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Good morning. It is a pleasure to be with you today. I appreciate this opportunity to discuss rural development strategies and the role of cooperatives in fostering investment and growth in rural areas.

I am a lifelong farmer from Marcus, Iowa, a community of 1,100 people in the heart of America's grain belt. I have spent most of the last 30 years growing what we grow in Iowa – mostly corn, soybeans, hogs and cattle. I've operated a grain elevator and warehouse.

Today, my brothers produce livestock and still farm the ground that my father and grandfather farmed before me. I hope that family members-- if they are so inclined -- will be able to do the same.

Five years ago, President Bush asked me to come to Washington, D.C. It is a high privilege for me to serve as a member of the President's team.

In all of these capacities … as a farmer … as the son and brother of farmers … as a citizen of a small rural community in a farm state … and now as the Under Secretary for Rural Development … I have seen firsthand the challenges and opportunities facing agriculture and rural America today.

Having seen those issues "up close and personal," as we say in Iowa, I am yet an unabashed optimist about the prospects for agriculture and rural development. The agency that I lead, USDA Rural Development, is by statute (law) the leading advocate for rural America at the federal level. Our mission is to increase economic opportunity and improve the quality of life in rural America. That is every bit as broad as it sounds.

That said, I must also acknowledge that many other agencies at both the federal and state levels play very significant roles in rural health care, business development, transportation, and the social safety net. Our

system is highly decentralized. At USDA Rural Development, we are a small part of a much larger whole.

We are also a very different organization than we were even a decade ago. Our mission has evolved significantly. Our predecessor agencies were widely regarded as lenders of last resort. Today, however, we are essentially an investment bank for rural America oriented towards sustainable, market-driven development.

Last year, with a total budget authority of about $2.6 billion, we generated $18 billion of investment in rural infrastructure, housing, community facilities and business development. This multiplier reflects our ability to leverage private investment through loan guarantees, which exceed our grants and direct loans by a wide margin.

Our cumulative loan portfolio exceeds $94 billion. Cooperative development is a relatively small, though important, part of this much broader Mission Area.

Our strategic approach to rural development begins with a respect for diversity. Rural America is very large. It covers 75% of the land mass

of the United States, over 2.6 million square miles. This is an area larger than Europe west of Russia.

Rural America ranges from Native villages in Alaska to the Florida Everglades … from the cranberry bogs of New England to the Central Valley of California … from the corn fields of the Midwest to Hawaii to the islands of the Western Pacific to the high deserts of the southwest.

Rural America is home to 50 million people if one counts by counties or 60 million people if one counts by census tracts. It includes areas of profound isolation … areas of deep and persistent poverty … as well as some of America's most prosperous and fastest growing jurisdictions.

The challenges of diversity, I am sure, are familiar to everyone in this room … but in America <u>as in China</u> those challenges are written on a continental scale. Strategies for rural development must begin with the recognition that one size does not fit all.

As an administrative matter, therefore, we have devolved significant authority to our state and local offices. We recognize that challenges, market opportunities, community capabilities, and development

strategies vary significantly from place to place. Investment decisions are often best made in the field, not in Washington, D.C.

Diversity is one strategic imperative. Acceptance of change is another. As we all recognize, this is an era of rapid and sometimes unsettling change. But I believe that if we are prepared to seize the opportunity, the future for rural America is bright indeed.

One can point to many transformative factors. Globalization is one. Since the fall of the Berlin Wall, between 2 and 3 billion people have joined the world market system. This is the greatest explosion of economic freedom in human history. The world is a freer, vastly more productive – and more competitive – place than it was just 15 years ago.

Globalization and the competition it brings can be unsettling. But a world in which manufacturers in Shanghai or software designers in Bombay can compete with people in Los Angeles or New York …

… is also a world in which people in small towns and rural communities have access to regional, national and global markets. A new world of opportunity is there for those nimble enough to seize it.

A second crucial factor, still in its infancy, is the emergence of renewable fuels and biobased products. Biofuels are a rural resource. Wind, because of its siting requirements, is a rural resource. Large solar installations are also likely to be deployed in rural areas. All of these are significant opportunities for investment, jobs, economic growth, and long-term wealth creation in rural areas.

To put this potential in perspective, the U.S. Department of Agriculture estimates the value of this year's agricultural production in the United States at $273 billion. At the same time, Americans this year will spend over $300 billion on imported oil.

