Statement of
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The Rural Policy Research Institute appreciates this opportunity to discuss our perspective regarding the critical decisions facing the Farm Credit Administration, as you adapt to ever-changing dynamics in the nature and structure of rural capital markets. As you know, RUPRI has had a longstanding concern regarding the availability, affordability, and appropriateness of rural capital markets. Over the last two decades, RUPRI scholars have produced some of the more relevant research and analysis regarding this sector, beginning in the mid-1990s. Most recently, we completed a major research study entitled *Access to Capital in Rural America: Supporting Business Startup, Growth and Job Creation in the Wake of the Great Recession* for Rural Business Services, Rural Development, USDA.[1]

Your decisions will have a major impact upon two of rural America's most important assets, entrepreneurship and regional innovation. The importance of these two economic drivers led to the creation of national RUPRI initiatives in both rural entrepreneurship and regional innovation, over a decade ago. Since then, these research and outreach programs have significantly enhanced our understanding of both, their intersection, and their importance to the overall functioning of viable rural economies. In the comments which follow, I will highlight several key trends within this space which impact the future of rural regions, and the role the Farm Credit Administration could play in mitigating potential liabilities and optimizing potential opportunities. I will then conclude with a cautionary perspective regarding the stark polarities inherent in this Farm Credit System consolidation choice.

[1] Markley, Deborah, Erik R. Pages, Patricia Scruggs, and Kathleen Miller. 2012. "Access to Capital in Rural America: Supporting Business Startup, Growth and Job Creation in the Wake of the Great Recession: Interim Briefing for USDA." Prepared for and presented to USDA RD; and Markley, Deborah, Erik R. Pages, Patricia Scruggs, and Kathleen Miller. 2012. "Access to Capital in Rural America: Supporting Business Startup, Growth and Job Creation in the Wake of the Great Recession: Insights from the Field and Policy Recommendations." Report prepared for and submitted to USDA RD.

Salient Rural Trends Impacting These Dynamics

We appreciate the myriad factors you must consider in developing a framework for this decision. The panels today, and in your prior symposium, have addressed many of these. We assume your interest in our perspective relates to our policy research and program expertise regarding the potential impact of consolidation on rural economic performance, beyond commodity agriculture, with particular attention to rural capital availability and affordability. With this perspective in mind, the following trends inform the particular considerations we outline below.

- **Federal rural community and economic development resources.** It is important to always recognize the relative rural disadvantage in federal per capita community and economic development funding. For example, in 2010, metropolitan counties received $1,519 per capita for these programs, compared to $925 per capita in nonmetropolitan counties. This is an historic difference that has not altered in 20 years, varying between $300 and $600 per capita, in each reporting year. This disadvantage points to the need for greater investment activity from non-federal economic development sources.[2]

- **Unique characteristics of rural business.** While rural and urban business startups share similar characteristics, rural firms tend to stay in a self-employment or small stage development phase. Furthermore, while rural firms tend to have a better survival rate, they also experience slower growth and create fewer new jobs or spinoffs. A 2010 NFIB survey indicated that 55.8 percent of rural respondents were able to access "all of the credit they wanted," compared to 44 percent of urban respondents. However, rural businesses tended to utilize bank loans more often and to attract outside equity investments less often.[3]

- **Debt and equity capital.** The NFIB survey confirmed the importance of local banks to rural businesses, 71 percent of whom indicated banks were the primary financial institution for their enterprise, compared to 49 percent of urban businesses. Equity investments still tend to concentrate in metropolitan areas, although some rural activity is emerging.[4]

- **The importance of rural equity funding.** The RUPRI study confirms a huge opportunity for equity funding in rural and micro regions, where venture investments perform just as well in terms of return on investment and job creation, as counterparts in

[2] Fluharty, Charles W. 2012. Written Statement for the Record. Testimony before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry; citing data from the USDA Economic Research Service analysis of Consolidated Federal Funds Data, FY2010.

[3] Markley, Deborah, Erik R. Pages, Patricia Scruggs, and Kathleen Miller. 2012. "Access to Capital in Rural America: Supporting Business Startup, Growth and Job Creation in the Wake of the Great Recession: Interim Briefing for USDA." Prepared for and presented to USDA RD

[4] Markley, Deborah, Erik R. Pages, Patricia Scruggs, and Kathleen Miller. 2012. "Access to Capital in Rural America: Supporting Business Startup, Growth and Job Creation in the Wake of the Great Recession: Interim Briefing for USDA." Prepared for and presented to USDA RD

California and Massachusetts. Performance was not the primary obstacle to rural equity investing, and large venture funds are not the only source of equity capital. Non-institutional sources, such as angel investors, angel funds, or community development venture funds tend to invest in smaller scale and more diverse businesses than large venture capital institutions. These findings point to the potential for expanding the rural angel investor opportunities in rural regions.[5]

