The Federal Reserve Board

Remarks by Governor Mark W. Olson

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Economic Growth: Lessons from the Sioux Falls Experience

Good afternoon. I am honored to have this opportunity to talk with you and to be with some old friends. In choosing a topic for this afternoon, I decided to begin with an examination of the factors that I think have helped make Sioux Falls a successful and vibrant community. This brief historical review will, I hope, be of interest to you as a retrospective as well as a tribute to your community for the things that it has done so well. I will then discuss the challenges I see for smaller metropolitan areas in the future. Finally, I will highlight the successes that your community has had in creating good jobs and maintaining a healthy economy. I believe that public policy makers--especially those at the national level--can learn much from your experiences.

To set the broad demographic background, let's review the recent data on population and job growth in your region. According to the U.S. Department of Agriculture (USDA) and the Census Bureau, both Minnehaha and Lincoln counties have grown rapidly in recent years compared with the rural counties of South Dakota and neighboring states. During the 1990s, the population of Minnehaha County grew about 20 percent, and that of Lincoln County grew more than 55 percent. In contrast, the population of the rural counties in South Dakota and Minnesota increased only about 3 percent, while the population of the rural counties in North Dakota dropped almost 8 percent.[1] This disparity in population growth likely reflects the better job prospects and higher level of community services available in the Sioux Falls metro area and has continued in recent years: Lincoln and Minnehaha counties grew about 9-1/2 percent between 2000 and 2004, while rural counties in South Dakota saw population declines of about 1-1/2 percent.

Rates of unemployment roughly parallel these population trends. In particular, the unemployment rates in the metropolitan areas of South Dakota have consistently been lower than in rural areas, and this relative abundance of job opportunities has tended to encourage migration to areas such as Sioux Falls. As of late summer 2005, the rate of unemployment was 3.0 percent in Minnehaha County and 2.4 percent in Lincoln County. In contrast, the rates of unemployment in the rural counties of South Dakota averaged about 5 percent; some of the highest county rates of unemployment reflect persistently high joblessness on Indian reservations.

An important cause of the migration from rural areas to metropolitan areas has been the phenomenal growth in farm productivity in recent decades. Those of us with roots in rural America are well aware of the decline in the number of farm families in this country. Although we may lament the steady erosion of small family farms, we must recognize the extraordinary improvements that have been made in the production of agricultural products. According to data from the USDA, two farmers can now produce enough to feed 100 people, a labor requirement that is down by a factor of at least 10 from a few decades ago.

In many rural areas, the resulting decline in the number of farmers meant a decline in population. One of the keys to the growth of Sioux Falls has been its ability to attract many of those who left the farm by providing good jobs and an attractive level of services. Indeed, employment growth in your locale compares favorably with comparably sized metropolitan areas in the rest of the country. Since 1990, the rate of job growth in Minnehaha and Lincoln counties has been more than twice that of other U.S. counties that include a metro area of similar size. And compared with similarly sized metropolitan counties in other upper Great Plains states, the rate of growth in jobs in your area since 1990 has been almost 50 percent faster.

Economists offer several general hypotheses to explain why some cities prosper. I think that the success of Sioux Falls reflects two in particular. The first is what economists term the concentrated-market theory, which emphasizes the benefits to a business of having consumers that are near at hand. Transportation costs are a key component of this factor.

In this context, some of Sioux Falls's economic success reflects its location along natural trade routes. Today, of course, the intersection of Interstate highways 29 and 90 makes Sioux Falls an obvious transportation hub. But even before the city was established, the falls of the Big Sioux River were a landmark that, in the early nineteenth century, provided a gathering place for Native Americans and fur buyers. Near the end of that century, the completion of railroads helped to make Sioux Falls an important trading hub in the region, even as agriculture and resource extraction remained the principal generators of wealth and income.

Building upon their early successes in promoting growth, your business forebears here in Sioux Falls were finding innovative ways to create more jobs, even before the great exodus from the farm to the cities after World War I. A good example of this innovation is the John Morrell meat-packing plant that was established here in the early twentieth century. The plant processed and added value to agricultural products and lowered transportation costs by reducing the volume of meat to be shipped. The success of the facility helped to diversify an economy otherwise dominated by agriculture and primary extractive industries. The John Morrell enterprise also helped to create an employment anchor for the local economy, and it continues to provide jobs today.

A second economic rationale that is often advanced for the development of cities and that seems applicable to the Sioux Falls experience is that of labor market pooling--the ability of an industry to take advantage of a labor force possessing a specific set of skills, thereby raising productivity compared with competing areas with a more dispersed set of skills. Perhaps the best example of this advantage in Sioux Falls is the extensive health care system, which not only delivers top-quality medical care throughout the region but also supplies a large number of good jobs.

