



## Rural Development

### Executive Summary

#### July 2006

This paper is the third in a series of briefing papers that assess general views advanced during the 2007 Farm Bill Forums convened by Secretary Mike Johanns in 2005 as well as additional policy ideas that have emerged in recent months.

This paper describes the current state of rural development, discusses and evaluates current key rural development programs available to communities and individuals through the Department of Agriculture (USDA), and concludes with a discussion of general policy alternatives.

These alternatives are generalized approaches for dealing with concerns raised about current programs. They are not meant to be exhaustive or represent specific Farm Bill proposals. Rather, they are presented as candidates for further public discussion on potentially effective approaches for development of the 2007 Farm Bill.

### What is Rural Development?

Rural development is the improvement in overall rural community conditions, including economic and other quality of life considerations such as the environment, health, infrastructure, and housing.

### What Drives Rural Development?

Rural America, home to about 50 million people and covering 75 percent of the total land area of the nation, is extremely varied in geography, population density, and economic and social assets.

Since rural areas are no longer dominated by agriculture, the rural economy has become highly diverse. In 1950, about 40 percent of rural people lived on a farm and one-third of the rural workforce worked in production agriculture. Today, less than 10 percent of rural people currently live on a farm and only 6.5 percent of the rural workforce is directly employed in farm production. Moreover, in 2003, 68 percent of farm households reported the operator or the spouse worked off the farm, and 89 percent of farm household income came from off-farm sources. In addition, 78 percent of farm-dependent counties lost population from 2000 to 2005, mainly attributable to inadequate natural amenities and lack of nonfarm employment opportunities making it hard to attract and retain young people.

Manufacturing now directly accounts for over a quarter of rural private sector earnings. More than one in every four nonmetro counties depends primarily on manufacturing for its economic base.

Rural counties have lagged metropolitan counties in employment growth and real per capita income. Poverty rates are also higher, although the gap has declined since 1990.

The largest growth in rural population and employment has generally occurred in areas which rely on non-traditional income sources. These include areas that have either capitalized on natural resources and climate for recreation and retirement or their proximity to urban areas. Alternatively, those regions of the country that rely on farming, lack urbanization, or are remote from large cities have seen declines in population.

### Federal Government Approaches to Rural Development

USDA is the lead Federal agency for rural development as designated by the Rural Development Policy Act of 1980. However, many other Federal agencies, including the Small Business Administration; the Environmental Protection Agency; and the Departments of Housing and Urban Development, Labor, Commerce, Health and Human Services, and Homeland Security have significant rural development programs. Because the focus of this paper is on providing information for consideration in the 2007 Farm Bill, we focus only on those programs within USDA.

USDA's rural development activities focus on financing housing, community facilities, and community water and wastewater systems; providing financial and technical assistance for business development, including in the area of alternative energy; expanding the availability of broadband; financing generation, transmission, and distribution of electricity; providing payments and technical assistance to develop, maintain, and conserve natural resources; and conducting research to study how agricultural products can be processed and developed for new uses, including for the production of alternative energy sources.

The instruments used by USDA to stimulate rural development are just as diverse as the goals of USDA's rural development programs. Current USDA programs

involve grants, direct loans, loan guarantees, financial and technical assistance, and research.

USDA's rural development programs mainly fall in the Rural Development mission area but other USDA mission areas also contribute to rural development. The Research, Education and Economics mission area aids rural development through research, education, and extension.

The USDA conservation and farm price and income support programs also support rural development through investment in rural economies. In addition, conservation programs support rural development by protecting and enhancing environmental amenities which can attract amenity-oriented businesses to rural areas, encouraging sustainable production practices that help ensure the long-term economic viability of rural areas, and providing direct rural development assistance to rural areas.

## **Economic and Policy Issues for Federal Rural Development Programs**

During the Secretary's Farm Bill Forums, considerable support was expressed for rural development programs. Public commenters consistently said the programs were effective.

USDA estimates that in fiscal year (FY) 2005 its business programs created over 73,000 jobs and "impacted" over 12,000 businesses. In addition, USDA electric programs approved 111 loans to rural distribution, generation, and transmission providers, which connected about 195,000 new consumers and improved electrical service to about 2.4 million customers. USDA water and wastewater disposal loans and grants also help to fund new or improved water and wastewater disposal systems and served over 1 million customers.

In FY 2005, USDA invested \$4.24 billion to assist 44,224 rural families obtain homes, and an additional \$66 million to rehabilitate the homes of more than 11,700 very low-income families. USDA also provided funds to construct, renovate or improve 812 essential community facilities, including 112 health-care facilities, 312 public-safety facilities, 92 educational facilities, 15 energy-related facilities, 157 public buildings, 7 recreation facilities, and a number of other essential community facilities.

USDA programs are also aimed at encouraging sustainable agricultural and forestry practices. For example, USDA programs support State efforts to protect environmentally sensitive forest lands and help local communities mitigate the potential damages from wildfires.

A review of program performance identified several concerns regarding USDA programs, including the importance of improving information on the economic impacts of specific programs, strengthening underwriting standards to reduce default rates on business and industry loans, ensuring broadband loans are focused on rural areas that would not have adequate service in the absence of program assistance, maintaining housing rental units and ensuring rental assistance is not excessive, and ensuring programs are not duplicative.

There is little question that USDA rural development programs have helped rural communities. A more important question for the 2007 Farm Bill discussion is how these programs can be improved to enhance both the efficiency and the equity of the programs.

## **Alternative Approaches to Rural Development**

USDA's rural development programs are designed to: provide socially-based assistance to local rural communities and residents in need and facilitate market-based rural development.

