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Innovative State Policy Options to Promote Rural Economic Development

Executive Summary

America's rural areas and small towns face unique and difficult challenges in the 21st-century economy. Rural economies generally face challenges from poverty, geographic isolation, infrastructure deficiencies, poor links with metropolitan and global markets, weak community infrastructure for business development and growth, and the flight of skilled human capital to metropolitan regions. In response, states have initiated numerous strategies to increase prosperity in non-metropolitan regions. These strategies concentrate on developing new economic drivers for rural regions that do not have a diverse economic base.

States are employing strategies that concentrate on developing new economic drivers for rural regions that do not have a diverse economic base.

Many rural areas have underdeveloped assets that compound their economic challenges and hinder potential expansion. States can employ economic development strategies that build on a region's strengths. Three promising strategies for governors interested in rural economic dynamism are:

- **Adapt cluster-based principles.** Economically successful regions have clusters of interconnected businesses that collaborate. States can support clusters by encouraging the development of industry networks that provide a channel for businesses to work together. To meet the need of cluster businesses for highly skilled workers, states have deployed colleges and universities as training centers. States can ensure that cluster businesses in remote, rural communities have access to the same capital and technical resources as their more advantageously located competitors.
- **Promote entrepreneurship outside the agricultural sector.** As traditional resource-based, extractive rural industries decline, entrepreneurship development can be an effective strategy for states to consider. States can best serve entrepreneurs by providing access to seed capital; by developing local ability to identify, encourage, and train entrepreneurs; and by using online networks and other technology to connect entrepreneurs with critical information and

financial resources.

- **Reinvigorate the agricultural sector through diversification and value-added agriculture practices.** There is more to farming today than simply growing commodity crops. Farmers know they can earn more by growing different types of crops or by raising non-traditional species of livestock. Other farmers are directly processing their crops into finished products that they market themselves. To support this new agricultural environment, states can provide the capital and technical assistance that allow farmers to follow these new paths to wealth creation.

The traditional divide separating rural America from its urban and suburban counterparts continues to define the challenges facing rural communities.

Background

Rural economic development is one of the most vexing issues facing governors today. Compared to urban and suburban areas, rural and small-community America is poorer and older, has smaller markets and fewer residents, and is experiencing poorer economic performance. Poverty is prevalent in America's rural communities. Nationally, 535 of the nation's 2,276 non-metropolitan counties—nearly one-quarter—have poverty rates of 20 percent or higher.[1]

The traditional divide separating rural America from its urban and suburban counterparts continues to define the challenges facing rural communities. Rural communities are isolated from robust markets, impeding access to markets and making it difficult to move people and goods.[2] Rural areas also have fewer cultural amenities, which makes it harder to attract new residents and businesses hindering the development of new amenities.

While rural America shared in the prosperity of last decade's economic boom, growth rates have lagged behind urban areas. Moreover, the recent economic downturn has affected rural areas disproportionately. Non-metropolitan employment dropped by 140,000 (0.6 percent) from 2000 to 2001 while metropolitan employment remained steady despite the recession, suggesting that rural communities are particularly vulnerable during lean economic times.[3] Market conditions in two of rural America's traditional economic drivers—agriculture and manufacturing—illuminate this vulnerability.

Farming jobs in the rural economy have declined for decades.[4] Farm consolidation and technological innovation caused rural farm employment to fall from nearly 2.5 million in 1975 to around 1.8 million in 1996—a 26.9-percent drop.[5] Globalization of commodity markets and shrinking profit margins in traditional crops also has contributed to this decline. In these markets, only very large-scale, capital-intensive agriculture remains profitable. While these entities are important to rural economies, they typically support fewer jobs and businesses in the regions where they are

located. The effect of large-scale agriculture on rural communities often is called "hollowing out," a process by which the business base erodes as fewer local products and services are purchased by a shrinking number of farmers.

Rural areas are generally not seen as feasible locations for high-technology manufacturing or service activities by investors. Instead they tend to look for areas where there are colleges and universities or amenities attractive to professional workers.

Likewise, past gains in rural manufacturing earnings have reversed. From 1995–1999, urban manufacturing earnings grew faster than did rural earnings, mostly because of an urban revival in high-technology manufacturing and a substantial loss of textile and apparel jobs in rural areas.[6] Rural areas are generally not seen as feasible locations for high-technology manufacturing or service activities by investors. Instead, they tend to look for areas where there are colleges and universities or amenities attractive to professional workers.

