

Do Government Subsidies Encourage Rural Development?

2007 Risk and Profit Conference and Trade Show

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Why Study this Topic?

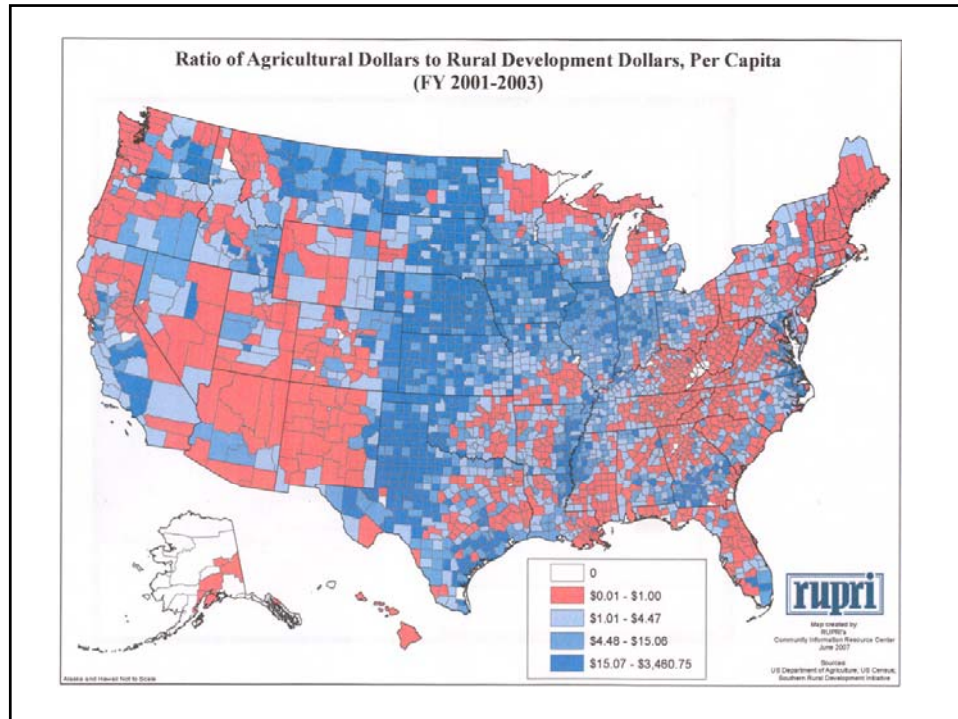
- 2002 Farm Bill had an extensive Rural Development Title
 - Rural Utilities
 - Rural Housing
 - Value Added Producer Programs
 - In 2007, fiscal outlays were about \$800 million.
- 2007 Farm Bill is expected to increase these programs
- Research suggests little correlation between government payments to farmers and rural development

Why Study Rural?

- Rural poverty in the U.S. declined since the 1920s
 - Noted economist Bruce Gardner argues that rural poverty is a function of labor markets rather than access to productivity improvements. Improving crop yields, improving export markets, etc. (all of which are funded by policy makers through USDA programs and land grant universities) are important but the research suggests that opportunities for labor to move to higher paying jobs in non-production agriculture regions has had the greatest impact on reducing rural poverty.
- Persistent pockets of poverty exist in rural U.S.
 - Areas where education is poor, hired labor (migrant labor) has “settled”, and special circumstances (i.e., Indian reservations, etc.) exist
 - Alabama, Georgia, Kentucky, Louisiana, New Mexico, Mississippi, and Texas
- Government has poured billions of dollars into farm subsidy payments and rural development programs
 - Yet outward migration of people continues
 - Research has found no plausible link between farm payments and increased rural economic activity

These Programs are Heavily Criticized

- USDA Business and Industry Guaranteed Loan Program (e.g., value added cooperatives, etc.) spent \$766 million in 2006
 - 14,837 jobs (\$51,648 per job)
- USDA Renewable Energy Program spent \$24.2 million
 - 170 jobs (\$142,000 per job)
- Rural development monies from USDA were 21.8 percent of farm payment monies in Kansas; the 2nd lowest in the U.S. behind Nebraska. Iowa received more than twice as much money for rural development as a percentage of farm payments as Kansas.



