

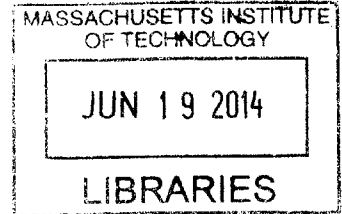
APPALACHIA'S NEW REGION-WIDE CDFI:
BUILDING LOCAL COMMUNITY WITH GLOBAL CAPITAL?

BY

JASON S. SPICER

BA IN ECONOMICS; BA IN SOCIOLOGY
THE JOHNS HOPKINS UNIVERSITY
BALTIMORE, MD (1996)

ARCHIVES



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Signature redacted

Author _____

Department of Urban Studies and Planning
May 20, 2014

Signature redacted

Certified by _____

Professor Amy Glasmeier
Department of Urban Studies and Planning
Thesis Supervisor

Signature redacted

Accepted by _____

Associate Professor P. Christopher Zegras
Chair, MCP Committee
Department of Urban Studies and Planning

ABSTRACT

The Appalachian Regional Commission is currently working with a major foundation on the development of a new regional Community Development Financial Institution (CDFI), Appalachian Community Capital. By connecting Appalachia's small businesses to large external investors, will this CDFI bring more community development capital into the region, and help alleviate poverty? Or, as the neoliberal era deepens into the "Age of Austerity", is this but the latest use of market logic to attempt to solve public, political problems, fraught with the shortcomings of such an approach?

I argue that the new CDFI may bring capital into the region. But because it does so using market logic, it cannot ensure that the money will go to the neediest areas, or that it will be invested in a manner which actually creates jobs for existing residents, in locally owned businesses (thereby keeping profit in the region), or in sustainable industries. It also cannot address the problems posed by a dysfunctional civic culture, in part the legacy of big coal's historic corporate paternalism and subsequent disinvestment, as corrupt local elites "other" the mostly white mountain poor as an intractable, permanent underclass.

Further, even if the new entity could surmount these issues, I argue that it does not address the underlying challenge: the ongoing outflow of capital out of the region. Due to both regulatory barriers and industry economies of scale, institutional and individual investors ship most of Appalachia's capital out to major national financial centers, where it is disbursed around the world. These levels of exported capital stock dwarf the small volumes of community development capital that any CDFI might hope to reinvest locally. For the region's poverty level to decline, this challenge might be addressed through the removal of regulatory barriers and creation of local institutions and investment platforms to invest both community development capital specifically, and other forms of capital, as well. These institutions and platforms may not be most appropriately constructed at the geographic scale of the Appalachian region, given the economic diversity in the region, and given the value-laden history of the social construction of the term Appalachia itself.

ACKNOWLEDGEMENTS

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APPALACHIA'S NEW REGION-WIDE CDFI: BUILDING LOCAL COMMUNITY WITH GLOBAL CAPITAL?

1 INTRODUCTION AND OVERVIEW: APPALACHIA'S CAPITAL PROBLEM?

The Appalachian Regional Commission, created fifty years ago as a novel regional planning agency in the United States, is currently working with a major foundation on the development of a new regional Community Development Financial Institution (CDFI), Appalachian Community Capital. By connecting Appalachia's small businesses to large external investors, will this CDFI bring more community development capital into the region, thereby helping to lift up its poorest places and people, long treated as an intractable "other"? Or, as the neoliberal era deepens in the post-financial crisis world into the "age of austerity,"¹ is this but the latest case to use market logic to attempt to solve public, political problems, fraught with the shortcomings embedded in such an approach?

