Wealth Creation in Rural America

This report is part of the Wealth Creation in Rural America initiative, funded by the Ford Foundation. The aim of the initiative is to help low-wealth rural areas overcome their isolation and integrate into regional economies in ways that increase their ownership and influence over various kinds of wealth. The initiative has produced nine previous papers, which can be found at http://www.yellowwood.org/wealthcreation.aspx. The goal of this report is to advance the initiative’s broad aim of creating a comprehensive framework of community ownership and wealth control models that enhance the social, ecological, and economic well-being of rural areas.

Author Organizations

The Rural Policy Research Institute (RUPRI) was founded in 1990 and receives on-going support from Congress to provide objective, non-governmental analysis regarding the impacts of public policy decisions on rural people and places. Continuous service is provided to policymakers and practitioners at the local, regional, state, national, and international levels. RUPRI is widely respected for its analysis and programs across a broad portfolio of rural policy issues from health care to entrepreneurship to regional innovation. RUPRI’s program of work is delivered by a small core staff in Missouri and Washington, D.C., partnering with a broad array of scholars, analysts, and practitioners through RUPRI centers and panels.

Contact:
214 Middlebush Hall
University of Missouri-Columbia
Columbia, MO 65211
Phone: (573) 882-0316
Fax: (573) 882-5310
Web Site: www.rupri.org

The Community Policy Analysis Center (CPAC) at the University of Missouri engages in innovative and applied research at state, national, and international levels, always with an emphasis on issues that affect rural areas and community policy. CPAC provides research, outreach, and training to support improved policy decisions in Missouri communities and engages in international rural development work through partnerships and research initiatives.

Contact:
215 Middlebush Hall, Columbia, MO 65211
Phone: (573) 884-9009
Fax: (573) 882-2504
Web Site: www.cpac.missouri.edu

The goal of the Rural Studies Program at Oregon State University is to improve environmental, economic, social and cultural well-being in Oregon’s rural communities by establishing the premier program for rural community sustainability in the Land Grant University system. The Rural Studies Program focuses research and outreach in four areas: rural economies, rural environments and natural resources, rural policy, and rural society.

Contact:
213 Ballard Hall
Corvallis, OR 97331-3601
Phone: (541) 737-1442
Fax: (541) 737-2563
Web Site: http://ruralstudies.oregonstate.edu
I. WEALTH CREATION IN A REGIONAL FRAME

The fact that poverty has remained deeply entrenched within parts of rural America is a failure of public policy and public imagination. There are 363 nonmetropolitan counties that have experienced poverty rates of 20 percent or higher in each of the decennial censuses between 1960 and 2000 (Miller and Weber). These counties are to be found mainly in the Black Belt and Mississippi Delta in the south, in Appalachia, the lower Rio Grande Valley, and in counties containing Indian Reservations in the south west and the Great Plains. Poverty has been resistant to successive policy initiatives, both public and philanthropic, which have attempted to provide income support, improve housing conditions, open up road access, build local capacity, attract businesses, and raise educational attainment.

Wealth Creation in Rural Communities is the latest effort to take on this challenge. Supported by the Ford Foundation, this initiative applies a different framework, with two critical components.

The first component stresses the importance of place, and specifically the linkages between rural and urban places. Increasingly, the limitations of framing solutions to societal problems within the existing pattern of governmental jurisdictions or within the silos of sectors and disciplines are being recognized. Rural counties just do not have the technical or financial resources to tackle the challenges of poverty, migration, economic development or environmental degradation on their own. Nor can the major challenges associated with climate change, energy, and urbanization be tackled as discrete problems of agriculture, health or transportation but have to be treated holistically across sectors. Viewing rural problems through a lens of regional innovation allows the exploration of rural-urban connections, and the potential for collaboration across public, private, philanthropic, and community sectors to take on seemingly intractable challenges such as long-term rural poverty.

The second component is a focus on wealth creation. For many rural communities and regions of the United States, the path out of poverty to resiliency and prosperity is blocked by factors that drain or diminish the value of their assets and inhibit the creation of new community wealth.

