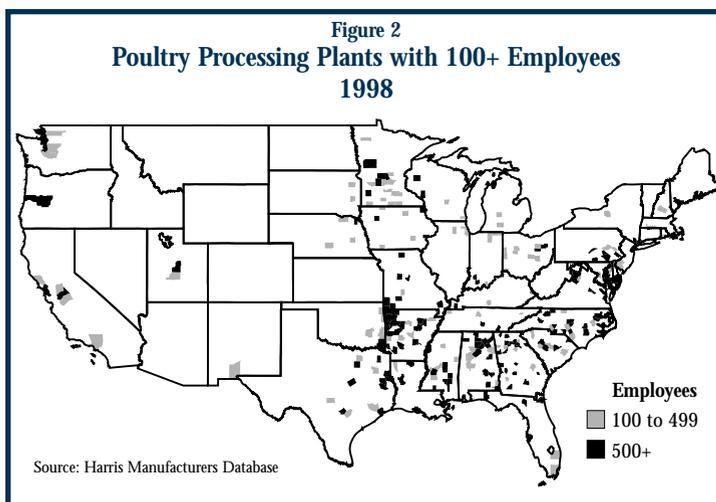
does business. Consumers are becoming more demanding of the foods they purchase. And food makers now have incredibly powerful technologies and processes that permit precise "food engineering"—from the farm to the dinner plate. As a result, many farmers no longer grow the generic commodities of the past. Instead, they have signed on as the first link in a more tightly choreographed food system. The key component in this choreography is a business alliance known as a supply chain. In a supply chain, farmers no longer make independent production decisions and sell their crops at the local elevator. Rather, farmers sign a contract with a major food company to deliver precisely grown farm products on a pre-set schedule.

The move to supply chains represents a tidal wave of change now beginning to sweep agriculture. Once confined to a handful of products, such as chickens and vegetables, supply chains are beginning to dominate hog production and are spreading to grain. In 1997, nearly 60 percent of all the hogs in the United States were sold under some form of contract, compared with less than 5 percent in 1980. While no one knows how many hogs are being sold under contract in 1999, the share is certainly higher than in 1997.

Supply chains change not only *how* agriculture does business but also *who* does business. The number of farms has been falling for decades as farmers have expanded operations to drive costs down. Supply chains represent an even more fundamental change in industry structure. In almost all cases, supply chains include relatively few farm producers. The number is held down since the firm putting the chain together wants to minimize the costs of managing highly integrated business alliances. For instance, industry participants now believe that 40 or fewer chains will control nearly all U.S. pork production in a matter of a few years, and that these chains will engage a mere fraction of the 100,000 hog farms now scattered across the nation. Thus, farmers increasingly ask themselves how they will remain part of rapidly changing business. Without doubt, some will be left

on the outside looking in.

While supply chains are redefining farming, they are literally redrawing the rural landscape. Indeed, agriculture's geography in the 21st century may be the most interesting, yet least understood, aspect of supply chains. For the past 200 years, a hallmark of commodity agriculture in the United States has been its wide dispersion. Corn, for instance, has been grown for more than 1,000 miles across the nation's midsection—from the rolling hills of Pennsylvania to the wide-open prairie of Nebraska.



Supply chains lead to a very different geography—one based on concentration in relatively few rural places. In that sense, the poultry industry may be prelude to the future. The poultry industry is now characterized by a handful of supply chains that are concentrated mostly in the South, the mid-Atlantic, and the upper Midwest. What may be even more striking is that poultry processing and production have concentrated even further within these regions (Figure 2). Quite simply, the poultry industry is found in relatively few rural places.

In short, a new geography in agriculture may turn into an economic revolution for rural America. Many rural places will still depend on a commodity agriculture that will continue for the foreseeable future, even as more segments are dominated by supply chains. The struggle for these "commodity communities" will be

building an economic future with fewer farms, fewer banks, and fewer businesses. In the end, this probably means far fewer farm communities.

Meanwhile, some rural communities will hitch themselves to the brave new world of industrialized agriculture and supply chains. These communities will benefit from the jobs that processing activity will bring, as well as the prospect of higher per-farm income for large local producers. Still, supply chains will locate in relatively few rural communities. And with fewer farmers and fewer suppliers

where they do locate, the economic impact will be different than with the commodity agriculture of the past.

The current pipeline of agricultural research points to a plethora of engineered food products on the horizon, all likely to give rise to new

supply chains. The question that remains is where this specialized agriculture of the future will locate. If the history of supply chains to date is any guide, relatively few rural communities may benefit.

Rural policy must embrace broader issues

The economic changes now sweeping rural America point to a broad new slate of policy issues. While agricultural policy *was* rural policy in the 20th century, a much broader approach will be required if rural America is to achieve its economic potential in the 21st century.