Objective

- My objective today is to present some information on this topic
- Cause and effect issue
 - There is no research to show what the effect of a certain value-added program is on rural development
 - Many different programs
 - Lots of case studies and anecdotal evidence
 - We know poverty exists and we can measure where it exists
 - Research in progress

My bias

- My bias is that Gardner's argument makes sense about labor markets. If true, consider the following scenarios
 - Value-added plants are built in a rural area through government programs. Employment happens but what if the underlying business proposition is not sound?
 - Grants encourage the development of "natural" beef and other meat products for a steak demand. What happens when the rest of the carcass cannot be sold for a profit?
- What happens when these are not based on a sound business proposition?
 - Effect on local businesses (multiplier)
 - Effect on producer equity invested (on-farm assets)
 - Effect on lender asset portfolio

Things to think about

- What happens when the government underwrites or guarantees loans in value-added?
 - Think about S&L, student loans, etc.
- What happens when taxpayers subsidize the business development process for ethanol plants that are already guaranteed to make money from other subsidies?
 - Think about service industries, crowding out, etc.
- We will come back to this at the end

2004 Rural Economy is Diverse

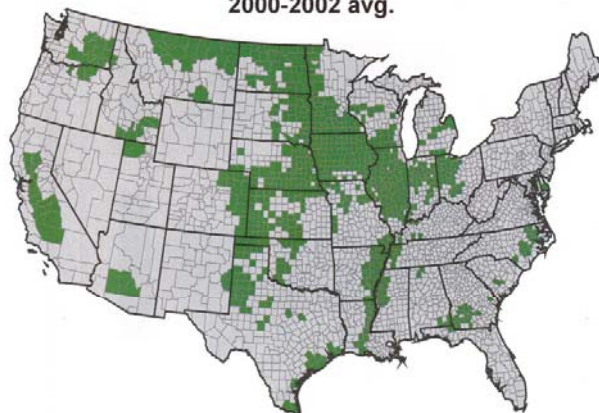


Source: U.S. Department of Commerce Bureau of Economic Analysis

Evidence for Gardner's Argument

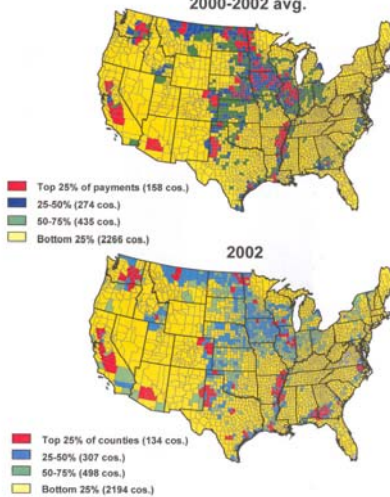
- **Earnings Gap**
 - Average earnings for non-farm jobs were almost \$18,000 less in non metro counties relative to metro counties
- **Per Capita Income Gap**
 - Relative income in these same counties was 72% of that in metro counties
- **Educational Attainment Gap**
 - Metro counties have more people with education beyond high school than non metro counties

Figure 1
Top 25% of Counties Receiving Farm Payments
2000-2002 avg.



Source: Bureau of Economic Analysis, REIS

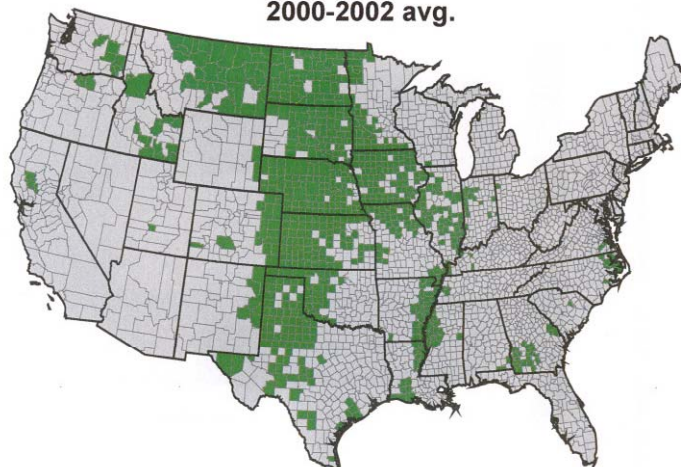
Figure 2
Farm Payments Distribution
2000-2002 avg.



