

# Chicago Fed Letter

## Globalization and rural America

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Globalization has been a great benefit to rural America in that it has opened overseas markets for its agriculture. Yet, there is growing concern that U.S. rural communities will lose not only their share of agricultural trade but also nonfarm jobs to global competition. This article examines how they can remain competitive relative to low-income countries.

Globalization has reduced the cost of many of the things that rural people buy while substantially increasing the variety of goods available for purchase locally.

Many parts of rural America have benefited significantly from globalization. American agriculture sells the production of one acre out of three overseas; this generates one-quarter of U.S. farm sales revenue. Without this outlet for its enormous productivity, American agriculture would be much less profitable, and land values, which make up a significant part of many rural communities' tax base, would be lower. Globalization has also reduced the cost of many things that rural people buy while substantially increasing the variety of goods available for purchase locally.

Nevertheless, globalization also gives rise to concerns in rural areas about U.S. jobs being shifted overseas. And the once large balance of agricultural trade has shrunk to close to zero as agricultural imports have grown. Midwestern farmers have watched Brazil capture most of the growth in the world market for their products. Despite the rapid rates of productivity growth in American agriculture, which have been the envy of the world, most U.S. farm families now earn most of their incomes from nonfarm sources.

Rural nonfarm jobs in the manufacturing and service sectors within commuting distance of farms have played a major role in increasing farm families' incomes and reducing poverty in those communities. The communities have also benefited

from having a more diverse economy, with less dependence exclusively on farming, a sector whose economic well-being gyrates with volatile commodity prices and crop yields. Rural community leaders fear that the nonfarm employment opportunities they have worked so hard to create will be lost to lower-wage workers in low-income countries.

### Dynamic change is the norm in agriculture

Out-migration of significant numbers of people from farming is a normal and essential component of economic development. A universal feature of economic development is that, as per capita income rises, the number of people employed in farming declines. As this happens, both the people who leave agriculture and those who stay behind (and can increase the size of their farms) enjoy higher family incomes. This phenomenon is driven by forces of both demand and supply.

Contrary to the predictions of Thomas Malthus, over the last two centuries, production of agricultural commodities in the world has grown faster than population. What Malthus did not foresee was the power of agricultural research to develop new, much higher-productivity technologies. In fact, during the twentieth century, productivity grew in American agriculture at a substantially

faster rate than in the rest of the U.S. economy. According to calculations from the U.S. Department of Agriculture's Economic Research Service, between 1948 and 2002, U.S. agricultural output grew 2.6 fold, while total inputs into agricultural production declined.

Because global agricultural production has grown faster than consumption, there has been a slight downward trend

also many who find nonfarm jobs within commuting distance of their farms. So, when a rural community loses nonfarm jobs, it is a source of great concern. However, it is important not to attribute to globalization changes in rural economies that would have happened in the normal course of economic development and poverty reduction. Otherwise, over the long run, misguided policies may further impoverish rural areas.

**International competition in the production of raw commodities is brutal. Because commodities by definition are undifferentiated, whoever can produce them at lowest cost will get the sale.**

in the real price (after adjusting for inflation) of grains over the past 150 years, albeit with significant variability around that trend from year to year. Whether this downward trend continues in the twenty-first century will depend on whether enough is invested in agricultural research to keep agricultural productivity growing faster than global demand, which is projected to double in the first half of the twenty-first century.

On the demand side, people with very low incomes spend most of any increments to their incomes on upgrading the quality of their diets. However, after a certain point, further increments get spent on processing, convenience, packaging, and luxury forms of what people eat, but not on more total food consumption. As a result, the percentage of consumers' food expenditures received by farmers declines continuously with economic growth and rising incomes. The percentage of income that people spend on food declines, while the percentage they spend on other goods rises. This causes the rest of the economy to grow, while the agricultural sector shrinks as a percentage of the total economy.

As economic development occurs in any community, farming inevitably comes to employ fewer people. Where poverty has been successfully reduced in rural communities, it has most frequently been through out-migration from agriculture. Many people move to distant cities to find higher paying jobs, but there are

### **Ongoing international trade negotiations**

Along with falling transport and communication costs, the liberalization of international trade, which has resulted from progressive reductions in manufacturing tariff barriers in the post-World War II era, has facilitated globalization. The current round of trade negotiations under the auspices of the World Trade Organization (WTO) aims to reduce barriers to manufactured goods trade further, but this time, there is special emphasis on liberalizing trade in agricultural products and in services.