Rapid changes in manufacturing make it advantageous to locate near suppliers and customers.[7] Many rural areas lack the professional-level workforce to attract or develop these industries. During the 1990s, this rural-urban division of labor became more pronounced not only in manufacturing, but in service industries as well.[8]

Moreover, a decline in manufacturing, which started in late summer 2000, and the national recession, which began in March 2001, created more unemployment and dampened earnings growth in rural areas. Much of the rural South in 2000 and 2001 faced large job losses fueled by the weakened manufacturing sector.[9]

Any policies or programs that states initiate must address what is missing in many rural areas, which include:

- access to capital and venture capital networks;
- networks that allow entrepreneurs and businesses to share ideas and explore contracting opportunities;
- access to a highly skilled workforce or to worker training programs to meet the demands of an increasingly global economy;
- environments in which entrepreneurship is encouraged; and
- Market research capabilities that allow businesses to expand to new markets and for entrepreneurs to turn ideas into viable products.

Innovative State Policy Options

States are looking beyond the traditional strategy of industrial business attraction and exploring new approaches to rural economic development policy. State policymakers should consider deploying the following three economic development strategies that could promote community self-reliance by harnessing existing and potential assets of rural communities.

- **Adapt cluster-based principles.** States can serve geographic

concentrations of businesses by supporting industry-driven cluster networks; deploying colleges and universities as resources to cluster firms; and providing access to critical technology, workforce, and business resources.

- **Promote entrepreneurship outside the agriculture sector.** This can be done by providing access to capital, developing community entrepreneurial capacity, and using technology to connect entrepreneurs among far-flung rural populations.
- **Reinvigorate the agricultural sector through diversification and value-added agriculture product development.** States can emphasize incentives for value-added products and diversification, or create policies and programs that create a nurturing environment for entrepreneurship.

Adapt Cluster-Based Strategies to Rural Communities

States should consider adapting the principals of cluster-based economic development—innovation, cooperation, and networking—to key rural business clusters. A cluster is a concentration of similar, related or complementary businesses, with active channels for business transactions and communication. Clusters encourage interaction that leads to robust networks. A critical mass of interrelated businesses also attracts venture capital investment and leads to targeted worker training programs. Rural areas tend to have more diffuse business networks, as well as limited access to capital and skilled workforce pools.

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States can foster rural cluster development through policies and programs that support the formation and operation of industry-driven networks; deploy community colleges and universities; and ensure remote clusters have access to critical resources.

- **Support the formation and operation of industry-driven networks.** States are well-served to work closely with networks because they are in constant contact with companies and clusters at local and regional levels. Networks bring cluster businesses together to share ideas and innovate. Networks articulate workforce needs to colleges and universities, which can adjust their program offerings accordingly. They also speak with one voice to government, helping to influence state policy.
- **Deploy community colleges and universities.** These can become focal points for targeted workforce training, technology access, and research and development (R&D) for dynamic rural clusters. By serving as a home for these resources, educational institutions create an environment where rural businesses can innovate and remain competitive.

- **Ensure that remote clusters have access to critical resources.** This includes capital, advanced technology, targeted workforce training, and business and marketing planning.

Clusters thrive because of their access to innovation, knowledge and know-how created by the concentration of their members.[10] Historically, where a tradition of interfirm collaboration exists, clusters create greater innovations in their sectors.

In rural areas, states are experimenting with clusters through formal policies and as supporters and partners to locally based networks. Rural America already is home to clusters that are as important in relative employment terms as those based in and around large cities.

To best understand the role of clusters, a state should analyze its economic base to identify the clusters that are driving the economy. It then must assess what resources are rooted in the region or state—including research universities, cultural attractions, infrastructure, and skilled workers—and provide these firms with the capacity to innovate and compete in global markets. A cluster approach also can reveal defects in the economic infrastructure, such as a lack of educated or well-trained talent, poor access to technology, or a weak physical infrastructure base, and what can be done to improve conditions. This information can help public officials choose strategies that improve the development and performance of clusters, which will, in turn, generate economic growth.[11]

Many states have pursued rural cluster development strategies in the last decade, as the concept—popularized by Harvard professor Michael Porter—has gained currency. The somewhat rural area of the Emilia-Romagna region of Northern Italy[12] is heavily reliant on agriculture and is a widely cited example of a successful cluster. Important U.S. clusters include biotechnology and telecommunications in San Diego, California; polymers in Akron, Ohio; computer hardware and software in Austin, Texas; automobiles in Detroit; and aerospace in Wichita, Kansas.

