Restoring Well-Being and Entrepreneurship in Rural America

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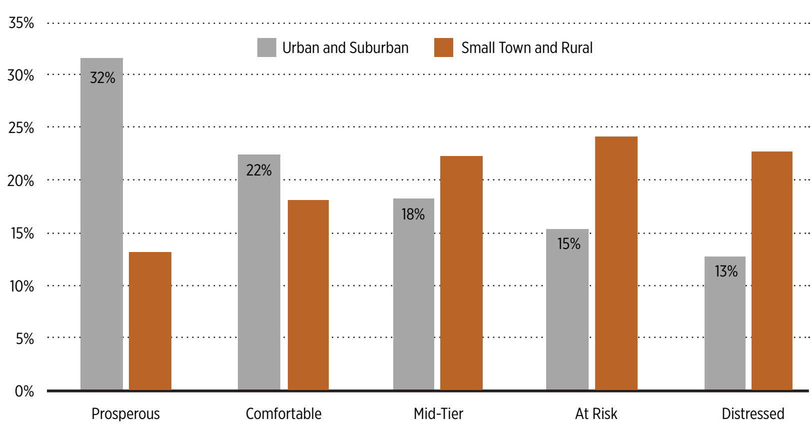
Rural America is as vast, as differentiated and, in many ways, as unequal as the country itself. In total, 31 million Americans live in rural and small-town ZIP codes (henceforth "rural") that are considered prosperous or comfortable on the Economic Innovation Group (EIG) Distressed Communities Index (DCI), meaning their communities rank in the top two-fifths of economic well-being nationwide.[1] And historically, certain parts of rural America have been forging grounds for the American dream, leading the nation in fostering upward economic mobility for young people.[2] However, 23% of the rural population resides in economically distressed communities, or ones that rank in the bottom one-fifth of national well-being. That compares to only 13% of the country's urban and suburban populations (henceforth "urban"). These figures suggest that many rural areas are struggling to gain their footing in the modern economy.

FIGURE 1

Share of the Urban versus Rural Population Living in Each Tier of Economic Well-Being



SOURCE: EIG's Distressed Communities Index.

Majority-minority rural communities are particularly disadvantaged. An alarming 63% of rural ZIP codes in which a majority of the population is nonwhite are economically distressed, compared to 19% of majority-white ones. And while 19% of the rural white population lives in a distressed ZIP code, 29% of rural Hispanics do. That figure rises to 49% each for the country's rural Black and Native American populations. By contrast, 32% of urban Blacks and 15% of urban Native Americans live in distressed communities, suggesting that the intersection of race and rurality can be an especially potent force in constraining economic well-being.

As recently as the 1990s, rural America powered the country's economic advance. Counties with fewer than 100,000 residents added jobs and businesses more than twice as quickly as counties with more than 1 million residents from 1992 to 1996.[3] By the 2000s, the playing field had leveled, and rural areas fell behind through the 2010s. Today, numerous forces compound to hold back rural economic well-being; they include the living legacies of past injustices facing minority groups.[4] Yet they also include underinvestment in the stocks of capital—human and digital in particular—that power the modern economy and would allow more economic opportunity to open in rural parts of the country. Indeed, the deteriorating state of rural entrepreneurship over the past decade signals that the United States has done too little to secure the preconditions for a healthy, dynamic economy to thrive in many rural parts of the country.

The Entrepreneurship That Defines the Rural Way of Life Looks Increasingly Imperiled

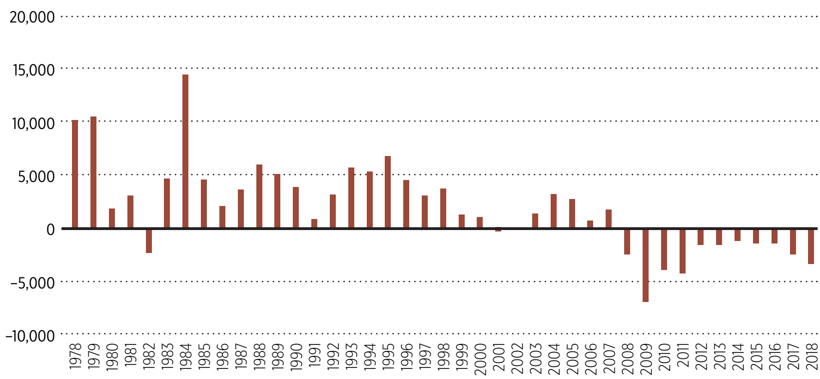
Entrepreneurs help economies evolve—globally, nationally and locally. They combine the factors of production—land, labor, capital and technology—in new and innovative ways. The future of the rural economy will come from within rural America itself, and entrepreneurs will shepherd it in.

