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ATTRACTING ECONOMIC GROWTH FOR THE RURAL ECONOMY

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HOUSE OF REPRESENTATIVES

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HEARING ON ATTRACTING ECONOMIC GROWTH FOR THE RURAL ECONOMY

THURSDAY, SEPTEMBER 4, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The Committee met, pursuant to call, at 9:30 a.m., in Room 2360, Rayburn House Office Building, Hon. Donald A. Manzullo [chair of the Committee] presiding.

Chairman MANZULLO. Good morning, and welcome to this hearing by the House Committee on Small Business. I appreciate the participation by all who have come to us today, especially those of you that have traveled some distance to attend our hearing.

The purpose of the hearing is to examine—review how the government is doing in encouraging growth in our rural economy. For many years, we have had a migration of people away from rural areas in general and towards metropolitan areas, especially metropolitan areas around the East and West Coasts.

One contributing factor in the migration within the country is insufficient economic activity in rural areas. When rural areas lose working-age people, many schools and hospitals begin to shut down. Housing prices drop, the tax base erodes, social services have to be cut; and it creates an atmosphere that tempts more people to leave, and then the cycle is reinforced. All the investments in roads, railways, airports, telecommunications and utilities become underutilized and, to a degree, wasted.

At the same time, the metropolitan areas these people move to have problems with too much road traffic, crowded schools and housing shortages.

For example, there have been cuts at the Goodyear Tire factory and Honeywell electrical switch facility in Freeport, Illinois, and nearby Galena; and the General Electric plant in Morrison, Illinois, in Whiteside County, which is part of the district that I represent, has gone from a couple of thousand employees down to 200.

When these larger factories shed jobs, many other small businesses are affected, some of which obviously close. And then some of the former employees have to move out of these rural areas to find new work, which put houses on the market for sale. The smaller work force hurts the property tax base and it goes on and on.

In fact, there was an article in the Washington Post on Sunday about a town by the name of West Point, Nebraska, that suffered, along with most of our rural areas where we are actually losing population, the challenge that it has with the wave of new immi-

grants repopulating the rural areas. All those challenges have really helped out that little town.

Congress recognized the important of maintaining our rural areas when it passed the Rural Development Act in 1972. Today, we will have a hearing and testimony on whether the government agencies are living up to the goals of that law.

We will also be hearing testimony on all the factors involved in creating the environment businesses need to thrive in rural areas. The recommendations we hear today will be important ones for developing any necessary future legislation to address critical problems.

A further purpose of today's hearing is to give the rural folks an opportunity to tout the fine things that they have done and no one knows about. That is why this is really not—it is not an oversight hearing, but it is a hearing that you can let the members of this committee, many of whom come from rural areas, and the delegates—we have four delegates that sit on this committee, which is extraordinary, and they, of course, are very much interested in economic development in their areas. So we are really thrilled to have what I consider a quite unique panel of people coming to help with us this issue.

The rules are, try to keep the testimony to 5 minutes, more or less, such as when you buy a farm, 160 more or less. And we anticipate that we are going to have a very interesting hearing. Now, I will have to admit the first two witnesses have been out—or Mr. Dorr was on his way to our district last week on two very sizable projects, but had to deliver the money without me. And Mr. Sampson was out, what, about a month ago?

Mr. SAMPSON. A month ago.

Chairman MANZULLO. About a month ago with a nice check from the Economic Development Administration where we worked with the City of Rochelle and Union Pacific to put in the largest intermodal hub in the United States. That is, in terms of the footprint, EDA made possible a huge, huge light of promise in an area where we are into double-digit unemployment.

So we look forward to the testimony.

[Mr. Manzullo's statement may be found in the appendix.]

Chairman MANZULLO. And now I defer to and recognize our ranking minority member, Mrs. Velazquez, back from a nice break and looking refreshed.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Good morning.

This committee has said time and time again, small business is big business in America. Nowhere is this truer than in rural America. From family farms to local restaurants to manufacturing, small businesses make up the bulk of the rural economy. Ninety percent of all businesses in rural areas are small firms, so when this committee examines policies that can impact small business, we are looking at policies that have a huge impact on rural America.

Today, entrepreneurs in rural areas are facing hardships. They face a weakening labor pool, as a younger and more productive population decides to leave and look for opportunity elsewhere. They have less access to capital and fewer government loan programs that reach them. These issues are a threat to the livelihood of rural America, and for those entrepreneurs and their employees

who struggle to survive in these communities the rewards of success are few.

During the 1990s economic boom other small firms experienced far greater growth. And today, workers' salaries in rural small businesses are nearly 35 percent below those found in cities.

Small firms in these communities are also adjusting to the changing face of the rural economy. At one time, when Congress talked about rural development, we talked about farm policy. Today, only 10 percent of employment in rural areas is related to agriculture. In fact, the largest employers in rural America are manufacturing companies. These communities are often dependent on a single manufacturing plant as it brings in high-paying jobs that form the area's economic and employment backbone. The loss of such companies can have a devastating effect.

These areas have also been particularly hard hit by the dramatic decline in manufacturing jobs. Rural manufacturing fell by 4.6 percent in 2002, and the numbers are getting worse. The loss of these jobs has created a ripple effect and hurt other small businesses as well.

Today's hearings will address how we can solve these problems. We will look at ways that we can use government programs to ensure the future is bright in rural America. Congress needs to make sure that we are not cutting critical funding to entrepreneurial programs during this economic downturn. It is during times like this that small businesses can spur a recovery.

The administration cannot continually turn its back on small businesses, particularly in rural America. They need help in overcoming the challenges that face them, like gaining access to capital, technical assistance and Federal contracts. The USDA and Department of Commerce need to make sure that the programs are reaching those businesses most in need.

These small firms simply need the right tools to level the playing field and be competitive in an ever-changing economic environment. Yet the administration's policies are actually hindering entrepreneurial development in rural areas, and because of policies that failed to help small firms, many rural businesses and our Nation's family farms are being threatened.

Small firms provide employment opportunities within these rural communities, but they cannot reach their full economic potential unless we provide them with the relief and assistance they need. As a key driver of our economy, small businesses require the working climate conducive to providing jobs to those living in rural areas. A high unemployment market in these small communities will cause workers and their families to leave and settle in more populated areas.

Failed policies are harming communities that rely most on their small firms. This is what is happening in our Nation's rural areas. We must prevent this in the future and examine ways in which Federal agencies can improve the programs to meet the needs of entrepreneurs in rural areas. Not only are small businesses the backbone of rural communities, they are the engine of our Nation's economy.

Thank you, Mr. Chairman.

[Ms. Velazquez's statement may be found in the appendix.]

Chairman MANZULLO. Okay. We will start with Thomas C. Dorr, Under Secretary for Rural Development, the U.S. Department of Agriculture, from the State of Iowa, where—did you live in Mr. King's district at one time?

Mr. DORR. I still live in Mr. King's district.

Chairman MANZULLO. Oh, okay. You have a constituent here. That is great.

Okay, we look forward to your testimony.

Mr. DORR. Thank you.

Chairman MANZULLO. The complete testimony, written testimonies of all the witnesses, will be made part of the record.

STATEMENT OF THOMAS C. DORR, UNDER SECRETARY FOR RURAL DEVELOPMENT, U.S. DEPARTMENT OF AGRICULTURE

Mr. DORR. Thank you, Mr. Chairman, fellow members of the committee, and particularly Congressman King. It is good to see you again. I would like to thank all of you for inviting me to testify on USDA's Rural Development capital investment efforts under way to create economic opportunities in rural America, opportunities that I believe give rural Americans greater control over where they will live, work and raise their families as well as allow them to enjoy an improved overall quality of life.

I think the question is, what is rural development at USDA. In fact, we are a sizable development bank. We presently have an $86 billion portfolio of loans and we will administer nearly $16 billion in program loans, loan guarantees, and grants through our three primary service areas of Rural Housing Service, the Rural Utilities Service and the Rural Business-Cooperative Service. In effect, we are really a venture capital firm for rural America, and we have two basic goals, that is, to increase economic opportunity and to improve the quality of life for all rural Americans.

How do we do this? We can increase economic opportunity by increasing the flow of capital to rural America, as well as provide leveraging opportunities. We are assisting in the sustaining and the rebuilding of the existing infrastructure in rural America. We are also involved in fostering and enhancing the build-out of the technological infrastructure necessary to enable rural America to compete both domestically and globally. And, in fact, we have implemented a $1.5 billion broadband loan and loan guarantee program as a result of our efforts this year; and finally, we are capitalizing on an emerging industry such as biomass and renewable resource development.

It is this type of comprehensive approach of high tech investments and diversification of rural economies that led the Federal Reserve Bank of Philadelphia to highlight in its 2002 Summer/Fall Cascade publication as contributing to a 1 percent increase in employment in rural areas of Pennsylvania, while the State's urban areas employment declined by 1 percent. And when you look at the impact such diversified investments are having in rural America, we expect in 2003 alone that through our programs approximately 350,000 rural jobs will be created or saved. Our housing investments are estimated to create or save over 52,000 jobs. Our utilities and community infrastructure investments are estimated to create or save nearly 204,000 jobs, and our business investments

through the Rural Business-Cooperative Service are estimated to create or save over 92,000 jobs.

The impact of the Bush administration's capital investments in rural America is tangible. According to USDA's Economic Research Service, although the U.S. Economy is now in recovery, job growth is not what we would wish. For the Nation as a whole in 2002, unemployment rates increased and employment growth was sluggish. However, nonmetropolitan areas fared slightly better in each measurement than metropolitan areas, and in May of this year the Federal Reserve Bank of Kansas City, through whom—you will hear from its director shortly—through its Center for the Study of Rural America, noted that the rural economy continues to hold steady with rural job growth increasing slightly by seven-tenths of a percent in February, compared with a year earlier. It should be noted that job growth is increasing at a slightly higher percentage in rural areas compared to growth in metropolitan areas, according to the Bureau of Labor Statistics.

A further illustration of this point is a recent Forbes Magazine article by Publisher Rich Karlgaard, who wrote in his monthly column, Digital Rules, a story entitled "Peaks and Valleys." It focused on how the IPO market, which went from over 200-plus per year in late 1999–2000, dropped about 20 to 30 per year after the boom years of the late 1990s; and he discussed how, specifically, this has led to a level of high-quality talent being much less scarce and less likely to relocate to where the limited new markets are now being located.

The connection for all of this to Rural Development is, in the second half of his article, which focused on Jonathan Weber, the founding editor of the Industry Standard, which was a must-read publication in the late 1990s if you were following the IPO market; and in a nutshell, when Weber's magazine went out of business in 2001, Weber was worn out having worked 70-hour weeks, chasing his tail and living in pricey San Francisco.

He needed a change, and by his own account, needed to lower his cost of living. So he moved his family to his wife's home town of Missoula, Montana, where he now lectures as an adjunct professor at the university, writes reports for Off the Record Research as an independent stock trader.

The beauty of living in the 21st Century is that Weber and others like him can maintain the competitive edge of doing their job from rural areas while writing about international companies and global markets, and still reside in these rural regions that provide both a lower cost of living and an improved quality of life.

My point is simply that technology and attractiveness of rural amenities are providing the tools to bring jobs to the people who choose to live in rural regions. Opportunities don't have to go overseas. They can come to rural America. We are investing in the technological infrastructure and creating a venue and environment for companies and individuals to look beyond the traditional mindset and geographical limitations needed to be successful.

As we look to future capital investments Mr. Chairman, we project that the more than $700 million in program level authority requested for fiscal year 2004 for our business programs alone will

assist in creating or saving another 73,000 jobs and provide the financial assistance to more than 2,270 businesses and cooperatives.

In our view, the rural economy is beginning to head in the right direction. President Bush's initiatives on tax cuts, business growth and energy are all vital parts of this equation.

We know we can't relax. There is still much to be done, Mr. Chairman. We must be diligent in our efforts to create an economically healthy rural America.

I do look forward to working with this committee on this effort. I will be happy to answer any questions you may have later on in this hearing. Thank you.

[Mr. Dorr's statement may be found in the appendix.]

Chairman MANZULLO. Well, thank you.

Let me introduce the members of our committee very briefly and give you an idea where they are from. Mr. King is from rural Iowa. Mr. Shuster has a lot of rural counties. Mr. Beauprez is from rural Colorado, Mrs. Velazquez is from an urban area, but she understands the issues of people that live in the country. Mr. Ballance is from rural North Carolina. Mr. Miller is from rural North Carolina. Mr. Case is from Hawaii, which is really mostly rural in terms of land mass. And I live outside of Egan, Illinois, a town of 39. My wife and I have a small cattle operation and so—Mr. Shuster.

Mr. SHUSTER. Mr. Chairman, I would just like to point out that the district that I represent is all rural and, in fact, the most rural district in Pennsylvania; and we just had a plant closing 4 days ago, so this hearing is very timely, losing our manufacturing base in this country.

So thank you for——.

Chairman MANZULLO. Okay. We will talk about that afterwards.

Mr. SHUSTER. Thank you.

Chairman MANZULLO. Okay. Great. Well, now that you know who we are, we look forward to the—Mr. Sampson, the Assistant Secretary for Economic Development with the Economic Development Administration of the U.S. Department of Commerce.

STATEMENT OF DAVID A. SAMPSON, ASSISTANT SECRETARY FOR ECONOMIC DEVELOPMENT, ECONOMIC DEVELOPMENT ADMINISTRATION, U.S. DEPARTMENT OF COMMERCE

Mr. SAMPSON. Chairman Manzullo, Ranking Member Velazquez, members of the committee, thank you for the opportunity to——.

Chairman MANZULLO. David, could you pull the mike closer to you.

Mr. SAMPSON. Certainly.

Thank you for the opportunity to testify before you today on matters regarding rural economic development. It is a matter that is very close to my heart.

I still own a cattle operation in north Texas; I know the challenges of rural America. Even though I have lived in town, in the Dallas-Fort Worth area, I have always said I had to do that to support my cattle.

I have been with Mr. Beauprez in his district and Mr. Case in Hawaii, and I certainly have seen that our challenges in north Texas are not unique, but are replicated around the country. And certainly, Mr. Chairman, it is good to see you again.

You have mentioned the opportunity I had to be with you and Speaker Hastert in Rochelle, Illinois, for the announcement of EDA's $2.2 million investment in Rochelle to support the development of a truly world-class intermodal hub. This endeavor is an excellent example of how Federal and local governments can work together with the private sector, in this case the Union Pacific Railroad. This investment in Rochelle underscores EDA's philosophy that we must leverage limited taxpayer resources to maximize return on taxpayer investment and private-sector job creation.

The Rochelle investment, for example, will bring in $625 million in private capital investment in that rural area, and create at least 400 higher-skill, higher-wage jobs, and will be a major economic driver for rural Illinois.

I would like to focus on three main aspects of EDA's agenda for advancing rural economic opportunity in the 21st Century. First, we believe that we must clearly understand what makes rural economies tick. Second, we believe that Federal economic development efforts should support strategies to advance regional competitiveness, innovation and entrepreneurship; and third, we believe it is important to work with our sister agencies to improve Federal coordination on rural economic development efforts.

First, we must develop a better understanding of what makes rural economies tick. There is a very wide body of research on building regional economies, identifying the key components to building strong regional economies. And there is excellent research, as well as practical experience, on cluster-based economic development strategies, that have been extremely useful to EDA and other organizations whose mission it is to promote economic development. But most of that research and experience is in the context of more urbanized regions and settings. Unfortunately, the same level of knowledge regarding rural economies does not exist.

EDA has made it a high priority in our research area to understand what makes rural economies tick. To accomplish this, we have partnered with world-class researchers, such as Professor Michael Porter of the Harvard Business School, the father of groundbreaking research and work on regional competitiveness strategies.

We have also worked with the Council on Competitiveness, which has done excellent work focused on enhancing U.S. competitiveness by advancing policies that support innovation. And we are engaged in extensive work with my fellow panelist, Mark Drabenstott of the Kansas City Federal Reserve Bank's Center for the Study of Rural America. We believe this is important because we can ill afford to throw taxpayer dollars at problems without knowing what market-based strategies work to build strong, growing rural economies.

While our research and collaborative efforts are ongoing, we have confirmed that a major difference in regional economic performance lies in a region's capacity to innovate, regardless of whether that region is urban or rural. Transforming new ideas and new knowledge into high-quality products or services is the cornerstone of innovation and, therefore, competitiveness.

Additionally, it is very important to understand that innovative activity is not limited to what we traditionally think of as the high-tech sector. Every region in virtually every industry can leverage

innovation to become more productive. And those of you who, like me, are involved in agriculture know that certainly that is a classic case of how embedding technology has truly transformed agricultural production. There are no inherently low-tech industries, only low-tech companies that have not yet fully and effectively applied technology. Deployment of technology intel communication networks and embedding technology into core business processes and industries, even if they are very old-line industries, can open new doors of economic opportunity in rural America.

Research indicates that the capacity for regional innovation is driven by industry clusters—broad networks of companies, suppliers, service firms, academic institutions and organizations and related industries that together bring products or services to market.

Now, clearly, clusters, business clusters and industry clusters in rural areas are going to look very different than in urban regions. But our research indicates that the promise and viability of developing business clusters in rural areas is very real. EDA asked Professor Porter and his team at Harvard——.

Chairman MANZULLO. How are you doing on—I hate to interrupt somebody who just gave me a check for $2.2 million.

Mr. SAMPSON. Not at all.

Chairman MANZULLO. But how are you doing on time? We are about a minute over.

Mr. SAMPSON. Okay. I can pause there and just end up by saying that we think the role of land grant universities is a very important, largely untapped factor in promoting rural competitiveness; and we look forward to working with the committee to develop strategies that will bring the many Federal agencies together to deploy all of our budgets in a much more direct way in an overarching strategy.

Thank you, Mr. Chairman.

[Mr. Sampson's statement may be found in the appendix.]

Chairman MANZULLO. Appreciate the opportunity. And thank you for your testimony.

Chairman MANZULLO. Our next witness is Bernard Ungar—oh, I am sorry. I have got the wrong order here. It is Mark—is it Drabenstott?

Mr. DRABENSTOTT. Drabenstott.

Chairman MANZULLO. Mark Drabenstott, Vice President and Director, Center for the Study of Rural America, the Federal Reserve Bank of Kansas City. And we look forward to your testimony.

STATEMENT OF MARK R. DRABENSTOTT, VICE PRESIDENT AND DIRECTOR, CENTER FOR THE STUDY OF RURAL AMERICA, FEDERAL RESERVE BANK OF KANSAS CITY

Mr. DRABENSTOTT. Thank you, Mr. Chairman. And good morning, distinguished members of the committee. My name is Mark Drabenstott. I am Vice President and Director of the Center for the Study of Rural America at the Federal Reserve Bank of Kansas City. The Center is the focal point for research on rural economic issues in the Federal Reserve System.

Small businesses have traditionally formed the images the Nation holds dear about the rural landscape—from the Chatterbox

Cafe to Floyd's Barber Shop. Entrepreneurs will have an even bigger impact on rural America's future.

Globalization has profoundly changed the industries on which the rural economy has relied. Rural America must now turn to a new frontier of economic opportunity, a promise that will only be realized if a new generation of entrepreneurs seizes it.

Since the Rural Development Act of 1972, a lot has changed in the rural economy. As a result, new directions are needed for rural policy. New initiatives to help Main Street entrepreneurs grow will be a cornerstone of new rural policy. In that light, this committee's discussion of rural issues is both timely and useful.

Since the Rural Development Act of 1972, globalization and rapid technological change have redrawn the rural landscape. Agriculture's role has diminished as fewer rural residents rely on farming. In 1972, agriculture was the leading source of income for roughly one in every four rural counties. Today, it is one in every ten.

While rural areas still depend heavily on manufacturing, recent trends give reason for pause. Last year, for instance, 200 rural factories closed. Rural America's claims to low-cost land and labor are being challenged by foreign competitors. Meanwhile, services are growing rapidly, but rural regions are struggling to seize high-skill service jobs that would lift rural incomes. Together, these trends reveal a rural economy where growth is highly uneven, and roughly six in every ten rural areas are looking for new economic engines. Fortunately, that quest for new rural growth is matched by a new horizon of opportunities.

Many of these are enabled by new technologies or new economic processes. We think three stand out: product agriculture, tourism, and advanced manufacturing. Product agriculture opens new, higher-value options for farmers that extend well beyond bulk commodities. Pharmaceutical crops, the opportunity to grow pharmaceutical inputs in fields instead of factories, is the most exciting option, although uncertainties surround its outlook.