Source: Bureau of Economic Analysis, REIS

Figure 3
Top 25% of Counties Dependent on Farm Payments

2000-2002 avg.



*Note: Dependency determined by Farm Payments as share of Personal Income, 2000-2002 average
Source: Bureau of Economic Analysis, REIS

Figure 4
Employment Growth in
Top 25% of Counties Dependent on Farm Payments
Employment Growth, 1992-2002

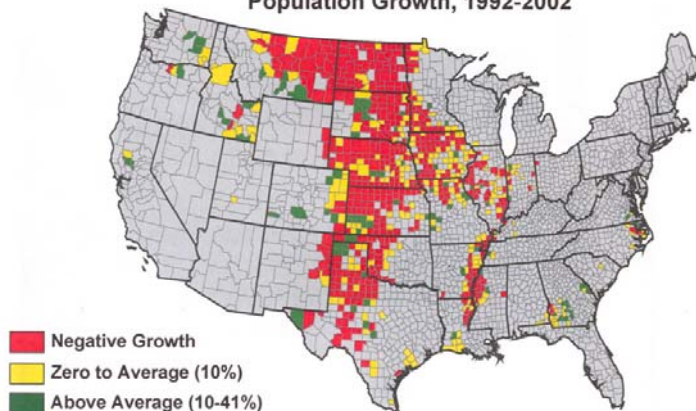


- Negative Growth
- Zero to Average (19%)
- Above Average (19-463%)

*Note: Dependency determined by Farm Payments as share of Personal Income, 2000-2002 average
Source: Bureau of Economic Analysis, REIS

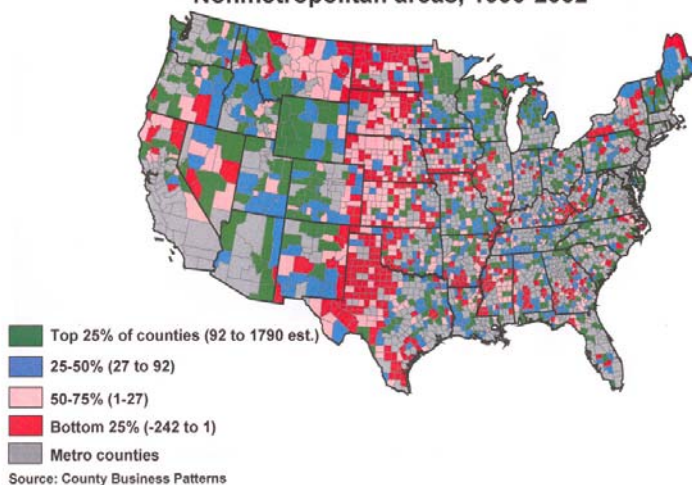
Figure 5
Population Growth in
Top 25% of Counties Dependent on Farm Payments

Population Growth, 1992-2002



*Note: Dependency determined by Farm Payments as share of Personal Income, 2000-2002 average
Source: Bureau of Economic Analysis, REIS

Figure 6
Change in Number of Establishments
Nonmetropolitan areas, 1990-2002



Government Payments do not Solve the Rural Development Problem

- Farm payments are not a substitute for rural development because
 - Most farm subsidies are commodity program specific
 - Being a low cost producer gives an operator more farm payments and hence, increases in size and scale are important
 - Leads to fewer farmers and hence, fewer ag-supported businesses and leads to economic consolidation

Who else does rural development?