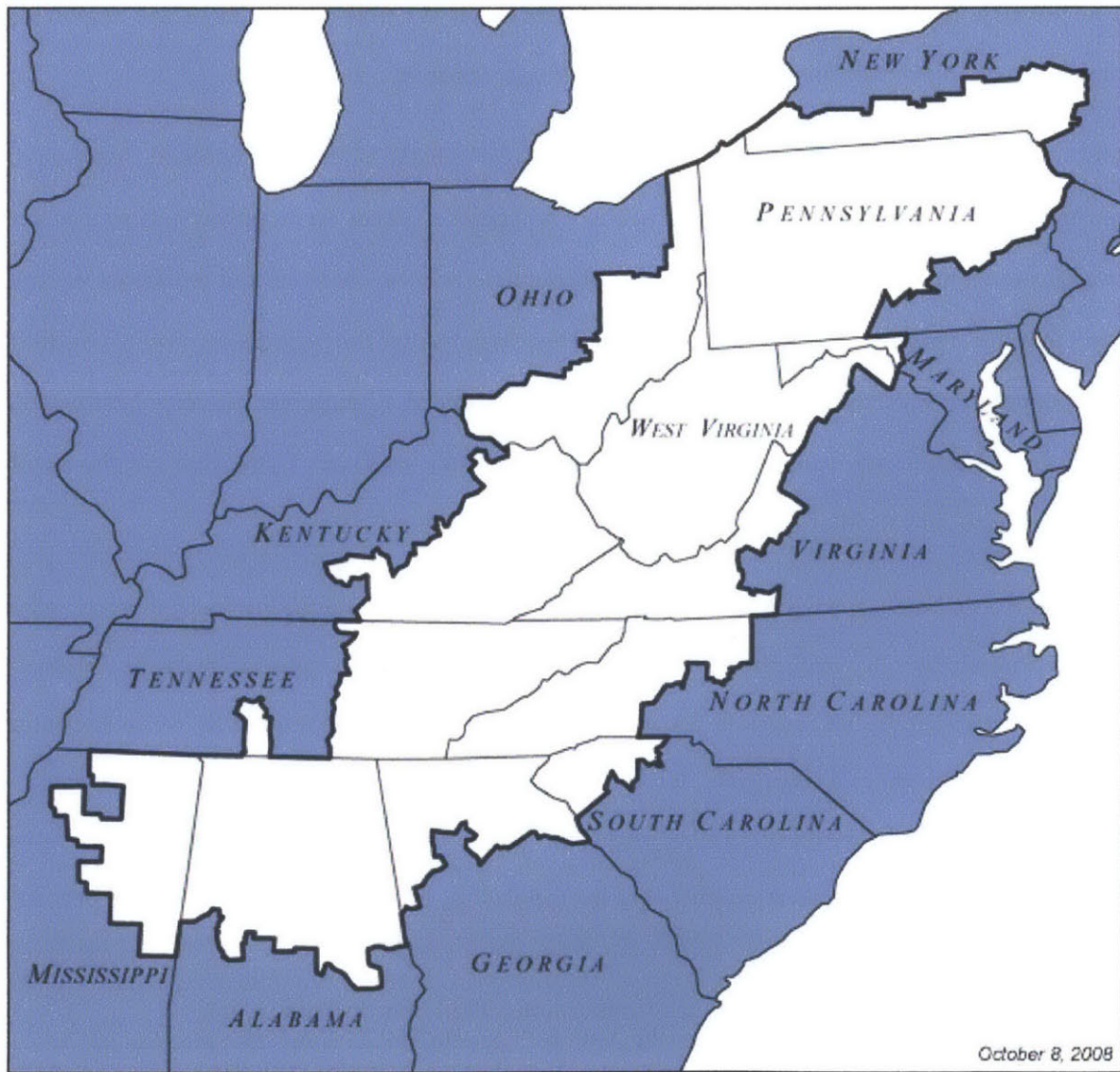
1.1 INTRODUCTION

Nearly fifty years ago, a novel regional planning partnership of the United States Federal Government and 13 state governments, the Appalachian Regional Commission (ARC), was created to invest public

¹ The phrase, now being used by policy analysts, social scientists and geographers to examine widespread public sector cutbacks throughout the Global North, was popularized by the UK's Conservative party leader David Cameron in a speech on April 26th, 2009. Cameron would become prime minister the following year in a coalition government, returning the Conservatives to power after nearly two decades in opposition.