Tourism offers a range of new opportunities from pheasant farming to linking regionally branded foods with unique heritage amenities.

Finally, advanced manufacturing offers the opportunity to build clusters of small rural factories that can stay on the leading edge of technology.

What policies are best suited to helping rural America seize the new opportunities? A first step is defining the goal for rural policy. A consensus is emerging on the importance of one goal—helping rural regions build new sources of competitive advantage. In a global economy, no imperative is greater.

If this is the goal, two principles are likely to frame any new rural policy efforts. First, rural policies should shift from a traditional focus on sector to a greater emphasis on regions. One size no longer fits all. And second, rural policy must shift from relying on subsidies which thwart business innovation to public and private investment in new engines of growth. Agriculture and basic manufacturing will continue for the foreseeable future, but knowledge-based industries must become more important parts of the rural economy.

Within this broad framework, what program directions might rural policy take? Four seem promising.

First, spurring new regional partnerships: Policymakers may want to examine the possibility of providing new incentives for regional collaboration. Economic development funds might be made available to rural regions, but only if they clearly demonstrate a regional strategy. Such an approach has the advantage of encouraging each region to pursue its own unique niche.

Second, growing more entrepreneurs: Our bank hosted a national conference on rural entrepreneurship earlier this year. Among other conclusions, we found that developing a more systematic approach to supporting the unique needs of rural entrepreneurs will be an extremely valuable program direction, as will understanding and forming a richer web of equity capital institutions.

Third, boosting investment in research and technology: Many of rural America's new economic engines will be built on innovations in research and technology. This raises new questions about the role of public policy in funding and developing such technologies as pharmaceutical crops and broadband.

And fourth, redefining roles for higher education: If rural America is to become a knowledge-based economy, its institutions of higher learning will play a pivotal role. Land grant universities might take on several new roles, including new efforts to support rural entrepreneurs. Community colleges and regional universities could spark new development efforts in rural regions.

In closing, a lot has changed since the Rural Development Act of 1972. More and more rural regions are looking for new sources of competitive advantage. Fresh policy initiatives to help grow more rural entrepreneurs will be especially helpful in claiming a new frontier of rural opportunity.

Thank you very much.

Chairman MANZULLO. Thank you.

[Mr. Drabenstott's statement may be found in the appendix.]

Chairman MANZULLO. Our next witness is Bernard Ungar, Director of Physical Infrastructure Issues at the U.S. General Accounting Office.

And it was the original GAO report, Mr. Ungar, that, I think, was issued a couple of years ago that gave rise to the interest of this committee to see if the goals of Congress have been met. We look forward to your testimony.

STATEMENT OF BERNARD L. UNGAR, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, U.S. GENERAL ACCOUNTING OFFICE

Mr. UNGAR. Thank you, Mr. Chairman, and other members of the committee. We are pleased to be here today to assist the committee in addressing this issue of development of rural economy; and of course, I would like to focus on bricks and mortar for a few minutes and focus my summary on two issues.

One is the impact of the Rural Development Act of 1972 on the location of Federal buildings in rural areas and the extent to which Federal employees who live in rural areas participated in telework. On the first issue, I think it is safe to say, based on the work that we did, which you cited in the report we issued a couple of years

ago, plus a similar report that we issued back in 1990, that the Rural Development Act has not had a major impact on the siting of Federal facilities in rural areas.

The act does require all executive branch agencies to give first priority to locating new and other Federal facilities in rural areas. However, what we have found over the last 13 years or so in the work that we have done is that most of the agencies in the Federal Government that have authority to acquire space, that we looked at, had not established policies and procedures as required by the act for siting Federal facilities or giving Federal facilities first priority in terms of rural areas.

Secondly, we found very little evidence that agency personnel who are involved in the siting decisions actually did follow the act and adhered to its provisions or even considered rural areas in siting their facilities.

Now, of course, in most cases an agency is going to site a facility where the mission or the requirements of the program being implemented require it, and that is going to often be in an urban area. But there are a number of situations and types of functions that could go in many different areas, such as data processing, accounting and so forth. So it is where agencies do have a choice where I think the act can have the greatest impact.

Between 1989 and 2000, the proportion of Federal employees working in nonmetropolitan areas did not change significantly—about 12 percent in both periods, indicating the act certainly hasn't been a major driver there. And there are a number of factors there. One that affects this situation—one is that agencies really haven't given a lot of emphasis obviously to this particular act. In fact, a number of the individuals whom we interviewed or got information from during our—we weren't even aware of the act, so it hasn't been widely known in a lot of areas.

Also, another factor that may be at play here is that the rural development, that initially had a definition of "rural" for the purpose of this particular requirement, but that requirement basically was repealed, and the act currently has no definition of rural. So different agencies are using different definitions, and we will, in fact, recommend that GSA develop a specific definition, which it has done for its use, as well as a guide for other agencies which it doesn't have authority over.

Since our report, a number of steps have been taken. GSA did improve its guidance in connection with the implementation of this act, pretty much along the lines that we recommended. Congress has required the agencies' inspectors general to review policies and procedures that agencies have established with respect to implementing the Rural Development Act, and actually issued a series of reports in 2002 and currently have a requirement the report, actually last month—we haven't had a chance to look at those. So some action has been taken; obviously, more steps can be taken to strengthening the implementation of the act.

And finally, just very briefly, on the availability of telework or the extent to which Federal employees participate in telework, OPM does publish statistics on that. The topic of Federal employee participation, unfortunately it doesn't identify the extent to which

rural employees are—or employees who live in rural areas participate.

Two barriers that would—are in common with some of what the other speakers have mentioned are the availability of broadband technology to rural areas—this has affected, according to Federal agencies, one, the extent to which they can locate in certain rural areas that they choose to do so or would like to do so, and secondly, the extent to which Federal employees would be able to do telework or telecommuting. If they don't have access to a high-speed Internet connection, which evidence indicates rural areas have less access to, that could be a problem.

I would like to end my summary now and be available at the appropriate time for questions.

Chairman MANZULLO. Well, thank you very much.

[Mr. Ungar's statement may be found in the appendix.]

Chairman MANZULLO. Our next witness is David Freshwater from the University of Kentucky, and we look forward to your—I have never known anybody with the last name of Freshwater before, or for that matter, Drabenstott. You know, that is very interesting.

If you could, pull your mike a little bit closer to you. And we look forward to your testimony. Thank you.

STATEMENT OF DAVID FRESHWATER, PROFESSOR, DEPARTMENT OF AGRICULTURAL ECONOMICS, UNIVERSITY OF KENTUCKY

Mr. FRESHWATER. Thank you.

Mr. Chairman, Members of the Committee, thank you for the opportunity to testify this morning. My name is David Freshwater, and I am a professor in the Department of Agricultural Economics at the University of Kentucky where I teach and conduct research in the area of rural economic development.

I will try not to be repetitive and move through my testimony fairly quickly. I think this is an important hearing, because the Small Business Committee deals with firms that play an especially important role in rural areas.

Small businesses are important to all of America, but they are particularly important to rural America because of a certain number of conditions. They better fit the rural conditions in terms of matching demands for labor with the available quantity in small places. They have a stronger sense of attachment to local communities. They are much less likely to pick up and move offshore.

They require loans of a size that local intermediaries can finance readily, and they provide more opportunities for forward and backwards linkages thereby creating additional employment than a lot of branch plants do. And this makes the creation of growth and the growth of small business even more important for rural America than it might be in urban areas where other factors are important.

I try and make three points in my testimony. They are that manufacturing is crucial to most nonmetropolitan counties east of the Mississippi, but these counties are facing limited success with their old development model. Much of rural manufacturing, especially in the rural South, relied upon recruiting branch plants of domestic firms from larger urban centers. The advantages of the rural south

were largely cost-related, and now foreign locations offer even lower costs that cannot be matched internally.

While branch plants of foreign reform that require U.S. location are already a significant source of employment, notably the Japanese auto firms, we should not minimize the impact that foreign investment in rural America's has had in the last 10 years, because it has created a vast number of jobs. It is more important to place attention on the relative role of small firms in rural areas, and that may include foreign enterprises.

Last year a Brazilian company located a manufacturing plant in Campbellsville, Kentucky, so we are starting to see an inflow from developing countries of branch plants. That was 50 new manufacturing jobs, which isn't a huge number by a large city standards, but in a town of 4,000, 50 new jobs has a significant impact.

Small businesses face some important impediments in rural areas that are not as common either for small businesses in urban centers or for large branch plants. This means that it is important for the SBA and other Federal and State agencies that try to promote small business to recognize the distinct features of rural America if their programs are to be truly effective. These differences include a high proportion of low-skilled workers and related to this, often a relative lack of workers with specific types of advanced skills.

In Pikesville in Kentucky we lost a furniture manufacturing plant that was recruited with EDA money because they couldn't get the five to ten skilled furniture craftsmen that they needed in order to do the finish work, and thereby jobs for 75 or 80 low-to-moderate-skilled people went away. So it is not just low-skilled work that is important; it is important to make sure that you have a small complement of highly skilled workers who are necessary for those firms to be viable.

Difficulty in getting access to markets outside the community for products and in developing supply chains, because physical distance and low density of economic activity are defining features of rural places, the Internet helps here, but it exposes those firms to competition as well. The Internet cuts both ways in rural America. It gives you a way out, but it allows other people to come in. And Amazon.com is sort of the classic example of doing in small book stores in rural areas.

Rural areas point to their strong tradition and history, and that is an attractive feature. You listen to the Japanese car manufacturers, and they say they like going to rural America because you have got honest people and they work hard. But sometimes rural America is reluctant to embrace change; and I think one of the things that we have to do is try and convince small communities that their future is in change.

More limited financial markets: Both in terms of the types of instruments that are available and the number of firms providing them, it is harder to arrange most forms of equity finance, subordinated debt and a whole lot of sophisticated financial instruments that in larger places are relatively common.

Finally, Federal policy plays a critical role in influencing the competitive position of rural America, both relative to urban America and to foreign places. Rural America is both the least developed

part of the industrialized portion of global economy and the most developed part of the developing portion of that global economy. Federal policy cuts both ways.

For example, electricity deregulation promises to equalize electricity rates across the Nation. But low electricity rates were a critical factor in economic development in rural areas. Similarly, opening U.S. Markets to foreign goods has led to a loss of manufacturing jobs, but made consumers better off.

We all know that there is far more to rural America than farming. But at present USDA is the only agency that has a clear rural mission. We also know that what gets measured is what gets done. If this committee used its oversight and authorizing capacity to encourage SBA to play a larger role in rural America, then additional support would be available to the small businesses and potential entrepreneurs that are being relied upon to improve incomes and the quality of life in small towns across the Nation.

Thank you.

Chairman MANZULLO. Well, thank you all for that excellent testimony.

[Mr. Freshwater's statement may be found in the appendix.]

Chairman MANZULLO. Has anybody on the panel here ever appeared before a congressional committee?

Okay. All right. I thought this was a unique experience, but I guess it is not. But one of the methods we use here is, if a question is asked and you have a staff member that really knows the answer and you want that staff member to scoot up to the table, introduce himself or herself and spell your last name for the record, you are welcome to do that. This is very informal.

And we have—I have just got a couple of observations and one would be, you would think that the Department of Energy and the EPA would have a tremendous interest in keeping people in rural America. I mean, this city is a zoo. The PTO is opening up that those buildings on Eisenhower in Alexandria—I am not criticizing, but I think they are combining 17 or 18 or 19 buildings into one particular campus. And the observation that I have seen is that it is somehow not fair that all the economic growth in this country takes place in a relative handful of clusters, a handful of areas.

Senator Byrd was successful in moving the FBI fingerprinting headquarters to West Virginia. But I—you know, if you want to save fuel, if you live in a small town, you can walk to work. If you want to keep the air clear, why spend all of our time and our money on—I mean, how big can the Washington area get?

I remember when Disney World wanted to set up in Haymarket. I mean, that is all you would need is to have that type of activity completely jam the Beltway. And as I see more and more development taking place between Capitol Hill and Alexandria, where we live in a—when we are in session, in a three-story town house with a back yard that is so small that I can't even have a dog out here. Everything that the Federal Government does somehow ends up being centered in Washington.

What suggestions, techniques, developments, programs, ideas do you gentlemen have, first of all, to get the agencies to take a look at the purpose of the Rural Development Act, to encourage settling in rural areas? Whoever wants to answer that question.

Mr. Ungar.

Mr. UNGAR. Mr. Chairman, I can start. A couple of thoughts there.

One is, perhaps the committee could assess the current Federal location policy and be a stimulus toward the development in the law of a more cohesive location policy for the Federal Government. Right now it is sort of fragmented. We have the Rural Development Act, which is quite clear and specific and is probably the major piece of legislation that affects specific siting decisions aside from the need to be competitive, which is a separate piece.

There is an executive order that deals with locating Federal facilities in central business areas, when an urban area is desirable; and another executive order that deals with choosing historic districts, which is slanted toward, again, urban areas—more so, I think, than rural areas. But there is no kind of cohesive policy that identifies a whole number of factors that probably could be considered in terms of—in addition to mission and program requirements would be cost of real estate, cost of operation and any local incentives that might be available. Typically these are for the private sector, but there have been some situations where local areas or States have made incentives available for Federal agency, although they didn't always look for that. So that is one thing that could certainly be done.

Another possibility for the committee to consider is perhaps modifying a current requirement in appropriation acts that for the IGs—right now, the inspectors general are being required to report on just the policies and procedures that exist, not looking—they are not required to look at the actual implementation of those policies and procedures by agencies and carrying out the act, the Rural Development Act. So that might be another step the committee might want to look into.

Mr. DORR. Mr. Chairman, I—in conjunction with Mr. Ungar's observations that there needs to be a consistent policy, my observation would also be that it is a bit of a cultural issue, cultural from the standpoint that I would suggest maybe managers who are involved in siting these projects and these opportunities really haven't had the opportunity to experience the depth and the breadth of capacity that exists in a lot of these regional areas.

It has been commented that there is a shortfall of bandwidth in a lot of rural areas and, in fact, that is correct. But there are also an amazingly large number of rural areas that are expanding into wireless connectivity, doing some very innovative things, that my experience, albeit fairly brief in this position, would suggest that there are a number of areas that are very attractive that would be very accommodating to these sorts of things; and in fact, above and beyond what the Federal opportunities or government siting opportunities might be are actually doing some very innovative things in areas such as Minnesota, areas in rural California, a number of areas in Montana. There are more than enough out there that I think would be helpful if managers would have a chance to perhaps take some time to look at them and find out what is, in fact, available.

Chairman MANZULLO. Mr. Drabenstott.

Mr. DRABENSTOTT. Clearly, Federal policy can be a tool in directing the location of government facilities, and there are some very interesting examples from the rest of the world that offer some insight into this as a regional economic development strategy.

Finland, for example, has done this very thing.

But I think your question really raises a much more fundamental issue and that is, "What is the justification for Federal rural policy?" In the past, that justification has been almost entirely about food. It has been a social contract between urban consumers and rural food growers. Going forward, I think we really have to rethink that. And with a nation where 60 percent of the people, according to the 2000 census, now live in the suburbs, I think the question may become, "Do we want to avoid some of the costs of congestion in burgeoning metropolitan areas by encouraging economic opportunity in other parts of our landscape?" If that is the case, I would urge this committee and others to really engage that issue because, in my opinion, the new social contract between suburbia and rural America has not been fully debated and discussed in our Nation.

We take for granted that food is a unique issue. But going forward, rural policy needs to be about more than food.

And so the very issues that you raised Mr. Chairman, I think, are an awfully important backdrop as we think about the role of Federal rural policy, and on what basis we justify that policy intervention going forward.

Chairman MANZULLO. Professor Freshwater.

Mr. FRESHWATER. Yes, sir. I don't want to sound critical in saying this, but I think a big part of it comes back to the Congress. There have been any number of rural development programs authorized in various farm bills going back through the 1970s. There have rarely been any appropriations to implement those programs.

I think a second thing that is important for the Congress to recognize is that oversight has to come from more than just the Ag Committees. It has to come in particular from this committee, Commerce, and if I was going to suggest one thing that you could do that would make a huge difference, I think it is to build on what Secretary Dorr is saying about innovate—the ability to innovate is the crucial thing, I think, about creating something that looks like the Agriculture Extension Service for manufacturing on a comprehensive basis and do it in the same way that ag extension works.

There is a three-way agreement between the states, counties and the Federal Government. But to do that, it is going to take the committees, the Commerce Committee and this committee, working together to take pieces of existing programs and put together an integrated structure. And then I think you would be able to see the same sort of success in innovation that has driven American agriculture applied to American manufacturing in some other places.

Chairman MANZULLO. Mrs. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Drabenstott, in your testimony you talked about the lack of capital available to small businesses in rural America. And this Congress created an instrument to address that issue and that was the New Markets Venture Capital program. That was specifically

designed to channel money into low-income and underserved rural areas. Yet this administration has continued to stall on implementing the New Markets initiative that was signed into law in the year 2000.

If rural development is truly a goal of this President, do you believe that this administration should have a stronger commitment to the New Markets program?

Mr. DRABENSTOTT. We believe that equity capital is probably the single biggest missing piece in rural financial markets and thus becomes especially important as we think about how we grow and finance entrepreneurs into the future.

At our conference, that I referenced in my oral testimony and that is described in my written testimony, we devoted one session to this specific topic. The long and the short of that discussion is that there have been a wide range of equity capital programs tried in rural areas, some at the Federal level, some at the State level, some spawned by philanthropic initiatives. The real issue, I believe, is not pinpointing any particular one of these as the solution. Rather, I think the issue is how does public policy play a hand in creating a web of institutions that can provide access to equity capital to rural entrepreneurs, and on the other side of the fence, allow equity funds to pool their risk across geographic areas and across different types of businesses.

That web of equity capital institutions just really isn't there right now. I don't think any particular program at the Federal level is going to solve that. What I would urge is an in-depth analysis, and examination of what it might take to create that web of equity capital institutions.

Ms. VELAZQUEZ. But—excuse me, because you know I have just 5 minutes to ask my question. But do you think that the New Markets venture capital could play a role?

Mr. DRABENSTOTT. There is no question it could play a role. There are other programs that could as well.

Ms. VELAZQUEZ. Okay. Thank you.

Mr. Dorr, in 1999 you were quoted as saying that certain rural areas in Iowa had higher economic growth than others. You noted the correlation that, and I quote, "Areas that were not particularly diverse, at least not ethnically diverse, had higher growth rates." these comments were at best racially insensitive, at worst bigotry.

Given the fact that minority small businesses are the fastest growing sector of the economy, would you agree that we should be encouraging diversity?

Mr. DORR. Absolutely. Those comments in no way reflect my view about diversity or about the value of diversity in this economy. They were a result of a day-and-a-half-long event designed to look at how to better utilize a gift that was given to the university; and it was in the context of that discussion that I made the observation that nonmetropolitan areas that were extremely successful in Iowa, which is a very nondiverse State, and if we were looking for success examples——[Interruption.]

Mr. DORR [continuing]. Did not happen.

Ms. VELAZQUEZ. Okay. I will accept your answer.

So, given that you entered office under this cloud of doubt about your commitment to diversity, what have you done in your position

to address these concerns by reaching out to minority businesses in rural communities?

Mr. DORR. There are a number of initiatives that we are involved with. We have recently signed a collaborative agreement with HUD to work together in the colonias area to develop new and evolved programs in housing and water and waste infrastructure development programs. I have initiated a number of discussions with a former director of the Federal Reserve Bank, the economic research director, who is now moving to the University of Connecticut, which is the largest real estate—one of the most successful real estate academic programs in the country, to study how to do a better job of trying to build out a program that would facilitate the development of the unbanked, and those who have limited trust in the institutions that we use, that are necessary to develop equity capital and growth.

One of the observations I have made, for example, in the Delta area is that there are absolutely minimal numbers of minority African-American appraisers, surveyors, title company owners, and there is a distrust in the infrastructure; and we are going to try to do something, if we can to figure out how, to rebuild that trust so that they can build a larger economic pie and a greater opportunities in those areas.

We have a number of other initiatives going as well.

Ms. VELAZQUEZ. Thank you. Do I have a chance for another question?

Chairman MANZULLO. Yes.

Ms. VELAZQUEZ. Mr. Dorr, in your testimony you noted that the 2002 farm bill created a rural business investment program. This program provides for $44 million in grants and $280 million in loan guarantees. Struggling rural businesses are in desperate need of this money, yet it has been nearly 16 months since the farm bill was enacted into law and there has been no action.