One challenge during the Farm Bill consideration of USDA's rural development programs is finding ways to use the available Federal budget authority most effectively to meet both of these two critical objectives.

Three broad alternatives for addressing rural development are discussed. The alternatives presented are not meant to be exhaustive or mutually exclusive, nor are they meant to represent specific legislative proposals for the upcoming Farm Bill. No specific alternative is being advocated. Rather, the alternatives represent generalized approaches to addressing concerns that have been raised with regard to current programs. They are presented as candidates for further public discussion to help inform the 2007 Farm Bill debate.

**Alternative 1: Maintain the Structure and Tools of Existing Programs but Refine Program Targeting.** Most USDA rural development programs are "targeted" in several ways, many with multiple eligibility requirements. While the impacts of most programs can usually be measured in a limited way, estimates of the larger impacts on the rural economy and rural residents are generally not available. A thorough assessment of the economic, environmental, and infrastructure conditions in rural America coupled with improved program targeting would lead to more efficient and equitable uses of Government funding.

Establishing a system for objective and continuous monitoring of program impacts on rural America would provide information on whether programs are achieving the ultimate goals of economic and quality of life improvements and enable USDA to redesign the

administration of programs to more equitably distribute funds and more efficiently meet program objectives.

Some targeting options could include:

*Targeting Based on Critical Needs.* Most current programs are based on a perceived need. While current programs contribute to rural development, it is not clear that they are addressing the most important needs in rural America. With changing demographics, economic opportunities, increased communication, and the multitude of other social and economic factors defining rural America, the needs facing rural America are also changing and some of those needs may not be as important as they once were. A more targeted approach would assess the critical needs of rural America and direct programs to those issues that address those needs.

*Targeting Based on Net Rural Development Impact.* Some rural development programs offer benefits to rural areas without necessarily determining if needs would be met in the absence of assistance of the program. While these programs contribute to rural development, the marginal or net contribution of the program could be relatively small. Programs could be re-targeted to circumstances where goods and services are not available and would not be provided by the private market without government involvement. Better targeting may be achieved if programs were limited to situations where alternative financing is significantly restricted and that goods or services needed for either economic development or an adequate quality of life are not forthcoming without the program's benefits.

*Targeting Market-Based Programs on Self-Sustainability.* Assistance provided by some rural development programs is offered to businesses or communities with the hope that recipients will use the assistance to become self-supporting and self-sustaining. Other programs are not so restricted. One targeting alternative would be to direct more assistance into the support of self-sustaining economic development projects and away from those that are either maintenance-oriented or would be self-sustaining without the benefits of the program.

*Targeting Assistance to Increase Funds Available for Socially-Based Programs.* Under the Federal Credit Reform Act of 1990, most socially-based rural development programs cost more Federal budget authority to implement than market-based rural development programs. To the extent that rural development issues can be addressed with market-based solutions which take fewer Federal budget dollars, these Federal dollars can be applied to situations that can only be addressed with more expensive socially-based rural development solutions. During the consideration of the Farm Bill, legislative changes could be made to encourage market-based rural development solutions where possible and reserve socially-based solutions to

those situations where rural communities were in most need.

**Alternative 2: Focus on New Business Formation Supported with Rural Private Investment.** Under this alternative, USDA would recognize new business formation as the core activity to increase rural economic growth and focus on market-based solutions.

A next step for rural development programs is to generate more new businesses that are at least partially financed by rural people. One source of capital for investment is the equity of rural residents, some of which could be a source of funding for rural business investment.

This alternative would require identifying, aggregating and assisting many small individual investors to finance critical investments. While small business and micro lending would continue to have a role, under this option, USDA (or some new development funding entity) would focus on facilitating the aggregation of financing for new rural businesses by helping to bring together entrepreneurs, rural communities, banks, potential individual rural investors, and nonrural investors and creating mechanisms to utilize rural wealth to create more wealth. The development of renewable energy systems in rural America represents one area of investment where application of exiting rural wealth invested in new energy plants is benefiting rural residents as well as U.S. energy consumers.

USDA would work with State and local governments, regional organizations, and other stakeholders to focus on meeting the needs of rural entrepreneurs. These needs range from education to dealing with regulations to establishing relationships with supporting businesses to obtaining financial capital. Some commercial banks will not lend to business start-ups unless equity investors are liable beyond their invested capital. Many rural investors are reluctant to accept such liability. A focus would be on implementing strategies that facilitate investment by rural residents in rural businesses.

This alternative would also require USDA's Rural Development (RD) mission area to continue its effort to simplify the structure and delivery of its programs to enable local staff to assume a larger leadership role in RD mission area activities of their rural communities. If increased coordination, organization, and targeting of USDA resources are successful, rural citizens would earn a return on their investments and would help generate economic growth and jobs.

**Alternative 3: Move Toward Greater Regionalized Funding.** The Farm Bill debate has from time to time focused on the structure of USDA's rural development programs. For example, block grants have been considered as a way to redistribute Federal funding as

well as to pass some funding decisions from the Federal to the State level.

Another restructuring approach which has garnered interest in recent years involves making more use of regional development strategies when awarding Federal grants and loans. Such a regional approach, it is argued, has more potential for succeeding in today's global economy.

Encouraging rural communities to band together to make the most of the local region's assets in pursuing a regional development strategy has several advantages. There are cost advantages over a single small rural town or county in doing planning. There is access to a wider variety of development assets (such as infrastructure, educational and financial institutions, etc.). A regional approach is also conducive to current growth strategies, including business clusters that locate not just in one town but over an entire region. In addition, a regional approach also reduces inter-local competition in bidding up tax incentives to businesses that locate in the region. One drawback of the regional approach is the potential difficulty of getting more political jurisdictions and geographically dispersed people to work effectively together.