However, I submit that there is an additional factor underlying Sioux Falls's success in generating jobs and attracting people. This factor--which sometimes seems to be missing from local, state, and federal legislative and regulatory actions--is the willingness to remove competitive barriers to business at the local and state levels. A good example of this willingness is South Dakota's legislative changes to state usury laws in the early 1980s, which removed regulatory ceilings on rates of interest charged on credit card accounts. These changes helped to encourage Citibank and other credit card subsidiaries to locate their credit card operations in South Dakota, bringing many new jobs in financial industries. In addition, flexible labor laws, as well as South Dakota's reputation as a state with one of the lowest per capita tax rates in the nation (including the absence of corporate income taxes), also make South Dakota attractive to new businesses. These and similar types of policies have helped the local economy grow without the substantial public subsidies that are commonly used elsewhere to woo new businesses.

To sum up my brief retrospective, since its founding, Sioux Falls, thanks to its advantageous location and the hard work and visionary leadership of its people, has prospered to a greater degree than the typical smaller metropolitan area in the United States. Sioux Falls has been quite successful in creating a vibrant and growing metropolitan area, but communities such as yours face many challenges in maintaining that vibrancy in an environment of economic change.

One of the challenges reflects a new migration pattern that is diminishing some of the flow from rural to metro areas that has benefited Sioux Falls. The 1990s began a rebound in population for many rural areas of the United States. Throughout that decade, more people moved into nonmetro areas than moved out, although the population growth in metro areas still exceeded that in nonmetro areas. This turnaround in population trends was not uniform across all of rural America, as one in four rural counties lost population between 1990 and 2000. During that period, a number of factors became increasingly important in influencing decisions on where to reside. Among these growing influences were amenities such as mild weather and attractive natural resources. Lakes and oceans seem to be especially conducive to attracting population growth.

Through its ability to change the competitive landscape, technological innovation is augmenting the nature-related attractiveness of certain rural areas. The Internet and other communications innovations are revolutionizing economies around the world, and many cities may see their competitive advantage erode. Advantages derived from transportation efficiencies seem especially susceptible to this type of erosion, particularly for competition among firms in service-oriented industries. In addition, changes in national policies, such as reduced trade restrictions or modified agricultural programs, can also restructure the competitive landscape dramatically. Finally, exogenous changes in economic conditions can rapidly alter the economic outlook--the recent run-ups in prices for energy and petroleum-intensive products come to mind. To maintain an advantage in the future, business and governmental leaders of Sioux Falls and similar communities must continue to promote economic flexibility and private-sector initiative.

Finally, from my current position as a Governor of our nation's central bank, I would like to spend a few minutes talking about the role of the Federal Reserve System in economic development. Certainly, a strong and active banking community is a tremendous contributor to an area's development. Experienced loan officers who are well acquainted with their markets can channel funds into the loans that are most likely to create wealth and growth in the local economy.

With regard to the Federal Reserve's role in promoting the growth of rural communities, the Fed is charged with maintaining credit conditions that are conducive to our nation's progress. To be sure, our main tool, monetary policy, is a blunt instrument that cannot be targeted at individual industries or regions. However, the Federal Reserve can play a critical role in creating a credit climate that fosters rural progress in general, a climate in which the inherent advantages of individual communities can be realized.

We can best promote a progressive credit climate by maintaining an environment of low inflation. An important reason for keeping inflation low is that entrepreneurs must be able to foresee substantial future benefits if they are to be willing to bear the long-term risks that are associated with creating new enterprises, and expected low inflation affords them a clearer view of projected benefits. We also strive to maintain strong banking organizations that can dependably offer the wide range of financial services that a growing community requires. And we promote sound lending practices among banking organizations so that solid enterprises have adequate access to credit and so that the accumulated capital of the community is not dissipated by lending for overly risky schemes.

We continually search for ways to make our financial system more competitive and responsive to economic needs. For instance, the Federal Reserve currently has a proposal out for public comment that would reduce regulatory capital requirements for bank holding companies that have consolidated assets of less than $500 million. This proposal would give these smaller bank holding companies more flexibility in determining their desired capital structure, which should improve their competitive position relative to larger bank holding companies.

Finally, the Federal Reserve Banks have initiated a variety of programs aimed at studying rural trends and promoting economic development in their regions. The Federal Reserve Bank of Minneapolis, especially through its Community Affairs Department, has been involved in a number of programs that examine strategies for community development. A major finding of these programs is the deleterious effects of a strategy in which metropolitan areas offer tax subsidies to compete for jobs and economic growth, a strategy that is distinctly different from those approaches that I have advocated today and that have characterized the Sioux Falls experience. In addition, in 1999, the Federal Reserve Bank of Kansas City established the Center for the Study of Rural America, which provides the Federal Reserve System and the nation with timely data and analyses of the progress of rural and smaller metropolitan areas.

To conclude, Sioux Falls has been very successful in how it has played the community development game. However, a review of the past reminds us that the economy of any region is subject to change over time and, for a community to remain on top, its business and governmental leaders must continue to push ahead with new ideas for promoting growth in the region. In part, this is true because other, historically less successful communities likely have been borrowing from your playbook, but it is also true because technological innovation likely is changing the rules of the game.

Footnotes

1. For convenience, I am designating as rural counties those in the last three categories on a USDA-devised population scale of 1 to 9. Counties in category 9 are the least populated; as of 2003, Minnehaha and Lincoln counties were in category 3. Return to text

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