Mr. DORR. Well, the 16 months is as equally frustrating for me as it obviously is for you. There has been action. As a matter of fact, I believe the farm bill was signed on the 12th or 13th of May of 2002. On the 31st of May, based on the report language that was in the bill—we had already begun an initial contact with SBA, as was indicated in the report language, that they were the organization that we were expected to work with.

We have been working with them aggressively since that period of time. We are having difficulty working things out, and in fact, yesterday I had a meeting with my staff, and we are going to make some alternate provisions if we have to.

Ms. VELAZQUEZ. Do you have a timetable, if there are any problems that you can tell us about in working with SBA, that maybe the chairman and I can help you with?

Mr. DORR. Yes. As a matter of fact, we have—I have talked personally with Director Barreto, others have visited with him. We are having some difficulty getting the economy act agreement put together that enables them to do it in the way in which we want.

We presented it to them a number of times. We are waiting for their questions. We have gotten up to the table twice, and frankly, we have never been able to get questions back from them; and if we could get some assistance in that, I would be delighted. As a

matter of fact, this morning I directed our legal counsel to look for other ways in which we could pursue this without the use of SBA, since there appeared to be some reluctance on their part.

Chairman MANZULLO. Well, I—what I would suggest, Mr. Dorr, if you could set up an appointment with Mrs. Velazquez.

Mr. DORR. I would be delighted.

Chairman MANZULLO.—we will bring in someone from the SBA and force that agreement.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you.

Mr. King.

Mr. KING. Thank you, Mr. Chairman. I would like to thank you and the ranking member for holding these hearings today. And this testimony has been extraordinarily interesting to me.

Initially, I would like to address the issue that was raised by the ranking member with regard to those counties in Iowa that were referenced by Mr. Dorr. I represent both of those counties. That would be Carroll County and Sioux County. I grew up next door to Carroll County, and I have been in and out of Sioux County most of my life.

Carroll County is a German Catholic county, and Sioux County is a Dutch Reformed county. Each of those counties has a unique culture that has developed there, and I believe that is what was referenced by Mr. Dorr. I think we need to be objective about our viewpoints here and not be intimidated by allegations of race being a factor. These are objective circumstances that were addressed by Mr. Dorr; and I will step underneath that cloud if there is one, Mr. Dorr. But I think that the people there have developed a culture that I would like to multiply across all of rural America and that is a culture that reinvests in its own community and has convinced their young people that grow up in these communities that their future lies there near where they grew up.

I have in my lifetime watched a generation of young people move out of rural Iowa; these entrepreneurs have gone elsewhere to build and develop the economy around America.

So I would direct my first question to Mr. Drabenstott, and that is, you made the comment that it will require legions of rural entrepreneurs in order to reverse this trend in our rural economy; and I absolutely agree with that statement.

I have seen the legions make that exodus to other points of the globe, and how do we bring those legions back again and where do they come from?

Mr. DRABENSTOTT. It is a great question, Congressman. I think there are two parts to the answer.

First, I think we have to focus on economic opportunity and steering these entrepreneurs into the new rural economy where I think there are some significant opportunities. To do that we must recognize that forming a business in rural areas is just a different proposition than doing it in the suburbs. Accordingly, we would need a different way of supporting the needs of rural entrepreneurs.

Second, I think we also need to give some attention to quality of life. The people who go off to college from rural areas frequently find lifestyle amenities in the suburbs that they may not find in

the rural communities. How we offset that and think about innovative ways of improving the rural quality of life will be equally valuable going forward.

Mr. KING. Thank you. And I know that is going to be a big project to try to make this shift, to get it turned back around.

And you also made a remark about shifting the emphasis that now relies on subsidies. And if I look across this district that I represent, and it is the western third of Iowa—32 counties, essentially all of them rural counties, and the small towns, 286 towns, they are, you know, I have watched them board up the businesses on Main Street in town after town throughout my adult life. And I see those subsidy checks go to Florida and Arizona and other points. And when that happens, that wealth leaves the community as well.

Could you make some remarks, your viewpoint on that, and go into a little more depth on the effect of subsidies?

Mr. DRABENSTOTT. When you look at what has happened in rural America over the last half century, there have been two subsidies that have been especially large. One is agricultural subsidies. The other is industrial recruitment subsidies. It is hard to put a price tag on these subsidies, because, quite honestly, the numbers had never been collected. Nevertheless, my sense would be that it is a very large sum.

In both cases what we are discovering is that in a globalizing economy, it is very difficult to build a rural economy on commodities, whether they be agricultural commodities or industrial commodities. So my view would be that it is time to think about redirecting our public focus away from purely making transfer payments or recruitment incentives, and, instead, growing more businesses, home-grown businesses that we can nurture within the local community through business development support, through equity capital, and other initiatives.

Mr. KING. And what about the tax and regulatory structure that you find in rural America versus urban? Is there a distinction there that makes a difference?

Mr. DRABENSTOTT. To be real honest, we haven't taken an in-depth look at that. Clearly, whether you are talking about a small business in rural areas or urban areas, regulations tend to be a higher proportionate burden for small businesses than large ones. So, because you have so many small businesses in rural places, I suspect it is a bigger burden.

Mr. KING. And you haven't looked at rural States versus urban States as to their tax structure.

Mr. DRABENSTOTT. No, we have not.

Mr. KING. That would be one thing I think might be instructive. And thank you very much.

I direct, then, to Mr. Dorr, and I want to thank you for your testimony, and a fellow Iowan and western Iowan coming here today. And just to follow up on the question that I posed previously with regard to the impact of subsidies on rural America, did you make some comments on why it looks the way it does and how it might look if that began to move in the other direction?

Mr. DORR. Well, I would refer back to Dr. Drabenstott's earlier comments about policy in rural America, and it has become very apparent to me that, historically, as he alluded to, there has been

a rural policy that has been focused on ag policy. It is becoming clear to me that that ag policy really directly impacts only about 2 to 2½ million rural Americans, but the number is kind of a moving number, but, depending on how you look at it, there may be as many as 65 to—our demographer at USDA would suggest maybe as many as 100,000,000 rural Americans in one definition or another.

Our policies as rural policies are focused. Ag policies don't deal with that. Our policies that have evolved in rural development are beginning to do that, and we are taking a much more holistic view that that is necessary. The outgrowth of the existing ag policy is that we have stifled—with the protection of the industry, we have stifled entrepreneurial activity. When you try to protect an industry, you generally end up killing it, and, so, quite frankly, I think that, by virtue of these efforts here as well as a number of others, people are beginning to look at the different kinds of policy options for this country as relates to rural America, and I am very optimistic, quite frankly. I think there are a lot of opportunities. I think it is going to be slow, but we are heading down the right path.

Mr. KING. Thank you, Mr. Chair.

Chairman MANZULLO. Mr. Ballance.

Mr. BALLANCE. Thank you, Mr. Chairman.

Mr. Dorr, I am sure you and the other panelists are aware I live in North Carolina, First District, and we used to have a lot of textile jobs. The last 7, 8 months, we have lost about 5,000, and in places like Roanoke Rapids, and in places like Henderson and Wilson and Bertie County, areas in my district, a lot of people who are out of work.

This is also traditional farm area, and there are still some farmers in—farm workers, but a lot of these workers have been in these factories for 20 years, more, and now they are out of work. And what I am interested in is the USDA Rural Development has a great program, 2002 farm bill and even before for rural development.

What do you have to offer—if you were sitting in Roanoke Rapids today and some of those workers were sitting around the room listening to you, what do you have to say that maybe you can put in place to cushion, not necessarily to solve, but these people are hurting.

Mr. DORR. Well, let us say as soon as those announcements were made, Congressman Ballance, we were collaborating with our State director in North Carolina. We were aware of that.

Mr. BALLANCE. Mr. Cooper.

Mr. DORR. Mr. Cooper.

Mr. BALLANCE. John Cooper.

Mr. DORR. Right; and John is a remarkable State director, and he has been very concerned about this, as well as have we.

The one thing that we can offer straightaway is forbearance on the direct family home loans, the single-family direct loans that we have made directly through our Rural Development programs. There is a mechanism in place that allows us to create forbearance in situations like this.

We also have our business and industry loan programs that enable us to facilitate the guarantee of loans for businesses and enterprises in certain areas under certain circumstances when there are extenuating reasons to do so. We are also working with a number of other Federal agencies to see what the impact will be and what we can do in other respects. Obviously, one of our bigger concerns is we have a number of water and waste loans and utility infrastructure loans in those communities, and we are able to—in the event that it becomes an inability to service some of those operations, we are able to come in and provide some assistance in doing that so that the infrastructures are not allowed to deteriorate or fall apart during this time when there may be a shortfall of funds.

Mr. BALLANCE. Mr. Freshwater, I guess I should jump to you, I guess. Obviously, apparently, our policies have to be to some degree reflected going back I don't know how many years. We should have seen this coming, and maybe we have not yet.

Are we on the right track, wrong track now in terms of our policies, our tax policies, trade policies?

Mr. FRESHWATER. I think we are largely on the right track from a national perspective. What we haven't done is realized or admitted in many ways that there are losers in this process that benefits the Nation as a whole from trade and the way we are going.

It is hard for an economist to be against free trade, it is one of our basic beliefs, but I think Kentucky is in the same situation as—as your district, sir. We have lost thousands and tens of thousands of textile jobs over the last 20 years, and, for me, the real plight is you have got people who have small tobacco farms and textiles—and work in textile mills, and between those two things they have stitched together a reasonable living, and now both of those supports are going away.

And the real question is what do you do with 40-to-50-year-olds that have 20 to 30 years of experience in the textile factory, no high school degree? They are highly unsuited for any of the retraining programs we thought about. They can't move to urban areas because they have no skills that are particularly useful in urban areas. And the only conclusion I can come to is at least in the short run we have got to look for more low-wage, low-scale employment opportunities for them, recognizing that it is a transition, that we have to find ways to help those people because we can't warehouse them. We can't leave them out there hanging for 20 years, until they hit the Social Security age.

Mr. BALLANCE. So we kind of missed that when we were making these earlier policies?

Mr. DORR. I think so. I think we haven't really thought about what to do with the people who lost, and one of the ways that I think you have to keep hope alive in America is by saying that when everybody benefits, or when we as a Nation benefit, that there has to be some help for the people who lose in that process, and try to think about programs that can provide that support.

Mr. BALLANCE. I think my time is up.

Chairman MANZULLO. Mr. Shuster.

Mr. SHUSTER. Thank you, Mr. Chairman, and thank all of you for being here today.

I come from rural Pennsylvania, and we are fortunate to be about—my district is actually about 30 miles from Pittsburgh and about 100 miles from Washington, D.C. And as I look now, we are losing jobs in rural Pennsylvania; Pennsylvania being an old industrial State, we have lost many, many manufacturing jobs, but as I look at knowledge-based industries growing, it seems to me they don't have to be in Washington, D.C., or New York or Los Angeles. They can be pretty much anywhere.

It is my thought, and I want you to maybe comment a little bit on this, whereas the last half of the 20th Century people migrated from rural and small towns to the cities, I think in a short period of time we should start seeing migration back the other way, because the knowledge-based industries, the cost to live—I don't know how young people can afford to live in Washington, D.C., and New York City.

In addition to that, when I look to the Southwest that has had such a great growth rate over the last decade, they don't have the water, and in Pennsylvania and other northeastern States plenty of water to be able to support populations. So it is my view that we will start to see that trend going to cities reverse and go back the other way.

I just wondered if you would comment on what your thoughts are and if you think that is—that is in the cards. Anybody can take it, and all of you, I would like you to make a comment on it.

Mr. SAMPSON. I do believe we are beginning to see as a result of a number of factors, one of which is September 11, that there are companies that are beginning to look at the issue of how much concentration they have in urban areas, and there are significant opportunities that we are seeing in the economic development realm of firms moving not necessarily headquarters operations, but support operations to rural America where there is an abundance of available workers that have basically good skills. And, as Secretary Dorr mentioned, there are significant hubs out there in rural America where there is the kind of telecommunications infrastructure that can support those support and back-office operations, and I believe that we are already beginning to see that within the space of the last 2 years, largely for security reasons, as well as for cost reasons.

Mr. SHUSTER. Secretary?

Secretary Dorr?

Mr. DORR. It is a great question. About 2 weeks ago, I took a little drive one Saturday up north to Middleburg and around and stopped at a farm station—or a farmer's market stand on the way back. There was a handsome lad about 40 years old who had come to the community on a basketball scholarship, built his own dot-com company, ran it for 15 years, sold it 2 years ago because he wanted to get out of the rat race and wanted to farm. Well, he found out that farming wasn't particularly as enlightening as he thought it was going to be, but he said, at least I can drive an old pickup without having to justify it.

But he made the point, he said, you know, one of my problems was that my employees were having to drive 3 hours a day to and from work. They were having to live in homes that were four and five and six, seven and eight times more expensive than they were

in other areas, and he said consequently all of this business is moving out of the country. He said, we are moving code writing and service work over to India and a number of others. I said, well, time out. I said, my home in Marcus, Iowa, that I probably couldn't get $80,000 for, would probably bring three-quarters of a million out here. You could drive, as someone else said, to and from a position anywhere in 15 minutes.

How do you mitigate that savings and overhead cost in doing business overseas when you have to deal with the political, the governance, the currency, and all the other issues?

I think we clearly need to look at policies that stimulate this move in that direction. We are leaving a considerable amount of overhead money on the table by allowing these jobs to leave the country, when, in fact, we can mitigate these costs in rural areas.

Mr. SHUSTER. What kind of policies would you see specifically?

Mr. DORR. I would have to give that, I mean, more thought, quite frankly, but I think that is something that needs to be discussed in greater detail.

Mr. SHUSTER. Yes, sir?

Mr. UNGAR. Mr. Shuster, in relationship to Federal agencies and locations, I think the fact you mentioned could be very relevant here to perhaps a shift in direction, more emphasis on cost and making decisions. I think that would probably lean more toward rural areas. And this issue of security now is even far more important, obviously, at the Federal level as well as other levels, and rural areas do generally offer some advantages in that area in terms of set-backs and space and so forth. So I think those issues, along with, perhaps, some upward movement or pressure from local areas in terms of incentives to offer to Federal agencies, such as free land and things like that, reduced rates or whatever, might help get Federal agency managers to consider rural areas more.

Chairman MANZULLO. Thank you.

Mr. Case.

Mr. CASE. Thank you, Mr. Chair. Thank you for the hearing.

Mr. Dorr, first of all, you deserve some public recognition for answering your own phone last night about 9 o'clock. Thank you. And I thank you for the good work.

And Mr. Sampson as well, thank you for coming out.

You have two great people in Hawaii: Lorraine Shin and Gail Fujita. Lorraine, by the way, is headquartered in Hilo, which is exactly in compliance with the mandates of the law, and I think the message that is sent on that is not just what the law says about trying to provide some economic incentives, but the message is that the Federal Government cares about the rural communities; otherwise, I think most of the Federal Government would be kind of headquartered in downtown Honolulu, which is very urban and not in my district. So I am very interested in pushing it out.

I think before we talk about how to help rural economies, we have to decide what rural is, and, Mr. Dorr, we have sent a letter to you that is exactly on point. In my own State, seven out of the eight islands are clearly rural and clearly need the kind of help and benefits that everybody here has talked about. Everything applies.

The eighth island happens to be the island of Oahu, where the city of Honolulu is located, but actually that is a minority of that

island. Most of that island is suburban and very rural. If I were to parachute you into someplace like Kahuku on that island, you would think you were coming right out of rural America, and yet the USDA has, perhaps out of a Federal Government one-size-fits-all look at the map and see the city and county of Honolulu on that island, decided that that is urban.

I wrote you on July 9 and asked for a response on reclassifying rural areas of that island back to rural so we could be eligible for that aid. So, number one, I would just like to ask if you would respond to that soon; and second, again to make the point to all of the panelists that we have got to talk about what rural is. So, Mr. Dorr, if you could kindly get back to us on that, that would be appreciated.

Mr. DORR. We will be delighted to do that. We have not overlooked that, we are working on that, and it does involve the definition of city and town; that is, as defined by the State. And it is somewhat complicated, particularly as a result of a couple of other changes within the 2002 farm bill, and we are working on it. And I apologize for having not at least informed you that we are addressing and attempting to work this out.

Mr. CASE. Thank you very much.

Chairman MANZULLO. Mr. Case, you have still got more time, but I would like to get to Dr. Christensen. Would you mind if we go to her, and then we can bounce back if we have more time, because the votes are coming.

Mrs. CHRISTENSEN. Thank you.

Chairman MANZULLO. I am sorry, Mr. Miller was before you.

Why don't we go with this: Why don't you go with Mr. Miller, and then Dr. Christensen. If you would take 4 minutes apiece, I think we could finish it up.

Mrs. CHRISTENSEN. I only have one question.

Mr. MILLER. I am sorry. I was not complaining about the order at all, but the frequent case of our being interrupted every time we seem to get a head of steam up by having to traipse over to the floor for votes.

First of all, I am not really from a rural area. My district is about one-third rural small-town North Carolina, but about two-thirds urban/suburban. I represent Raleigh and Greensboro and Burlington, which are definitely considered urban in North Carolina, and I live inside the Beltline in Raleigh. I grew up in Fayetteville in North Carolina. That makes me a city boy, although, like most people, I am not that far from North Carolina. I am not that far from removed from the farm. My father was born in a farm outside of Rowland, North Carolina. You haven't heard of Rowland? That is fine. Most people have not heard of Rowland either.

However, I have spent a great deal of last month visiting the one-third of my district that is rural small-town North Carolina, and I think it is very much as Dr. Freshwater described. The unemployment rate is 10 percent or so. I have got the county by county back in my office, but Rockingham County, North Carolina, which is largely dependent on tobacco and textiles and furniture, their unemployment rate is 10.8 percent; percent in Caswell County is also hovering around 10 percent.

The 10.8 percent does not reflect the job loss from the decorative bedding plant, the Pillowtex operation in Eden, with about 450 employees, or the closing of Stoneville Furniture in Stoneville, in Rockingham County, also 2- or 300 jobs in a county of about 90,000. Adding to the difficulty is that about 45 percent of the adult population of Rockingham County does not have a high school diploma or a GED. It is about a similar number of persons in Caswell County, a little bit less because some of the employees in those counties really did require that their employees go back and get their GEDs and actually provided some of the training on their—at the workplace.

Those workers are not going to become code writers. They have got a very difficult time, and even if the jobs are considered to be lost because of trade, in 2 years they are not going to go back, get their GED, and also learn skills for a new job.

I have heard a lot of the discussion; in fact, some of the descriptions of farm living reminded me of reruns of Green Acres. It doesn't really match up with the reality of what I have seen in rural North Carolina and how hard it is. A lot of the wonderful phrases I have heard talk about innovation, seizing opportunities, building new sources of competitive advantage, growing more entrepreneurs, building a knowledge-based economy, all those kind of obligatory phrases, but I just don't see much going on to help make those things happen.

Let me give two examples. One is community colleges. Probably nothing is more important, to use the economists' phrase, to building human capital than the community colleges. That is where we match up skills to jobs. But the Bush administration has opposed eliminating the principal source of funding for vocational education, community colleges: the Carl Perkins grants.

Second, Mr. Drabenstott, I think, spoke about the land grant universities. North Carolina State University, a land grant university in North Carolina, offers an industrial extension service which is funded through the Manufacturing Extension Partnership, which is part of NIST, the National Institute of Science—of Standards and Technology, which is part of the Commerce Department, and that provides services similar to ag extension to go to small businesses, provide them the advice, show them how to cut costs. If they have to deal with regulations, show them what the regulations are and how to deal with them.

Chairman MANZULLO. Fifteen seconds.

Mr. MILLER. The Bush administration has proposed cutting about 90 percent of the funding for that program.

Mr. Freshwater, do those two cuts make any sense to you at all?

Mr. FRESHWATER. No, sir. I think the Manufacturing Extension Partnership is a wonderful thing, but it doesn't push, at least in the case of Kentucky, which is the one I know the most about——

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Chairman MANZULLO. I have got to cut you off.

Dr. Christensen.

Mrs. CHRISTENSEN. Thank you, Mr. Chairman. I just have really one question. And coming from the Virgin Islands, I often have to remind my colleagues that we are basically a rural area, sharing

many of the problems and also the untapped potential of the stateside rural areas.

My one question would be to Assistant Secretary Dorr. The USDA used to have a REAP program, the Rural Economic Area Partnership, and it seems to me that that kind of program, which was only utilized in one or two areas in the United States, would be—bring the kind of focus and collaboration that is needed to provide for economic development in our rural areas, but yet I don't hear of it being revived. Is there any——.