In rural areas, states are experimenting with clusters through formal policies and as supporters of and partners to locally based networks. Rural America already is home to clusters that are as important in relative employment terms as those based in and around large cities. These include the carpet manufacturing (Dalton, Georgia.), houseboat manufacturing (southern Kentucky), woodcrafts (north-central Minnesota), and software development (Fairfield, Iowa) industries.[13] Many longstanding institutions, such as farm cooperatives and the grange, illustrate a history of rural social organization. This has been central to building social capital that creates trust within the community and provides the economies of scale that attract specialized services and reduce costs.[14]

Hosiery Technology Center, North Carolina

The industry-driven hosiery cluster network in western and central **North Carolina** is championed by state government. The state has supported the network through funding and technical assistance to the network and the

cluster firms. The state also has deployed two community colleges to provide targeted worker training programs. In 1990 the hosiery cluster formed the Hosiery Technology Center (HTC), a research and development network that trains workers and serves as a unified voice to maintain industry competitiveness.

Changing market conditions have affected the competitiveness of the hosiery cluster—composed of manufacturers and suppliers of yarn, dyes, chemicals, and machinery. Of the 277 hosiery manufacturers doing business nationwide in 2000, some 60 percent were located in the state, most of them in rural western and central North Carolina. One of the biggest challenges the cluster has faced during the last decade is fewer retailers to whom to sell. Increased competition from foreign manufacturers is adding pressure.

Instead of isolating themselves, hosiery manufacturers came together to talk about how to improve their competitiveness. These talks led to the development of a strategic cluster plan. Development of the plan was encouraged and funded by the North Carolina Department of Commerce. First published in 1995, "Preserving Hosiery Manufacturing" has been updated four times as the industry reached certain milestones and considered new goals. The plan carries clout with the state government because it represents roughly 40,000 workers in the industry cluster.

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HTC began as a tangible home for the cluster, based at a state-run community college. It provided training for skills such as knitting, dyeing and bleaching to the manufacturers and suppliers. The center still trains hosiery workers, but now it also offers services in research and development, prototype creation, Web site development, and electronic commerce. The strategic plan has evolved to address ways the industry can export its wares and become competitive globally. The network has added a second location at another community college in North Carolina.

The cluster has received grants from the state and federal governments. The state has played a significant role beyond funding. The department of commerce helped the center present seminars on exporting. The department of labor worked with the center to educate cluster members about compliance with federal workplace laws. The department of environment and natural resources offered training on compliance with state wastewater regulations.

Connecticut Industry Cluster Initiative

Central to the **Connecticut** cluster strategy is state support of the cluster networks that help improve the overall competitiveness of its clusters. The state provides seed money for the formation of networks for each of the clusters it has identified. The networks include not only cluster businesses but also academic institutions and state government.

The cluster networks eventually will be self-sufficient, but the state needed to provide up-front support. The state seed funding has helped the networks get started and leveraged private-sector funding to maintain momentum.

Based on recommendations from business leaders, who were recruited by Governor John Rowland to study how the state could remain economically competitive, the legislature in 1998 created the Industry Cluster Initiative. The agricultural business cluster—the first predominantly rural cluster—was just identified in March 2002, so the impact of state support remains unknown. However, looking at another cluster provides insight into the potential results. In October 1998, the state launched a bioscience cluster, whose network is organized by a nonprofit corporation. The network began with $300,000 in state seed money and $700,000 from industry. Cluster firms and their network encouraged the state legislature to create a $60-million fund to underwrite the construction of incubator and laboratory space.

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Support of the agricultural cluster network promises to have a significant return for the state economy. The cluster is composed of producers of dairy products, mushrooms, fruits and vegetables, tobacco, wine, and forestry products that collectively generate $1 billion in annual sales. It also includes the state's aquaculture, nurseries, greenhouses, and florists. The cluster spans 4,000 farms, 50,000 workers, and 400,000 acres of land (including 68,000 acres within the Long Island Sound that are leased to shell fishermen).

Educational Institutions and Rural Clusters in Minnesota

Minnesota has deployed its entire postsecondary system to help shape an environment that encourages rural businesses to innovate and remain competitive. Colleges and universities that understand the skill needs of area companies can develop curricula that are responsive and meaningful to the workforce.[15] Relationships between industry and community and technical colleges have led to industry-specific training and workforce development to strengthen the members of key rural clusters. The Minnesota State Colleges & Universities (MnSCU) system uses a campus-based approach to address local clusters and a systemwide approach to focus on five industries.