In other words, the United States is now spending more on imported oil than for every bushel of wheat, gallon of milk, and pound of beef grown in the United States <u>combined</u>.

If we can displace even one billion barrels of oil imports – about 20% of the total – with biofuels, that is a new market for American farmers

larger than today's net farm income. Wind and solar add even more potential.

Catalyzing and accelerating the development of these new, distributed energy resources is a national priority … and encouraging local investment and local ownership of these distributed resources is a very high priority for rural development in the United States.

A third factor – and the one on which I want to dwell today – is the impact of the information revolution: distributed computing and broadband. From a rural perspective, connectivity changes everything.

From time immemorial, poets and philosophers have celebrated the virtues of rural life. On the other hand, however, rural areas have faced profound barriers of time, distance, and isolation. They have lacked access to information and capital. They have lagged in income and opportunity. But now this is changing.

Today the old barriers are crumbling. Until very recently the dominant <u>transportation</u>, <u>manufacturing</u>, and <u>administrative</u> techniques all encouraged centralization. But now, rather suddenly, it is a new world.

Distributed computing and broadband in fact represent the greatest decentralization of information in human history:

- **Rigid and centralized structures can give way to distributed networks. Large organizations no longer need everyone in the same building to move paper from desk to desk. Inventory, production, and distribution can be easily dispersed.**

- **In the U.S., the shift of a significant fraction of manufacturing to rural areas is one obvious result. In the very near future, the emergence of networked, distributed renewable energy resources such as wind, solar, and biofuels will be another.**

- **In addition, the information revolution provides rural areas with unprecedented access to financial and legal services, improved health and educational services, management and technical expertise, and the capacity to aggregate local capital.**

- **The quality of life, the ability to form new businesses, the ability to exploit new resources, and the ability to compete effectively in regional, national, and global markets are all enhanced.**

These are very large changes. Distributed computing and broadband are transformative for all of society, but for the reasons I've described, their impact in rural areas is even more profound.

> **<u>For the first time in history, rural areas are now able to compete across a wide range of intellectual capital issues</u>. In a knowledge-driven economy, this is essential for growth.**

This is the context which now frames rural development policy in the United States. It challenges us to rethink and reform long-settled approaches. The implications for rural development are sweeping. Everything is affected.

With this in mind, I would like to turn now to the specific question that brings us here today: the role of cooperatives in building a better future for farmers and other rural residents. This is a complex question.

To ask about the role of cooperatives is like asking about the role of a hammer or saw in a carpenter's tool kit. Like hammers and saws,

cooperatives are important tools. But they are not the only tools, and they come in many sizes and forms.

And -- as with all techniques of production -- the computer revolution is changing everything beyond the simplest applications.

To be sure, traditional cooperatives have important strengths. While not the dominant form of business in the U.S., cooperatives historically have played -- and continue to play -- a leading role in some sectors.

- **In the United States today, for example, rural electric cooperatives serve three-quarters of the nation's land area and deliver about 10% of the electricity sold in the United States.**

- **Credit unions are cooperative consumer banking organizations. The approximately 10,000 credit unions in the United States have more than $500 billion in assets and almost 80 million members.**

- **Cooperative business are also prominent in a number of other sectors, frequently in support of small rural businesses and entrepreneurs such as groceries, natural foods, restaurant**

purchasing, hardware, insurance, hospital and pharmacy supply, and lodging.

- **In rural America, the cooperative Farm Credit System is the nation's oldest and largest financial cooperative. Created in 1916, it provides real estate loans, operating loans, home mortgage loans, crop insurance and other financial services to over 500,000 farmer, small-town resident, and cooperative borrowers.**

- **Finally, the United States has over 3,000 farmer cooperatives. About 1,200 of these are primarily farm supply cooperatives. Another 1,600 are primarily marketing cooperatives. The remainder provide a wide range of services including processing, trucking, artificial insemination, and other agricultural services. Total membership exceeds three million, with many farmers belonging to more than one.**

Cooperatives, however, also have weaknesses, notably in their ability to access outside capital, to respond quickly to emerging market opportunities, and to adapt to new strategies and forms of organization.

The relatively small size of the cooperative share of U.S. GDP – about 1.3% in 2005 – suggests the underlying limitations of the traditional cooperative model. In a market system, agility is critically important. This historically has been a weakness of cooperative businesses.

It is important, therefore, to keep our eyes on the goal. The goal is higher incomes for farmers and rural residents … a higher standard of living … the provision of basic services … sustainable and growing rural businesses … and wealth creation in rural areas.