Mr. DORR. I believe last year there were two additional REAPs announced in the United States, one in, I believe, Maine, and one in Texas. I don't know what the status is relevant to REAPs as they would impact the Virgin Islands, but we can check into that and get back to you on it.

Mrs. CHRISTENSEN. So it is a program that is still ongoing.

Mr. DORR. They are designated annually, and I quite honestly, I don't know how that is done, and I will have to get back to you.

Mrs. CHRISTENSEN. Do you have another question? That was my only question, unless someone else wanted to answer it from the panel.

Chairman MANZULLO. Mr. Miller wanted an answer, and I believe I cut you off.

Mrs. VELAZQUEZ. It is just fair.

Mr. MILLER. Dr. Freshwater?

Mr. FRESHWATER. It is an excellent program, but it hasn't really—most of the SBA programs as well, they haven't pushed into rural areas because people don't know about them, they don't have the personnel. So what you have got is a manufacturing extension program in Kentucky that works well in Lexington, works well in Louisville, works well in northern Kentucky, but does nothing outside the major metropolitan areas.

Mr. MILLER. Would it make sense to expand the funding rather than cut it by 90 percent?

Mr. DORR. I think expanding the funding and pushing into rural America would be a real excellent thing to do.

Mr. MILLER. How about community colleges?

Mr. DORR. And community colleges, as you said, are the basis for people upgrading their skills, and we have to do that.

Mr. MILLER. Okay. One more question on the same topic?

Chairman MANZULLO. We have got to go.

Mr. MILLER. Okay. Never mind.

My question was just to Mr. Sampson: What were you thinking?

Mr. SAMPSON. With regard to what, sir?

Mr. MILLER. The industrial extension services and community colleges, cutting both of those programs pretty dramatically.

Mr. SAMPSON. The Manufacturing Extension Program is operated under the Technology Administration Program at the Department of Commerce, not the Economic Development Administration. I am afraid I was not involved in those decisions. I would be happy to have the appropriate person get back with you on that.

Chairman MANZULLO. Okay.

Thank you very much. We have got to go vote. Appreciate your time.

[Whereupon, at 11:04 a.m., the committee was adjourned.]

DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
108th Congress
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

September 4, 2003

OPENING STATEMENT

CHAIRMAN DONALD A. MANZULLO
HOUSE COMMITTEE ON SMALL BUSINESS

Good morning and welcome to this hearing by the House Committee on Small Business. I appreciate the participation by all who have come before us today and especially for those of you that have traveled some distance to attend this hearing.

The purpose of this hearing is to examine how the government is doing in encouraging growth in our rural economy. For many years we have had a migration of people away from rural areas in general and toward metropolitan areas, and especially metropolitan areas around the east and west coasts.

One contributing factor in this migration within the country is insufficient economic activity in rural areas. When rural areas lose working age people, schools and hospitals begin shutting down. Housing prices drop, the tax base erodes, social services have to be cut, and it creates an atmosphere that tempts more people to leave. Then the cycle is reinforced. All the investments in roads, railways, airports, telecommunications and utilities become underutilized and to a degree, wasted.

At the same time the metropolitan areas these people move to have problems with too much road traffic, crowded schools, housing shortages, and a greatly increased cost of living that in many cases forces both spouses to work when that is not their first choice.

For example, there have been job cuts at the Goodyear Tire factory and the Honeywell Electrical Switch facility in Freeport, Illinois and nearby Galena. Now Freeport's unemployment rate is over 10 percent. When these larger factories shed jobs, many other small businesses are affected, some of which closed.

Then some of the former employees had to move out of these rural areas to find new work, which put houses on the market for sale. The smaller workforce hurts the property tax base and it goes on and on.

Congress recognized the importance of maintaining our rural areas when it passed the Rural Development Act in 1972.

Today we will be hearing testimony on whether the government agencies are living up to the goals of that law. We will also be hearing testimony on all the factors involved in creating the environment businesses need to thrive in rural areas. The recommendations we hear today will be important ones for developing any necessary future legislation to address critical problems.

Again, thank you for your participation in this hearing. I now yield to the Ranking Member, Ms. Velàzquez for her opening statement.

DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
108th Congress
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2361 Rayburn House Office Building
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STATEMENT
of the
Honorable Nydia M. Velázquez
Hearing on Rural Development
House Committee on Small Business
September 4, 2003

Thank you, Mr. Chairman.

As this committee has said time and time again – small business is big business in America. Nowhere is this truer than in rural America.

From family farms to local restaurants to manufacturing – small businesses make up the bulk of the rural economy. Ninety percent of all businesses in rural areas are small firms. So when this committee examines policies that impact small business, we are looking at policies that have a huge impact on rural America.

Today, entrepreneurs in rural areas are facing hardships. They face a weakening labor pool – as a younger and more productive population decides to leave and look for opportunity elsewhere. They have less access to capital and fewer government loan programs that reach them. These issues are a threat to the livelihood of rural America.

And for those entrepreneurs and their employees who struggle to survive in these communities, the rewards of success are few. During the 1990's economic boom, other small firms experienced far greater growth. And today, worker salaries of rural small businesses are nearly 35 percent below those found in cities.

Small firms in these communities are also adjusting to the changing face of the rural economy. At one time, when Congress talked about rural development, we talked about farm policy. Today, only 10 percent of employment in rural areas is related to agriculture.

In fact, the largest employers in rural America are manufacturing companies. These communities are often dependent on a single manufacturing plant, as it brings in high paying jobs that form the area's economic and employment backbone. The loss of such companies can have a devastating effect.

These areas have also been particularly hard hit by the dramatic decline in manufacturing jobs. Rural manufacturing fell by 4.6 percent in 2002 and the numbers are getting worse. The loss of these jobs has created a ripple effect and hurt other small businesses as well.

Today's hearing will address how we can solve these problems. We will look at ways that we can use government programs to ensure the future is bright in rural America. Congress needs to make sure that we are not cutting critical funding to entrepreneurial programs during this economic downturn. It is during times like this that small businesses can spur a recovery.

The administration cannot continually turn its back on small businesses, particularly in rural America. They need help in overcoming the challenges that face them – like gaining access to capital, technical assistance and federal contracts. The USDA and Department of Commerce need to make sure that their programs are reaching those businesses most in need. These small firms simply need the right tools to level the playing field and be competitive in an ever-changing economic environment.

Yet the administration's policies are actually hindering entrepreneurial development in rural areas. And because of policies that fail to help small firms, many rural businesses and our nation's family farms are being threatened.

Small firms provide employment opportunities within these rural communities. But they cannot reach their full economic potential unless we provide them with the relief and assistance they need.

As a key driver of our economy, small businesses require a working climate conducive to providing jobs to those living in rural areas. A high unemployment market in these small communities will cause workers and their families to leave and settle in more populated areas.

Failed policies are harming communities that rely most on their small firms. This is what is happening in our nation's rural areas. We must prevent this in the future and examine ways in which federal agencies can improve their programs to meet the needs of entrepreneurs in rural areas. Not only are small businesses the backbone of rural communities – they are the engine of our nation's economy.

Thank you.

DRAFT

TO: **Democratic Members of the Small Business Committee**

FROM: **Nydia M. Velázquez, Ranking Member, Small Business Committee**

RE: **Hearing on Rural Development**

On Thursday, September 4, 2003, at 9:30 am the Committee on Small Business will be holding a hearing in Room 2360, Rayburn House Office Building to discuss attracting economic growth for the rural economy and whether the federal government is adequately supporting a policy of growth in the rural portions of the country. The hearing will examine efforts by the failures of the federal government to create an environment that fosters growth in these rural areas, particularly for small businesses. Included within the discussion is the decline of small manufacturers in these areas and what efforts can be used to increase manufacturing in these areas.

Representatives of the Department of Commerce, Department of Agriculture, the General Accounting Office and the Federal Reserve will testify about the challenges facing rural America and what measures can be or have been taken to address these issues. The GAO representative will testify on the progress, or lack thereof, of compliance with the Rural Development Act of 1972 that was designed to promote rural development. A GAO report issued in 2001 focused on only one aspect of the Rural Development Act examining the progress of agencies in expanding their location sites to rural America, as required by the RDA.

DRAFT

I. Background

The hearing will include a broad discussion of the problems facing entrepreneurs in rural America and the particular issues facing small businesses. Among the problems are population out-migration, particularly in the younger more productive age groups, population aging, low per capita and median family income levels, as well as problems related to health care issues, essential public and private services, inadequate and deteriorating infrastructure, and a lack of adequate employment opportunities. Testimony will also examine the issues of access to capital and improving technical assistance to these areas.

Rural Development includes the planning, development, and expansion of business and industry in rural areas to provide increased employment and income; the planning, development, conservation, and use of land, water, and other natural resources of rural areas to maintain or improve the quality of the environment or people and business in rural areas; and the building or improvement of institutional, organizational, and leadership capacities of rural citizens and leaders to define and resolve their own community problems. A number of government programs have been implemented to improve the business environment in rural areas. These actions are designed to encourage continued growth in the agricultural sector while improving opportunities for manufacturing, retail, service and other types of small businesses. The non-agricultural sector is critical as 90% of rural workers have non-farm employment.

II. Rural Development

Government Programs

As there is no Congressional Committee with exclusive jurisdiction over agricultural policy, numerous agencies have programs to assist small businesses. Over 88 programs administered by 16 different federal agencies target rural economic development. While the USDA has the majority of programs designed to assist small businesses in rural areas, the Small Business Administration has a number of stated goals to assist rural areas.

The SBA 504 loan program has a stated public policy goal of rural development that includes higher loan amounts to borrowers in these underserved rural areas. In addition, the Small Business Committee is looking at ways in the re-authorization to increase SBA 7(a) loan guaranties for rural areas that meet certain requirements. A provision was included in the SBA re-authorization passed out of Committee on July 24, 2003 to increase these guaranties. This legislation has not passed out of the House, but will likely be on the floor in September 2003. The hearing will offer Members an opportunity to ask representatives of these federal agencies how the SBA can be used to further assist rural development, whether it be through increased access to capital or other development assistance.

As noted above, the United States Department of Agriculture (USDA) has the majority of programs designed to promote economic growth in rural areas. The USDA administers the greatest number of rural development programs and has the highest average of program funds going directly to rural counties (approximately 50%). The Rural Development Policy Act of 1980 designated the USDA as the lead federal agency for rural development.

The Rural Business-Cooperative Service (RBS), the Rural Housing Service (RHS), and the Rural Utilities Service (RUS) constitute the Rural Development mission area under the USDA. The mission of these programs is to "enhance the capacity of all rural residents, communities and businesses to prosper." Some of the business-oriented objectives of these USDA programs include "maximizing the leveraging of loan funds to increase the number of rural residents assisted by Rural Development programs." The plan also calls for "improving the quality of life in Rural America by providing technical assistance and financing for modern, affordable telecommunications services."

The USDA Rural-Business-Cooperative Service was created nearly 75 years ago with the goal of assisting agriculture, mining, and fishing industries. Since the 1950's, the program has shifted to help manufacturing and other non-farming industries. *(See manufacturing discussion below)* The program has also been critical in providing specialized technical and marketing assistance. The programs authorized in the 2002 farm bill (PL 107-171) also address the needs of rural businesses through this program, especially in capital formation.

The USDA Rural Utilities Service (RUS) has focused on providing infrastructure to get rural products to markets or transportation nodes. Because of great geographical distances and low population densities, rural areas would be unlikely to have electrical and telecommunication services without some sort of federal support. Today, rural electrification and telecommunications are the core programs of the RUS. New infrastructure includes facilities for health service delivery, e.g., telemedicine, and new broadband telecommunication services. Infrastructure is critical if small businesses are expected to compete in what is becoming a global economy.

Many of these programs are designed to promote growth outside the agricultural sector. This hearing offers a good opportunity to examine the ways that the government can be further used to promote economic growth in these areas beyond agricultural goods and services. As traditional resource-based, extractive rural industries decline, entrepreneurial development can be an effective strategy for the government to consider. The Small Business Committee has worked with the SBA to ensure that all sectors and areas receive the support they need to expand and create jobs. Members can ask the panel what efforts are being taken by their respective agency to increase the amount of capital, improve technical assistance, and adapting to technological changes.

GAO Study on Rural Development Act

One piece of legislation that will be examined during the hearing is the ongoing implementation of the Rural Development Act (RDA or Act). The RDA was designed to provide rural areas with the opportunities and investment to meet the needs of a changing economy and ensure vitalization of these areas. The Act is designed to address the particular needs of rural areas and provide for government assistance in promoting rural development. The Act states, the overall purpose is "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 our Nation by providing the essential knowledge necessary for successful programs of rural development." The goals of the Act were to:

> (1) Encourage and support rural United States, in order to help make it a better place to live, work, and enjoy life;
> (2) Increase income and improve employment for persons in rural areas, including the owners or operators of small farms, small businesses, and rural youth;
> (3) Improve the quality and availability of essential community services and facilities in rural areas;
> (4) improve the quantity and quality of rural housing;
> (5) improve the rural management of natural resources so that the growth and development of rural communities needed to support the family farm may be accommodated with minimum effect on the natural environment and the agricultural land base;
> (6) improve the data base for rural development decision making at local, State, and national levels; and
> (7) improve the problem solving and development capacities and effectiveness of rural governments, officials, institutions, communities, community leaders, and citizen groups in(A) improving access to Federal programs;(B) improving targeting and delivery of technical assistance;(C) improving coordination among Federal agencies, other levels of government, and institutions and private organizations in rural areas; and (D) developing and disseminating better information about rural conditions.

While the Rural Development Act includes a broad array of programs, the author of a 2001 GAO report will testify before the Committee about the findings of the report that examined federal agency responses to the RDA provision requiring agencies to set up their local sites in rural areas. The GAO report strictly focused on the provision of the Act that was designed to promote rural development by diversifying the locations of federal agency offices. The report found that agencies have failed to comply with the RDA goals of locating sites in rural areas, as opposed to urban areas.

The findings of the GAO report revealed that federal agencies have failed to meet their requirements under the RDA to establish sites in rural areas. The vast majority of federal agencies had site locations in urban areas, with a heavy concentration in Washington, DC and ten other "federal regional" cities. Eight of the 13 cabinet agencies surveyed had no formal RDA siting policies, and there was little evidence that agencies considered RDA's requirements when siting new federal facilities. Further, GSA has not developed for congressional consideration a cost conscious, government wide location policy, as recommended by the GAO in 1990.

The report found that room for improvement exists and that several government functions, such as research and development, data processing, accounting and finance, and teleservice centers, can be located in rural areas. Although it is not clear from the GAO report whether any of the federal agencies that located sites in urban areas could have located them in rural areas, one matter that is clear is that the RDA has not had the influence on federal agencies for siting practices that Congress appears to have intended.

The GAO found that in order to improve these agencies record of compliance, federal agencies need to have at a minimum, a written policy. The GAO advised that Congress should consider (1) enacting legislation to require agencies to consider, along with other mission and program requirements, real estate, labor, and other operational costs and applicable local incentives when deciding whether to relocate or establish a new site in a rural or urban area, and (2) amending RDA to clarify the definition of "rural area" for facility siting purposes to facilitate its implementation.

Manufacturing and the Rural Economy

Another focus of the hearing will be the declining manufacturing sector in the rural economy. The Committee has held a number of hearings in the 108th Congress to examine the declining manufacturing sectors. These hearings have addressed monetary policy, trade agreements, tax policy and other barriers to manufacturing and international trade. This hearing will focus on manufacturing in rural areas, the general trends of the sector in these areas.

As with the rest of the country, rural areas have been particularly hard hit by the decline in manufacturing. Two of the witnesses will address the issues facing manufacturers in rural areas. The representative of the Federal Reserve will testify about the declining manufacturing sector and the monetary policies that can affect manufacturing. This will include domestic monetary policy, as well as that of other countries. Mr. Freshwater, a professor at the University of Kentucky, will also discuss the changing rural economies and how this has been impacted by the loss of manufacturing jobs.

Members will have the opportunity to ask the representative of the Federal Reserve about the impact that monetary policy has had on trade, and particularly manufacturing. The overvalued dollar has also been a key factor in diminishing U.S. manufacturing competitiveness, which has driven up the trade deficit. From January 1995 to January 2003, the dollar appreciated in international value by 33 percent. A rise in the dollar has caused elevated prices in U.S. produced goods relative to foreign goods, making them less attractive to consumers in both the domestic and world markets. An overvalued dollar has also discouraged investments in domestic manufacturing, since investors can get more for their money by investing in foreign companies that require less money to expand. This trend alone in 2001 reduced manufacturing investments by $37 billion.

The manufacturing sector represents the best of American businesses. Manufacturing is more than just an engine for growth. It is about research and innovation, higher incomes, and quality of life improvements for all Americans. U.S. manufacturing industries account for about two-thirds of private research and development expenditures, our competitive edge in the global marketplace, and a strong national defense, which are so crucial for robust economic growth and rising standards of living. Historically, this industry has led the economy in productivity growth and has been a major source of good jobs for three-quarters of American workers without a college degree.

Manufacturing is one of the three largest sectors in all but eight states, and it is the largest sector in 13 states as well as in the Midwest region as a whole, where many of these "rural areas" are located. Manufacturing workers are among the best paid in our country. The average manufacturing employee earns $46,000 a year, with total compensation of $54,000. Both of these figures are 20 percent higher than the average for all other U.S. workers. In rural areas, manufacturers can serve as the economic engine of a small city or town and the loss of such manufacturers can lead to the decline of such towns and/or areas.

During the 1990s, manufacturing was responsible for over a quarter of America's total economic output. Manufacturing accounted for 21 percent of total economic growth and one-third of productivity growth. But technology is not the only area where this industry exerts a ripple effect across the whole economy. Manufacturing has one of the highest "multiplier" effects in terms of job creation. Every $1 million in final sales from manufactured products supports eight jobs in the manufacturing sector, and six jobs in other sectors, such as services, construction and agriculture. This is best reflected in rural areas where high paying manufacturing jobs provide an infusion of money for other businesses in these communities. Thus, in addition to providing 16.5 million jobs directly, manufacturing supports nine million jobs in other sectors.

Without manufacturing, America would not be the economic powerhouse and world leader it is today. Many of these rural areas and communities depend on manufacturing as their economic base. Despite a lengthy, sector-specific recession that has just begun to ease over the past several months, U.S. manufacturing still accounts for roughly 17 percent of our gross domestic product (GDP) while providing millions of jobs. These facts may surprise those who believe manufacturing has passed its prime, but those living in manufacturing communities understand because they see, firsthand, the relatively high wages, benefits, and ancillary job creation manufacturing has on local economic development.

It is true that U.S. manufacturing employs fewer people today than it did in the past, even as its share of GDP has remained fairly steady. But lower employment does not necessarily mean the manufacturing industry is weak. The situation parallels what has occurred on America's farms – far fewer people work on farms these days, but the U.S. agricultural sector is more productive than ever, feeding our growing population and much of the rest of the world. U.S. manufacturing is the most efficient when it comes to productivity, or output per hour of work. High productivity per worker means rising wages, declining costs to consumers and low inflation. And manufacturing also gives our nation an edge in innovation by contributing almost twice as much research and development to the economy as non-manufacturing sectors.

Because of its higher wages and its linkages to other goods and services, manufacturing has a greater job multiplier effect than other nonmanufacturing sectors. Each manufacturing job supports as many as four other jobs, providing a boost to local economies. For example, every 100 steel jobs and every 100 auto jobs create 400 to 500 new positions to the overall economy. Aside from the direct jobs it creates, manufacturing also stimulates the creation of numerous jobs in high-end services and tertiary services in local economies.

The crisis in manufacturing is apparent – while the economy boomed in the late 1990s, the manufacturing sector plunged into recession, losing more than 2.4 million jobs. This is the first time since World War II that the United States has lost manufacturing jobs during a period of growth. There have been 31 consecutive months of job losses in manufacturing, including 16,000 last January. The recession of 2001 can be labeled as a manufacturing recession because it was largely confined to business investment and exports, both of which dropped significantly and directly affected this industry. By contrast, consumer spending held up reasonably well, growing by 2.8 percent in 2001. More recently, the 2002 recovery was largely driven by consumer spending, which accelerated modestly to a 3 percent growth rate last year. At the same time, business investment spending continued to decline by 3 percent, while goods exports edged up just 2 percent (remaining 8 percent below their level two years ago).

