The Main Street Economist

Commentary on the rural economy

Building Rural Prosperity in Regions: *The Road Less Traveled*

2004 Annual Report

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The First Five Years *of Our Journey*

For five years now, the Center for the Study of Rural America has been exploring the economic future of the nation's rural regions. Our five-year anniversary is a good time to reflect on what we've learned on our journey of discovery. Globalization is driving profound change in the fabric of the rural economy, forcing most places to build new economic engines. Regions are becoming an essential unit in the rebuilding, as a critical mass of ideas, capital, technology, and skills now seems essential to new growth.

Regions must find a niche in a globalizing economy by playing to their distinct strengths — and by growing a new generation of entrepreneurs. Equally important to success are new ways of forging partnerships among regional leaders, what many now call governance. Finally, public policy must turn away from subsidies that thwart innovation to supporting public and private investments aimed at each region's new niche. Put another way, the era of one-size-fits-all development policy has passed.

Together, these conclusions from our journey point to a future for rural America that has never been more challenging — or as exciting.

Globalization Paves a New Road to *Prosperity*

by Nancy Novack

For more than a century, America led the way in exporting agricultural commodities and manufactured goods to marketplaces around the world. Towns throughout rural America were prosperous. But one by one, these two traditional pathways to success grew crowded. Competition around the world has become fierce — and the rewards at home, fewer and fewer. Meanwhile, the cost of subsidizing farm commodities and giving tax incentives to rural factories has climbed steadily.

With profit margins eroding, rural America has seen producers leave their farms and factories close their doors. For the first time, U.S. commodities and manufactured goods are no longer the undisputed champions of the world market — because rural America is no longer the home of the lowest cost land and labor. Those titles are now in contention throughout the globe. Commodity producers in agriculture and manufacturing now must be the highest volume, lowest cost producers to thrive in global commodity markets. The resulting consolidation means most rural regions must find a new way in the global economy.

South America's abundance of land has quickly made it a dominant force in world agricultural markets. Not only is land cheaper there, but, as elsewhere, South American countries have adopted technologies that have helped them boost their agricultural productivity. For example, the U.S. supplied more than 40 percent of world wheat exports three decades ago, but that number has fallen to about one-fourth today. Similarly, the U.S. was recently surpassed as the world's largest producer of soybeans by South American countries — 30 years ago, the U.S. accounted for 70 percent of that market.

In much the same way, globalization has transformed rural manufacturing. Lower costs of production prevail in many less developed countries. Rural manufacturing industries in food, textiles, furniture, and paper face considerable competition, as production of these products expands in many regions around the world. Companies without close ties to a community have little incentive to continue operating there when their costs are rising. The stories of rural manufacturers leaving town have become very familiar in recent years. Although factory closures eased in 2004, the previous three years saw hundreds of rural plants close down — with many of them moving operations overseas. And when rural factories disappear, so do their high-paying jobs.

The rural service sector also faces strong pressure from globalization. Labor is much cheaper elsewhere, and for lower-skilled service jobs, qualified workers abroad are plentiful. Some services require no human contact, making it feasible for U.S.-based companies to locate a service component overseas. One commonly cited example in rural America is call centers. Ironically, not long ago call centers were a source of new rural jobs — the same jobs that rural communities are now losing.

Globalization makes rural businesses face new strategic choices. Producing commodities has been the route that most rural businesses have taken over the years. But commodity production, whether corn or car parts, has become so intensely competitive that only the most cost-efficient businesses will survive. Consolidation will prevail, as firms aim to capture economies of scale. Adopting new technologies that increase output and lower unit costs will be vital to success — even to the largest operations.

A global economy with freer trade is not just a challenge, it is also an open door to new market opportunities.

Other rural businesses will take a much different path to the future — exploiting niche markets. A global economy with freer trade is not just a challenge, it is also an open door to new market opportunities. Niche markets with a product focus enable businesses to operate on a smaller scale because competitive advantage is not always gained by being the lowest-cost producer. The virtue of these markets is the higher profit margins they afford. To succeed, though, firms must know what products consumers want — and deliver the quality they expect.

Producing for niche markets in agriculture is now called "product agriculture." Some opportunities in product agriculture are made possible by genomics. Pharmaceutical crops have the potential to be the highest-value farm products ever. Producing organic food products for the health conscious consumer, a rapidly growing segment of the population, also holds potential. Whatever the product, producers must have a closer tie with consumers. And for products such as those just mentioned, adopting high-quality standards of production and following strict production protocols will be critical to success.