Parts of agriculture in most high-income countries enjoy relatively high levels of government assistance and protection from import competition. According to the Organization for Economic Co-operation and Development (OECD), farmers in the 30 member countries (most of which have high per capita incomes) receive 30% of their gross receipts through various forms of government intervention—from subsidies to import barriers. Until the last round of international trade negotiations, the Uruguay Round, little liberalization of agricultural trade had occurred.

As with many programs that subsidize and protect specific industries, the beneficiaries of farm programs have relied on active lobbying to sustain their support. And, in this instance, lobbying efforts have generally proven to be highly effective in generating larger income

flows attendant to certain land uses in agriculture. For this reason, removal of government support could result in declines in related asset values—in this case, agricultural land located far from urban development. However, it is important to recognize that under trade liberalization and reduced agricultural supports, all fertile land could be expected to stay in production, growing whichever crops would be most profitable based on market returns. The question is not whether good land would stay in production, but how far the price of land would fall.

### **Farm policy as rural development policy?**

There are strong reasons to believe that farm policy, as traditionally practiced in the U.S. (and most other high-income countries), does not make very good rural development policy. Because much of the support is distributed in proportion to sales of specific commodities, those farmers who produce the most receive the largest benefits. If anything, this has facilitated farm consolidation and a reduction in the number of jobs in rural areas, rather than creating more jobs.

Because farm program payments get capitalized into the price of farmland, the appreciation of this land has increased the tax base of many rural communities. Since real estate taxes finance schools, roads, and other local government services, this has been beneficial to the communities. On the other hand, artificially inflating the price of land reduces the competitiveness of the farmers involved, ties up excessive investment capital in agriculture, and becomes a barrier to entry into farming.

Perhaps the most damaging aspect of current U.S. farm policy is the fact that government payments are linked to the production of specific commodities, so farmers become locked into producing those specific commodities. This suppresses entrepreneurship that might otherwise lead farmers to diversify into higher value per acre crops for which there is stronger market demand. This is what happened in New Zealand until it eliminated all farm subsidies in 1985. The change unleashed a huge amount

of creative and entrepreneurial activity when farmers were no longer constrained to produce those commodities that the government had previously supported. Agriculture in New Zealand has never been more profitable than since this change occurred.

U.S. agriculture continues to have a comparative advantage in many agricultural products. It has many natural advantages, including fertile soil, favorable climate, and low-cost water transportation; however, modern farming is very much a high-tech industry dependent on continuing investments by the public and private sectors in agricultural research to sustain that comparative advantage.

International competition in the production of raw commodities is brutal. Because commodities by definition are undifferentiated, whoever can produce them at lowest cost will get the sale. Margins of profitability are likely to be razor thin, with farms that produce bulk commodities continuing to expand. It will be difficult for farms that produce bulk commodities to be profitable if they pay more for land than the discounted present value of expected net revenues from the market for the most profitable crops that can be grown on it. The competitive niche of small- to middle-sized farms is expected to be in differentiated products that offer higher margins, as long as commodity programs do not constrain their entrepreneurship.

### **Minimum requirements for rural development**

There is widespread anxiety in rural communities across America that they will lose nonfarm jobs. The first thing for rural leaders to recognize is that the U.S. does not have a comparative advantage in unskilled labor-intensive manufacturing industries. The advantage belongs to low-income countries that have an abundant supply of unskilled labor at low wages. For the U.S., trying to create or protect jobs in such industries will likely incur very high costs per job created or retained.

However, the United States does have a comparative advantage in high-tech, knowledge-intensive sectors, particularly

those at the cutting edge of innovation, and in many service sectors, such as finance. This applies as well to modern farming—a high-tech, capital-intensive industry in which success requires sophisticated financial management and marketing skills, as well as an understanding of the science on which modern agriculture's productivity rests.

An important focus for policymakers interested in rural development should be on upgrading the quality of schools in rural areas. Higher quality education leads to a stronger local work force, while making communities more attractive places to live for potential employers and workers from elsewhere. Better educational opportunities are essential for rural communities seeking to be competitive in either agriculture or non-farm employment.