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Locally, Minnesota schools have provided technology and specialized workforce training to support the following three "rural knowledge clusters," which have become models of high-performance rural economies.[16]

- **A wireless technology cluster** around the small city of Mankato in south-central Minnesota has been supported by Minnesota State University-Mankato and South Central Technical College. Applied research at the university increased engineers available for the cluster.

The technical college features a two-year degree program for technicians and provides customized training for contracting companies within the cluster. Building upon these successes, the schools formed the Institute for Wireless Education for employees of major telecommunications firms to get advanced training.

- The city of Alexandria in west-central Minnesota, population 10,000, is the center of a thriving **automation technologies cluster**. Alexandria Technical College is integral to the cluster and it established a degree major in fluid power technology to serve the established industries and the emerging workforce. The college also formed the Center for Automation & Motion Control as a home for related R&D and technical training. The center later established the Manufacturing Automation Research Laboratory with funding from state and local government and industry.

- In sparsely populated northwest Minnesota, there is a robust **recreational transportation equipment manufacturing cluster**. Two snowmobile manufacturers, Arctic Cat and Polaris, are the heart of the cluster and of the regional economy. Together they employ more than 3,000 workers in the towns of Thief River Falls and Roseau, which have a combined population of just 11,150. Since the remote location and rugged winters make it difficult to attract skilled workers, Northland Community & Technical College has played a key role in improving the skills of the resident workforce. The college offers customized training through the Minnesota Jobs Skills Partnership program, which makes matching state grants for education-industry partnerships. Industry growth has led the college to expand its certificate-based programs.

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From a systemwide perspective, MnSCU created the Targeted Industry Partnerships (TIP) program and selected five of the state's largest clusters—health care, manufacturing, printing, software, and taconite production—as partners. The system used funds appropriated by the state legislature to structure programming to meet these industries' needs, particularly workforce training.

TIP is a statewide cluster approach that reaches throughout rural Minnesota. MnSCU system officials met with each industry group to understand what each group's educational and worker training needs were, and how the system could craft and improve effective programming. Issues such as

working conditions, salaries, and health care coverage were addressed simultaneously with industry representatives.[18]

TIP works in rural—and non-rural—Minnesota, according to Morrie Anderson, chief of staff to former Governor Arne Carlson and former MnSCU chancellor, "because it's a way to incorporate the small businesses that you might not normally catch in greater [metropolitan] Minnesota or that may not have resources to take advantage of educational and training opportunities on an individual basis. Work with businesses on a cluster basis and you had opportunity to capture them. And you had an opportunity to develop standards and educational programming that a campus in rural Minnesota could not find the horsepower to do [on its own]. They might have the faculty, but they may not generate enough revenue from the offering to make it worth their while. If you build on a cluster basis, a small campus in west-central Minnesota can take advantage as well as any of the larger campuses, as well as smaller industries."

Specialty Foods in Ohio

In rural southeastern **Ohio**, the state has supported a specialty foods cluster network that has grown in 10 years from a small group of farmers and food processors to a thriving entrepreneurial region.

Ohio has contributed to ACEnet's success through grants and technical assistance from the departments of agriculture and development.

The Appalachian Center for Economic Networks (ACEnet) identified businesses that could form strategic clusters, and then determined whether the clusters could take advantage of untapped markets via a strong local capacity for product development and a culture of innovation. The state has contributed to ACEnet's success through grants and technical assistance from the departments of agriculture and development. In fact, ACEnet has received assistance from 40 government agencies, foundations, schools, and others to reach the point it is at today.

In 1993 ACEnet looked at a nascent cluster composed of six specialty food-processing businesses and a number of farmers and restaurants with unique products. ACEnet created the Food Ventures Center, where entrepreneurs could rent kitchens and equipment to turn crops into all manner of products like ketchup and sauces. The center created a favorable environment for entrepreneurs because it was less risky for them than buying expensive equipment to test an idea. In the center's first three years, ACEnet staff provided technical assistance to more than 150 food businesses, and 70 entrepreneurs or organizations used the facility.

ACEnet responded to this growth by developing new services. It created a nonprofit subsidiary, ACEnet Ventures, to meet the need for high-risk and "patient" capital by providing funds that help area food and technology companies expand rapidly and create high-quality jobs. ACEnet also

North Carolina helped ensure that cluster businesses had access to capital that they needed to grow.

expanded its warehouse to be a distribution hub and upgraded the equipment to give businesses access to the latest production technology.