Manufacturers can also become more product-focused by engaging in advanced manufacturing. Advanced manufacturing holds great promise for rural regions. High-tech industries face competition, too, but not as intensely as commodity-based industries. The U.S. is a global leader in developing and adopting technology, creating opportunity for rural manufacturers. Some rural manufacturers have made this transition, turning their factories into sites for new-product development and making precision products. For instance, Osborne Kansas, has used new technologies to transform itself from a livestock and pet equipment company to an ISO9000 maker of specialized plastic containers.

Rural regions cannot ignore the globalization of markets. Indeed, globalization has brought rural America to a crossroads. One path leads through agricultural and manufactured commodities, where only the low-cost producers can survive. But remedies for fostering an environment in which *all* commodity producers thrive have proven costly in the past. Tax incentives and subsidies are only short-term fixes, and increased scrutiny of these practices by policymakers both here and abroad raises questions about their use in the future.

But there is another road with a new focus on *products*. The key to navigating it will be investments in new technologies, new worker skills, and, perhaps most important, a new willingness to take the road less traveled.

An Economy of *Regions*

by Sarah Low

For years, commodities producers have been fiercely competitive. Farms and factories have struggled to squeeze out costs and stay competitive. Profit margins have grown thinner and thinner. One by one, factories have closed their doors, and farmers have found additional work elsewhere — or else left farming altogether. Those who stayed on borrowed more for machinery, acquired more land for production, and continually searched for cheaper labor and ways to be more productive. In short, they have run their businesses on a treadmill.

Conventional wisdom had always told them that market prices were the result of forces beyond their control. Teaming up with neighbors or other communities to get more for their products, therefore, was futile. The neighbors *were* the competition. After all, independence was the bedrock of rural America. When one community met another, it wasn't to team up — it was to do battle on the football field.

But the new global economy has changed all of that.

Globalization has dramatically redrawn the map of regional economies. Some regions have prospered by finding niches to capture gains from global trade. Other regions have struggled. From 1996 to 2001, job growth varied widely across regions in industrialized nations — from 14.0 percent in some places to -6.0 percent in others. About 37 percent of national unemployment in industrialized countries was concentrated in just 10 percent of their regions.

As globalization has changed regional economies, so has the way rural communities view themselves. Communities are beginning to see each other, not as rivals, but as economic partners that must depend on one another to prosper.

Regional partnering can often overcome the challenges of being too small in the market — a challenge that small rural communities cannot surmount by themselves. Rural communities typically lack the critical mass needed to support cultural and entertainment amenities. Their labor supply is often too small and ill-prepared to support new business activity, innovation, and entrepreneurship. Many of the youngest and brightest people in rural regions have already left home to attend college in urban areas — and the lack of career opportunities keeps them from coming home when they graduate. Existing businesses suffer because they lack the support networks needed to thrive in a global market. Firms in isolated places often find it harder to obtain capital to invest in new technology. And without a healthy local demand for more products and services, new retail stores and services have little incentive to invest in rural markets. The limits of small scale in rural places seem endless.

But by partnering with neighbors, rural communities can overcome many of these limits. The first step is to think regionally. For many small communities, focusing on *interdependence* rather than *independence* can make the difference between languishing and prospering. But thinking regionally requires a paradigm shift for communities —and their leaders alike.

Over the past five years, the Center for the Study of Rural America has identified a number of regions in rural America and around the globe that have embraced the idea of partnering. Here are a few examples:

In Morgan County, Colorado, business and community leaders recognized that infrastructure was holding back economic progress in their communities. They had access to interstate highways and the new Denver International Airport, but not to the high-speed Internet highway. Four key partners — the community college, their economic development corporation, local chambers of commerce, and county officials — all worked with schools, towns, healthcare providers and the private sector to gain support for broadband Internet service among businesses and residents.

In the Midwest, crop producers began to explore the possibilities of growing pharmaceuticals in cornfields. Corn genetically engineered to produce pharmaceutical inputs could yield much more value than traditional feed grade corn. However, for a region to grow enough of the new corn to merit a processing facility, neighboring producers would have to cooperate with each other. They would have to develop a team, or critical mass, of local businesses and researchers to aid in the production of this highly specialized product. Developing the team is difficult, one reason that growing pharmaceutical crops is a new opportunity still in its infancy.