This stands in stark contrast to the 10 percent growth in exports during the first year of recovery following the 1990-1991 recession. Weak business investment demand and export growth have constrained the recovery for manufacturers. In short, the expansion-to-date has been narrow, unbalanced and historically sluggish. Despite low interest rates, and a bonus depreciation stimulus package passed in 2003, significant inhibitors to economic growth remain. Some of the challenges facing manufacturers are long-term problems that need to be addressed to create a better environment. Manufacturers are competing in a deflationary environment, with pricing power falling at an average annual rate of 0.9 percent since 1995. By contrast, the inflation rate for the economy overall has averaged 2 percent since the mid 1990s. At the same time, heavy regulatory and legal burdens cost U.S. firms $697 billion, or 6.7 percent of our GDP in 2002. The price tag of regulatory compliance alone adds up to $8,000 per manufacturing employee, which is 67 percent higher than the average cost to large companies.

The profitable economic expansion of the 1990s was something that was not shared by the manufacturing sector. Rural areas also did not experience the boom in the same way that many urban areas did. At the start of the current recession, real manufacturing output dropped sharply, resulting in the loss of manufacturing jobs. But the crisis that the manufacturing industry faces is more than just a consequence of a recessionary decline. Analysts of this industry suggest that the United States is losing a larger share of its capacity to produce material goods. For example, capacity utilization in U.S. manufacturing – a measure of production activity – dropped to 74 percent in November 2002, and the manufacturing GDP declined by 6 percent in 2001, which was the second largest decline in 50 years.

While exports have somewhat bounced back, they still have not reached their pre-recession levels. Since 1997, the U.S. share of world manufactured exports has fallen from 13 to 11 percent. Exports across the Atlantic have fallen by $17.6 billion, accounting for half of the total decline in exports. Meanwhile, American manufacturers are also grappling with a huge surge in imports. In the fourth quarter of 2002, imports accounted for 26.7 percent of all non-oil goods bought in the U.S. Economists expect that market share to edge up even further in 2003, given America's ever-increasing appetite for foreign-made goods. Furthermore, economists predict that the rise of imports from low-cost producers means manufacturers will have a difficult time raising their prices. Cheaper labor will enable other countries to keep the cost of exports down, boosting their market share. Right now manufacturing skills in low-cost labor countries are not very high, however, as their manufacturing abilities increase, this will put further pressure on the U.S. manufacturing sector. The chief beneficiary will be U.S. consumers, who will continue to find bargains when shopping, and the biggest loser will be manufacturers, their workforce and investors.

III. Conclusion

The hearing will examine a broad array of issues affecting rural areas. As a key jobs producer, small business needs a good business climate in order to thrive and provide job opportunities to those living in rural areas. Without a healthy employment market, workers and their families will continue to leave rural areas and settle in metropolitan areas.

The representatives of the various federal agencies will discuss their agencies different roles in improving business opportunities in rural areas. While issues of rural business development are also being addressed by state governments, the USDA and other federal agencies such as the SBA have been improving their programs to meet the needs of all entrepreneurs in these areas, not just agricultural jobs. While no representative of the SBA is testifying, the hearing can be used to find what is working for other agencies to improve the SBA.

The hearing will also continue to go along with the theme of identifying the problems surrounding the decline of the manufacturing sector and what can be done to bring back the industry. Rural areas are often more dependent on manufacturing as it brings in high paying jobs that are the backbone of a small community. The loss of a major manufacturing plant can be devastating to these rural areas and this hearing can be used to examine ways to keep these jobs.

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U.S. House of Representatives
Committee on Small Business

Congress of the United States
House of Representatives
Committee on Small Business

HEARING

Attracting Economic Growth in Rural America

Statement of Thomas C. Dorr
Under Secretary for Rural Development
United States Department of Agriculture

Mr. Chairman, Members of the Committee, it is a pleasure to be here today to discuss the United States Department of Agriculture's Rural Development efforts to promote and sustain small business in rural America.

As Under Secretary for Rural Development, I am charged with the administering over 40 programs designed to increase economic opportunity and improve the quality of life of rural residents. Rural Development's programs are delivered through three primary agencies – Rural Business-Cooperative Service (RBS), Rural Housing Service, (RHS), and Rural Utilities Service (RUS). Rural Development also delivers programs through our Office of Community Development.

The services delivered by all Rural Development programs are vital. Rural Development's overall efforts set the foundation for successful business ventures and economically viable communities throughout rural America. Today I will focus on the programs that help create businesses and jobs and are delivered by RBS.

Earlier this year I testified before the House Appropriations Subcommittee on Agriculture and stated the importance of focusing the programs of Rural Development on creating new opportunities and jobs, not just efforts to create off farm jobs, but also to retain and expand existing employment opportunities and to look for new ways to help our rural shopkeepers, business owners and entrepreneurs.

I truly believe there are opportunities available in rural America if we utilize new ideas, new solutions, and new approaches. Re-tooling and re-thinking how our federal dollars are spent will develop new business opportunities in rural American as well as help to sustain existing and viable business enterprises.

In the past, USDA Rural Development was viewed as the lender of last resort. A better approach is available. During my tenure as Under Secretary for Rural Development, I have spent countless hours in re-tooling and changing the mindset at Rural Development.

Rather than serving as the lender of last resort, today's Rural Development with its funding serve as rural America's venture capital firm.

When a venture capitalist invests in an entrepreneur, what is expected in return? It expects a return on its investment. But if the entrepreneur is successful, in addition to the venture capitalist's expected return, the entrepreneur and the rural area also reap extension benefits.

I know President Bush and the Congress believe in rural America. We believe the return on our equity from rural America is a stronger rural economy and a higher quality of life for rural Americans.

What is Rural Development?

Rural Development, in effect, is a large development bank. We have an $86 billion portfolio of loans and we administer nearly $16 billion in program loans, loan guarantees, and grants through our 3 primary service areas.

Serving as a venture capital firm for rural America, Rural Development has two goals:

- To increase economic opportunity in rural America, and
- To improve quality of life for all rural Americans.

Rural Development helps increase economic opportunity by:

- Increasing the flow of capital to rural America,
- Maintaining, sustaining, and rebuilding the existing business and industrial infrastructure in rural America,
- Fostering and enhancing the building of the technological infrastructure to enable rural America to compete successfully both domestically and globally, and
- Helping to capitalize the emerging industries related to bio-mass and renewable resource development.

Rural Development helps improve the quality of life in rural America by addressing these basic, essential, and necessary needs:

- Basic – housing, water and wastewater treatment, and other infrastructure needs,
- Essential – access to quality health care and education, and
- Necessary – enabling access to needed cultural and recreational amenities.

In FY 2003, Rural Development will place nearly $16 billion into rural development to be leveraged at a time when some of our brightest and most dedicated rural citizens and our policy makers are looking at exactly the same issues and concerns as this Committee.

This Administration's economic program will help foster the ability of rural Americans to be more innovative and entrepreneurial. Such assistance will help rural businesses

remain competitive in domestic and global markets. Our success will be measured by the jobs created. Each new job provides new opportunities for rural youth to remain in rural America. Retaining and attracting youthful leaders is key to maintaining and increasing the vitality of rural America.

Rural Development Programs Create Jobs

We have the ability to foster strong economic growth in rural America. We have the tools at hand that will make the difference. Though our programs may be traditional in name, we must look for new and improved ways to leverage and use these resources.

Our rural entrepreneurs need to improve their business knowledge and skills. Serious attention needs to be given to business strategies, finance, marketing, and decision making that will enable farmers, business, and community leaders to lead dynamic, creative businesses that can succeed.

I reiterate -- critical to creating economic opportunity in rural areas is the development of new business and employment opportunities. Rural Development serves as a vital link to such development by stepping in when local lending institutions do not have the capacity or capital needed to sustain growing local businesses or financing entrepreneurial upstarts.

Rural Development programs fall into two broad categories: loan, loan guarantee, and grant programs to assist rural businesses; and programs of assistance to rural residents organized on a cooperative basis. Rural development programs increase opportunities for underserved rural areas and populations, moving them toward improved economic growth by providing capital, technology and technical assistance. Rural Development's RBS programs, particularly the Business and Industry loan guarantee program, help supplement the efforts of local lending institutions in providing capital to stimulate job creation and economic expansion.

What will be the impact on rural America? Consider the following:

The more than $700 million in program level requested for fiscal year 2004 for RBS will assist in creating or saving about 70,000 jobs and providing financial assistance to more than 2,270 businesses and cooperatives. Included in this request is $29 million in budget authority for the Business and Industry program to support $602 million in guaranteed loans that will help create or save over 19,000 jobs.

An example of one success story to illustrate how this program has improved the economic climate in an underserved area of rural America is Finger Lakes Construction located in Wayne County, New York. Finger Lakes is a general contractor that specializes in the construction of post frame and steel frame buildings. They employ 115 people and have built numerous buildings for residential, commercial, and agricultural customers throughout central and western New York. The company had financed a considerable amount of its growth out of cash flow, which negatively affected its working

capital. Both the September 11, 2001 disaster and the high out-migration of several New York communities had seriously affected many businesses, including the construction industry in many areas of the state. A $1,062,000 Business and Industry guaranteed loan capitalized those investments, and the company now has the working capital to meet their goals. This guaranteed loan helped to preserve local jobs in rural New York.

For Rural Development's Intermediary Re-lending Program, the fiscal year 2004 budget request of $17.3 million in budget authority will support $40 million loans that will create or save an estimated 9,000 jobs. This program is operated as revolving loan funds, and because these funds are loaned three or four times by the intermediary over the 30-year loan term, the initial investments will create or save over 30,600 jobs over 30 years.

Rural Development also has the Rural Business Enterprise Grant program that assists small and emerging businesses. Past experience has shown that for every dollar of investment provided by this program, another $2.40 in private capital is generated. The fiscal year budget request of $44 million will create or save over 16,300 jobs.

In addition to this program, Rural Development has requested $3 million for fiscal year 2004 for Rural Business Opportunity Grants that will provide much needed technical assistance in rural areas. Many rural regions need to implement economic and community development strategies that will attract private investment capital as well as federal and state assistance. This program is designed to provide assistance to communities as they take steps toward developing these strategies.

Rural Development has also requested $15 million in fiscal year 2004 for Rural Economic Development loans. Under this program unique partnerships between rural electric and telecommunications borrowers are developed to promote community and economic development projects. This program has been quite successful in leveraging additional funds. In FY 2002 each dollar invested in this program attracted an estimated $9.91 in other capital.

Yet another Rural Development program, the Rural Cooperative Development Grant program, focuses its investment on projects that assist small minority cooperative producers. The program encourages the establishment of centers for cooperative development for conducting feasibility analyses, outreach, and other forms of technical assistance for new and existing cooperatives.

New Opportunities to Create and Maintain Jobs in Rural America

Thus far I have tried to outline for the Committee some of the many and varied ways and programs that Rural Development delivers to help promote business and business opportunities in rural America. The goals of these programs are to create new jobs, establish the environment for business and financial investments, and promote economically viable communities in rural America.

Last year the Federal Reserve Bank of Philadelphia in its publication *Cascade, No. 49, Summer/Fall 2002* had several articles dealing with rural development concerns. One article in the publication was titled "Rural Pennsylvania in the New Century." That article pointed out that Pennsylvania's rural economy is more diverse and increasingly more high tech. The article stated that rural Pennsylvania had increases in high-technology manufacturing and between 1996 and 2000 employment in this area increased one percent, while the state's urban areas employment declined one percent. Pennsylvania's rural economy is now more diverse and this diversity better prepares the state to take advantage of new economic opportunities presented by telecommunications.

The United States Department of Agriculture, Economic Research Service, in a publication issued this week found that despite a continuing soft job market, rural areas fared better than urban areas in 2002, with higher job growth and lower unemployment. Employment levels rose significantly in many nonmetropolitan counties, particularly in the Northeast and the West.

In May of this year, the Federal Reserve Bank of Kansas City noted, through its Center for the Study of Rural America, that the rural economy continues to hold steady, with the number of rural jobs increasing slightly by 0.7 percent in February compared with a year earlier. It should also be noted that job growth is increasing at a slightly higher percentage in rural areas compared to job growth in metropolitan areas, according to the Bureau of Labor Statistics.

On the question of whether is rural America getting its fair share of federal funding, the USDA Economic Research Service found that, based on federal programs reported at the county level (about 90 percent of federal funding), nonmetropolitan areas received $5,481 per capita in fiscal year 2000. This compares closely with the $5,743 per capita received by metro areas.

It appears that the rural economy is heading in the right direction. President Bush's initiatives on tax cuts, business growth, and energy are all vital parts of this equation. We know we cannot relax. We must be constantly vigilant in our efforts to create an economically healthy rural America.

There are three areas of concern that I believe merit attention – infrastructure, energy, and investment.

As I have already described, Rural Development provides communities an effective set of tools to help them improve their economic growth. One of the greatest challenges to our rural communities is the development of technical and business infrastructures, especially in telecommunications. High-speed telecommunications services can spur the growth of new jobs for rural residents. Modern infrastructure can bring in many benefits that rural communities need: businesses, quality housing, modern schools, quality health care, dependable electric power, safe drinking water, and ecologically sound waste disposal.

Earlier this year, Secretary Veneman and I announced a new Broadband Loan program to provide advanced, high-speed telecommunication networks in rural America. We continue to support this highly visible and vital program.

Just as citizens in our cities and suburbs benefit from access to broadband services, so should our rural residents. The promise of broadband is not just faster access. It also means new educational opportunities through distance learning. It means life saving medical treatment over telemedicine networks. It means economic growth and new markets where businesses can prosper and grow locally, nationally, and internationally as well.

The simply stated genius of this technology is that it takes jobs to the people. To place high paying and knowledge-based jobs in rural or less populated areas, rather than overseas, is significant in terms of quality of life for all Americans. Overhead costs are lower while legal, political, and currency issues need not be contended with since the jobs are kept in the United States. All of this can be accomplished while improving the quality of life of many Americans and reducing costs.

The necessity of reliable energy for rural America is self-evident. Recent events serve as a clear example of what harm can be done when "the lights go out."

Rural Development, in addition to its electric and telephone programs, is also assisting in the research, development, and financing of renewable energy systems and energy efficiency improvements throughout rural America. These programs are part of the Bush Administration's overall effort to increase America's energy independence through the development of renewable energy resources as well as improving efficiency of existing systems.

The 2002 Farm Bill authorized the Renewable Energy Systems and Energy Efficiency Improvements program under which Rural Development makes funds available to agricultural producers or rural small businesses to support the conversion of our natural resources and residuals of farming operations into new sources of energy and help meet the energy goals outline by the President in 2001. This past week, Rural Development announced the awarding of over $21 million for renewable energy systems and energy efficiency improvement grants in 23 states. Eligible projects included those that derive energy from a wind, solar, biomass, or geothermal source, or hydrogen derived from biomass or water using wind, solar, or geothermal energy sources.

Another new tool from the 2002 Farm Bill is the Rural Business Investment Program. The $44 million in grants and $280 million in loan guarantees will promote business and job opportunities through local investments. We are working with the Small Business Administration to get this program up and running.

Mr. Chairman, I hope that I have informed the Committee of the variety of programs and benefits that Rural Development has committed and devoted to promoting business and

business opportunities to rural America. I want to thank you for the opportunity to appear before you today.

This concludes my formal statement and I am now ready to answer any questions that you Mr. Chairman, or other Members of the Committee may have.

Thank you.

Testimony of

David A. Sampson

Assistant Secretary of Commerce

For Economic Development

Economic Development Administration

United States Department of Commerce

Hearing on

Attracting Economic Growth for the Rural Economy

Committee on Small Business

U.S. House of Representatives

Thursday, September 4, 2003

Chairman Manzullo, Ranking Member Velazquez, and Members of the Committee, thank you for this opportunity to appear before the Committee on Small Business to discuss the Federal government's role in addressing the challenges in the rural economy and, specifically, the Economic Development Administration's focus on addressing the critical needs of rural America.

Background on EDA

The mission of the Economic Development Administration (EDA) is to help our partners across the nation (states, regions and communities) create wealth and minimize poverty by promoting a favorable business environment to attract private capital investment and higher-skill, higher-wage jobs through world class capacity building, planning, infrastructure, research grants, and strategic initiatives.

EDA was created in 1965 to help communities generate new jobs, retain existing jobs, and stimulate industrial and commercial growth in economically distressed areas of the United States. Assistance is available to both rural and urban areas of the nation experiencing high unemployment, low per-capita income, or other severe economic distress.

In fulfilling its mission, EDA is guided by the basic principle that distressed communities, rural or otherwise, must be empowered to develop and implement their own economic development and revitalization strategies through close collaboration with

the private sector, local governments, and other local resources such as universities and non-profit organizations.

Based on locally and regionally-developed priorities, EDA partners with state or local governments, regional economic development districts, public and private non-profit organizations, and Indian tribes to help provide pro-active strategies to confront long-term economic distress, sudden and severe economic dislocations due to natural disasters, the closure of military or other installations, changing trade patterns, or the depletion of natural resources.

Since its creation nearly forty years ago, EDA has invested over $12 billion to help distressed communities create an environment conducive to job growth and economic opportunity. This is a small fraction of the overall federal investment in economic development activities over the same period. According to a General Accounting Office study of federal economic development programs conducted in 2000, there were at least 30 federal economic development programs which provided approximately $7 billion to support economic development activities. (GAO: Economic Development: Multiple Federal Programs Fund Similar Economic Development Activities, Letter Report, 9/29/2000,GAO/RCED/GGD-00-220) And yet, despite this significant allocation of federal resources, many communities remain economically distressed.

EDA has worked with Rural Development at the USDA and nearly every other agency to advance economic development in rural America. We look forward to continuing to

work with these agencies in our sister departments for better coordination and simplification.

Regions Compete Globally with Innovation and Competitiveness

To compete globally, every region in America must leverage its unique set of assets, ideas, and skills to compete in the global marketplace. The key question we have been trying to answer at the Economic Development Administration is: "Why do some regions succeed in creating higher wage jobs and a higher standard of living while others seem to fall short?" The answer is competitiveness. That is, how effectively do regions build upon their inherent assets and advantages and deliver innovative solutions to the marketplace.

Private sector companies drive competitiveness through effective, innovative business strategies. While the private sector is the primary agent in economic development, good government policies and regulations can provide a business environment that supports investment, innovation, development, and job creation. Competitiveness arises from a region's economic, political, and institutional environment in which the private sector does business.

Coordinated actions of corporate and governmental entities can improve a region's competitiveness. In any economy, government alone cannot create sustainable competitive advantages. As President Bush has said, "the role of government is to create conditions in which jobs are created in which people can find work."

Innovation - the Real Competitive Advantage

In the past, the federal government too often relied solely on transfer payments, i.e. subsidies, to bolster under performing economies. We have learned first hand that ongoing subsidies do not create a competitive advantage, but, instead, they thwart innovation. To put it another way, if the basic premise is that innovation is a key driver of competitiveness, those actions that diminish innovation also, in turn, diminish competitiveness. In many instances, past policy had the effect of thwarting innovation and stifling the ability of rural communities to gain regional competitive advantage. Subsidies not only fail to create competitive advantage, but subsidies also act as a force that slows innovation, degrades competitiveness, and stunts economic growth.

Research confirms that one major difference in regional economic performance lies in a region's capacity to innovate, transforming new ideas and new knowledge into high-quality products or services. Additionally, it is vitally important to understand that innovative activity is not limited to "high tech" sectors.

Although some regions have targeted high technology sectors as a means to increase productivity and economic performance, any industry can innovate to become more productive. Even low-tech companies can apply technology more efficiently.

Cluster Theory

EDA's work with such leading researchers as Professor Michael Porter of Harvard Business School and the Council on Competitiveness also shows that the capacity for regional innovation is driven by industry clusters, providing broad networks of companies, suppliers, service firms, academic institutions, and organizations in related industries that, together, bring new products or services to market.

Clusters significantly enhance the ability of regional economies to build prosperity because they act as the incubators for innovation. Clusters possess the primary elements needed to transform ideas into prosperity, for example, -- universities or research centers churning out new knowledge; companies transforming knowledge into new services or products; suppliers providing critical components or equipment; and marketing and distribution firms delivering the product to customers. By developing several diverse clusters, regions can inoculate themselves against cyclical industries and market trends. Regions with successful clusters enjoy innovation, higher average wages, increased productivity, and expanding rates of business formation.

The case for clusters is clear and compelling. Government policy-makers must now ask the question: "What's next?" The answer is that individually and collectively, we must move from policy to practice, especially for rural America.

Culture of Investments and Results

At the Economic Development Administration, we are moving forward. We are modeling ourselves much like a venture capital firm. We are seeking to create a culture

of investment and results. We are focusing our limited public dollars on those partners that understand that simply subsidizing outdated practices is not conducive to meaningful and robust economic growth.