Arts and Crafts in North Carolina

Searching for a fresh strategy to strengthen the rural western **North Carolina** economy, a group of residents in 1993 looked to the regional heritage of artisans as the means to their economic development end. The state helped ensure that cluster businesses had access to capital they needed to grow.

The residents, who organized into a nonprofit development corporation called HandMade in America, received an organizational development grant in December 1993 from the Pew Partnership for Civic Change. More than 360 people convened to determine how the area could become a national center of handmade arts and crafts.

A survey in 1995 measured the annual economic impact of crafts in the 22-county region at $122 million, or four times the revenue generated by burley tobacco. The same survey revealed needs within the craft community if it was to maintain and expand its economic role. One glaring need identified was access to capital, a typical need in rural communities.[19]

The North Carolina Department of Commerce and the Self-Help Credit Union, a Durham-based community development financial institution, created an investment bank to make loans to artisans and crafts-related businesses. The bank addresses the critical lack of access to capital in rural areas for people with new ideas. Most rural banks offer only a few types of loans, like farm loans, and are not comfortable making loans for projects that stray from the norm, such as for artisans to ply their trade and go into business for themselves.

HandMade and the artisan-based cluster have spurred economic growth in the communities where they are present. Participating artisans have seen up to 15 percent increases in their income. Six of the region's small towns have seen more than $11 million in new public and private investment.

Promote Entrepreneurship Outside the Agricultural Sector

Entrepreneurial businesses are responsible for the vast majority of job creation in the U.S. According to the National Commission on Entrepreneurship, entrepreneurs create 600,000-800,000 businesses annually.[20] High concentrations of entrepreneurs create robust economies highlighted by more growth and better quality jobs.[21]

Entrepreneurship policies are especially attractive options for rural areas.

They rely on developing assets that are unique to the community, are flexible with specific conditions of rural regions, can be scaled to the size and needs of the community, and can be implemented through local intermediaries. Entrepreneurship development also is an effective strategy in light of declines in traditional resource-based, extractive rural industries, namely farming and mining.

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Several characteristics of rural communities and regions present special challenges for entrepreneurship. Small population and low density limit the availability of producer services and access to markets. Many rural areas also face serious human capital constraints. Highly skilled individuals tend to seek employment in metropolitan areas, and those remaining in rural areas may not be aware of entrepreneurial opportunities or possess the skills necessary to take advantage of them. Finally, rural areas frequently lack the institutions for collaboration in business, and the linkages to urban markets and businesses that permit business growth.

States should explore policy and program options to facilitate rural entrepreneurship. Effective tools include the following.

- **Provide access to capital** through budget appropriations or by support of venture capital fund intermediaries. Capital is one of the most critical and glaring needs in rural entrepreneurship.
- **Develop community capacity**—the ability to identify and encourage local entrepreneurs—through specialized training programs.
- **Use technology** such as online networks to connect far-flung rural populations to the informational and financial resources that can assist entrepreneurial business development.

Kansas Rural Enterprise Facilitation

In the spirit of rural self-reliance, **Kansas** has initiated a program to develop community capacity. The program utilized Enterprise Facilitation, a proprietary method developed by the Sirolli Institute to create community networks that support entrepreneurial business development.[24] This process has been used in **Idaho**, **Minnesota**, **Oregon** and **South Dakota**, as well as Australia, Canada, and New Zealand.

During a 30-month program, community leaders learn how to: identify local entrepreneurs, connect entrepreneurs with the resources they need, and create a local environment that encourages more people to take risks and start their own businesses or expand their businesses.

During a 30-month program, community leaders learn how to: identify local entrepreneurs, connect entrepreneurs with the resources they need, and create a local environment that encourages more people to take risks and start their own businesses or expand their businesses. The Enterprise Facilitation model provides a general framework for communities to follow that can be tailored to their unique resources and characteristics.

Five Enterprise Facilitation demonstration projects have been established in

some of the poorest and most remote parts of Kansas. This was spearheaded by the commerce and housing department and with the direct support of then Governor Bill Graves. The state is paying $1 million of the $1.5-million project cost with federal Community Development Block Grant funds. Participating communities must raise the remaining funds.