If these goals are best achieved through cooperatives, that is fine. If another form of organization is better suited, that too is fine.

Cooperatives – like any other business model – must be able to change and adapt or they will be supplanted by more agile rivals.

China in this area must find its own path. <u>I would suggest, however, that founding conceptions cast a long shadow</u>. As China begins to explore the cooperative model, it is therefore important to keep in mind that this is one tool among many. The role of any cooperative must be:

- **Context dependent;**
- **Mission specific;**
- **And, at least in theory, time limited. By this I mean simply that cooperatives, like any other form of business organization, are subject to periodic reinvention and change.**

In this area, the American experience may be instructive. Rural development in the United States includes both successes and failures. It includes legacy systems that have become anachronistic – systems which China may well be able to leapfrog. It includes, frankly, some policy errors that no one in his right mind would want to repeat. Coping with change is not easy.

The modern history of rural policy in the United States begins at a very grim moment: the 1930's. The world of course remembers the 1930's for the Great Depression and the onset of war. In the broad scheme of things, the crisis in American agriculture is scarcely a footnote. But for rural America, for America, the crisis was real.

- **The national economy was mired in Depression while the Dust Bowl – a severe drought extending over most of the decade – devastated farming across the southern plains region.**
- **At the same time, mechanization and farm consolidation were beginning to displace several million tenant farmers and laborers. The numbers affected were perhaps small on the Chinese scale but were very large for the United States in the 1930's.**

  32 million people lived on America's farms in 1935. Fewer than 3 million, including children, live on farms today.

- **Rural America also faced significant structural deficits. The United States in the 1930's in fact still had a classic dual economy with a modern sector in the cities and a countryside lagging far behind.**

- **The electric grid usually stopped at the edge of town. Rural America went to bed when the sun went down, got its water from a well, lacked indoor plumbing, and lacked telephone service.**

My grandfather, by the way, did not consider this to be poverty. It was simply the way life had always been on the farm. It was thought to build character, and perhaps it did. But I can assure you that as soon as he could get electricity, running water, indoor plumbing and an automobile he did.

- **In the 1930's, therefore, American agriculture was still living in the previous century. Most farmers plowed behind a horse or a mule. Farm incomes were half the non-farm level.**

- **Rural banking and financial services were rudimentary. Rural schools were often inadequate. The country doctor did what he could but access to sophisticated care was severely limited.**

- **Days were long, work was hard, opportunities were few, and (just like China) the young and ambitious flocked to the cities to seek opportunity.**

Today that world has passed. In a single lifetime we have gone from plowing behind a mule to gene splicing. The income of farm households now exceeds the national average. Rural families are as addicted to

television, the internet, and email as their city cousins. Rural schools are generally competitive and often excellent.

In short, there has been a fundamental structural transformation, in which cooperative organizations such as the rural electric coops and the Farm Credit System played a pivotal role.

The transition has been rapid. Essentially it has occurred in the space of a single lifetime. My grandfather plowed behind a team of horses and bought his first tractor about 1938 or 40. Today our tractors use GPS positioning in the fields.

Mechanization, of course, also means consolidation. As recently as 1950, 40% of rural Americans lived on farms and one-third of the rural workforce worked in production agriculture. One could still say "rural" and mean "farm."

Today, however, fewer than 10% of rural people in the United States live on farms. Only 6.5% of the rural workforce is directly involved in agriculture.

Of approximately 2 million farms in the United States, about 200,000 produce three quarters of the total agricultural output. Most of the remaining farmers hold off-farm jobs and farm part-time.

Over 95% of total rural income is today earned off the farm. Even among farm households, the majority hold non-farm jobs. In 2003, for example, 68% of farm households reported that the farm operator or spouse – or both – worked off the farm. In that same year, across the country, nearly 89% of total farm family income was non-farm.

As the American Farm Bureau – a private-sector organization -- acknowledged in a recent report, farmers today are far more dependent on rural communities than rural communities are dependent on farmers.

The Department of Agriculture has developed a classification of counties based on their economic type. In 2000, out of 2,052 non-metropolitan counties in the United States, only 403 were farming dependent, defined as counties in which 15% of either income or employment was farm-related. One should note, by the way, that a 15% share for agriculture is a low threshold to begin with.

By contrast, 615 non-metro counties were classified as "non-specialized" – that is, highly diversified.