- **The critical importance of intermediary support.** In all this, one must recognize supply of debt and equity capital is only one side of the rural capital access equation. Rural entrepreneurs need a combination of a diverse capital mix, along with quality business advisors and networks. Providing robust and entrepreneurial service beyond basic business formation, as well as mentoring and connections to business networks, appears to have major rural entrepreneurship advantage, and should be considered by institutions seeking to improve future capital flows, through business advisory services in rural capital distribution.[6]

Potential FCS Impact, for Good or Ill

As you are well aware, consolidation, across all sectors, has not had a particularly positive impact upon rural regions. While it has been rationalized in the name of overall economic performance, consolidation in transportation, education, health care, telecommunications, and banking, have all negatively impacted the institutional capacities of rural regions. As is always the case, rural citizens, firms, organizations, and jurisdictions have adapted in innovative ways. But each capacity lost has a detrimental cultural, social, and economic impact, whether it is the loss of a rural school, bus route, airline, hospital, or bank.

Farm Credit System consolidation must be considered within the broader context of rural capital markets. Our research, analysis, and field-based evidence consistently point to a general misunderstanding regarding the availability of, and access to rural capital. While generalizations are always risky, the exceptions here simply prove the rule - capital access for medium-sized rural businesses is not the greatest challenge. Instead, beneath this global assessment, a myriad of challenges exist for small business, entrepreneurship, and microenterprise lending. Conversely, very large scale venture and equity capital aggregation to support opportunities in regional innovation beyond agriculture, need far greater attention. In each case, greater enterprise-specific technical assistance capacities are needed. While it can be argued that neither of these enterprise supports should be of principal concern to the Farm Credit System, we would argue exactly the opposite is true. A Government-Sponsored Entity with a statutory obligation to the future of the rural economy should be concerned, if its operating framework

[5] Fluharty, Charles W. 2012. Written Statement for the Record. Testimony before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry; citing data from the RUPRI *Access to Capital in Rural America* study.
[6] Fluharty, Charles W. 2012. Written Statement for the Record. Testimony before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry; citing data from the RUPRI *Access to Capital in Rural America* study.

appears challenged in addressing two of America's most promising rural wealth creation frameworks.

In fact, as we well know, over 80% of the new jobs created in the American economy will be in small and entrepreneurial businesses, and their formation in rural geographies is necessary to provide distributed economic opportunity, as well as a contribution to the overall GDP of our nation. A recent landmark study by the OECD, *Growth in All Regions*, highlights this critical dynamic, too often missed in our world's developed nations. This data-intensive study found that over two-thirds of total GDP growth across all OECD nations emanates from regions beyond large urban areas. Finally, the unparalleled growth in entrepreneurial agriculture and regional and local food systems offers great opportunity for further diversification, from commodity agriculture to value-added enterprises. However, this will only occur if available, affordable, and appropriate capital distribution occurs, across the rural landscape.

A Cautionary Tale Regarding a Polar Choice

We are certain this FCS consolidation discussion has resulted in intensive lobbying from other institutional interests. Such political positioning is to be expected, given the competitive dynamics within this sector. However, wise public policy would suggest the ulterior nature of proprietary positions arrayed around this decision should be factored into the relative merit awarded these perspectives. As you are aware, RUPRI has been supportive of a careful and cadenced advancement in the use of "Mission-Related Investments." This position has been informed by our belief that the initial intent of Congress in FCS formation was to advance agriculture, as rural America's leading economic driver. Nonetheless, this system should be allowed to evolve and innovate, as rural economic activity has diversified, far beyond commodity agriculture. We appreciate the regulatory considerations regarding this issue. However, rural entrepreneurship and innovation have moved far beyond commodity agriculture. A GSE designed to serve rural America should reflect these structural changes.

Therefore, a cautionary tale regarding this choice: If the Farm Credit System is designed to support commodity agriculture, and only commodity agriculture, it is probably in the best interest of both this system and your borrowers to examine the potential which further consolidation offers. Clearly, there are advantages to be gained in both the cost of capital, and reduced risk factors for both the System and eventual borrowers. The global nature of commodity markets will necessitate further enterprise consolidation, as one of the few factors solely under the control of the producer. This will not change, and FCS consolidation to serve these customers has much to argue for it.

However, there is an obvious end game to this dynamic, as fewer and fewer customers, all larger, produce the same commodities. As an FCS business model, this has a foreseeable half-life.

A consolidation decision based solely upon the advantages of this business model precludes appropriate servicing of the immense business opportunities which exist in the other segments of the rural economy. It will also fail to capture the emerging potential to provide business development assistance in capital-intensive financing packages, aligning venture and equity capital partners with FCS-based borrowers, beyond agriculture. In each case, FCS-based business acumen would add significant enterprise development expertise, and would provide elements essential to the growth of both of these enterprise models. Should this potential be captured, it offers an amazing FCS opportunity for regional innovation capacity-building, at both the very small scale, and the very regional scale. Unfortunately, neither can be appropriately expressed, nor given sufficient management and resource investments, if the overriding FCS business model is solely continuing service to a consolidating commodity future. We would argue all three are necessary, but none sufficient, to fully optimize rural America's amazing innovation potential.

We realize the enormity of the task before you, and thank you for your careful consideration of this perspective.