Volunteer boards of 35 to 50 local residents are responsible for hiring a facilitator to manage the local team and be an informational resource for would-be entrepreneurs and existing businesses looking to expand. To develop a broad community network, board members must introduce the facilitator to 10 people they know. This helps inform the community that a free and confidential service is available and provides a method to receive referrals.

The state of Minnesota has used an online network that connects far-flung rural populations with the informational and financial resources that promote entrepreneurship.

Minnesota Virtual Entrepreneurial Network and BizPathways

Through the Rural Entrepreneurship Initiative, **Minnesota** identified four challenges to its rural entrepreneurship development efforts: access to capital, access to technical assistance, access to technology, and a cultural background that discourages individuality and entrepreneurship. To overcome these challenges, the state used an online network to connect far-flung rural populations with informational and financial resources that promote entrepreneurship.

Minnesota Rural Partners (MRP), the state rural development council, created two mechanisms—the Virtual Entrepreneurial Network (VEN) and BizPathways—to address entrepreneurship needs. VEN organizes rural entrepreneurs and service providers from across the state by encouraging local community gatherings and online interaction. Entrepreneurs and service providers join VEN by registering on the BizPathways Web portal, where entrepreneurship resources are aggregated for easy access. The department of trade and economic development provides the portal with information about state entrepreneurship resources and reviews other site content to ensure accuracy.

Entrepreneurs register with BizPathways by entering details about themselves. Similar to how retail giant Amazon.com operates, BizPathways uses customization technology to alert users of available, relevant resources. This helps entrepreneurs understand what must be done at every stage of company development. It gets entrepreneurs to the right resources at the right time. This is perhaps more important for rural entrepreneurs because they often are geographically isolated and valuable resource information may be difficult to access. BizPathways also stores entrepreneurs' business plans and allows the user to access their plan at any time, such as when making presentations to potential investors.

Nebraska EDGE

Nebraska EDGE (Enhancing, Developing, and Growing Entrepreneurs) develops community capacity through tailored training programs. This state-supported initiative allows rural communities to customize training courses based on local needs and abilities. The program is run by the Center for Applied Rural Innovation at the University of Nebraska at Lincoln and is sponsored by the department of economic development.

Communities interested in hosting a training course must submit a workplan that outlines how the community will sponsor a course. Courses can cost a community about $9,000, and communities with approved plans receive a $3,000 grant to support their course. Communities are encouraged to assemble a coalition of small business associations, banks, accounting and legal firms, media, educational institutions, local government, and others interested in supporting entrepreneurship development. A manager is chosen from this coalition to oversee the course locally. The coalition also can select an instructor from its community or choose from a statewide pool of certified instructors.

Since its formation in 1993, more than 76 courses have been taught to 1,500 residents. Aside from providing grants to support Nebraska EDGE, the department promotes the training courses throughout the state.

Wisconsin CapVest

Wisconsin Rural Partners, the state rural development council, provides access to capital to entrepreneurs through CapVest, the first venture capital fund in the state specifically for rural, high-growth small businesses. Its creation in early 2001 culminated a three-year effort by Wisconsin Rural Partners. Community Bankers of Wisconsin, an association of small-town banks, and venture capital firm Wilshire Investors formed the fund.

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The Wisconsin Department of Financial Institutions provided administrative assistance to the rural council during the three-year effort. The overriding policy goal was to provide more opportunities for rural businesses via the network of community banks throughout the state.

Once fully capitalized, the $10-million fund will be a stable source of funding that will be accessible through local community banks. At that stage, the fund will seek licensing from the U.S. Small Business Administration as a Small Business Investment Corporation. That would allow the fund to leverage its capital for up to $30 million.

Kentucky Rural Innovation Fund

The **Kentucky** Rural Innovation Fund, one of four funds created by the 2000 Kentucky Innovation Act, focuses on early-stage funding for rural entrepreneurs. It provides access to capital so that small and medium-sized rural-based businesses can conduct high-technology research and development with Kentucky colleges and universities.

The fund provides pre-seed and seed capital to knowledge-driven rural companies so they can determine proof of concept for commercializing products, processes, or services. Entrepreneurs must work with colleges and universities, the Kentucky Small Business Development Center Network and/or third-party entities engaged in R&D.

Two levels of funding are available. Initial investments are made in projects that show strong initial promise but need further research to qualify for full program support. One-time investments of up to $7,500 are available. Secondary investments of up to $25,000 per year for up to two years are made in projects that are deemed more complete.