- Federal and state government
 - \$6,131 per capita (urban counties) and \$6,020 (rural counties) in 2004
 - Direct payments are made to metropolitan counties (50.5%) and non metro counties (63.9%).
 - Metro counties have greater flexibility for use of funds for infrastructure and capacity improvements
- Foundation grant making
 - \$30 billion annually; \$100 million for rural development (3.3%). 20 foundations contributed over 80% of the activity led by the Ford Foundation and Kellogg Foundations
- Corporate grant making
 - Less than one percent goes to rural organizations
- Source: RUPRI

Some Notes on Definitions

- Definitions Matter
 - Urban / rural does not equal metro / non metro
 - 51% of all rural people live in metropolitan counties. This is almost 30 million people
 - Rural programs are aimed at non metro counties
 - Urban programs are aimed at cities with more than 50,000 people
 - Small town clusters do not qualify for some rural development programs
- Farm Bill language is attempting to better define this

Ethanol is an interesting case

- Promotes economic activity during the construction phase
- Opportunity to use rural labor (but most jobs pay less because education requirements are less)
- Heavily subsidized and will continue to be subsidized
- Difficult to separate the success of ethanol (which requires subsidies) from rural development projects that are built around a business model independent of subsidies
- Hard to measure the impact of rural development from ethanol (easy to estimate multipliers!)

Things to Consider

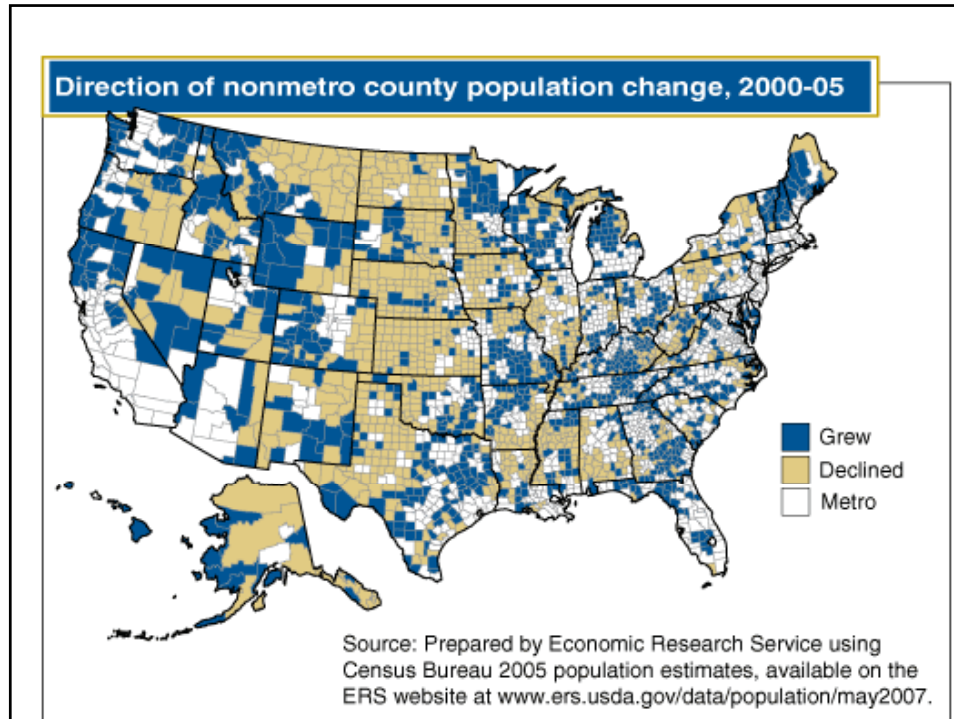
	Distribution of Population			
	Urbanized Area	Small Urban	Rural	Total
Metropolitan	192,064,228	10,338,988	30,176,724	232,579,940
Micropolitan	255,305	14,976,437	14,299,972	29,531,714
Noncore	18,588	4,704,763	14,586,901	19,310,252
Total	192,228,121	30,020,188	59,063,597	281,421,906