capital for the purpose of spurring economic development to ameliorate poverty in one of the United States' poorest regions. Long studied as a model for large-scale regional planning initiatives, the ARC "has been the longest serving place-based regional development program in the U.S. after the Tennessee Valley Authority, which was established by President Roosevelt during the Great Depression, and to this day remains the largest in terms of geographic scope".² Several other US Regional Commissions have been created and modeled off of the ARC, including the Delta Regional

ARC (and ACC) Service Area



Source: Appalachian Regional Commission

² Ziliak, 2012.

Authority, The Denali Commission, and the Northern Great Plains Commission³. Though the ARC has been criticized by some, economic conditions in the region have improved markedly over the course of its fifty years in existence.

1.1.1 ARC Successes and Challenges

Since the ARC's enabling legislation (1965 Appalachian Regional Development Act or ARDA), the poverty rate in the region has fallen dramatically: in 1965, roughly one-third of the region's residents lived in poverty, today, approximately half that share does. Whereas once 223 of the region's 420 counties were economically distressed, today, just 98 are, according to the ARC.

Connectivity-enhancing project and investment efforts⁴ of nearly \$25B have enabled, among other infrastructure initiatives, the completion of nearly 2,500 miles of roads and highways, as well as major water and sewer improvements. The ARC and independent scholars have conducted frequent studies showing that these projects have made a significant improvement in the region's economic conditions. A recent county-level study concluded that the ARDA "reduced Appalachian poverty between 1960 and 2000 by 4.2 percentage points relative to border counties, or about 10 percent on the baseline 1960 poverty rate, and real per capita incomes grew about 4 percent faster."⁵

Despite these successes, Appalachia remains a region still marked by significant rural poverty, which the ARC acknowledges. Though the ARC's 420 counties account for roughly 13% of the nation's total number of counties, they account for one-fourth of the nation's economically weakest counties (twice as many as its pro rata share). As noted by the ARC itself, "Appalachia has proportionally more of the economically weakest counties and fewer of the economically strongest counties. Over 25 percent of the nation's weakest counties are in Appalachia, while the Region has only 2 percent