For many small communities, focusing on interdependence rather than independence can make the difference between languishing and prospering.

Regions seeking new ways to prosper have also discovered they are best served by fostering an entrepreneurial climate to encourage local business startups. Entrepreneurs are innovative by nature and may ultimately be the most adept at recognizing a region's strengths. Entrepreneurs use the strongest assets to create profitable businesses, which in turn create local jobs and new opportunities for local investment.

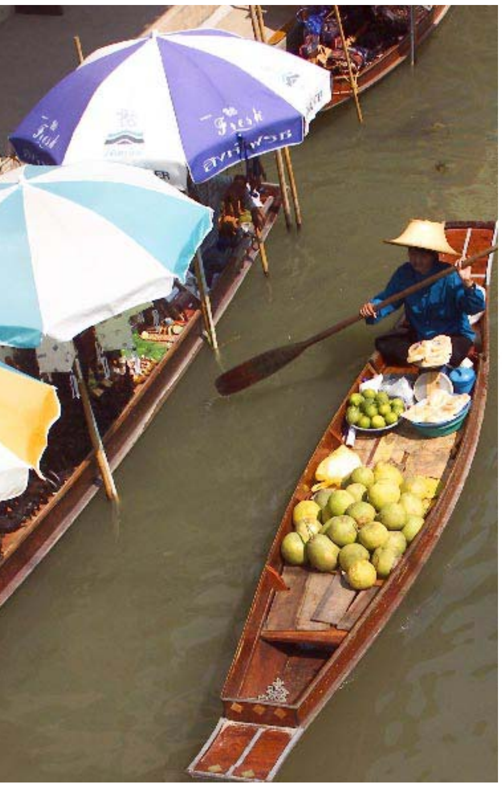
In today's global economy, rural America can no longer rely on producing even more farm and industrial products. Rural America must now build new economic engines. To do so, communities must build critical mass, develop skills for their workforce, and provide access to the capital needed to generate growth and innovation — but they can't do it on their own. They must work interdependently.

Government policies designed for sectors that grow or manufacture products for these markets, such as farm subsidies or firm recruitment incentives, simply perpetuate the motions of the past. In other words, they keep firms and regions on the same treadmill. For most rural communities, today's path to economic success lies elsewhere. The place to begin the quest is in *regions*.

Regional Competitive Advantage IN THE NEW MILLENNIUM

by STEPHAN WEILER

Regions clearly matter in a globalizing marketplace. When communities combine their strengths, they can reach markets they could never reach alone. But how can communities decide which strengths to combine to compete in the new global economy?



The answer lies in whether a region can effectively understand, support, and exploit its own competitive advantage. Competitive advantage is defined by an economic niche that aligns regional strengths with market opportunities. Every region has a range of assets. If it can find ways to match its strengths with selected market niches, it can use that competitive advantage to reshape tomorrow's economic prospects.

With regional competitiveness as the clear goal, assets become the building blocks to reach that goal. To be successful, regional economies must create the right skills to reach today's high-value niche markets. Businesses must innovate constantly to provide new products, better services, and higher value. As the high-value niches in the market spectrum multiply, they encourage regions and producers to focus on *creating value* rather than relying on the dead-end strategies of cost competition that served the past.

How can communities and regions evaluate their strengths to determine which high-value niches they can fill?

Regions increasingly need new maps to navigate in today's innovation-oriented economy. Forward-looking measures to guide them to prosperity are lacking, leaving regions to wander along roads already traveled. Rural areas in particular have struggled with new innovation-oriented perspectives, as their economies have traditionally focused on commodity-oriented assets and activities. Reflecting this growing need for measures to guide regions, the Center began a major project aimed at measuring regional assets critical to new economic engines.

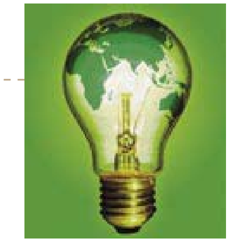
Five types of measures will help regions assess their competitive advantages so they can reach higher-value niche markets. *Workforce* and *Finance* indicators will help identify potentially overlooked labor and financial market opportunities. *Lifestyle* and *Innovation* indicators will measure a region's quality-of-life amenities and innovative activities. *Information* indicators will estimate information flows about the local economy, such as business activity and consumer demographics. The scarcity of such information hinders business development and suggests a productive role for policymakers.