Yet rural entrepreneurship is declining, arguably just when it is needed most. According to EIG's analysis of U.S. Census Bureau Business Dynamics Statistics data, rural America (defined in this section as nonmetropolitan areas) produced its smallest crop of startups ever in 2018, just shy of 18,000[5] —that's 44% below its 1995 peak. It also falls well short of offsetting the 21,300 rural firms that closed in 2018.

And this imbalance did not occur only in 2018. In fact, every year since 2008, more firms have wound down across rural America than have started. This is a new development historically, and as a result, the total number of firms in the rural United States has fallen by 10.5% since just before the Great Recession. There are fewer rural firms active in the United States today than at any time since 1987.

FIGURE 2

Net Difference between Firm Starts and Firm Closures in the Nonmetropolitan United States



SOURCE: EIG analysis of U.S. Census Bureau Business Dynamics Statistics data.

Fading entrepreneurship is not a phenomenon unique to rural America. Startup rates have been falling nationally for several decades, accelerating modestly at the start of the 21st century and then swiftly with the 2008 financial crisis. However, the fall has been steeper for rural areas and pushed them below the critical "replacement rate" threshold that would have at least one new company forming for every one that folded. We see the same accelerated downward trend with respect to rural self-employment rates, although for the time being, rural areas still beat out metropolitan areas on this more individualized measure of entrepreneurship.[6]

The drying startup pipeline is making itself felt across rural labor markets, especially when combined with the broader trend toward increased corporate concentration across the economy (in which a smaller number of firms have come to dominate larger shares of their respective markets).

A burgeoning area of academic research finds that a phenomenon called *labor market monopsony*, in which a single firm or set of firms dominates demand for an occupation in an area, is likely suppressing wages in many industries in low-population areas.[7] Where there are fewer employers, workers simply have less choice and therefore less power.

While corporate concentration is a fraught and complicated issue, meaningful wins for workers and entrepreneurs can be achieved in the near term by reforming certain anti-competitive practices, such as the use of noncompete agreements. An estimated 20% of the U.S. workforce is currently subject to a noncompete agreement. These agreements are typically forced upon workers as a condition of employment and prohibit them for working for or starting a competing firm within their employer's market area.[8] It is easy to imagine how noncompete agreements might have disproportionate impacts on rural areas. A single firm armed with a noncompete can effectively lock in specialized talent, block spinoffs and prevent competitors from opening in the market. This chokes off most local economic development potential in the affected industry. Promisingly, momentum is building at both state and federal levels to dramatically curtail the use of these agreements. 2019 was a banner year for state-level reforms, and for the first time ever, in early 2021 bipartisan groups of lawmakers in both the House and the Senate introduced federal legislation to effectively ban the use of noncompete agreements.[9]

Recent Transformations in Capital Markets Present Challenges and Opportunities for Rural Areas

A number of changes to the country's banking sector affecting rural businesses and entrepreneurs took place in the wake of the Great Recession, triggered by the event itself (e.g., the crisis-instigated wave of mergers and acquisitions), its regulatory fallout (e.g., Dodd-Frank Act) or its lasting impact on monetary policy (i.e., perpetual low-interest-rate environment). Banking data reveal how significant a combined impact these developments had on the wider market.

In real terms, total small-business lending (defined as commercial loans under $1 million) fell by nearly one-quarter between 2008 and 2013 and stagnated thereafter, even as big businesses drove real total commercial lending to new heights.[10] The small-dollar share of all commercial loans fell from 40% in 1995 to 20% in 2018.

In addition, many regional and community banks disappeared or were absorbed into larger enterprises as the banking industry consolidated, severing long-established ties between business owners and their trusted bankers. A Federal Reserve report from 2019 found that 41% of rural counties (disproportionately distressed and minority ones) lost bank branches from 2012 to 2017, and nearly 100 rural banking markets lost their only headquarters.[11] The same report showed that most small businesses enjoy real tangible benefits from banking in person, which include better access to credit under better terms.