48.8 million people live outside nonmetropolitan counties
 40.5. Million people live outside urbanized areas in metropolitan counties

Source: www.RUPRI.org

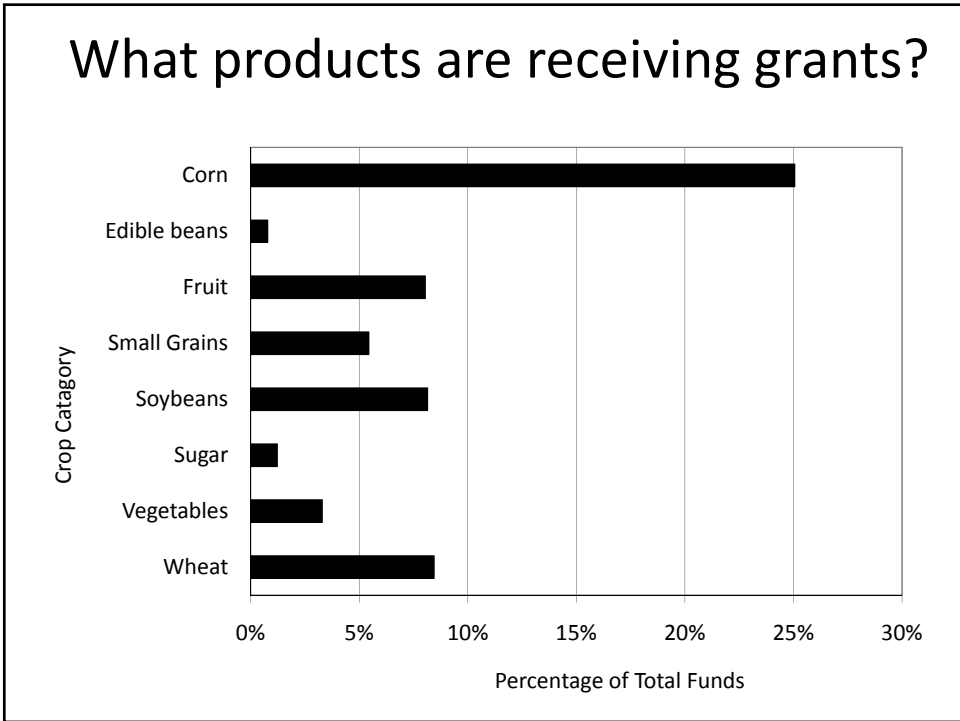
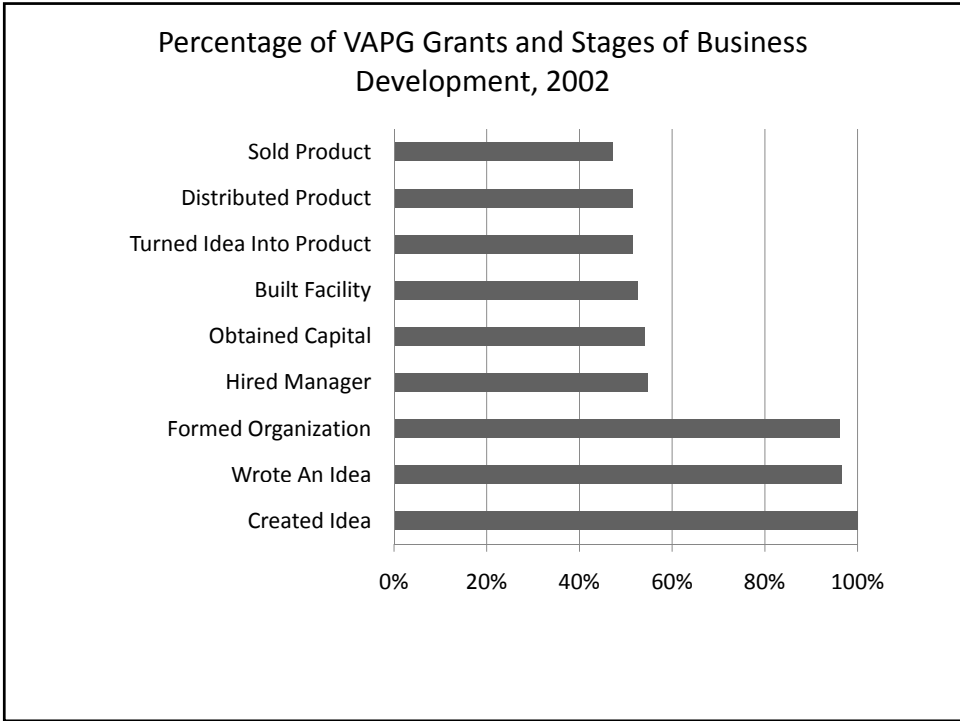
What do the experts say?