Clearly, not all rural regions have as many competitive capacities as metropolitan areas. But their distinct assets are likely to complement metro assets. Unique rural advantages include natural amenities, like mountains and waterways, which attract workers, firms, and entrepreneurs. Simple geography itself can also be an asset. The Quad Cities of Iowa and Illinois have taken advantage of their nearness to major metro areas to become a logistics and distribution center for tens of millions of Midwestern consumers.

Rural regions can partner across previously sacrosanct jurisdictional boundaries to exploit complementarities. County lines were crossed in western Kentucky in its multicounty Town Hall regionalization effort. Even state lines were crossed in the Four Corners region of the Southwest, where the San Juan Forum promotes regional development. A unique mix of broader regional amenities can make a whole set of counties considerably more attractive than their individual parts. Partnering also provides the critical mass needed to leverage market opportunities.

Entrepreneurs are a critical asset in building new economic engines, especially in low-density rural economies. The stars of new urban and rural economic success stories are fast-growing small, nimble, niche firms, which are based almost universally on entrepreneurship and characterized by their continual innovation. Nonmetro areas have greater entrepreneurial *breadth* than metro areas, suggesting the seedbed for such small firms in rural America is fertile.

But regional prosperity relies on more than just high numbers of entrepreneurs. A region must also create entrepreneurial *depth*. In other words, a region's entrepreneurs must create high-value, high-growth firms. Innovation in new technology, new products, and new competitive practices in marketing and distribution are critical to creating value. Urban areas naturally generate new innovations more quickly,



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but rural areas can tap into established innovative metro centers, perhaps exploiting recent innovations revealed by other firms. Or they can complement value innovators with necessary supplies and services. Certain rural regions, particularly those with high amenities, have created many new small firms with entrepreneurial depth. Other rural regions can partner with these areas as well.

Crafting new strategies to match assets with the global marketplace is a daunting challenge for regions. The private sector, of course, is the key to generating regional economic dynamism. However, both private firms and public policymakers need the tools to assess local strengths, build critical support structures, and seize market opportunities. Analytical methods for aligning assets with market opportunities are in short supply but are slowly being developed. To speed this process along, the Center is actively promoting better communication between the research and policy communities.

Exploiting regional competitive advantages requires coordinating a region's public and private institutions. Public investments in infrastructure make private investment more effective. Furthermore, public investments enrich the seedbeds that are so vital for entrepreneurial innovation to thrive. Entrepreneurs constantly probe fresh possibilities with new mixes of a region's assets, helping the region compete in high-value markets. Such dynamism matters not only for the region itself. A nation's economic well-being directly reflects the innovation and growth of its regional economies.

New Governance for New *Competitive Advantage*

by Jason Henderson

Identifying a region's competitive advantage in the global economy is the first milestone along the road to economic viability. To reach the next milestone, regions must devise and implement a plan to put their competitive advantage to work. Doing so requires a new process — one that analysts now refer to as governance.

Governance is *not* government. Whereas government is about public services, governance describes the process of key economic and policy actors in a region coming together to craft and launch a development strategy.

Creating the right structure for governance is just as important as selecting the right competitive advantage. The two concepts, in fact, are two sides of the same coin. Without good governance, regions cannot hope to build a competitive advantage.

In a regional framework, governance embodies collaboration and partnership. Indeed, partnership is the new byword for effective development — *vertically* across levels of government and *horizontally* across public, private, nonprofit, and educational sectors. Partnership is important for all communities, but especially for rural communities, which often lack the resources needed to compete in the global economy.

Vertical partnership fosters collaboration through local, state, and federal entities. Government agencies at all levels help foster economic development. Public investments and services play supporting roles to private-sector engines of economic growth. Policies at all levels must be aligned so they do not hinder each other or the private sectors.

Horizontal partnerships are collaborations within and between communities. Many types of community institutions play roles in economic development. But forging partnerships horizontally across these institutions can introduce a whole new set of challenges.

The expanding roles of governments, nonprofits, businesses, and higher educational institutions in economic development inevitably spawn new rivalries. In some communities, business groups and local development officials battle for leadership of economic development initiatives. Advocates of industrial recruitment can leave the impression that officials do not value existing businesses. Existing businesses can appear self-serving if they block revitalization efforts that might bring new sources of competition for local dollars. Turf battles can erupt between long-standing rivals. Barriers can mount between traditional industries swimming in "old money" and new industries awash in "new money." One of the worst outcomes is spending scarce resources on creating duplicate programs by competing institutions.