Assets are the natural and created attributes of a place, a community, or an individual, the value of which can be increased by investment to create wealth, or decreased by abuse or neglect. Wealth, both individual and collective, is a stock which accumulates or dissipates depending on the flows in and out. It usually refers to accumulated net income or savings in a household or business, where accumulation occurs when income is greater than expenditures – or at a broader economy level, when production exceeds consumption. When this accumulation is invested in a productive asset, it becomes wealth. This approach can apply equally well outside the traditional areas of household and business into the realm of human, social and environmental assets, although much less analysis has been done in these areas. When expenditures exceed income, or for instance when removal of timber exceeds its replenishment, the result is a draining of wealth and eventually disinvestment out of a productive asset.
Putting the two components together, the following working definition can be offered:

A truly wealthy community is one:

- where most or all of its assets are being put to productive use and managed in ways that continue to enhance their value, and
- which is able to leverage its economic and other connections with its neighbors, both urban and rural, to expand and develop its assets, and strengthen its ability to manage them sustainably.

This essay, representing a modest contribution to the Wealth Creation in Rural Communities Initiative, attempts to lay the groundwork for bringing together the two components of wealth creation and regional innovation in a way that might be useful for policymakers and practitioners. The conceptual and technical work of which this is a summary is the result of collaboration between Thomas Johnson and Dennis Robinson of the University of Missouri, Bruce Weber and Mallory Rahe of Oregon State University, and Brian Dabson, Kathleen Miller and Jennifer Jensen of the Rural Policy Research Institute. The paper has also benefitted from feedback from two meetings hosted by the Ford Foundation in New York in November 2009 and in Georgia in February 2010.

II. THINKING REGIONALLY

Regional approaches to dealing with pressing, complex issues date back to 18th century Philadelphia but they have since fallen in and out of favor with changes in the economic and political mood of the nation. Generally speaking good economic times lead to a declining interest in regionalism, and hard times reawaken interest in its possibilities. This ebbing and flowing has left a complex legacy of regional organizations and administrative structures, such as the Tennessee Valley Authority, the Appalachian Regional Commission, the nationwide network of economic development districts, and a variety of other less formal arrangements. These were formed at different times in response to different motivations – the better management of natural resources, the alleviation of poverty, the promotion of economic development, and the improvement of global competitiveness to name a few.

In the last five years, there has been a resurgence of interest in regionalism, driven in part by the Brookings Institution’s arguments that future national prosperity will depend on strong and vibrant metropolitan regions. These have been influential in the framing of the Obama Administration’s approach to urban policy, and in particular, a set of policy principles to advance its domestic and fiscal priorities:

“Many important challenges demand a regional approach. The Nation is increasingly a conglomeration of regional economies and ecosystems that should be approached as such. Federal investments should promote planning and collaboration across jurisdictional boundaries. Given the forces shaping smaller communities, it is particularly important that rural development programs be coordinated with broader regional initiatives. Programs in neighboring zones and within larger
regions – some of which connect rural communities to metropolitan regions – should complement each other.” (The White House)¹

This clear argument for thinking regionally also reflects a growing global recognition of the importance of rural-urban interaction and interdependence. Despite official definitions that distinguish urban from rural, and metropolitan from non-metropolitan, the realities of settlement, commuting, and migration patterns suggest a far more complicated interface in which much mixing occurs among urban and rural populations, and rural areas themselves exhibit a great deal of diversity. Research, especially in the developing world, has tracked these complicated human, market, environmental, and functional interactions that link urban to rural areas, especially at the so-called ‘peri-urban’ interface where urban meets rural.

America’s rural and urban areas are interdependent across many domains: rural areas provide critical consumption goods for metropolitan customers, such as food, energy, labor, land, and unique natural and cultural experiences. Urban areas are the end market for rural production and provide specialized services, offer diverse job opportunities, and generate resources for public and private investment in rural America.

It is against this backdrop that new Federal programs are emerging. The Sustainable Communities Initiative has brought together the US Department of Housing and Urban Development, the US Department of Transportation, and the US Environmental Protection Agency around a set of ‘livability principles’ and a $150 million program for 2010. These principles relate to more transportation choices, equitable affordable housing, enhanced economic competitiveness, support for existing communities, coordination of policies and leverage of investment, and the valuing of communities and neighborhoods. A proposed $100 million grant program within this initiative is designed to encourage multi-jurisdictional, multi-sectoral partnerships to achieve holistic development goals within metropolitan regions.

Regional collaboration is also central to another new program, the Regional Innovation Initiative, from the US Department of Agriculture, in which $130 million has been set aside to encourage rural regions to create partnerships around broadband, bio-fuels, food systems, ecosystem markets, and forest restoration and land conservation.