Reinvigorate the Agricultural Sector through Diversification and Value-Added Agriculture Product Development

There is more to farming than simply growing traditional commodity crops. Farmers today recognize that they can earn more income through diversification—by growing different types of crops, raising non-traditional species of livestock or using farmland for different uses. Other farmers are directly processing their crops into finished products that they market and sell to new markets. States that understand this "value-added" new agricultural environment can provide the capital and technical assistance that allow farmers to follow this new path to wealth creation.

The entrepreneurial concepts of agricultural diversification and value-added agriculture encourage farmers to explore higher and different uses for enduring cash crops, and to expand the types of crops grown to adapt to higher-value market niches.

The entrepreneurial concepts of agricultural diversification and value-added agriculture encourage farmers to explore higher and different uses for enduring cash crops, and to expand the types of crops grown to adapt to higher-value market niches. Diversifying agricultural products provides greater value and economic stability. Value-added agriculture strategies can lead to a greater share of final sales in agricultural products in the rural areas where they are grown.

Declines in commodity prices have helped erode rural economies. By processing crops locally, farmers and rural entrepreneurs attempt to retain value-adding activities in rural communities rather than simply selling commodities at low margins on a competitive world market. In some cases,

rural growers have successfully differentiated their products through marketing and branding strategies, further increasing the value of agricultural shipments.

Several states have established policies and programs that form a supportive infrastructure that nurtures entrepreneurship. These approaches:

- **provide finance mechanisms**, including grants, loans, and equity investments, to create higher value products and move agriculture in more profitable directions; and
- **complement diversification efforts with technical and infrastructure support** by promoting new markets, market evaluation, and product development and distribution.

Transitioning away from commodity agriculture can be challenging for farmers. As a result, state agricultural diversification efforts are likely to fail if they do not provide the infrastructure and technical assistance to help farmers make these transitions. The most innovative programs provide resources for careful planning and market analysis, and technical assistance to emerging agricultural entrepreneurs.

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Kentucky Agricultural Development Fund

As the second largest tobacco-producing state, **Kentucky** has worked to diversify its economy in light of declining tobacco production and sales. An ambitious state strategy provides capital and technical support to broaden the base of its rural economy.

Governor Paul E. Patton and the state legislature committed $300 million from the National Tobacco Grower Settlement Trust Fund for the Agricultural Development Fund. This is the largest pot of money invested by a state in the diversification of its rural economy. The state requires every county to establish a local agricultural development council of eight farmers. These councils evaluate local needs and identify projects to receive funding that are best suited to support their agricultural economy. Councils forward comprehensive plans to the state agricultural development board, which oversees funding. The state has chosen to set aside 65 percent of the funding for regional and statewide agricultural projects and 35 percent for individual counties, based on their tobacco dependence. The state will not finance more than half of any project.

Through this funding, the state supports product development, technical production expertise, market research, and supply chain development, all as part of the broad infrastructure of entrepreneurship. For example, projects that have been funded through the program have: improved management practices to bolster the value of the state beef cattle herd; developed vegetable processing and marketing cooperatives; built meat processing

plants and greenhouses; purchased equipment to process and add value to crops; and assessed new market opportunities for selling catfish, shrimp, dairy and meat products, medicinal herbs, wine and table grapes, pecans, and raspberries.

North Dakota Agricultural Products Utilization Commission

The **North Dakota** Agricultural Products Utilization Commission (APUC) **provides grants** to support agricultural diversification. There is no grant limit, although only $1 million is available for grants during the current biennium. Until the early 1990s, the commission primarily made grants for basic research into product development, such as creating new types of wheat to grow. Farmers and other entrepreneurs also used funds to analyze the feasibility of their business plans. Manufacturers used grants to test out new marketing plans and access new markets, particularly international ones. Several cooperatives used funds to market their value-added products. The state has since added farm diversification to its funding priorities.

APUC has evolved with agricultural trends and North Dakota farmers' needs. In the 1980s and early 1990s, farmers sought grants to diversify the animals they were raising (adding bison, elk, and emus) and the crops they were growing (adding chick peas, for example). Diversification is different today. Farmers who grow soybeans are making candles from the oil. Other farmers have taken advantage of an influx of nonresident waterfowl hunters and built cabins and other accommodations on their lands to rent to hunters, a truly non-traditional use of the land. Enterprising farmers can earn $20,000 in additional income during each fall's hunting season. Goose and duck hunters from around the country find North Dakota a prime hunting area because of its location in the birds' migration patterns, the generally high waterfowl populations, and the presence of abundant wetlands. The number of out-of-state hunters receiving permits in North Dakota rose from a low of 4,223 in 1998 to 30,028 in 2001. Nonresident waterfowl hunting permits were capped at 30,000 for 2002.[25]

The Value-Added Ag Subfund program provides loans that: find niche markets that will add value to South Dakota-grown commodities; fund marketing and feasibility studies of projects; and help coordinate the people, capital, and labor that will ensure successful projects.