In addition to ending internal community rifts, horizontal collaboration in governance must overcome the tradition of independence and rivalries between rural communities. From industrial recruitment to high school sports, rural communities have competed against one another for decades. Rivalries often go back generations — sometimes to the days of the Hatfields and the McCoys.

For governance to capitalize on a region's competitive advantage, these rivalries and turf battles need to be set aside. Regional partnerships require a basic understanding that regions are about communities that share power. Coming together and forging a common objective is necessary for defining a common vision. All partners must have a vested interest in the region's success and demonstrate a willingness to march together down the road to prosperity.

Nevertheless, the regional initiative must preserve community autonomy. The unique resources provided by each community must be valued and appreciated. The benefits of the regional initiative must match the contributions of these assets to ensure an equitable outcome for all communities.

Fostering effective governance begins with developing new champions, forging institutional support, and building a new regional constituency.

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Developing new champions is critical to effective regional governance. New governance requires change, and *public entrepreneurs* must serve as the agents of that change. Public entrepreneurs are the champions that must understand, verbalize, advocate, and lead initiatives for new regional governance. Local and regional leaders, which truly understand the region's assets and opportunities, must be developed. These leaders must have the integrity, respect, and trust to cross boundaries, take risks, and accept the consequences. In short, rural communities must tend their leadership garden. It is the seedbed from which champions emerge.

Effective regional governance also relies on institutions to bring people together. As regional champions cross boundaries and take risks, they need the support of public, private, nonprofit, and educational institutions. Colleges, universities, community foundations, social organizations, and business groups can serve as intermediaries by facilitating meetings and fostering communication across institutional, political, community, and cultural boundaries. These intermediary institutions can act as educators, capacity builders, social inventors, coalition builders, and organizers of new groups. The most effective intermediary institutions are able to create incentives that foster collaboration.

And finally, effective regional governance also requires building a regional constituency. People are loyal to their community — to their schools, churches, and service clubs. New governance for a region requires a new base of popular support. That base must understand the importance of regions and the need for new governance. The new regional constituency will lend support to champions and intermediary organizations and serve as the foot soldiers in a new movement. The regional constituency is the foundation from which leadership capacity is replenished.

The road to regional economies is not easy to follow. Developing new sources of regional competitive advantage requires forming regional partnerships. Forming regional partnerships requires new governance. New governance requires leaving turf battles behind, so that governments, communities, institutions, and organizations can cross existing boundaries and work together for regional prosperity. For all of this to happen, a new set of regional champions must emerge. Regional institutions must become partners. And new regional constituencies must support the effort.

And so, the question arises: Can regional economies arrive on their own?

New Policies for *New Economic Engines*

by Mark Drabenstott

Public policy will play a critical role in building new economic engines across rural America. Yet just as regions must approach the future economy with new strategies, so must policy officials. In many ways, policy instruments for rural development are still aimed at 20th century problems.

Rural development policy currently has two defining features. First, it is still anchored in agriculture. From its first framing in the Great Depression, agricultural policy has been the primary policy instrument for the rural economy. But a *lot* has changed since then. Fewer than one in every 10 rural counties now count agriculture as their leading source of income. And the typical farm family now earns 90 percent of their income off the farm. In short, rural America has become far too diverse to wear a public policy still mostly made for "one size."

Second, subsidies absorb a huge share of public funds spent on rural development. Though many subsidies come into play, the two biggest categories are farm commodity payments and a trove of financial incentives paid by state and local governments to lure businesses.

Quite apart from being expensive, the subsidies are losing their effect. Farm subsidies often fail to bring vigor to Main Street, even in farming regions. What is more, they tie vast regions to commodities, when the market beckons with opportunities in new products. This "path dependence" represents an enormous cost to regions — yet it is almost entirely ignored.

For its part, industrial recruitment has become both high-cost and high-risk. Communities trying to recruit a factory not only must give away the farm to get it, but are now discovering that many firms leave town as soon as cheaper labor and land come into view.

Looking ahead, the growing consensus among policy analysts and officials is that rural development must be founded on four pillars: focusing on regions instead of sectors; shifting more solutions from federal to regional officials; stoking the fire of innovation; and investing in the public goods that sustain new economies.

For reasons discussed earlier in this *Annual Report*, regions have become the new unit of economic development. This presents big challenges for rural policy and represents the first pillar. Most of the policy instruments and institutions still have agriculture as the centerpiece of their mission. While innovations in agriculture will fuel new economic gains, most rural regions must look well beyond farm fields.