The pace of innovative activity and competitiveness must be driven by the private sector at the regional level, but public sector policies can play a supporting role. Economic success, particularly in distressed regions, can be supported by active and flexible partnerships between federal, state and local governments and private sector leaders, which support the research infrastructure, talent pool, and environment for small business growth. National leaders, such as those in the room today, can serve as a catalyst by bringing key stakeholders together.

What Makes Rural Economics Tick?

A focus on cluster-based development is more easily applied to urban or suburban settings. When it comes to rural economies, we must realize their challenges are different. At EDA, we are responding to these challenges by focusing our research and collaborative efforts on the question: "What makes rural economics tick?"

As we all know, rural wages are typically about 70% of urban wages and many rural communities are losing their most productive workers to urban areas with greater opportunities. In many rural communities, the boom of the 1990's completely passed them by and their situation grows more dire with each passing year.

EDA is pleased to be working with fellow panelist Mark Drabenstott and the Center for the Study of Rural America on this question of what makes rural economies tick. Our partnership has resulted in a growing appreciation of the critical role entrepreneurship plays in sustaining healthy rural economies. While Mr. Drabenstott will address this issue in more detail in his presentation, EDA is currently funding significant research on this subject and is in the process of evaluating research options for Fiscal Year 2004 that we believe will help us bolster entrepreneurship in the nation's rural areas.

EDA also is expanding our work with Professor Michael Porter to more specifically address the question of rural economies. We asked Dr. Porter and his team to look at rural regions through his competitiveness lens. Although Dr. Porter's work is still underway, I am pleased to be able to preview some of his findings today.

What is evident in Dr. Porter's research is that there is no overall strategic approach or consensus among leading practitioners and policy-makers on how to approach rural economic development. To make the challenge even more complex, rural regions are very heterogeneous groups that differ in performance, proximity to other economic areas, and business environment. As a result, it is necessary to look at the "true economic region" to design a customized economic development strategy. We expect that the research by Dr. Porter and other groups, such as the Council on Competitiveness, supported by the US Department of Commerce, will help all branches of the federal government identify common themes and opportunities to move forward together,

implementing the appropriate strategies to improve the economic well-being of rural communities.

No Overall Strategic Approach to Rural Economic Development

Coordination of institutional networks serving rural regions is extremely complex. Through Dr. Porter's research, his team identified nine federal agencies, six regional organizations, six independent agencies and numerous state and local-level organizations serving rural regions. Although it is difficult to estimate the billions of dollars invested in rural areas annually by government and other organizations, suffice it to say that investments in rural communities are not made with an emphasis on maximum return on a collaborative investment strategy. Essentially, federal agencies have been described by experts as "silos" of rural development activity and attempts at coordinating the institutional network have largely failed. The lack of a cohesive conceptual framework and strategy is widely recognized among leading practitioners and policy makers. While it is difficult to quantify the effect on rural America resulting from the lack of coordination among federal assistance programs, I can say that the more coordinated the federal approach is, the more return the taxpayer will receive. As we achieve more coordination among federal assistance programs promoting rural economic development, we must also employ common and quantifiable measurements of success.

True "Economic Regions"--Necessary Collaboration between "Urban" and "Rural" Areas

Dr. Porter's research shows that U.S. Government policies and activities have targeted rural areas primarily as entities separate from urban areas. As a result, purely "rural" strategies may be missing an important dimension of regional competitiveness. Rural areas are linked to urban areas and distinguishing between "rural" regions and "urban" regions misses the true "economic region."

What one traditionally thinks of as a rural region, in fact, obtains products and services from, and sells outputs to, adjacent regions. In other words, industry clusters regularly cross over traditional rural-urban boundaries. If a strategy is developed for the rural region alone, it may overlook the very industry clusters that can drive the regional economy.

Instead, we can think about developing strategies for rural areas around "regional hubs" and "rural spokes". Every rural region needs a regional hub to which to connect. This hub does not have to be a major city but simply a hub with a greater level of activity than that of the rural region.

Connections to the hub, however, are critical. Therefore, in addition to building a strong local business environment, the rural "spoke" also requires efficient business linkages with a regional "hub," including highways, airports, water ports, and of course, telecommunications.

Professor Porter's research demonstrates that to increase the prosperity in rural communities, we need to move away from thinking about purely "rural strategies" and focus on the economic regions in which entire competitive clusters are found and rural strategies and activities are linked to centers of economic activity.

Supporting Groundbreaking Research

The Department of Commerce is pursuing and fostering this innovation-based approach to building regional competitiveness through its policies and strategic initiatives. The old model of transfer payments to distressed regions, uncoordinated and without a comprehensive economic development strategy, is an obsolete paradigm that cannot drive higher-wages and increased standards of living.

Cluster development, strategic linkages, targeted investments in support of innovation, and the embedding of technology are among the factors that, when mixed properly, can set the economic development stage for regions to be competitive in our ever more dynamic global economy.

I am pleased to comment, with regard to EDA's Fiscal Year 2004 appropriation, that President Bush demonstrated his support for EDA's efforts with a request to increase EDA's appropriation by roughly $46 million over the Fiscal Year 2003 appropriation, providing a total of $364.4 million. I strongly urge all members of this Committee to support the President's request of $364.4 million. The House Appropriation Committee has included $318,680,000 for programs and administrative expenses in the bill they

reported to the House. I urge the Congress to fund EDA at the President's requested level so that EDA can provide economic development investments at the level so critically needed in distressed communities across America, particularly in rural communities.

In conclusion, The Economic Development Administration is focused on catalyzing the networks and infrastructure for innovation and providing the analytical tools regions require in order to improve their economic performance. We cannot afford to leave any distressed region behind or perpetuate ineffective models, and as the President has said, we are committed to leave no geographic or demographic sector of America behind when it comes to participating more fully in the American dream.

Thank you, Mr. Chairman, for the opportunity to address this distinguished committee. I appreciate your time and look forward to answering your questions.

A New Era for Rural Policy

Mark Drabenstott
Vice President & Director
Center for the Study of Rural America
Federal Reserve Bank of Kansas City

Testimony before the

House Committee on Small Business

Washington, DC

September 4, 2003

The views expressed are strictly those of the author and do not necessarily reflect those of the Federal Reserve Bank of Kansas City or the Federal Reserve System.

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. 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. In light of that, this committee's discussion of rural issues is timely and useful.

My testimony today 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?

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, agriculture 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.

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 make-up 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.

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.

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.

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.

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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Chart 1
Share of Employment

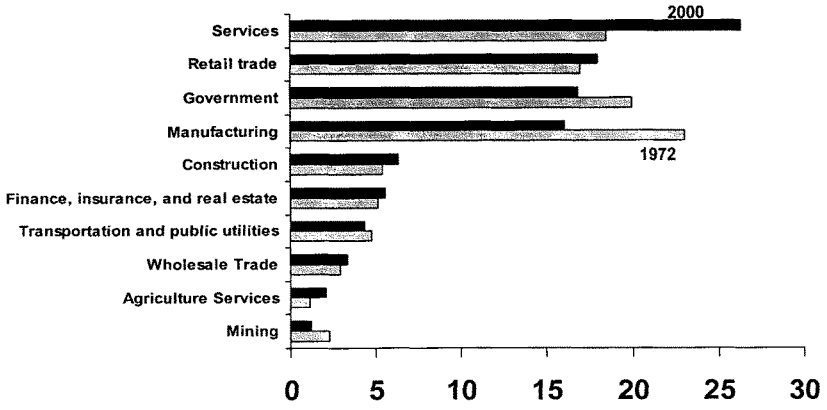


Chart 2
Share of Earnings

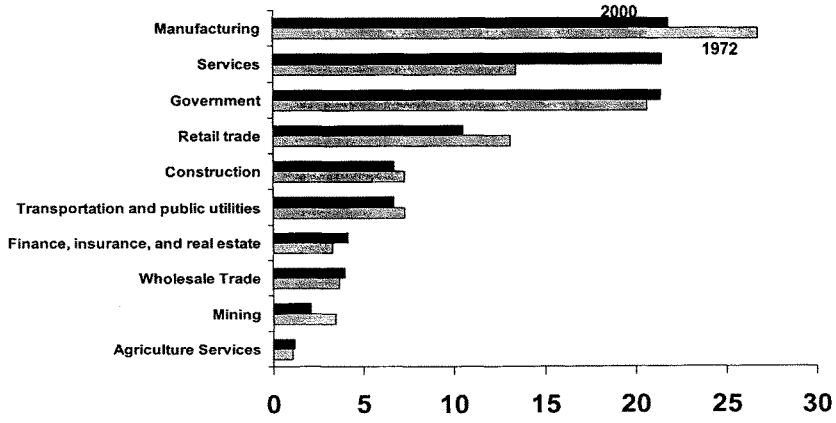
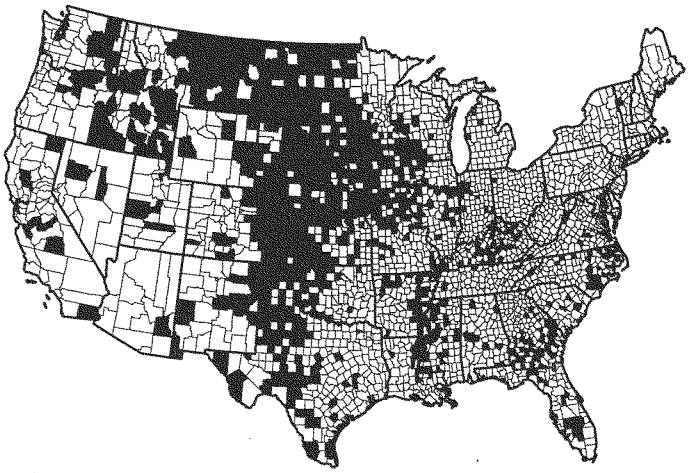


Figure 1
Farm Dependent Counties

1972



2000

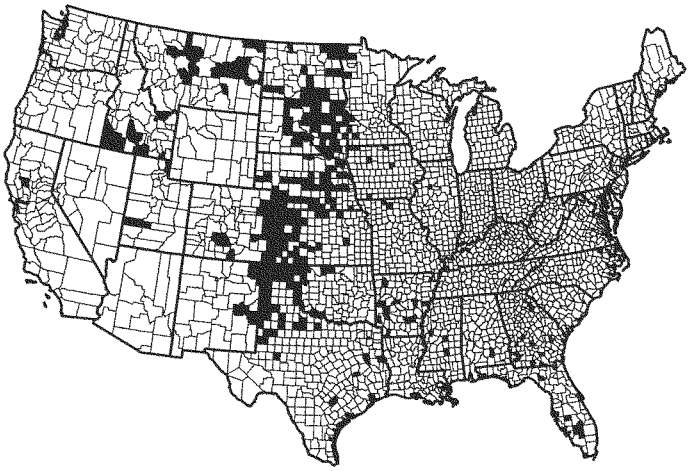
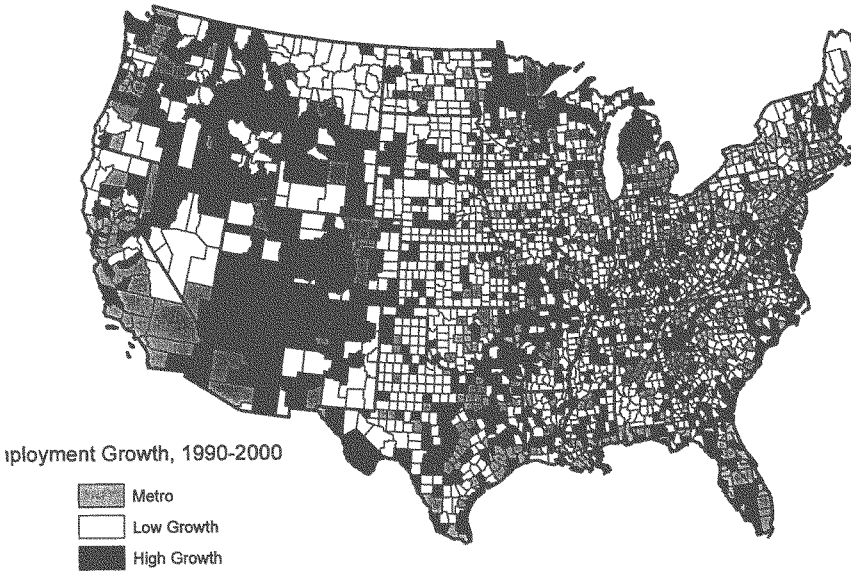


Figure 2
Employment Growth



United States General Accounting Office

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FACILITIES LOCATION

Progress and Barriers in Selecting Rural Areas and Using Telework

Statement of Bernard L. Ungar
Director, Physical Infrastructure Issues

GAO-03-1110T

September 4, 2003

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Highlights

Highlights of GAO-03-1110T, a testimony to Committee on Small Business, House of Representatives

FACILITIES LOCATION

Progress and Barriers in Selecting Rural Areas and Using Telework

Why GAO Did This Study

The location of an organization's facilities has far reaching and long-lasting impacts on its operational costs and ability to attract and retain workers. The Rural Development Act of 1972 has required federal agencies to give first priority to locating new offices and other facilities in rural areas. Rural areas generally have lower real estate and labor costs, but agency missions often require locations in urban areas.

Telework, also called telecommunicating or flexiplace, is a tool that allows employees to work at home or another work location other than a traditional office. Benefits of telework include reducing traffic congestion, improving the recruitment and retention of workers, and reducing the need for office space. Telework could allow federal workers who live in rural areas to work in or near their homes, at least some of the time.

This testimony summarizes and updates work GAO has previously done on the progress in and barriers to the federal government's efforts to locate its operations and workers, when possible, in rural areas.

www.gao.gov/cgi-bin/getrpt?GAO-03-1110T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Bernard Ungar at ungarb@gao.gov.

What GAO Found

Even though federal agencies have been required since 1972 to develop policies and procedures to give priority to locating new offices and other facilities in rural areas, this requirement has not been an important factor in location decisions. In September 1990 we reported that there were multiple laws and regulations to guide federal agencies in selecting facility locations, but they did not always provide for consideration of the best financial interest of the government as a factor in the decision-making process. In July 2001 we reported that many agencies had not issued policies and procedures to give rural areas priority when considering the location of new facilities. Only about 12 percent of federal workers were located in nonmetropolitan statistical areas, a percentage that remained unchanged from 1989 to 2000. Agencies said the need to be near clients, primarily in urban areas, dictated the location of most operations in urban areas. In spite of not having policies to give priority to rural areas, agencies sometimes locate their operations in rural areas to serve clients in those areas. Also, some functions, such as research and development, supply and storage, automated data processing, and finance and accounting, can be located in rural areas. Rural areas can offer lower real estate costs, improved security, reduced parking and traffic congestion problems, and better access to major transportation arteries. Potential barriers to locating in rural areas include the lack of public transportation, lack of available labor, location far from some other agency facilities, and sometimes insufficient infrastructure for high-speed telecommunications. In our July 2001 report, we made several recommendations to the General Services Administration and Congress to improve location decisionmaking. Congress and the General Services Administration subsequently took action to stress the requirements of the Rural Development Act.

Congress has promoted telework in several ways, including authorizing of telework centers in the Washington, D.C., area, requiring agencies to establish a policy under which employees may participate in telecommuting to the maximum extent possible, and encouraging the development of high-speed Internet access in rural areas. However, only about 5 percent of the federal workforce is currently teleworking. In our July 2003 report, we recommended that the General Services Administration and the Office of Personnel Management improve their coordination and provide agencies with more consistent guidance on telework and assist agencies in implementing key practices we identified. The agencies generally agreed with our recommendations and committed to implement them. In addition, the Congressional Research Service reported in July 2003 that about 85 percent of U.S. households have broadband access, although rural, minority, low-income, inner city, tribal, and U.S. territory consumers are particularly vulnerable to not receiving this service. Technological barriers, such as the lack of access to high-speed Internet connections, could have a detrimental effect on the ability of some federal workers in rural areas to take advantage of telework.

Mr. Chairman and Members of the Committee:

We are pleased to be here to testify on federal agencies' efforts to consider locating facilities in rural areas, as required by the Rural Development Act of 1972 (RDA), and to use telework[1] as a way of allowing workers to live in rural areas. My testimony is based on our September 1990 and July 2001 reports on facilities location[2] and subsequent actions by the General Services Administration (GSA) to address our recommendations; selected agencies' responses to a requirement in a fiscal year 2002 appropriations act directing Inspectors General to report on policies and procedures their agencies have to give first priority to the location of facilities in rural areas; and our July 2003 report on telework[3] and other GSA, Office of Personnel Management (OPM), and Congressional Research Service (CRS) reports on telework. My testimony focuses on the progress federal agencies have made and barriers they face in locating federal buildings, when possible, in rural areas and making telework available to federal workers who live in rural areas.

Summary

Although RDA has required federal agencies to establish policies and procedures giving first priority to the location of new offices and other facilities in rural areas since 1972, RDA has not been an important factor in federal location decisions. Many agencies have not issued policies and procedures regarding RDA, and there is little evidence that agencies consider RDA's requirements when locating new federal facilities. Agency officials said requirements to be near clients in urban areas to accomplish their missions dictated the location of most operations in urban areas. However, some agencies locate operations in rural areas to serve rural populations, and functions such as research and development, supply and storage, automated data processing, and finance and accounting can often be located in rural areas. Benefits of rural areas can include improved

[1]Telework, also referred to as telecommunicating or flexiplace, is work that is performed at an employee's home or work location other than a traditional office.

[2]U.S. General Accounting Office, *Facilities Location Policy: GSA Should Propose a More Consistent and Businesslike Approach*, GAO/GGD-90-109 (Washington, D.C.: Sept. 28, 1990); and U.S. General Accounting Office, *Facilities Location: Agencies Should Pay More Attention to Costs and Rural Development Act*, GAO-01-805 (Washington, D.C.: July 31, 2001).

[3]U.S. General Accounting Office, *Human Capital: Further Guidance, Assistance, and Coordination Can Improve Federal Telework Efforts*, GAO-03-679 (Washington, D.C.: July 18, 2003).

security, reduced parking and traffic congestion problems, and better access to major transportation arteries. Potential barriers to locating in rural areas include the lack of public transportation, location far from some other agency facilities, the lack of available labor, and insufficient infrastructure for high-speed telecommunications. In 2000, about 12 percent of federal workers were located in nonmetropolitan statistical areas.

In 2002, about 5 percent of the federal workforce was teleworking. In 2003, we assessed the federal government's progress in implementing telework programs and found that, while recently improved, OPM and GSA have not always coordinated their efforts; as a result, agencies have not always received consistent, unambiguous support and guidance related to telework. We identified 25 key practices, including 5 relating to technology (such as providing technical support for teleworkers), that federal agencies should implement in developing telework programs. We found that the agencies we reviewed had fully implemented 7 of the 25 practices but had generally implemented the 5 practices relating to technology. CRS reported in July 2003[4] that about 85 percent of U.S. households have access to high-speed Internet connections, but rural, minority, low-income, inner city, tribal, and U.S. territory consumers are particularly vulnerable to not receiving this service. Technological barriers, including the lack of access to high-speed Internet connections, could have a detrimental effect on the ability of some federal workers in rural areas to take advantage of telework.

In our July 2001 report on federal location policies, we suggested that Congress consider requiring agencies to consider real estate, labor, and other costs, and applicable local incentives when making location decisions and to amend RDA to clarify the definition of "rural area." We made similar recommendations to GSA and also recommended that GSA require agencies to provide a written statement that they complied with RDA and to justify their decision if they did not select a rural area. Subsequent to our report, Congress has required agency inspectors general to report on what policies and procedures are in place at their agencies to comply with RDA, and GSA has issued additional guidance and policies on RDA. In our July 2003 report on telework efforts, we recommended that GSA and OPM improve coordination of their efforts to

[4]Congressional Research Service, The Library of Congress, *Broadband Internet Access: Background and Issues* (Washington, D.C.: Updated July 1, 2003).

provide agencies with enhanced guidance on telework and to assist agencies in implementing key practices we identified. GSA and OPM generally agreed with our recommendations and committed to take steps towards their implementation.

The Rural Development Act and Other Federal Location Policies

When considering areas in which to locate, RDA directs the heads of all executive departments and agencies of the government to establish and maintain departmental policies and procedures giving first priority to the location of new offices and other facilities in rural areas. Any move by an agency to new office space in another location would be considered a new office or facility covered by RDA.