Another 585 non-metro counties were manufacturing dependent, while 222 were classified as government dependent … 114 were service-dependent … and 113 were dependent on oil, natural gas, or mining.

The picture that emerges is clearly of a rapidly diversifying rural sector. This is even more pronounced when one examines demographic shifts. While rural population in the United States is growing, 78% of the 403 farming dependent non-metro counties lost population in 2000-2005.

This was due primarily to the loss of young people -- the farming population is an aging workforce. The rural counties that prosper are precisely those that diversify.

These trends are likely to persist. Indeed, they are likely to accelerate under the impact of the information revolution and the continuing diversification of the rural economy.

This represents a challenge to policymakers, who have long assumed that rural policy was a subset of farm policy. Today the reverse is nearer the truth.

My assessment is therefore simple: As China begins to explore the cooperative model, the historical experience of cooperatives in the United States or elsewhere may be instructive …

… <u>but the main focus needs to look forward to the diversified, knowledge-driven, internet-empowered economy of the future</u>.

Just as developing nations are sometimes able to leapfrog whole generations of technology -- the jump straight to cellular phones is a classic example -- so too must business and investment models be built to 21st century standards. This emphatically includes cooperatives.

Let me describe some of the challenges we have identified in this area.

One longstanding issue for traditional cooperatives has been access to capital. In response, many cooperatives have begun to explore non-

traditional financing models, and several states have modified organic statues to permit greater cooperative flexibility.

A recent survey by our Cooperatives Program staff ["Summary of Models for Accumulating Equity in Cooperatives"] **has identified at least 8 separate cooperative financing models now in play.**

These range from the traditional Proportional Investment Cooperative, in which capital continues to be generated internally from members, to "Demutualization", in which a cooperative is converted into a for-profit, proprietary organization.

Other options include New Generation Cooperatives which provide greater liquidity through tradable delivery rights; the formation of strategic partnerships with outside parties; the issuing of preferred or non-voting common stock; and the formation of trust companies or subsidiaries in order to access outside capital.

Which -- if any -- of these options may be appropriate for a Chinese model is for China to decide. I would simply suggest that the incentives

and pressures that have led U.S. cooperatives in this direction should be anticipated and accommodated from the outset, not be viewed as threatening.

For cooperatives as for rural development in general, one size does not fit all. Again, founding conceptions cast a long shadow. It is easier to build in flexibility at the beginning.

A closely related question is cooperative governance. The traditional cooperative model was based on the social ideal of one-member, one-vote. This, however, is obviously a barrier to outside investment. It tends to inhibit additional investment by member-patrons as well. If the goal is to maximize entrepreneurship, investment, and wealth creation in rural communities, more flexible arrangements may be desirable.

A third and final observation is that the capacity of rural areas to generate internal capital is substantial <u>given an appropriate legal and institutional framework</u>. The experience of the U.S. Farm Credit System is instructive.

The Farm Credit System was established in 1916 in response to a severe lack of long-term credit from commercial banks to finance agricultural land purchases. Congress provided initial working capital, although these funds were entirely repaid by 1968.

The System today is a network of borrower-owned lending institutions organized on the cooperative principles of User-Owner, User-Control, and User-Benefit. The System today holds about 31% of the market share of agricultural credit in the United States.
Ironically perhaps, this 31% figure is a measure of success. A common observation is that the Farm Credit System taught commercial banks how to lend to agriculture. It stepped into a void and created a market.

Today, commercial banks hold about 40% of the agricultural credit; the Farm Credit System holds 31%; other lending institutions 20%; investment companies about 6%; and the federal government only 3%.

Because we have a robust, competitive market based on clear title to land and the ability of farmers to borrow against these assets, rural America controls very significant amounts of investment capital. America's

farmers alone control over $1.9 trillion in assets with a net equity in excess of $1.7 trillion.

These assets exceed our annual program budget at USDA Rural Development by approximately 3 orders of magnitude. This should put the strategy of standing in line waiting for a government loan or grant into proper perspective.

In conclusion, therefore, let me note that the key challenge for us is thus not to provide direct funding. The real challenge is to nurture an entrepreneurial culture … to induce farmers and other rural investors, through cooperatives or other business models, to seize the opportunities that new technologies and markets present today.

If we can do this, we can face the challenges of a highly competitive, increasingly interconnected global economy … not with fear … but with confidence and faith. The opportunities are real. The future is in our own hands – and I am convinced that the future of rural America and I suspect, Rural China is bright indeed.

Thank you.