South Dakota Value-Added Agriculture Subfund

Working from the North Dakota model and with backing from his state legislature, then **South Dakota** Governor William J. Janklow in 1999 created a $3-million fund for feasibility studies and marketing value-added agricultural projects. Based out of the governor's office, the Value-Added Ag Subfund program provides loans to: find niche markets that will add value to South Dakota-grown commodities; fund marketing and feasibility studies of projects; and help coordinate the people, capital, and labor that will ensure successful projects.

For example, a loan awarded in May 2002 will pay for a feasibility study of a new beef packing plant. South Dakota ranchers raise more than 1.3 million

beef calves annually, yet there are few in-state packing plants. Creation of another plant would create savings via economies of scale for ranchers and expand the state beef industry.

In the first three years of the program, 25 loans totaling $1 million have been made. Marketing or feasibility study expenses can comprise up to half of a project's costs. Entrepreneurs must provide an equity contribution of at least 10 percent. Recipients are required to pay back these loans—at no interest—within three years should their value-added concepts become active businesses. However, if the idea it is deemed infeasible or if the entrepreneurs cannot raise the necessary equity, then the loan essentially becomes a grant and the debt forgiven. The state then takes possession of feasibility studies, which may have future value if market conditions change or if another entrepreneur wishes to explore a similar concept.

Iowa has pursued two separate strategies promoting value added agriculture.

Iowa Value-Added Agriculture and Product Branding

Iowa has pursued two separate strategies that promote value-added agriculture—one that provides capital for the development of business plans, and another that complements diversification efforts by promoting market expansion for locally grown products.

Established in 1994, the Iowa Value-Added Agricultural Products & Processes Financial Assistance Program offers loans of up to $525,000 for projects that are beyond the initial stages. These projects have business plans that show a viable market and a feasibility study that has determined the viability of the enterprise.

The program covers three areas:

- innovative products and processes that create products not commonly produced in the state or utilize a process not traditionally used in Iowa to produce a new and innovative product;
- renewable fuels and coproducts that encourage production of renewable fuels, such as soy diesel and ethanol, and coproducts for livestock feed; and
- project creation assistance, which encourages creating business partnerships and networks to work on ideas for new agricultural products or processes.

Funding preference is given to projects in which there is a significant local match to the state funding, where there is a high level of economic need of the region where the facility is or would be built, and where the value-added item is produced and marketed in the same locality.

Financial assistance of $20,000 or more for any given project generally is awarded as a combination of loans and forgivable loans, with the forgivable portion decreasing as the award size increases.

As a way to expand market opportunities for Iowa- produced and processed goods, the state also initiated the "A Taste of Iowa" campaign. Food and other value-added agricultural products that are at least 50-percent raised, grown, or processed in the state are eligible to use the program's trademarked logo on packaging and in advertisements. The trademark is administered by the business development division of the department of economic development. By raising the awareness of Iowa products in new markets, sales could increase and help the state maintain a primary role in agriculture and food production, which are central to the state economy.

Rural economic development policies must build upon the inherent strengths of rural America—abundant natural resources, close-knit communities, strong local business networks, and a largely untapped tradition of entrepreneurial creativity.

The program also convenes buyers and sellers. Program marketing managers travel within the state and to national and international markets to share Iowa products with buyers and to share sales leads and market information to sellers. Any Iowa-based business can participate so the program reaches all levels of producers.

Conclusion

Rural economic development has unique challenges for policymakers. In following the three strategies described here—cluster development, non-agricultural rural entrepreneurship and agricultural rural entrepreneurship—states can drive policy and its subsequent actions or support the policies and programs set out by colleges, universities, and community-based organizations. However they are formed and implemented, rural economic development policies must build upon the inherent strengths of rural America—abundant natural resources, close-knit communities, strong local business networks, and a largely untapped tradition of entrepreneurial creativity. State policies that comprehend this environment can be successful in creating sustainable and replicable economic development where it is needed most.

Endnotes

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