INVESTMENT STRATEGY FOR
REGIONAL DEVELOPMENT OF THE UPPER MIDWEST

Talk by

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Before the

1967 Minnesota Economic Association

University of Minnesota, Duluth

October 14, 1967

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Rarely have I been assigned a topic as frustrating and slippery as that suggested by the title, "Investment Strategy for Regional Development of the Upper Midwest". If I have correctly interpreted the title -- and I'm not at all sure I have -- it connotes the possible existence of a definitive plan or even a series of alternative plans to marshall the available financial resources, and then allocate them throughout the region, which will assure optimal development and economic growth. If it exists, I'm all in favor of such a plan. If, however, you expect me to outline a plan for a strategy this morning, you're in for a disappointment, because I don't have one. But I can outline the reasons why I don't, and suggest some possibilities.

Let me start with difficulties of definition. Not the least of these is posed by the words in the title. I would wager that only three words in the title would be uniformly defined in this room, and those are the words, "for", "of" and "the".

The temptation to embark on a lengthy discourse based on my understanding of regional economic growth is one I can only partially resist. I'm sure that Ray Vlasin will cover in much greater detail and depth the major considerations of the phrase, but let me set out a number of postulates I consider relevant to my topic.

Judging from the enthusiasm with which local, state and regional development organizations discuss regional growth, it is probably a safe statement that it is generally accepted as a good idea. These discussions are usually directed towards the single goal of increasing the business activity of the area; an uncomplicated search for smokestacks. Generally the discussants are in the private sector or closely oriented to it. The judgments and value systems are from the market place, and the broader social determinants of national concern are accorded short shrift -- until the price tags attached to the disregard of these determinants are presented for payment.

It is implicit in the title of this talk that there may be a better way. I am enough of a pragmatist to acknowledge this, with only a cautious "perhaps". Planned regional economic growth may be possible, but human experience offers no precedent of any scale. Yet to avoid terminating this talk long before I'm supposed to, let us assume such a system could be devised, and it would work -- two assumptions about which I have serious reservations.

The first postulate is that it must start in the public sector. The pattern of private investment is determined by enterprise objectives, the major one of which is still to make a profit. Labor supplies and a fit with a national marketing and production design are major locational factors for most private industrial investment. Exhortation of social goals can modify these designs to a degree, but generally the hard tests of profit feasibility must be met. To a considerable degree, then, private investment cannot be directed by public consortium; no economic plan, no investment strategy, that by its nature is a neutral environmental factor will alter enterprise plans materially. But an economic plan that involves as part of its grand design the altering of the economic environment, can alter the pattern of private investment. Huntsville, Alabama; the whole of Appalachia; are regions significantly altered by federal design.

Attempts to equalize regional economic constraints, so investment opportunities for private capital are comparable, are many - and they seem to be increasing in geometric progression. But the point appears inescapable that the impetus for the effort is largely from the public sector, be it state, local or federal. Substantial capital investment is usually required to redress basic shortcomings; capital that may carry large social dividends but minimal financial ones. The seed corn analogy, so overworked but appropriate in a money capital sense, has equal validity in a social sense.

The second postulate is that there exist, or can be created, social mechanisms to determine regional goals and priorities that will also assure compatibility with national goals. Regional commissions created as part of EDA, such as the Upper Great Lakes Commission, may be such a device, though it is too early to tell. Quite obviously, the realities of the American political framework require that these mechanisms be based in some way on the existing layers of government. The five great regional authorities proposed by F.D.R., of which only TVA came into existence, would face no fewer political obstacles today than they did when first talked about.

The third postulate is that there can be a reasonable consensus about regional boundaries. As a starter, it seems reasonable to assume that an economic region is simply a sub-region of the national economy, and should represent a grouping of common elements, such as resources or markets, which can be used to define geographical boundaries. Having stated it grandly, and even eruditely, I flatly refuse to illustrate it. The number of different economic regions recognized in legislation of the states and the federal government, and the counties, within the Ninth Federal Reserve District is unknown -- and probably fortunately so. My guess is that it would be some thousands. However, the problem is not going to go away, and the definition of regions will continue to proliferate until it is approached as a conceptual problem directly related to the choice of goals and selection of strategy.