III. THE CENTRAL APPALACHIAN REGION

The Wealth Creation in Rural Communities program began with a focus on the Central Appalachian Region, a group of 87 counties straddling Kentucky, West Virginia, Virginia, and Tennessee, which lie in the mid-section of the Appalachian Regional Commission’s territory. These counties share many

¹ The White House (2009), Developing Effective Place-Based Policies for the FY 2011 Budget. Memorandum from Peter Orszag, Office of Management and Budget, et al, August 11, 2009, pp. 5-6
characteristics that define them as economically distressed or natural resource dependent yet they do not comprise a coherent economic region. In fact, they constitute part of five Economic Areas, as defined by the Bureau of Economic Analysis\(^2\), centered on Nashville, Lexington, Knoxville, Charleston, and Johnston City. Together these five Economic Areas include 181 counties with a total population of 7.3 million and for the purposes of this essay make up the Greater Central Appalachian region.

![Five BEA Economic Areas around Central Appalachia](image)

About one-third of the population live in what can be defined as urban core counties, and two-thirds live in rural periphery counties, as shown in the above map. The size of the economy in terms of the amount of goods and services produced was nearly $543 billion in 2007. The largest export commodities overall were transportation equipment and chemical products. It is interesting to note that despite the region’s close association with coal mining, coal contributes just one percent of total production of goods and services, although its impact is concentrated in certain counties – the Charleston Economic Area.

\(^2\) Economic areas comprise one or more economic nodes – metropolitan areas or similar areas that serve as centers of economic activity – and the surrounding counties that are economically related to the nodes. The main factor used in determining these economic relationships among counties is commuting patterns, so each Economic Area includes as far as possible, the place of work and the place of residence of its labor force.
produces over half of the region’s coal, but even there it ranks third in value of exports. Other important exports are stone, glass and masonry products (mainly in Lexington EA) and food manufacturing (mainly in Nashville EA).

IV. PROSPERITY AND WEALTH CREATION

There is no shortage of data, studies and reports on the economic, social, and environmental challenges faced by the residents of central Appalachia. On just about every indicator, central Appalachia can be shown to be disadvantaged or lacking, which makes it much harder to take a positive assets-based, “glass half full” approach. The work of Andrew Isserman et al (2009) and Mallory Rahe (2008) offers an alternative to measuring what is wrong in an area by measuring what is right through a focus on the components of prosperity. Isserman et al developed an index of prosperity based on lower levels of unemployment, low high school dropout rates, low poverty rates, and the prevailing quality of housing conditions, and were able to apply this to every county in the United States. Rahe extended this to look at how communities change over time in respect of these measures.

The same method was applied for this project to see what might explain variations in levels of prosperity across central Appalachia. The results of the analysis, as illustrated in the maps above, showed that there had been some significant improvements in prosperity over the period 1980-2000. In 1980, 63 out of the 87 counties failed to meet any of the four prosperity criteria; by 2000, this had been reduced to just 20 counties. Conversely only three counties met two or three criteria in 1980; by 2000 this number had increased to 38 counties. A study is now underway to understand what factors have been at play in
Appalachian counties that have been persistently prosperous over the 20 years and those that have shown marked improvement in prosperity in that period.

V. REGIONAL ACCOUNTING AND WEALTH CREATION

Introducing the Social Accounting Matrix

A proven, structured method of understanding the flows of production, consumption, savings and investments within and between regions, is to use a Social Accounting Matrix or SAM. This tool enables calculations of a region’s “current account”, in much the same way as a business or household tracks the monetary flows in and out of its bank account.

In theory, a SAM can also generate a “capital account” that links the surpluses and deficits from the current account to stocks of capital or wealth. However, there are severe data limitations that prevent a clear understanding of who owns assets, where they live, and what return they are getting on those assets. In a region like Central Appalachia, where substantial portions of the natural resources are owned by people and corporations outside the region, or outside the country, lack of information on the status of these assets masks the condition of the region’s capital account. All that can be done at this point is to focus on the net balances on the current accounts of the Economic Areas and of the constituent urban cores and rural peripheries. A positive net balance on a current account opens up the possibility for wealth creation as it implies that more financial resources are entering the region than leaving in a given time period, which can be used to increase the accumulated stock of wealth.

Typically, SAMs measure flows of traditional economic indicators, but they can also be used to trace environmental and social indicators. For example, the consumption of energy for transportation requires a flow of money from consumers to energy producers, but it also means the release of greenhouse gases, the use of public infrastructure, and increased rates of traffic accidents and thus health care costs. A proper accounting of these flows would enable the tracking of the effect of these flows on environmental and human capital as well as on the financial stock of the energy producer. There is little known about the precise relationships between the different forms of assets but these linkages do exist, and can be recognized through SAMs or similar accounting frameworks. This, however, was beyond the scope and resources of the project.