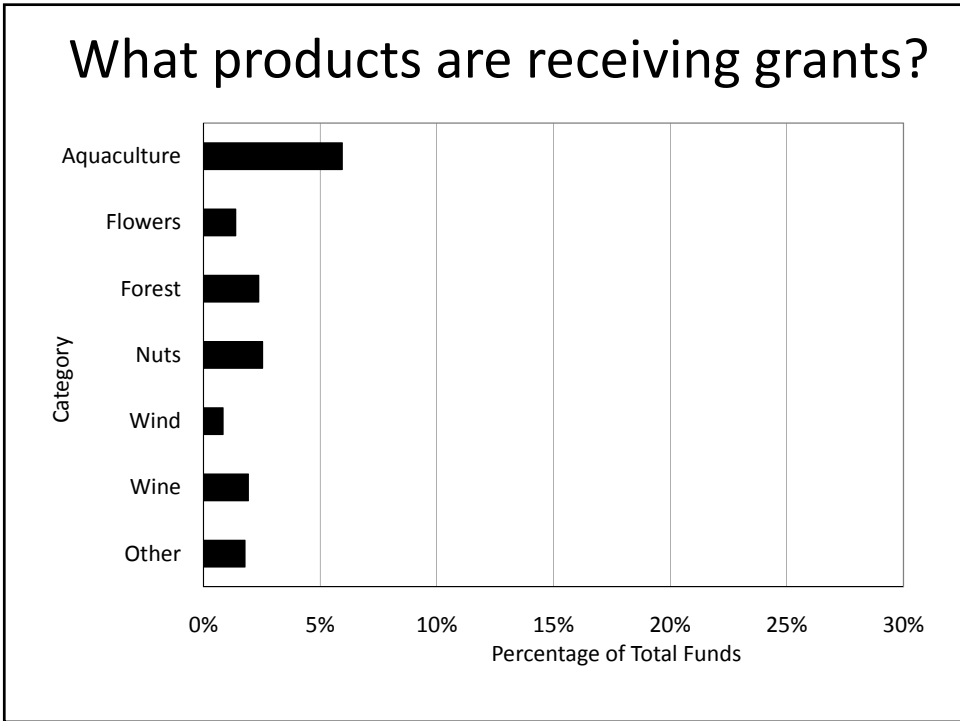
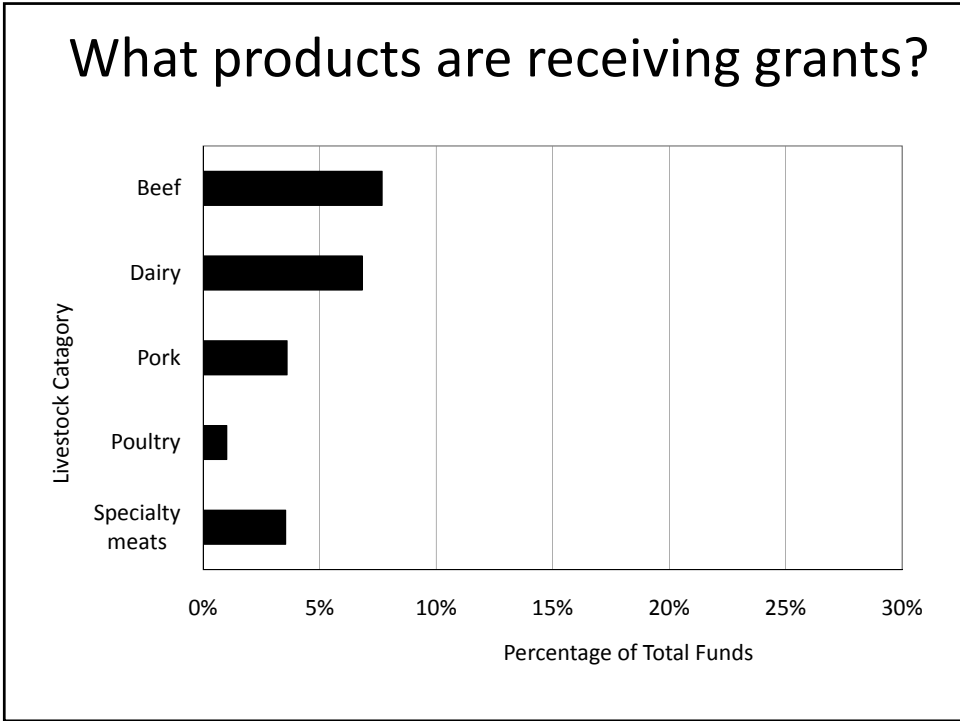
- Adopt regional clusters
- Niche strategies (e.g., ag tourism)
- New governance models (private-public partnerships in investment)
- Encourage entrepreneurs (e.g., micro finance)
- Change the definitions