The major point, and the one I wish to emphasize, is that no matter how we draw the geographic boundaries, we are still talking about the subsets of the nation. We are not concerned with isolated areas that can undergo a unique process of economic growth or change; we must recognize the relationships among different regional areas, and with the nation as a whole. We know that regional growth in the present environment consists of competition among regions and between communities. It also follows that there can be conflicting goals among these subsets, which simply reflect the prejudices of the designers (or maybe institutional biases of the planners might be a happier phrase). It is quite unlikely that the financial strategy for Upper Midwest development we might design in the Twin Cities would be the same as that developed for the Upper Midwest in, say, New York City or other major financial centers. By the same token, the financial strategy developed in the Twin Cities for regional growth in the International Falls or Ely areas might be quite different from that developed locally. Quite obviously, there is little agreement between various areas as to the propriety of developing industrial activities in our primary recreational areas, for example.

In broadest terms, then, this logic leads to the question of the regional dimension of national policy. Do the parts of regional development plans add up to the goals of our national policy? Is there conflict between such goals as a stable price level and full employment at the national level and the desire to create employment opportunities at the regional level? Put another way, one can imagine an investment strategy that would achieve a regional goal of higher per capita incomes, while at the same time accomplishing a better allocation of resources on the national level. This seems to be what is happening in the Ninth District with the demise of farm numbers and the movement of the rural people out of the country and into cities frequently beyond our district boundaries. Whether this is good or bad, I do not know. It obviously conflicts with some alternative regional goals, and the problem certainly has a direct effect on an investment strategy. For example, should our investment strategy be in terms of training people so that they might leave our region to seek employment opportunities, or should it be to bring jobs into the district?

For what it is worth, may I suggest that as an additional possibility, you think of regions only as discrete administrative units, of a size facilitating a reasonable degree of operating efficiency. To the degree homogeneity of social, demographic, economic criteria can be also considered, I say fine. But the mobility of our population and our economic efforts is such that only the broadest factors of homogeneity remain constant in any particular area. And certainly we need a regional policy designed on the national basis -- an approach that would recognize the interrelationships among the regions, which would utilize in some way the costs and benefits of varying degrees of regional growth.

What I have done so far, of course, is to blame others for my own inability to design a financial strategy. For a rational financial strategy to be developed, however, we must answer some of these questions, and to answer these questions means that we must continue to allocate our investment funds towards research. There is nothing original, of course, about a plea for more research, nor am I particularly happy about making it, but I don't think we know enough yet about regional economics in terms of developing a definitive analysis of alternatives and costs. Perhaps we need an economic model of regional economic development and growth. Past research efforts have given many of the elements that will be necessary for this model. An impressive amount of excellent work has been done in terms of delineating problems and describing the resources that are available on a regional level. What remains is an examination of the alternative ways in which we can use these resources and the alternative ends that can be achieved within the regional context.

Unless we resign ourselves to either an intuitive approach, or the impersonal judgments of the market place, the art has to be advanced. May I say, my particular body of instincts and prejudices urges me to opt for the market place, because its operations seem inextricable from the pattern of American life as it has always existed. I am not sure we can alter that role without doing serious violence to the total society we are trying to protect. However, this same society has had another characteristic -- an overpowering drive for self improvement -- that keeps saying things can be better. But the hope is not enough. We must know more, in a scientific way, about our choices.

One of the major steps, then, in developing an investment strategy is to simply allocate more funds into research. I hope a greater intensification of such effort into some of these fundamental economic questions will occur in your institutions. At my own, the Federal Reserve Bank is planning to support regional research efforts through the use of our facilities and through direct financial aid, where the research is compatible with our institutional objectives. As an added encouragement for basic regional research, we are considering a periodic publication, probably in a journal format, devoted to regional economic studies. The purpose of the journal would be to provide an outlet for original papers in this field and to provide a broader forum for discussions and analysis of regional economic development. A major question yet to be resolved before we commit ourselves to the journal is whether or not a supply of high quality papers could be generated within the District to sustain such a journal over the years. It is one of those ideas that has broad appeal, though, and we would be interested in your reactions.