The starting point for rural policy discussion in the period ahead will be whether the United States goes beyond agricultural policy. Much of the nation's agricultural policy framework was put in place when agriculture dominated the rural economy. That is no longer the case. Since 1950, the

number of farm-dependent rural counties has plummeted from more than 2,000 to just 556 when the 1990s began (Figure 3).

The conclusion is inescapable: agricultural policy no longer cures rural ills. To be sure, agricultural policy will remain a basic element of rural policy. Yet if policy-makers want to shape the economic future of *all* of rural America, rural policy must encompass a much broader array of issues. Four issues will be especially important to the course of the rural economy in the 21st century:

New economic engines. Much of rural America is searching for new sources of economic growth, yet little is known about which industries may hold the greatest promise. Public research into new rural economic engines may be considered, but the key will ultimately be the ability of rural entrepreneurs to establish new businesses in rural America. Business and technical assistance programs aimed at rural businesses may get new attention.

Physical and digital infrastructure. Roads, bridges, and water and sewer systems will have a major impact on sustaining new economic initiatives in rural America. And with a declining tax base in many rural communities, tough decisions over new investments lie ahead. An even bigger issue may be providing adequate digital infrastructure in rural America.

Financial markets. Rural businesses face a shorter menu of capital options

than their metro area counterparts. This points to the opportunity for market innovations that increase the availability of equity and other forms of capital.

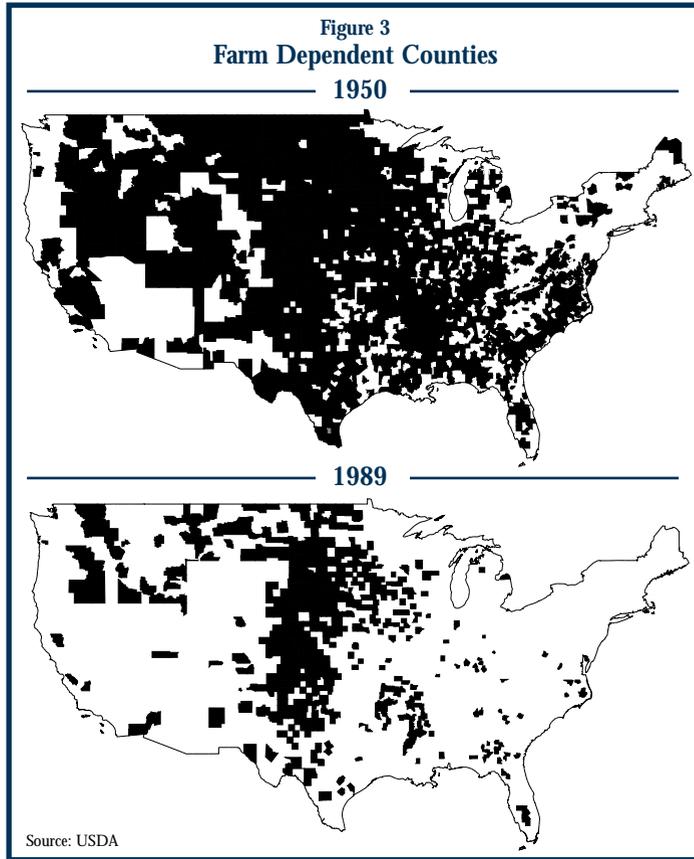
Reinventing public services. With a tide of economic changes, many local governments in rural America struggle to maintain public services. Especially in areas where population and tax revenues are declining, innovation in traditional delivery systems will be a necessity in the 21st century.

Addressing these rural issues will be a tall order in the period ahead. The challenge is only made bigger by the fact that rural policy is not the province of one agency or level of government. Should rural issues be sorted out at the federal, state, or local level, or all of the above? This question will be but the beginning of what promises to be a long debate over rural policy in the years to come, a debate that likely will begin in earnest as Congress

reconsiders agricultural policy over the next couple of years.

Conclusions

A vital part of the U.S. economy, rural America is undergoing enormous changes as the 20th century draws to a close. Agriculture, currently in a deep slump, is also being transformed by a new way of doing business—supply chains. The ebb and flow of rural America's other industries have left a deeply divided rural economy—a number of growth havens that are booming and a countryside full of communities being left behind. Unlocking rural America's economic potential in the new century will fall in part to a new generation of rural policy, a policy that will extend far beyond agriculture.



The Center for the Study of Rural America will track the shifting currents in the rural economy each month in *The Main Street Economist*. In-depth studies of major rural economic and policy issues will appear in the Federal Reserve Bank of Kansas City's *Economic Review* and other publications. Next spring, we will launch a new national conference on rural issues. A lot is happening in rural America. Stay tuned.

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