In other words, the country's increasingly consolidated banking industry has curtailed small-business lending and partially retreated from more peripheral or riskier areas, activities or groups.[12] These transformations matter disproportionately in rural areas, where 62% of workers are employed in small businesses, compared to 47% in metropolitan areas.[13] Bank lending is by no means the only form of capital available to rural business owners and entrepreneurs, but it is generally the most common.[14]

Nevertheless, rural capital markets demonstrated real strength during the COVID-19 pandemic. The Paycheck Protection Program (PPP) showcased rural banking's competitive advantages; for example, the community-centric and relationship-powered banking ecosystem of the Great Plains kicked into high gear to deliver some of the fastest rates of PPP penetration in the country.[15] And as other chapters in the book will show, community development financial institutions, loan funds and other creative and mission-oriented lenders stepped in to support small businesses in other regions where the traditional banking ecosystem was less responsive.

Policymakers have also created a few new tools to increase access to capital in rural areas. Both the rural business investment companies, created by the 2008 farm bill, and "opportunity zones," enacted as part of the 2017 Tax Cuts and Jobs Act, are helping to improve rural access to equity capital. Equity is particularly important for companies with high growth potential. Promisingly, early evidence suggests that rural areas are holding their own in attracting opportunity zone investments into startups and growth businesses, as the associated tax incentives encourage investors to seek promising investment opportunities in traditionally overlooked areas.[16] Led by groups such as the Center on Rural Innovation in Vermont or Four Points Funding on Colorado's Western Slope, opportunity zone investors are taking a second look at rural business models and finding growth opportunities in everything from outdoor recreation and tourism-focused businesses to mental health, water and space technologies. The revival of the successful State Small Business Credit Initiative in the March 2021 COVID relief package should add momentum.

The Country's Demographic Slowdown Is Hitting Rural Areas Particularly Hard

One national challenge especially exaggerated on the country's rural landscape is demographic decline.

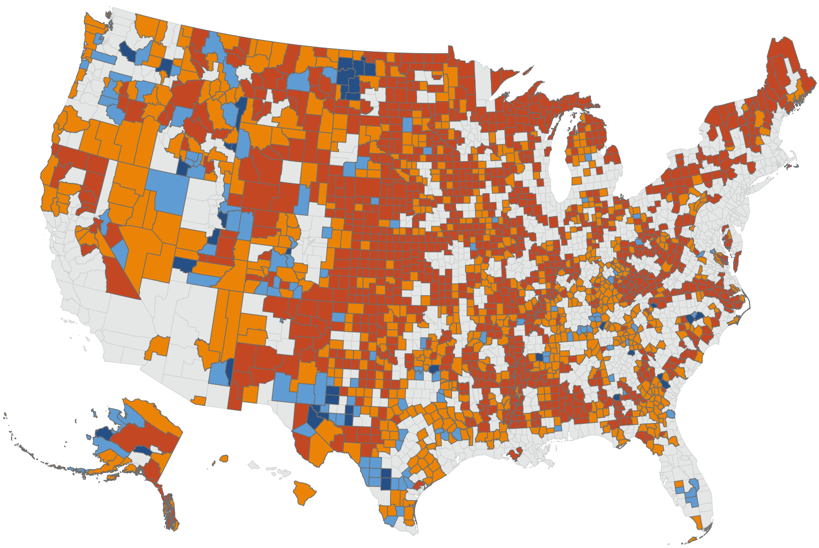
The United States registered its slowest decade of population growth ever in the 2010s, as birth rates tumbled and international immigration dried up. This demographic transformation creates headwinds that are compounded in rural areas by the out-migration of young people, who often move away for education and opportunity elsewhere. In total, 81% of U.S. counties, home to 158 million Americans, lost prime working-age (25-54) adults from 2010 to 2019. For rural counties, the share was 91%. Rural counties experiencing population growth almost exclusively cover oil and gas beds, recreation hot spots and exurban sprawl in the Southeast.

Population decline complicates the work of restoring economic growth and prosperity. Once population loss sets in, housing markets can begin to flounder, eroding household wealth. Local and county government finances can begin to struggle as the tax base shrinks. Leaders eventually find themselves having to make such wrenching decisions as whether to increase ambulance wait times or distances children must travel to school. A shrinking labor pool is less attractive to outside firms scouting locations. Meanwhile, the aging workforces left behind may have a harder time integrating new technologies into their workstreams, stymieing productivity growth locally. Making matters worse, it becomes even harder to start a business in areas where labor has moved away and the local pie of consumer spending is shrinking.[17]

Thus demographic decline can also be a cause of economic decline, not just a symptom of it. Many rural areas are not yet ready to accept demographics as destiny, however, and they are working to shore up demographic flanks and rekindle economic activity in tandem.