Even when the policy discussion goes beyond agriculture, a challenge still remains. The geography of policy and the new economy are fundamentally misaligned. Economic development policy is mostly the province of state and local governments. Not surprisingly, these policies are aimed entirely within their own lines of jurisdiction. Yet the regions framed by the new economy do not respect the lines of the old political economy. Quite to the contrary, regions that share common ground in the new economy invariably spill across the borders of cities, counties, and sometimes even states.

The new development policy for rural regions, therefore, requires major realignment. Policy institutions, designed when agriculture was the countryside's ubiquitous economic engine, need serious reassessment.

A new sense of geography will also be critical in redirecting public investments in research and technology. For the most part, current policies assume that new ag technology will create an economic tide to lift all rural regions in a state. Yet most rural regions must look at a much broader horizon of economic opportunity in the future. Thus, it will be especially important to ask which strands of the broader public research pipeline will advantage which regions. This "where" question must become a much more visible feature of public investments in research.

A second pillar of rural policy will be shifting the roles of federal and regional policy officials. With sectors and subsidies at the core of past policy, federal decisions were often viewed as the most important. But the world has changed. Regional competitive advantage is much more *bottom-up* than *top-down* — a sharp reversal of past approaches to

development. Accordingly, most experts now conclude that regional officials must take much more leadership in regional development, while federal officials must become more flexible and facilitative.

Local and regional leaders have a far better understanding of a region's assets and opportunities than does Washington — or the state capitol, for that matter. Identifying and giving voice to the region's vision, however, depends critically on the leadership and analytical capacities of those leaders. Many regional development efforts elsewhere in the world now commit a portion of the total public funds to investing in the capacity of regional leaders. At home, federal policy might also play a valuable role by providing new financial incentives for regional partnerships to form — a role that deserves more attention in the future.

A third pillar is stoking innovation in rural regions. Many, if not most, rural regions must take an economic journey from commodities to a knowledge-driven economy. Innovation, the fuel for that journey, is scarce in far too many rural regions today.

Two policy thrusts will be critical to helping regions innovate. One is public investments in research and development of new technologies. Broadband technology is the poster child for this topic, but the research horizon is actually much broader. Pharmaceutical crops and smart aircraft for new air transportation systems are but two examples of the opportunities.

The other is a new focus on policies and support mechanisms that grow entrepreneurs. Building regional competitive advantage means focusing less on recruiting and more on growing your own entrepreneurs. Indeed, many analysts believe that entrepreneurship will be

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decisive in determining the regions that prosper. If that is true, then public policy must pay far more attention than it does now to the set of policies that make regions fertile places for growing entrepreneurs.

The final pillar is renewing our commitment to investments in public goods that link directly to each region's competitive edge. Economic development policy has always stressed investment in public goods. The difference in the new framework is identifying the public goods that contribute directly to a particular region's competitive advantage. Unless a region has a clear sense of what that advantage is, the public investments are likely to be poorly designed and limited in their effect. The key is requiring regional leaders to aim public investments at underutilized assets in the region, which suggests a natural oversight role for federal officials.

A *Special Thanks* to Our Partners

We are especially thankful for the rich web of rural leaders, policy officials, and fellow analysts that have been our companions on our journey. In particular, the Rural Policy Research Institute, the Organization for Economic Cooperation and Development's Territorial Development Policy Committee, and our fellow analysts in regional science have lent many helping hands.

The Road *Ahead*

The past five years have been a great journey for the Center, and we have learned much about the wonderful people and places that make up rural America. For us, it has truly been a journey of discovery.

With a rich reserve of ingenuity, rural America greets an exciting future. Many rural places now contemplate an economic future unseen a few short years ago. To be sure, thinking and acting regionally now seem to be the pathway to progress. Yet, rural America has a proud heritage of community, and that very sense of place and partnership can be a real source of strength.

In the months ahead, the Center will explore new ways that rural communities are partnering with one another to develop their regional strengths. We'll continue to develop new tools to measure those strengths. We'll investigate why some regions prosper — and why others don't. With help from other rural and regional analysts, we'll develop new ways to match a region's competitive advantage with the global marketplace. And we'll strive to shed new light on new models of regional governance that can contribute to effective development strategies. And, we'll explore a range of policies that help regions prosper in the new economy.

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