Two primary executive orders on federal facility location decisions are Executive Order 12072, Federal Space Management, dated August 16, 1978; and Executive Order 13006, Locating Federal Facilities on Historic Properties, dated May 21, 1996. Executive Order 12072 specifies that when the agency mission and program requirements call for federal facilities to be located in urban areas, agencies must give first consideration to locating in a central business area and adjacent areas of similar character. Executive Order 13006 requires the federal government to utilize and maintain, wherever operationally appropriate and economically prudent, historic properties and districts, especially those located in the central business area.

Agencies Generally Locate in Urban Areas and Lack Policies and Procedures for Considering RDA

In 1990, we reviewed whether federal agencies give rural areas first priority in location decisions as required by RDA and whether any changes in federal location policies were warranted. We reported that RDA had not been an important factor in federal facility location decisions. In fiscal year 1989, about 12 percent of federal civilian workers were located in nonmetropolitan statistical areas. Agency officials attributed mission requirements, the need to be in areas where the populations they serve are located, political considerations, and budget pressures as reasons why urban areas received more facilities than rural areas. Those agencies that did locate in rural areas said it was more because they served rural populations than because they were following the requirements of RDA.

We also reported that a growing number of private sector corporations were moving to suburban and rural settings to take advantage of incentives offered by localities to attract jobs and the ability to separate functions resulting from changes in telecommunications technology. We concluded that there were multiple laws and regulations guiding federal

agencies in selecting facility locations, but they do not always provide for consideration of the best financial interest of the government as a factor in the decision-making process. We recommended that GSA develop a more consistent and cost-conscious governmentwide location policy that would require agencies, in meeting their needs, to maximize competition and select sites that offer the best overall value considering such factors as real estate and labor costs.

In 2001, we performed follow-up work on our 1990 report including identifying what functions lend themselves to being located in rural areas. We reported that since our 1990 study, federal agencies continued to locate for the most part in higher cost, urban areas. The percentage of federal employees located in nonmetropolitan statistical areas in 2000 remained virtually unchanged from 1989, at about 12 percent. Eight of the 13 cabinet agencies we surveyed had no formal RDA policy, and there was little evidence that agencies considered RDA's requirements when locating new federal facilities. Further, GSA had not developed a cost-conscious, governmentwide location policy as we recommended in 1990 and the definition of rural used in RDA was unclear.

We reported in 2001 that agencies chose urban areas for most (72 percent) of the 115 federal sites acquired from fiscal year 1998 through fiscal year 2000. Agencies said they selected urban areas primarily because of the need to be near agency clients and related government and private sector facilities to accomplish their missions. The agencies that selected rural areas said they did so because of lower real estate costs. Agencies that relocated operations tended to relocate within the same areas where they were originally located, which were mainly urban areas; newly established locations were almost equally divided between urban and rural areas. Private sector companies surveyed said they select urban areas over rural areas largely because of the need to be near a skilled labor force.

Agencies said the benefits of locating in urban areas were efficiency in agency performance as a result of the ability to share existing facilities, close proximity to other agency facilities and employees, and accessibility to public transportation. Agencies that chose rural sites said that benefits included close proximity to agency support facilities, improved building and data security, and better access to major transportation arteries, such as interstate highways. Barriers reported for urban sites included the lack of building security and expansion space. For rural areas, barriers included the lack of public transportation, location far from other agency facilities, and insufficient infrastructure for high-speed telecommunications.

The functions that were located predominantly at urban sites during 1998 through 2000 were loans/grants/benefits administration processing, inspection and auditing, and health and medical services. The functions that were located predominantly in rural areas in that period were research and development, supply and storage, automated data processing, and finance and accounting. Some functions, such as law enforcement, were placed in both urban and rural areas, although this particular function was located more often at urban sites.

For our 2001 study, we contracted with a private sector consultant, John D. Dorchester, Jr., of The Dorchester Group, L.L.C., to assist us in a number of tasks. One task was to identify functions the private sector might locate in rural areas. The consultant identified the following functions:[5]

- Accounting
- Account representative
- Appraisal/market research
- Clerical/secretarial
- Data processing
- Distribution/warehousing
- Education/training
- Enforcement and quality control
- Field service operations
- Human resources and social services
- Information technologies services
- Legal support
- Logistical support
- Manufacturing and assembly offices
- Operations centers
- Printing and publishing
- Records archiving
- Repairs and servicing
- Scientific studies and research and development
- Technical functions and support
- Telemarketing, order processing, and communications

We also asked our consultant to identify the benefits and challenges associated with rural areas for selected functions. (See table 1.)

[5]The Dorchester Group, LLC., *Office Location Considerations of Large U.S. Corporations: U.S. Government Potentials* (Scottsdale, AZ: Mar. 31, 2001).

Table 1: Benefits and Challenges Associated With Rural Areas for Nine Functions

Function	Benefits	Challenges
Accounting	Lower wages and operating costs	Data security and quality control
Data processing	Reduced costs of office and labor	Needs skills more often found in metropolitan areas
Distribution and warehousing	Savings on labor and real estate	Needs good transportation links
Education and training	Fewer distractions and recreation opportunities	None identified
Enforcement/quality control	None identified	Needs good regional access
Printing and publishing	None identified	Needs good transportation links
Records archiving	Lower costs for real estate and wages	Limited access to records
Scientific studies/research and development	Better security; in some cases, access to universities	Specialized employees may have to be recruited nationally
Telemarketing, order processing, communications	Operating cost efficiencies	Sufficient and sustainable labor pool

Source: The Dorchester Group, L.L.C., Office Location Considerations of Large U.S. Corporations: U.S. Government Potentials (Scottsdale, AZ, Mar. 31, 2001).

Our July 2001 report suggested that Congress consider enacting legislation to (1) require agencies to consider real estate, labor, and other operational costs and local incentives when making a location decision; and (2) clarify the meaning of "rural area" in RDA. We also recommended that GSA revise its guidance to agencies to require agencies making location decisions to consider real estate, labor, and other costs and local incentives. In addition, we recommended that GSA require agencies subject to its authority to provide a written statement that they had given first priority to locating in a rural area and to justify their decision if they did not select a rural area. We also recommended that GSA define rural area until Congress amended RDA to define the term. Subsequent to our report, GSA took action on our recommendations; actions which are described in greater detail below.

Policies to Consider RDA Have Been Strengthened but Procedures are Still Lacking

The Fiscal Year 2002 Treasury and General Government Appropriations Act, Public Law 107-67, required the inspectors general (IG) of departments and agencies to submit to the appropriations committees a report detailing what policies and procedures are in place requiring them to give first priority to the location of new offices and other facilities in rural areas, as directed by RDA. These reports were due in May 2002. A similar requirement was included in the Consolidated Appropriations Resolution for Fiscal Year 2003, Public Law 108-7. However, because the IGs had until August 20, 2003, to report on this, we did not have the opportunity to review those reports required by Public Law 108-7 for this testimony.

GSA's May 2, 2002, response to the Public Law 107-67 requirement described the policies that GSA had in place to give first priority to the location of new offices and other facilities in rural areas, as well as what actions GSA had taken in response to our July 2001 recommendations. GSA took the following actions:

- The Federal Management Regulation, section 102-83.30, was revised to require federal agencies to also consider real estate, labor, and other operational costs and applicable incentives in addition to mission and program requirements when locating space, effective December 13, 2002.
- The Public Buildings Service Customer Guide to Real Property was revised to require agencies to provide GSA with a written statement affirming that they have given first priority to locating in a rural area as required by RDA when requesting space from GSA.
- The Federal Management Regulation, section 102-83.55, effective December 13, 2002, was revised to define "rural area" as a city, town, or unincorporated area that has a population of 50,000 inhabitants or fewer, other than an urban area immediately adjacent to a city, town, or unincorporated area that has a population in excess of 50,000 inhabitants.[6]
- GSA published a recommendation in the *Federal Register* on January 21, 2003, that federal agencies with their own statutory authority to acquire real property use the above definition of rural area and demonstrate

[6]We noted in our 2001 report that the definition of "rural area" in RDA was unclear. In 2002, the RDA definition was repealed in its entirety, and currently there is no statutory definition of rural area in RDA. In 1972, RDA defined rural as any area in a city or town with a population less than 10,000 inhabitants.

compliance with RDA by including a written statement in their files affirming that they have given first priority to the location of new offices and other federal facilities in rural areas.

These actions responded to all of our July 2001 recommendations with the exception of one. We had recommended that GSA require agencies, when selecting a new facility location, to provide a written statement that they had given first priority to locating in a rural area. If a rural area was not selected, agencies were to provide a justification for the decision. GSA's new guidance does not require agencies not selecting a rural area to justify their decision.

We also reviewed the IG reports detailing the policies and procedures in place regarding giving first priority to rural areas as required by Public Law 107-67 for the Departments of Energy, the Interior, Justice, Transportation, and Veterans Affairs. According to GSA data,[7] these agencies, along with the Department of Defense and the United States Postal Service, have the largest amount of owned and leased building square footage in the federal government. We excluded sites acquired by the Defense Department because it has so much vacant space available at its bases nationally that it has no choice but to give priority consideration to its existing vacant space when locating new or existing operations. We excluded Postal Service sites because the Postal Service advised us it had little or no discretion in deciding where to locate most of its facilities in that they needed to be in specific locations to serve customers or near airports. In addition, the Postal Service is exempt from federal laws relating to contracts and property and it has authority to acquire space independently of GSA.

The IG reports for the five departments said that only two departments had written policies regarding RDA, and only one of these two had issued procedures. However, the departments said that in spite of not having written policies or procedures, they had located many of their facilities in rural areas.

The Energy IG reported that Energy had no specific policies or procedures, but it reported that a preponderance of the department's activities are located in remote parts of the United States.

[7]U.S. General Services Administration, *Federal Real Property Profile, as of September 30, 2002* (Washington, D.C., 2002).

The Interior IG reported that Department of the Interior and the U.S. Geological Survey, 1 of 35 bureaus and offices in the Department of the Interior, had policies regarding RDA. However, neither the department nor any of the bureaus and offices had procedures to ensure compliance with the policies. The IG reported that of the 270 locations established in the last 5 years, 197 (73 percent) were located in rural areas. The IG said that the decision to place facilities in rural areas was influenced by Interior's mission rather than by the requirements of RDA.

The Justice IG said Justice had no specific policy or procedures on RDA, but department bureaus, offices, boards, and divisions were instructed to implement all applicable federal regulations. The Justice IG cited the GSA regulation requiring agencies to give first priority to the location of new offices and other facilities in rural areas. The IG said it relies upon GSA for most of its space needs, and GSA is responsible for compliance with RDA. Further, the IG said the locations of its facilities are ultimately determined by mission and operational requirements, which predominantly require locations in major metropolitan areas. For example, U.S. Attorneys Offices and the U.S. Marshals Service need to be located near federal courthouses to accomplish their missions. The Bureau of Prisons is located in rural areas to decrease land costs and increase security. The Immigration and Naturalization Service[8] is stationed in both urban and rural areas along the borders of the United States. The Federal Bureau of Investigation and the Drug Enforcement Administration are law enforcement agencies, and their missions and operational requirements determine the location of facilities. The IG also pointed out that the Federal Bureau of Investigation's data center is located in a rural part of West Virginia.

The Department of Transportation policy on RDA was the most complete of the agencies we reviewed in that Transportation has procedures that require a discussion of the considerations given to rural areas and requires an explanation if a rural location is not selected. However, the Transportation IG said the department does not provide any guidance on decision criteria or factors to be considered, such as cost-benefit analysis, access to public transportation, or effects of relocation on the workforce. Of 33 site location decisions made from October 1997 through February

[8]The Justice Inspector General report is dated July 30, 2002. Since the report was issued, part of the Immigration and Naturalization Service is now in the Department of Homeland Security.

2002, the Transportation IG found that 24 had no documentation in the files to indicate compliance with RDA.

According to the Veterans Affairs IG, the department had no written policy or procedures regarding RDA. The IG said priority is given to locating new Veterans Health Administration medical care facilities in locations convenient to veteran patients and to collocating Veterans Benefits Administration regional offices on Veterans Affairs medical center grounds.

Federal Telework Efforts are Improving but Limited

Telework could be used to allow federal workers who live in rural areas to work in or near their homes, at least on a part-time basis. For over a decade, telework, also called telecommuting or flexiplace, has gained popularity because it offers the potential to benefit employers, including the federal government, by reducing traffic congestion and pollution, improving the recruitment and retention of employees, increasing productivity, and reducing the need for office space. Employees can benefit from reduced commuting time; lower costs for transportation, parking, food, and clothing; and a better balance of work and family demands, which could improve morale and quality of life. Other benefits might include removing barriers for those with disabilities who want to be part of the work force and helping agencies maintain continuity of operations in emergency operations.

Congress has enacted legislation that has promoted the use of telework in several ways, including authorizing GSA telework centers, requiring each agency to consider using alternate workplace arrangements when considering whether to acquire space for use by employees, requiring each agency to establish a policy under which eligible employees may participate in telecommuting to the maximum extent possible, and encouraging the deployment of high-speed Internet access in rural areas. Congress has provided both GSA and OPM with lead roles and shared responsibilities for advancing telework in the federal government.

Under the telework centers program, GSA supports 15 centers located in the Washington, D.C., metropolitan area. These centers make alternative office environments available to federal employees to perform their work at a site closer to their homes.

According to a recent OPM report,[9] federal agencies reported in November 2002 that about 90,000 employees, or about 5 percent of the workforce, were teleworking, compared with about 74,500, or 4.2 percent, reported in 2001. OPM reported that about 625,300 employees, or 35 percent of the federal workforce, were eligible to telework in 2002, and 68.5 percent of the total eligible federal workforce had been offered the opportunity to telework. In 2002, 14.4 percent of eligible employees teleworked. OPM reported that the rise in the number of teleworkers was due to a number of factors, including intensified efforts by agencies to encourage telework and a decline in management resistance to telework after training and education efforts. OPM did not report on the number of federal workers who resided in rural areas who were able to telework. We did not verify the accuracy of the OPM data.

OPM reported a change in the ranking of major barriers to telework from an April 2001 survey of agencies to the November 2002 survey. As shown in table 2, security became the main barrier in 2002, replacing management resistance, which had been the main barrier in 2001.

Table 2: Ranking of Major Barriers to Telework

April 2001 Barriers	November 2002 Barriers
Management resistance	Data security
Funding	Information technology issues
Employee resistance/concerns	Funding
Information technology issues	Employee resistance/concerns
Data security	Management resistance

Source: OPM.

In July 2003 we reported on the federal government's progress in implementing telework programs. We found that although OPM and GSA offer services and resources to encourage telework in the government, they have not fully coordinated their efforts and have had difficulty in resolving their conflicting views on telework-related matters. As a result, agencies have not always received consistent, inclusive, unambiguous support and guidance related to telework. We recommended that OPM and GSA improve the coordination of their efforts to provide federal agencies with enhanced support and guidance related to telework and to assist

[9]U.S. Office of Personnel Management, *Report to the Congress: The Status of Telework in the Federal Government* (Washington, D.C.: Jan. 2003).

agencies in implementing 25 key practices we identified. After we discussed the issues created by the lack of coordination between GSA and OPM, a GSA official indicated that GSA and OPM would commit to improved coordination. The 25 key practices we identified by reviewing telework-related literature and guidelines that federal agencies should implement in developing telework programs are listed in table 3.

Table 3: Key Telework Practices for Implementing Successful Federal Telework Programs

Program	Telework practices
Program planning	• Designate a telework coordinator • Establish a cross-functional project team, including, for example, information technology (IT), union representatives, and other stakeholders • Establish measurable telework program goals • Develop an implementation plan for the telework program • Develop a business case for implementing a telework program • Provide funding to meet the needs of the telework program • Establish a pilot program
Telework policy	• Establish an agencywide telework policy • Establish eligibility criteria to ensure that teleworkers are selected on an equitable basis using such criteria as suitability of tasks and employee performance • Establish policies or requirements to facilitate communication among teleworkers, managers, and coworkers • Develop a telework agreement for use between teleworkers and their managers • Develop guidelines on workplace health and safety issues to ensure that teleworkers have safe and adequate places to work off-site
Performance management	• Ensure that the same performance standards, derived from a modern, effective, credible, and validated performance system, are used to evaluate both teleworkers and nonteleworkers • Establish guidelines to minimize adverse impact on nonteleworkers before employees begin working at alternate work sites
Managerial support	• Obtain support from top management for a telework program • Address managerial resistance to telework
Training and publicizing	• Train all involved, including, at a minimum, managers and teleworkers • Inform workforce about the telework program
Technology	• Conduct assessment of teleworker and organization technology needs • Develop guidelines about whether the organization or employee will provide necessary technology, equipment, and supplies for telework • Provide technical support for teleworkers • Address access and security issues related to telework • Establish standards for equipment in the telework environment

Program	Telework practices
Program evaluation	• Establish processes, procedures, and/or a tracking system to collect data to evaluate the telework program • Identify problems and/or issues with the telework program and make appropriate adjustments

Source: GAO analysis of telework-related literature and guidelines.

We found that the four agencies we reviewed for that report, the Departments of Education and Veterans Affairs, GSA, and OPM, had implemented 7 of the 25 practices and had generally implemented the 5 practices relating to technology. Nevertheless, technological issues, such as not being able to access to high-speed Internet connections, could have a detrimental effect on the ability of some federal workers in rural areas to take advantage of telework.

CRS reported this year on the ability of users to take advantage of high-speed, or broadband, Internet access. CRS reported that although many, but not all, offices and businesses now have Internet broadband access, a remaining challenge is providing broadband over "the last mile" to consumers in their homes. Congress has required the Federal Communications Commission (FCC) to determine whether advanced telecommunications capability is being deployed to all Americans in a reasonable and timely fashion and, if not, to take immediate action to accelerate deployment by removing barriers to infrastructure investment and by promoting competition in the telecommunications market.[10]

In August 2000, FCC concluded that advanced telecommunications capability was being deployed in a reasonable and timely fashion overall, although rural, minority, low-income, inner city, tribal, and U.S. territory consumers were particularly vulnerable to not receiving service in a timely fashion. In February 2002, FCC concluded that the deployment of advanced telecommunications capability to all Americans was reasonable and timely and investment in infrastructure for most markets remained strong, even though the pace of investment trends had slowed. According to CRS, about 85 percent of households have access to broadband.

CRS also reported that the President's Council of Advisors on Science and Technology concluded in December 2002 that although government should not intervene in the telecommunications marketplace, it should apply existing policies and promote government broadband applications

[10] 47 U.S.C. 157 note.

and telework, among other actions. CRS also noted that much broadband legislation introduced in the 107th Congress sought to provide tax credits, grants, and/or loans for broadband deployment, primarily in rural and/or low income areas. It also noted that Public Law 107-171, the Farm Security and Rural Investment Act of 2002, authorized a loan and loan guarantee program to entities for facilities and equipment providing broadband service in eligible rural communities. The purpose of this legislation is to accelerate broadband deployment in rural areas.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

Contacts and Acknowledgments

For further information on this testimony, please contact Bernard L. Ungar on (202) 512-2834 or at ungarb@gao.gov. Key contributions to this testimony were made by John Baldwin, Frederick Lyles, Susan Michal-Smith, and Bill Dowdal.

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ATTRACTING ECONOMIC GROWTH IN RURAL AMERICA
September 4, 2003
DAVID FRESHWATER

Mr. Chairman and Members of the Committee, thank-you for the opportunity to testify before the Committee this morning. My name is David Freshwater and I am a professor in the Department of Agricultural Economics at the University of Kentucky, where I teach and conduct research in the area of rural economic development. Much of my work deals with how public policy affects economic development opportunities in the United States and in other industrialized countries. Most of what I learned about policy formation comes from the time I spent in Washington working as a staff member for the Senate Agriculture Committee and the Joint Economic Committee. I have also been employed as a consultant on rural policy by the Organization for Economic Cooperation and Development (OECD), The World Bank, and by government agencies in the United States and Canada. For five years I managed a research center that was a cooperative effort between the Tennessee Valley Authority and the College of Agriculture at the University of Kentucky that looked at ways to enhance economic development opportunities in rural areas of the Southeastern United States.

This is an important hearing because the Small Business Committee deals with firms that play an especially important role in rural areas. Small businesses are important to rural America for the same reasons they play a crucial role in the national economy. But in addition to their broad national value, small firms better fit rural conditions in terms of: matching demands for labor with the available quantity, having a stronger sense of attachment to the local community, requiring loans of a size that local intermediaries can finance, and providing opportunities for additional forward and backward linkages.