While the Federal Reserve Bank is concerned with the broad aspect of regional economic development, and has a strong desire to encourage and assist research, we have a special interest in a particular phase of economic research that is largely neglected -- the role of the financial sector in regional growth. This special interest arises not only out of our commitment to the improvement of the Ninth District's economic welfare, but from the bank's direct responsibility in the field of monetary policy and in bank regulations.

For some reason, the relationship between the financial sector and regional development has not been given a great deal of explicit attention. It seems obvious, however, that there is an important tie between the two. For example, to what extent does an effectively working capital market enhance efforts to achieve economic growth; or to put the same question negatively, to what extent does an ineffective capital market impede the desired reallocation of resources? This general question becomes especially important in the Upper Midwest, where farms and small businesses, physically removed from the money centers, are the dominant economic units. Given the present structure of the financial sector, can we reasonably expect a flow of funds back into the hinterlands to accomplish the kind of regional readjustments that are deemed desirable? In a historical context, the rural areas have provided much of the savings for the industrial development for the urban areas. Can and should this flow be reversed -- and if so, how can it be accomplished? Are the institutional arrangements that now exist sufficient to achieve this end result. In a broader sense, we are concerned with the flow of funds in terms of a regional area and to the extent to which monetary policy decisions on a national level have an effect on the regional capital and credit markets. Again, we open up a whole series of intriguing research questions that call for analysis.

The bank has recently entered into a joint venture with the Department of Agricultural Economics at the University of Minnesota to establish a research program in the area of agricultural capital markets. The basic purpose of this program will be to analyze rural credit and capital markets with emphasis on the relationship to the agricultural sector. In the same vein, the bank is establishing an internal research program intended to be complementary to the program of the University, but with greater emphasis upon the implications of monetary policy in its various forms on regional capital allocations. This, of course, reflects the bank's responsibilities in the field of monetary policy, and is intended to draw upon the research talents and sources of information that are unique to the Federal Reserve System. We hope we can come to grips with questions concerning the differential effects of the various policy tools on the flow of capital into a region, and define ways in which adverse effects of policy decisions on the regional economy can be alleviated.

A second area of internal research emphasis in the bank relates to the regulatory functions of the Federal Reserve. The tie to regional finance lies in the importance of country banks as a source of credit for agriculture and small business, and the likelihood of significant changes in the District's rural banking structure. The current decisions of the bank regulatory agencies in regard to bank mergers and acquisitions undoubtedly influence the long-run structure of banking. These decisions, however, are being made in an environment where there is still considerable controversy over the most desirable type of long-run bank structure. Not only do we need more information and thought applied to that particular problem, but we are also finding that we know very little about such mundane matters as the proper definition of a bank market and a clear definition of the economics of competition in banking. These are matters we feel must be cleared up if we are to proceed toward the development of a financial structure which will be of assistance in the broad field of regional growth.

In summary, let's look again at the title of this presentation -- "Investment Strategy for the Development of the Upper Midwest." The topic concerns the action phase of regional development -- a phase it is impossible to enter until we know where we are going and how we're going to get there.

Thanks in substantial measure to the efforts of the Upper Midwest Research and Development Council, we have a body of data about our resources --

hardly exhaustive, but certainly more than a beginning. It is appropriate now that we address ourselves to the definition of alternative decision mechanisms. It is here that the interdisciplinary exchange must start. The private, the public, and the academic sectors must enter freely into the search for these social mechanisms. There are few reasons to expect success very fast, if at all. I almost added the metaphysical to the sectors whose cooperation must be solicited, because of the reservations I expressed at the outset about such a grand scheme. Going for such an inquiry is the certainty that time is running out. The gaps and lags in social and economic development of the different areas of the United States will not be tolerated much longer by those who, for whatever reason, regard themselves as disadvantaged. Programs designed to equalize regional social and economic opportunity will proliferate in response, at all levels of political origination. Talent and resources are not limitless in this country -- how much better it would be to marshall these effectively instead of dissipating them across an expanding spectrum of national effort.