Globalization has been facilitated by declining costs of international transportation and telecommunications. Rural communities have natural disadvantages in terms of distance to markets and low density of population, so they need to do everything possible to overcome these cost disadvantages. The minimum infrastructure requirement for a rural community that wants to be competitive in the modern economy is good roads. America's interstate highway system has been a huge boon to the rural communities located near the highways. A great competitive advantage of the central part of the country is the low-cost transportation available via the Mississippi, Missouri, and Ohio river system, although its locks and dams are in urgent need of maintenance. Rural communities have suffered setbacks in transportation service with deregulation in the transportation industry. In the past, airlines and railroads were forced to maintain unprofitable service to many rural communities; these were paid for via cross-subsidization from earnings on more profitable routes.

The isolation of many rural areas puts them at a disadvantage for some types of manufacturing and distribution, as well as many service activities. High transportation costs associated with remote locations make manufacturing that involves

heavy or voluminous inputs not cost effective. Nevertheless, in many U.S. locales, significant transportation infrastructure has been put in place over time for movement of agricultural commodities. For this reason, some manufacturing operations find rural areas advantageous, especially those adjacent to divided highways and rail lines. Also, weight-shedding industries that transform local raw materials and increase the value per unit of weight, such as food processing and biofuel production, are advantaged.

It is difficult for rural areas to compete in the provision of many services. The U.S. population is increasingly concentrated in urban areas, and many services require face-to-face communication and personal delivery. For many business-to-business services, such as finance and professional services, urban areas are favored because of the mutual proximity of many highly skilled workers who can exchange information that is complex or often ambiguous.

However, high-speed broadband communications do offer many rural areas the opportunity to compete in the arena of many business and information services. In today's service economy in which the cost of "transporting" data or voice can

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be negligible, the transportation cost disadvantage of rural communities can disappear, as long as these communities have access to high-speed, broadband Internet. Without it, rural communities have little chance of creating new non-farm jobs, and they will be increasingly at risk of losing those they do have to places that have better Internet connectivity, such as some cities in India.

### **So what are rural communities to do?**

In addition to addressing the basic educational and infrastructure requirements outlined previously, development-seeking rural communities should inventory their unique assets, such as landscape and recreational amenities. In our increasingly affluent, urban, and stressed-out society, people want to be able to get out of the cities into rural areas to enjoy some tranquility as well as recreational opportunities.

A rural community with attractive landscape or recreational assets can often easily use them to generate nonfarm income. Unique scenic or recreational amenities can also help a community attract new residents who telecommute to their jobs. Of course, good schools and health care are also very important selling points.

With America's aging population, more and more seniors are looking for pleasant places to locate in their retirement years. They are attracted by the lower cost of living, particularly for housing,

as well as lower crime rates in many rural communities. Access to good health care is particularly important in attracting new senior citizen residents. A modicum of social and cultural amenities adds to the attractiveness of a rural community as a place to settle. Institutions of higher education, including community colleges, are particularly valuable assets in rural communities trying to develop.

Development of rural community leadership is also essential. Two communities can have comparable infrastructure and human resources, and one takes off while the other stagnates. Inspired, charismatic community leadership can make the difference between progress and stagnation. Rural leadership development programs, which strengthen communications, media relations, and coalition-building skills, can pay big dividends.

Longtime residents of rural communities need to recognize, however, that their communities will change, especially if there is significant in-migration. If they want economic development, they have to be ready for at least some social change. In addition, in sparsely populated areas, cooperation among historically rival communities is often necessary for success. Without this, it may not be possible to achieve the necessary scale economies for a new employer to be competitive.

Entrepreneurship, an essential element in business start-ups, appears to be a less

abundant resource in many rural communities than cities. Until a business is up and running, it often has a hard time attracting financing. While inadequate credit availability is often cited as a significant barrier to rural business development, there is a huge amount of capital in rural communities that is tied up unproductively in overpriced farmland.

### **Conclusion**

Globalization has exposed even isolated rural communities to an unprecedented degree of competition and has led local leaders to fear that the nonfarm employment opportunities that they have worked hard to create will be lost to lower-wage workers in low-income countries. There are many areas in which rural communities can be competitive if they make the necessary investments in infrastructure and human resource development. In order to compete, these communities must also create an attractive business climate for potential investors. Rural leaders need to recognize that existing agricultural commodity policy does little to create the necessary enabling environment for successful rural development and may even detract from it. Farm programs that link payments to the production of specific commodities stifle entrepreneurship among farmers, who often represent the community's largest group of people with experience in running a business.