My testimony makes three major points that I will be happy to expand upon as questions arise. These are:

1. Manufacturing is crucial to most nonmetropolitan counties east of the Mississippi, but these counties are facing limited success with their old development model. Much of rural manufacturing, especially in the South, relied upon recruiting branch plants of domestic firms from larger urban centers. The advantages of the rural South were largely cost related, and now foreign locations offer even lower costs that cannot be matched. While branch plants of foreign firms that require a U.S. location are already a significant source of employment, notably the Japanese auto firms, it is important that more attention be paid to increasing the relative role of small firms in rural areas.

2. Small business faces some important impediments in rural areas that are not as common either for small businesses in urban centers, or for large branch plants. This means that it is important the SBA and other federal and state agencies that try to promote small business recognize the distinct features of rural America if their programs are to be truly effective. These differences include:

- a high proportion of low-skill workers, and related to this, often a relative lack of workers with specific types of advanced skills,
- difficulty in gaining access to markets outside the community for products and in developing supply chains because physical distance and low density of economic activity are defining features of rural places,
- a strong sense of tradition and history in rural communities that can make it difficult for them to accept different ways of doing things, and,
- more limited financial markets, both in terms of the types of instruments that are available and the number of firms providing those instruments.

3. Federal policy plays a critical role in influencing the competitive position of rural America both relative to urban America and to foreign places. In many ways rural America is in an awkward position. It is both the least developed part of the industrialized portion of the global economy and the most developed part of the developing portion of that economy. Federal policies influence its ability to compete in both directions. For example, electricity deregulation promises to equalize electricity rates across the nation, but the low rates available under the old regulatory structure offered a competitive advantage for many rural areas. Similarly opening U.S. markets to developing countries offers consumers access to lower priced goods as well as higher levels of income for the developing world, but it has led to the loss of manufacturing jobs in rural America.

These policy changes may be beneficial to the nation as a whole and to most Americans, but we should not ignore the fact that there are losers in every policy change. It is in the national interest to help those people who are disadvantaged by change return to a productive state. In this regard the SBA has played an important role in rural areas, but there is room for improvement. When Senator Abdnor was the Administrator of SBA in the late 1980s he tried to expand the rural mission of the agency. While some of his legacy remains, there is much more that could be done.

We all know that there is far more to rural America than farming, but USDA is the only agency that has a clear rural mission. We also know that what gets measured is what gets done. If this Committee used its oversight and authorizing capacity to encourage SBA to play a larger role in rural America, then additional support would be available to the small businesses and potential entrepreneurs that are being relied upon to improve incomes and the quality of life in small towns across the nation.

I would like to thank you for this opportunity to testify and I ask that my entire statement be entered into the record.

Statement of David Freshwater Before The Committee On Small Business

Attracting Economic Growth In Rural America
September 4, 2003

While farming continues to be the major land use in rural America far more people earn their income from occupations other than farming than in agriculture or even all the natural resource based activities together (mining, forestry, fishing and farming). This means that economic opportunity in rural areas is mainly a function of the level of employment in the manufacturing and services sectors. In this regard rural America is not much different than urban America, except that the relative role of manufacturing is larger in rural America.

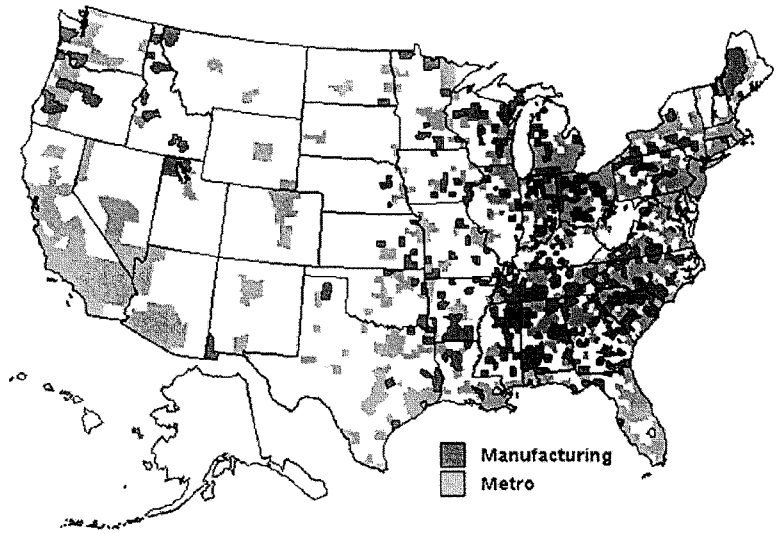
For the last few decades the overall role of manufacturing has declined in the United States as the nation has moved into what has been termed the "post-industrial economy." During the 1990s during the height of the Information Technology boom it was often said that manufacturing was no longer important to the United States because growth in computer software, telecommunications and all the related service sectors was so strong that they would provide the economic base for the future. Yet in the last few years we have returned to worrying about levels of manufacturing output and employment as key indicators of economic recovery. In July the Wall Street Journal printed a column with the title "Why Manufacturing Won't Die" (Ansberry, 2003). In it the writer argued that while the nature of manufacturing would continue to change, it would remain a significant source of income and employment. This suggests that manufacturing still plays a crucial role in the national economy, and I will argue an even more important one in rural America.

Current Conditions For Rural Manufacturing

USDA has documented the importance of manufacturing in nonmetropolitan areas, showing that manufacturing dependent counties comprise the second largest category within the Economic Research Service typology after farming dependent. These counties are largely found in the eastern half of the nation in the Midwestern and central Southern states. In addition manufacturing is extremely important in the ring of counties that surround major urban centers. While these counties are counted as part of metropolitan areas, they typically have large amounts of rural land with numerous small towns, and are more like neighboring nonmetropolitan counties than urban centers.

In the rural South, and to a lesser degree the rural Midwest, manufacturing has been driven by a conscious decision to diversify the economy beyond farming. In the South industrial recruitment brought plants primarily from urban areas in the Northeast and Midwest. By contrast, in the Midwest although recruitment has been important in the last few decades, much of the manufacturing base in rural areas comes from local firms.

Nonmetro manufacturing-dependent counties, 1989*



*Counties with 30 percent or more labor and proprietors' income from manufacturing, 1987-89 annualized average.
Source: Economic Research Service, USDA.

What attracted all this manufacturing from urban places to remote rural locations? Five factors account for much of the success in rural industrial recruitment in the post World War II era. They were:

- cheap labor
- cheap power
- cheap land
- financial incentives
- few regulations

In recent years these have become less powerful means for bringing new firms to the rural areas. The rural labor force is no longer cheap by foreign standards and much of the manufacturing activity that has left the United States left rural areas because it could find workers with the same level of skills who would work for far less in developing countries. Because rural workers have lagged behind in building their level of education and skill, they have been particularly susceptible to the same cost-saving measures that brought the firms to rural America in the first place.

Surviving manufactures in the United States link sophisticated technology with skilled workers in ways that result in high levels of productivity. Unfortunately, many rural areas lack the core group of skilled workers that is essential to attract this type of firm. In addition the rural areas where formal education levels have long been weak are ill prepared to develop this type of worker because the training cycle becomes long and expensive. As a result a crucial issue for rural areas that have lost manufacturing is what do you do with that portion of the work force that is thirty to fifty years old, but has a low level of education. They are typically not good candidates for retraining, they are relatively immobile, but they are too numerous and too young to abandon to public assistance.

Cheap power, especially electricity, was a major factor in bringing manufacturing to the rural South. The Tennessee Valley Authority implemented a major economic development program based upon power from dams originally designed for flood and erosion control. Other power companies, including investor-owned firms, cooperatives and municipal systems adopted similar strategies. Indeed it is likely that the largest single group of economic development professionals in the rural South in the 1980s were employees of power companies. Electricity deregulation, even in states where it is still not endorsed, has changed this situation. The main premise of deregulation is that power should move from low cost areas to higher cost ones, thereby equalizing rates; rather than firms moving to cheaper power. Because large power users now have the ability to choose an electricity supplier there is little incentive for any utility to engage in economic development efforts. Why undertake the expense to bring a company to your region, if they can purchase power from someone else? Thus a clear consequence of deregulation has been both a reduction in the ability of rural areas to attract industry, and perhaps more importantly a major decrease in the number of professionals engaged in local economic development activity.

Cheap land in rural America has similarly lost much of its appeal. One of the early beliefs of the rise in modern telecommunications was that location would become less important because proximity was less important. This has been less true than was initially thought (Kelko, 1999). Some areas in rural America, those with high amenities, seem to have prospered from the ability of some professionals to choose a more remote place to live and conduct business. However, for many industries in both the manufacturing and service sectors, location is still important. Much of the literature on clusters is not very applicable to many rural places because they are too small to support a linked complex of firms. In addition the increased use of "just-in-time" manufacturing places a premium on proximity to interstate highways and the end assembly firm. Just as importantly, for those firms where location is not important, off-shore locations can become more attractive than rural America.

Financial inducements have now been adopted by all states and virtually all local governments. Rather than being a factor that works to specific places advantage they are now an integral part of the cost of doing business. Consequently rural areas now have to compete with suburban areas that often have more money

available to attract firms. As financial inducements have become more common, efforts to recruit firms have been likened to a buffalo hunt. More hunters are shooting at a smaller herd and most are disappointed. Yet choosing to abandon the hunt implies that the community will have to find an alternative source of meat, which may not be so easy.

The last factor relied upon in the past was limited regulation. While regulatory burdens are still lower in rural areas, the magnitude of the gap between rural and urban places is less than it used to be. Federal and state regulations now impose fairly uniform standards on companies irrespective of where they locate. More importantly the cost to a firm from being described as a polluter or an exploiter of labor can be significant in terms of lost sales and public image. Further local residents are less willing to market their community as a pollution haven than in the past.

To a considerable extent the reduction in rural manufacturing that has taken place over the last ten years reflects the decline of these primary factors that gave rural America, particularly in the South, its competitive advantage. In addition as manufacturing declined in urban areas, there was an inevitable decrease in the number of urban manufacturing firms looking for a rural location. As a result, the future of manufacturing in rural America has been questioned. There is a clear concern that job losses in the current recession will not be offset by job gains when recovery takes place because there will be fewer manufacturing jobs in the United States and the greater benefits of an off-shore location will lead to firms skipping the stage where they locate in rural America.

It is important to recognize that this story concerns only one aspect of U.S. manufacturing, branch plants of domestic firms engaged in the production of standardized commodities using a production system that employs largely low-skill workers. These are the textile and shoe plants and consumer good assembly plants that are now hard to find anywhere in the United States.

There are however other types of manufacturing that have not experienced the same magnitude of decline and in some cases are growing. If branch plants are considered, the decline in the number of U.S. branch plants in rural areas has been offset by increases in the number of subsidiaries of foreign companies. The Japanese auto industry is the most obvious example. Japanese auto manufacturers have chosen primarily rural areas for their assembly and major component plants. The supplier firms for the Japanese auto firms are almost always found in rural places. Not only has this been a rapidly expanding industry, it has been one where the quality of jobs is far better than most of those lost to developing countries.

A colleague of mine has argued that the primary benefit of Toyota coming to Kentucky was not the direct income and jobs it created, but the fact that it changed the attitude of many young people in the state. Whereas U.S. branch plants had largely ignored formal education, Toyota would only take applications

from people with a high school diploma, and having some post-secondary education increased the chances of employment. As a result, potential high school drop-outs saw a real opportunity cost if they left school early.

Another source of employment that is small today, but has significant growth potential, is the creation of branch plant operations by firms from the more advanced developing countries. As their sales to North America increase, the same logic that led U.S. firms to introduce branch plants in Europe will lead to subsidiaries in the U.S. At some point it is cheaper to conduct assembly and distribution functions closer to the market. We are already seeing the first of the subsidiaries from developing countries locate in rural America. One would expect that if Homeland Security increases the delays in shipping goods into the United States there will be a fairly rapid response to move production inside the security wall. The United States is too large and wealthy a market for others to abandon. A number of countries, including, Brazil, China, Korea, and India for example, have now developed advanced technologies and invested extensively in research and development. This is leading to the capacity to export to other nations and it suggests that a new round of branch plants can have a future in rural areas.

The other clear opportunity lies with small business. The literature arguing that small business has been the source of most innovation and job creation in the last two decades is extensive and well known. Small business has clear benefits for smaller places. Most notably the labor, infrastructure and capital requirements of small business are of the same scale as is available in a rural community. This makes it far easier to support a local economy based upon small business than a large branch plant. In addition if a local economy is made upon a number of small firms then the failure of a few firms has limited impact on the community.

However small firms in rural areas can face the same challenge of a poorly prepared work force. To the extent that small firms produce goods that can be imported they too face potential competition. While small firms rarely relocate to another country to control their labor costs, they do shut down. And unlike larger firms, small firms can have problems in providing training for workers or making investments in better technology. Analysis conducted for SBA shows that small firms employ a disproportionate number of low skill workers and that rural small firms have the highest share of these workers. Assuming skill levels are related to wage levels, some 66% of all minimum wage workers are found in firms with less than 500 employees (Loof and Associates, 1999, p. viii). If we look at differences between metropolitan and nonmetropolitan areas, 16% of workers in nonmetro areas work in firms with less than 100 employees and earn less than $6.16 per hour ($12,300 per year) compared to a rate of 10% for workers in metropolitan areas (Loof and Associates, 1999, Tables 3.17 and 3.18). Thus we should expect small firms to face much of the same cost pressures from foreign competition as have plagued larger firms in rural America.

Smaller, locally owned manufacturing firms have played a central role in local economic development in the rural Midwest for decades. These firms have been

successful when they have been able to adapt new technologies to their production methods and to develop new markets. For many of these firms new computer technologies have led to increased efficiency and the Internet has opened up new marketing and procurement opportunities. The recent USDA survey of manufacturers found that many small firms believed that new technologies could play a key role in enhancing their competitiveness. However many of these small firms lack the time and skills to analyze how to introduce potential innovations. For a small firm there are often too few resources to be able to divert people and energy from day to day problems.

The Future of Rural Manufacturing

Manufacturing in rural America is at a crossroads. The past reliance on low wage, low skill domestic branch plants that created tens of thousands of jobs and facilitated the outward movement of labor from farming has come to an end. In the process it has created great hardship for many families and made many rural communities much poorer. The burden of this transformation has fallen largely on middle-aged workers with limited skills. For these people relocation to another place is a difficult task. They have few skills that are in demand in the modern economy, they lack the financial means and contacts top move to another place and their age presents a significant barrier for retraining. If they stay in their current community they create a local burden as they slip into public assistance.

Both the large number of jobs lost as domestic branch plants have closed and the clear plight of their former employers has left the impression that rural manufacturing is no longer a viable economic activity. Yet at the same time there is evidence of manufacturing expansion in other forms. Foreign branch plants and many smaller domestic manufacturing firms continue to provide manufacturing jobs in rural America. However these new branch plants typically demand higher skill workers. While it is true that the old domestic operations are not going to return, the crucial policy questions now involve how to enhance those types of manufacturing that do have a future.

By their nature rural areas are highly exposed to change. While rural people are widely seen as conservative and as embracing tradition, their economic history shows continuous change in response to outside forces. Rural areas have always had to export to survive and the products they have sold have changed as technology, tastes and competition evolved. Even when domestic branch plants were pervasive in the 1960 s and 1970s , individual communities still experienced shocks as specific firms closed and had to be replaced by another type of industry. In the larger history of rural America the recent decline of manufacturing is analogous to other major boom and bust cyclic changes such as the timber boom of the upper Midwest, periods of high farm prices in the early twentieth century and various mineral booms (Morrison, Commager and Leuchtenburg, 1980).

For rural areas four driving forces have led to most of the major changes and they continue to influence patterns of development. They are global trade effects, technological change, transportation costs and national policy. Periods of trade liberalization open markets for some rural products and expose other rural products to competition. This has been true for resource base activities like agriculture minerals and forestry since colonial times. Rural manufacturing benefited from the dominance of the U.S. economy in post- World War II period as countries rebuilt their domestic markets with the support of the United States Now the open trade system that America encouraged has led to an expanded manufacturing capacity in both the developed and developing world. As a result the open border policies that facilitate the export of airplanes, films, financial services and software result in imports of textiles, toys and small manufactured items here. Since urban areas account for much of the production of the things America is most competitive in and rural areas account for a large share of the things we are less competitive in the benefits and costs of this policy are not distributed uniformly across the population.

Technological change has always played major role in rural America. Farming notably has increased output and reduced labor as a result of technological innovations. A similar process has taken place in mining and forestry. The remaining jobs in these industries typically link a few skilled individuals to sophisticated equipment to produce large quantities of output. In the process unskilled labor had to find a new occupation. The shifts in manufacturing are largely following this model. Because technology is now advancing at a much faster rate, the process of change is also much faster in manufacturing than it was with other rural industries so the dislocation effects are more visible. It is important to note that these industries did not disappear. Although they now account for a smaller share of GDP then in the past, the absolute value of their output has increased and the average level of wealth and income of those still employed is higher.

Those manufacturing firms that have prospered in rural areas have tended to be able to introduce new technologies that offset the higher cost of operating in the United States relative to developing nations. Thus embracing technological change has been an important survival strategy. However small rural businesses have difficulty both in identifying technological changes and in determining which changes are appropriate for them. These firms are typically a long way from where new technology is introduced and do not have ready access to peers that may have tried to implement new approaches. In some states manufacturing extension services, or other forms of technical assistance provide support, as does the Commerce department through the NIST state based Manufacturing Extension Partnership, but more outreach would help improve the competitiveness of rural firms.

Steady declines in transport costs, including the cost of identifying and contacting customers and suppliers has been a major factor in the globalization of the economy. If transport costs are high then more production has to take place

close to markets. At present the principal impediments to transport are higher security barriers designed to deter terrorism. It is still too early to determine the impact on firm location decisions but they could be significant. The Internet has greatly increased the ability to coordinate activities over long distances, which favors large firms and to have a presence anywhere in the world which favors small firms. In the process some rural businesses have been helped, notably specialty manufacturers and rural tourism and other hurt, small bookstores and sporting goods stores. It is clear that the full implications of the technology introduced in the last decade have yet to be felt and we know technology continues to evolve. Providing support to rural small business similar to the support provided to farmers could be a powerful way to stimulate local development.

Changes in government policy have great influence on the competitive position of rural America. The direct influence of policy, such as the Farm Bill is well understood. But the indirect influence of policies that are not focused on rural areas is less appreciated, even though these can have much larger effects. The impact of electricity deregulation has already been discussed. In a similar vein there is some evidence that rural areas were not aided by deregulation of the banking sector (Glover, 1999, pp. 174-180), nor by airline deregulation. There is also a considerable body of evidence that differences in federal payments for health care between rural and urban areas impose burdens on rural doctors and hospitals.

Certainly national policies cannot be designed to benefit all equally, and the primary criterion must always be whether the broad national interest is being served. However it is important that those who lose in the process believe that they are still important. This is more than a basic social equity issue, because it also involves wasted resources. If we do not find creative ways to reemploy the low-skill, middle aged workers displaced when their firms closed we not only face social problems but we give up any contribution they can make to national output.

Conclusions

Rural development has been a thorny issue from the time of the Country Life Commission in the early 1900s. There have been no "silver bullets" found that lead to wide spread increases in development and it is unlikely that they will ever exist. Yet it is important to keep reflecting upon the problems and trying to make rural life better. We have made clear progress since the 1960s in modernizing the rural economy and in reducing rates of poverty.

I believe that the federal role can be enhanced by following three simple strategies. Continue to emphasize formal education. If rural areas are to improve it will have to be by enhancing the productivity of the people who live there. Even if these people eventually leave for urban areas, the nation as a whole benefits

because they come with far better skills. This to me is the most compelling argument for a national role in K-12 education.

When public policy changes think about the impact on rural areas. The change may be desirable in terms of aggregate gains, but some form of compensation may be appropriate for those who lose. Rural areas are too easy to forget because they are not well organized and are not very visible from the highway or airplane. This compensation should not be thought of as public aid, but as an investment in adapting to change. It should not be an entitlement but it should provide enough resources to allow change to take place.

Finally within the jurisdiction of the Committee, encourage the SBA to find innovative ways to deliver their programs in rural areas. For example, in Kentucky the Small Business Development Centers have a statewide agreement with Cooperative Extension to cross-refer clients and to coordinate their assistance to people and firms that are engaged in food processing and other businesses that might otherwise fall between the cracks. This is an inexpensive action but it links two programs that otherwise often fail to communicate. The most recent list of SBA advocacy activity in rural areas largely describes interventions in Washington politics and on data collection but they appear to be largely reactive (Office of Advocacy, 2001). Advocates should be leading the charge not reacting to the ideas of others.

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