The SAM framework emphasizes the fact that all economic activities – production, consumption, and investment – occur in the context of space and distance, and that there are important economic stocks and flows not captured in the more basic inter-industry input-output data. Decisions by individuals on where to live, work, shop, and recreate; by firms as to where to locate, purchase inputs, hire labor, and sell products; and by governments as to where to locate infrastructure, provide services, and impose taxes, all determine the spatial structure of an economy. From an economic viewpoint, space is generally regarded as an asset, but distance is usually a liability.
Towards A SAM for Greater Central Appalachia

The framework for a Social Accounting Matrix was used to estimate economic flows for Greater Central Appalachia applying data from IMPLAN\textsuperscript{3} on 2002 commodity-specific county-to-county trade flows, updated with 2007 databases for the region. These data show flows in sales both by industries and sectors from each county to every other county across the five Economic Areas. This analysis is unique because of the data used and because of its spatial perspective. Most previous studies look at linkages based on commuting patterns which tell part of the story. A few have used input-output relationships to look at flows of goods and services. In this study input-output data were combined with unpublished data on source-destination estimates for goods and services flows. These data allowed flows to be estimated to and from multiple locations, disaggregated by sectors. Finally, indicators of key economic flows related to wealth creation potential were estimated for several regions (five in this case) and examined for patterns across regions.

For comparison purposes, the same methodology was also applied to another natural resource-rich region in Oregon. This region comprises four Economic Areas centered on Portland, Eugene, Bend, and Pendleton, with a total of seven core and 31 periphery counties. The region has a population of 4.1 million of which 62 percent live in the core counties.

Three accounts are important for looking at the relationship between urban core and rural periphery: the account of each core with its own periphery; and the accounts of each core and periphery within a region with the economy beyond its boundaries (the outside economy). These are shown in graphic form below:

\textsuperscript{3} IMPLAN is a proprietary economic impact modeling system that is used to create Social Accounting Matrices and Multiplier Models of local economies. It provides software tools and region-specific data to enable in-depth examinations of state, multi-county, county, sub-county, and metropolitan regional economies.
The net current account and thus a region’s propensity to accumulate (or lose) wealth, has three components:

1. **Net trade balances** – the relationship between the export and import of traded goods and services.

2. **Net federal funds flows** which comprise transfer payments – primarily social security payments but also unemployment insurance and income maintenance – and Federal taxes.

3. **Net income flows from assets** – dividends, interest and rent payments.

The analysis for Greater Central Appalachia produced some clear indicators of the scale of the challenge for wealth creation and the nature of the relationships between the urban cores and the rural peripheries. The Economic Areas of Knoxville and Charleston have positive net current account balances (3.5 percent and 1.6 percent respectively) – these areas at the north and south ends of central Appalachia are generating surpluses that point to wealth accumulation. However, the Economic Areas at the heart of central Appalachia – Lexington (-7.5 percent) and Johnson City (-2.0 percent) – have negative net balances, suggesting a draining of the wealth out of these areas.

The situation for core periphery counties is even more stark within the Nashville, Lexington, and Johnson City Economic Areas, which have negative current account balances of -13.2 percent, -11.3 percent, and -4.9 percent respectively.

Looking at the components of the net current account balance, there is a clear difference between the accounts for urban cores and rural peripheries as summarized in following graphic.
All Economic Areas (in both Appalachia and Oregon) have a trade deficit with the outside economy, ranging from -0.2 percent in Portland to -16.5 percent in Lexington. The positive trade balances for the urban cores of the largest Economic Areas, for example, Portland core (3.4 percent) and Nashville core (5.1 percent), were more than offset by the trade deficits of the rural peripheries, ranging from -7.6 percent for the Pendleton periphery to -19.7 percent for the Nashville periphery. In all Economic Areas, the urban cores had a trade surplus with their rural peripheries ranging from 2.8 percent of production in Nashville to 0.7 percent in Charleston and Johnson City.

Net Federal funding flows were positive (contributing to wealth creation potential) in every Economic Area but Nashville and every periphery county in central Appalachia. Net Federal funding flows were negative, however, for the Nashville Economic Area and the urban cores of Lexington and Nashville. This is in part because transfer payments went disproportionately to the periphery counties (largely due to their lower per capita incomes, aging demographics, and health status) and because the Federal tax burdens were highest in Nashville and the urban cores of Lexington and Knoxville.

As for net income flows from assets, the central Appalachian region receives much lower dividends, interest, and rent payments as a share of personal income than the nation as a whole: this source accounts for 12.3 percent of personal income in central Appalachia compared to 17.5 percent for the nation. Income from dividends, interest, and rent that did accrue in the region went disproportionately to the urban core counties.