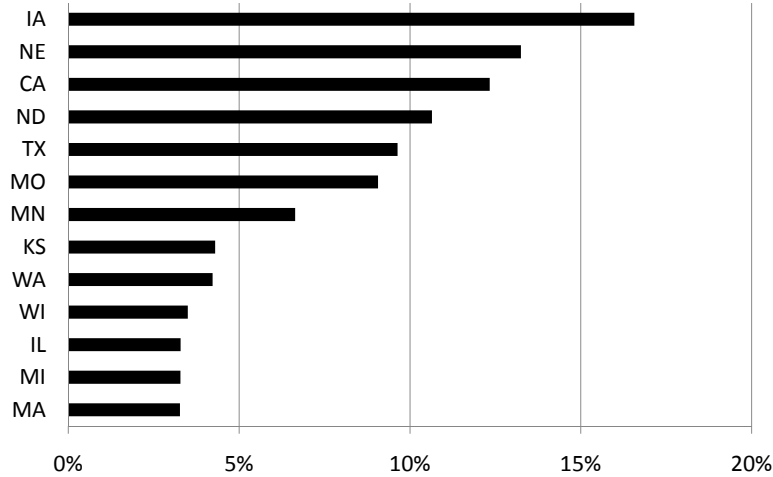
Value Added Producer Grant Program

- In 2002, there were 175 VAPG grants,
 - 105 grants were found to have been successful
 - Involved 91,527 producers at a cost of \$18,829,230 in VAPG funds or \$205.72 per producer.
 - 78 grants were not successful
 - Involved 342,581 producers who obtained knowledge of these emerging markets for products and services and decided not to proceed with equity capital. The cost of this knowledge and decision to not invest was \$9,758,822 in VAPG funding or \$28.49 per producer.





75% of the \$142 million have gone to



Who got funding in Kansas?