FIGURE 3

Prime Working-Age Population Change, Rural Counties, 2010 to 2019



SOURCE: EIG analysis of U.S. Census Bureau data.

An idea advanced by EIG to create a "Heartland Visa" is gaining adherents. Heartland Visas would add to top-line national immigration flows (which are now near modern historical lows) by opening a new class of visa that would allow skilled immigrants to come to communities contending with prime-age population loss. Communities would opt in to the program, choose how many visas they wish to make available, and ultimately what support and integration services they would like to wrap around the program. The visa would be employment-contingent but not employer-based, meaning skilled visa holders could start their own businesses (and immigrants are already around twice as likely to start a company as native-born residents) or find work on the open market, making their talents available to new, small and midsized businesses, as well as the big ones that typically dominate traditional classes of employment-based visas. Such an injection of entrepreneurial zeal, human capital, spending and demand could provide a welcome spark to many rural communities and complement initiatives to further develop the local workforce and enhance the skills of long-term residents.

The Pandemic Offers a Chance for a Rural Reset

The COVID-19 pandemic brought the longest economic expansion in modern American history to an abrupt and tragic end. The convulsions it has caused, however, may have a silver lining: The asymmetric shock it levied against American society and the economy means long-established assumptions about behavior no longer hold, patterns of growth are being disrupted and economic opportunities are opening up.

Yet the pandemic has also accelerated the digitization of economic and social life by at least a decade, estimates McKinsey & Company, a consulting group.[18] Rurality itself is no impediment to prosperity, but isolation—physical or digital—is. Digital connectivity is the key that opens the possibilities of this moment. It is what will allow rural areas to attract remote workers, and it is the foundation on which new rural business models will form. Without modern digital infrastructure and rapid, reliable internet connectivity, rural areas cannot compete in providing advanced services, for example, and they will be at a disadvantage in tapping into knowledge networks. Sadly, our haphazard nationwide rollout of rural broadband and intermittent commitment to the cause left thousands of rural communities less well-positioned than they should have been to take advantage of 2020's step-change increase in professional demand for rural living.[19] The pandemic should be a wake-up call that we, as a nation, must commit to universal broadband as an essential service and achieve a full nationwide rollout within five years.

However, connectivity alone is a necessary but insufficient condition for rural areas to thrive. As also noted in this chapter, the country's recommitment to rural prosperity must include efforts to improve access to capital, ready more of the workforce for the jobs of tomorrow, safeguard competitive markets nationally and overhaul the systems that perpetuate racial injustice. Rural America has immense capacity for endurance and renewal. It is as resilient as the land itself. But after a long period of strong economic headwinds and policy neglect, the garden needs tending. Nevertheless, with some new tools and real attention to the conditions that allow natural processes of economic renewal to unfold, new pathways to rural prosperity are sure to open.

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Endnotes

1 The DCI compares the performance of all ZIP codes with at least 500 residents across the country on seven distinct measures of economic well-being, and groups them into five quintiles ranging from prosperous and comfortable at the top to mid-tier and then at risk and distressed at the bottom. The seven measures are poverty rate, median income relative to a benchmark area, share of adults without a high school diploma, share of prime working-age adults not employed, housing vacancy rate (excluding seasonal and recreational properties), change in jobs and change in number of business establishments. For more information on the DCI, see Economic Innovation Group, *Distressed Communities Index*.

2 See Economic Innovation Group, 2017.

3 See Economic Innovation Group, 2016.

4 See Ajilore.

5 The geographic definitions in this time series are standardized to 2018, so the figures are not biased by the shrinking portion of the country that is considered nonmetropolitan.

6 See Wilmoth.

7 See, for example, Azar et al., and Stansbury.

8 See Starr.

[9] See O'Donnell, and Lettieri.

[10] EIG analysis of Federal Deposit Insurance Corp. (FDIC) Historical Bank Data; all commercial loans encompass commercial and industrial plus nonfarm, nonresidential lending as categorized by the FDIC. For more information, see Fikri.

[11] See Board of Governors of the Federal Reserve System.

[12] For a related story, see Simon.

[13] EIG analysis of 2018 Business Dynamics Statistics data; small businesses are defined here as firms with fewer than 500 employees.

[14] See McKay et al.

[15] See Abello.

[16] See Fikri et al.

[17] For more on these forces, see Ozimek et al.

[18] See McKinsey & Company.

[19] A 2021 assessment by the advocacy group BroadbandNow estimates that 42 million Americans, many of them rural, lack broadband access; see Busby et al.