VI. IMPLICATIONS

Two general observations can be made from these results. First, if a region’s ability to create wealth is dependent upon generating a trade surplus with the outside economy and attracting investors, the economic competitiveness of the urban core appears to be key. However, if the rural periphery is experiencing substantial trade deficits then this will have a substantial negative impact on the whole region. Second, for some regions, the net influx of Federal transfer payments, although an indicator of low social welfare, can offset a weak rural periphery trade position, as in the cases of Knoxville and Charleston Economic Areas. However, the prospects for wealth creation and retention in the rural periphery of Nashville, Lexington and Johnson City look challenging, given that even with transfer payments they are running net negative overall current account balances.

There are many possible explanations for this situation. Wealth creation in any place, whether urban core or rural periphery is determined by a number of inter-related factors, such as the productivity of labor and capital, the impact of tax codes and spending patterns on public and private infrastructure investments, the characteristics of the residents and the labor force, the level of access to transportation and information, the local history and culture, and where the owners of the region’s assets reside. Some of these factors are more amenable to change than others. For example, the larger urban cores will tend to have positive trade balances because they produce specialized services that...
cannot be readily produced in the rural periphery, and their agglomeration economies allow their assets to be more productive and their firms to be more competitive.

Nevertheless, there are strategies that can be adopted that may reduce the trade deficits that rural peripheries have both with their urban cores and with the outside economy.

1. **Add greater value to locally produced goods** – finding ways to locally process, package or otherwise add value to raw materials extracted from rural peripheries opens up opportunities for increased rates of return, additional and better paying jobs, and improved trading conditions. The presence of drying kilns and milling facilities to process timber before it is shipped out; the local slaughtering of livestock and meat processing; the development of local supply chains for farm produce are all examples of adding value. The extent to which this is possible is determined by who owns the raw materials, who controls the distribution and processing chains, and the ability of the region to attract the necessary capital investment to conduct value-added activities.

2. **Substitute imports from elsewhere** – identifying goods and services that rural peripheries purchase from the core or from the outside economy that could be produced locally. For this strategy to work, any goods and services produced in the rural periphery would have to be offered for the same or lower cost or for the same or higher quality as those available from elsewhere, and to generate levels of value-added higher than alternative uses of the resources used in their production.

3. **Diversify and localize ownership and control over the production of goods and services** – in theory this would enable the rural periphery to have greater say in the operation of their local economy and to intervene in strategies 1 and 2 above. However, this cannot be based on a notion that local ownership is a self-evident good – for it to have an impact on wealth creation possibilities, investments made by local actors would have to be in the high value, high return activities.

4. **Mobilize local capital for community investment** – attracting or retaining individuals with higher net worth who would be willing to invest in local productive activity. This is in part another facet of strategy 3 above, but it also refers to mechanisms to capture outward flows of capital, such as intergenerational estate transfers from rural areas to the cities and suburbs. Actions might include pooled investment opportunities through community foundations or angel networks.

5. **Identify new productive assets** – encouraging entrepreneurial activities to convert assets, whether they are economic, social or environmental, into economic opportunity. Such a
strategy would yield, if successful, a double benefit of impacting both the current account by increasing exports, and the capital account by creating new regional assets.

The analyses of trade flows and the potential for wealth creation in central Appalachia suggest two important sets of policy implications. The first is the need to frame policies for urban and rural development and revitalization in a broader regional context. Such policies that focus primarily on urban cores may not necessarily offer any improvements in the prospects for the rural periphery – trickle-out effects cannot be guaranteed. Similarly, policies designed to revitalize rural areas may serve ultimately to provide significant benefit to the residents of the urban core. For both urban and rural areas, and for a region as a whole to succeed, then policies need to recognize and embrace the interdependence of all parts of the region. Moreover, policies need to provide incentives to innovative and effective approaches to regional collaboration so that the challenging tasks of cross-jurisdiction, cross-sector, and rural-urban planning and investment can yield positive outcomes.

The second is the need to frame policies for urban and rural revitalization in terms of their potential for regional and community wealth creation – the necessary precondition for tackling deep-seated poverty, inequality, and lack of opportunity. This requires an understanding and appreciation of regional and community assets, some of which could not be captured in this analysis. The abovementioned strategies for reducing trade deficits between rural periphery areas and their urban cores and the outside economy all require an orientation towards building on assets, together with fostering entrepreneurship, mobilizing local capital, and encouraging local ownership and engagement in economic development.