Producer	Value-Added Crop	Grant Dollars	Year
Cooperative Agricultural Services, Inc.	Majority Controlled Producer Organization	\$11,000	2001
American White Wheat Producers Association	Farmer / Rancher Cooperative	\$499,997	2001
Valley Vegetables Cooperative	Farmer / Rancher Cooperative	\$500,000	2001
Jewell County Sunflower Processing	Ag Producer Group	\$42,000	2002
Padonia Grain Farmers, Inc.	Farmer / Rancher Cooperative	\$50,750	2002
American White Wheat Producers Association	Independent Producer	\$218,710	2002
Western Plains Energy, LLC	Farmer / Rancher Cooperative	\$290,650	2002
East Kansas Agri-Energy, LLC	Independent Producer	\$450,000	2002
Cooperative Agricultural Services, Inc.	Farmer / Rancher Cooperative	\$500,000	2002
21st Century Grain Processing Cooperative	Ag Producer Group	\$500,000	2002
Ethanol Grain Processors, Inc.	Ag Producer Group	\$17,500	2003
Beef Marketing Group Cooperative, Inc.	Majority Controlled Producer Organization	\$37,500	2003
Rainbow Organic Farms Company	Ag Producer Group	\$144,500	2003
Heartland Mill, Inc.	Ag Producer Group	\$150,000	2003
Farmer Direct Foods, Inc.	Ag Producer Group	\$349,033	2003
Walter's Pumpkin Patch	Farmer / Rancher Cooperative	\$27,666	2005
Frontier Equity Exchange	Farmer / Rancher Cooperative	\$41,500	2005
Bird City Bird Seed	Majority Controlled Producer Organization	\$62,850	2005
Harvest Lark Company	Ag Producer Group	\$72,600	2005
NEK-SEN Energy Partners	Majority Controlled Producer Organization	\$100,000	2005
McKenzie, William G.	Independent Producer	\$10,250	2006

We are doing research on this program

- Variables we are looking at include
 - Population density per county
 - Age of population
 - U.S. market share of historical crop production before and after the grant was awarded
 - Educational status in county
 - Number of jobs created
 - Number of entrepreneurs (farm and non-farm) in the county
 - Sales history
 - Whether they received grants from other sources
 - Number of rural development employees in that state
 - Underlying crop or livestock that value was being created for (demand trends, etc.)
 - Number of commercial farmers in that county
 - County level income
 - Venture was a group (e.g., co-op) or single producer or family
 - Type of value-added activity (change physical form, segregation, differentiated product, or bioenergy)
- Variables we have excluded
 - Farm payment subsidies (difficult to know what actually stays in that county or zip code)

My two cents!

- International observations in countries where subsidies were eliminated or never strong history of subsidies
 - Much more diversity in economic activity
 - Agrotourism, farm stays, etc. (Australia, New Zealand, EU)
 - More plantation style farming (Brazil, Paraguay, Argentina)
 - Larger farms with more local labor
 - Diversification matters (some monoculture)
 - Ease of entry (and exit)
 - Look at global trends more closely in that year (use fertilizer or not that year depends on exchange rates and cash availability)
 - Cash or barter economy
 - Management (and information) is very critical input in production
 - Low cost production with more labor (cheaper) relative to other inputs
 - Every farmer in the world knows the exchange rate relate to US dollar. How many Kansas farmers know anything about exchange rates?

My two cents!

- We are different in the U.S.
 - Our poverty is different than other countries
 - Best property right protection in the world
 - Generates collateral which is needed for capital markets
 - Our labor markets work in general (it is possible to go from bottom to the top using legal means available through public sector)
 - Without subsidies we would probably see a combination of economic activity and diversity (tourism issue closer to population areas) and plantation (more rural areas)
- What policies work best for rural development?
 - Micro finance type things rather than big processing plants
 - Education
 - “liquidity or “working capital” for specialized things like legal fees, etc.
 - Changing the definitions
 - Conservation programs may lead to regional clusters perhaps (hunting, tourism, etc.)
 - Find things that are already working in cluster areas
 - There are large costs when underlying business proposition is not sound

Some Popular Press References on This Topic

- www.kansascityfed.org/RegionalAffairs/mainstreet/MSE_0305.pdf
- www.cato.org/downsizing/agriculture/rural_subsidies.html
- www.cfra.org/files/Analysis_of_USDA_Farm_Program_Payments_and_Rural_Development_Funding_in_Low_Population_Growth_Rural_Communities.pdf
- www.RUPRI.org