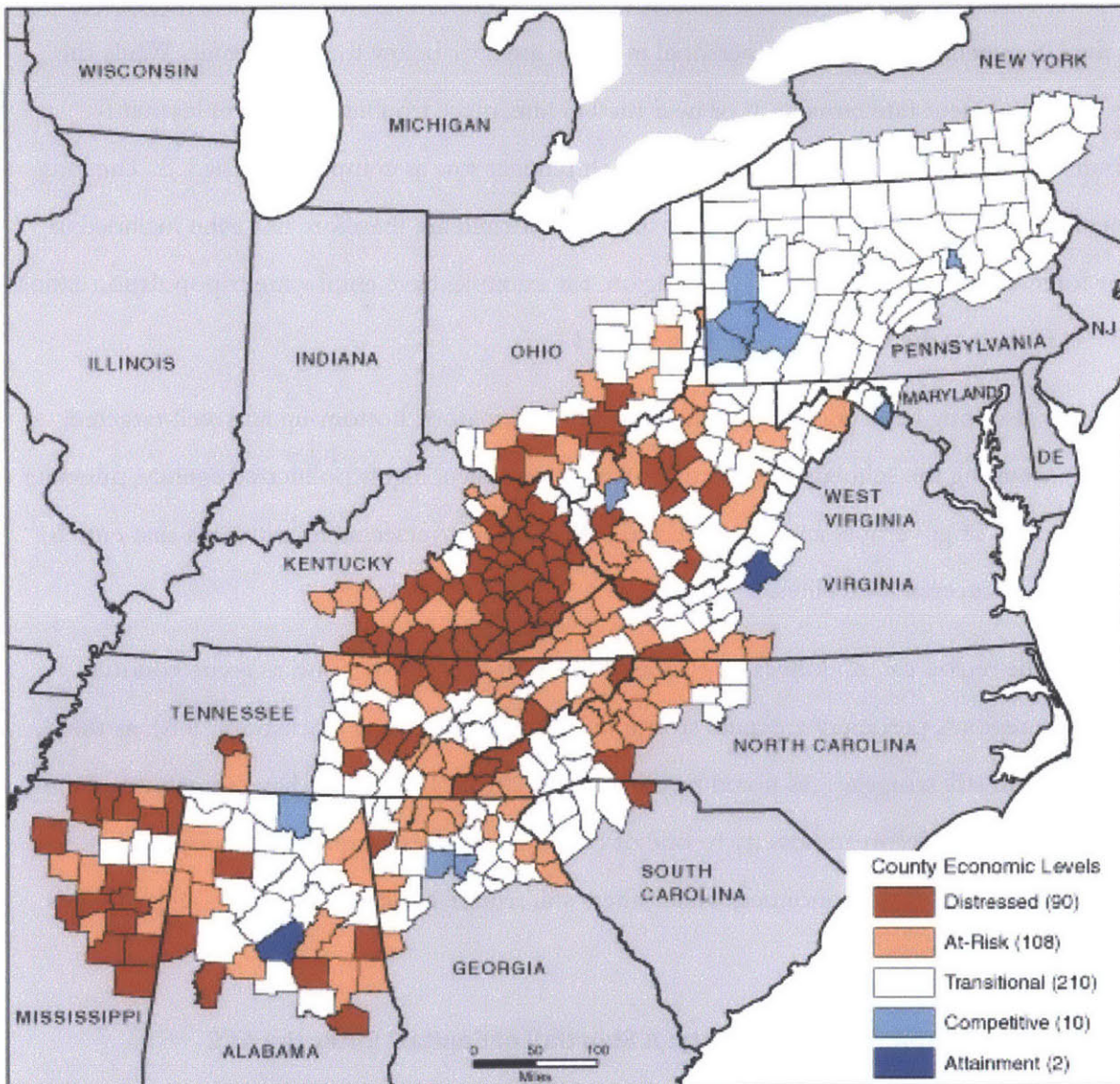
³ Boyd, 2006. Federal Regional Authorities and Commissions: Their Function and Design.

⁴ In the first 25 years of its existence, between the ARC and other federal initiatives that invested in Appalachia, a total of \$15B was invested in the region. Since then an additional \$10B has been invested, according to Zilak, 2012. Also see: <http://www.nytimes.com/1986/11/02/us/a-look-back-and-a-look-forward-find-the-view-bleak-for-appalachia.html>

⁵ Ziliak, 2012.

of the nation’s strongest counties—which are often the engines that drive regional economic growth”.⁶

2014-2015 ARC Counties by Economic Status



Created by the Appalachian Regional Commission, March 2014
Data Sources:
Unemployment data: U.S. Bureau of Labor Statistics, LAUS, 2010–2012
Income data: U.S. Bureau of Economic Analysis, REIS, 2012
Poverty data: U.S. Census Bureau, American Community Survey, 2008–2012

Effective October 1, 2014
through September 30, 2015

⁶<http://www.arc.gov/images/newsroom/publications/fy2014budget/FY2014PerformanceBudgetApr2013.pdf>

Based on data from the Census Bureau and the ARC analysed for this thesis, roughly 4 million of the region's 25 million residents live in poverty today, but the figures swell when the poor who are living marginally above this threshold (e.g. at 150% and 200% of the poverty rate) are included. Nonetheless, the share of the population living below the poverty line in the region remains higher than in the US overall, and per capita personal incomes are 25% below the US average. While the region's unemployment rate remains at or near the US rate, more troubling is its employment-population ratio and labor force participation, which remains low as compared to the US. The long-term unemployed have given up hope of ever finding work and are therefore not even included in the labor force. Seventy-five counties in the region, for example, have employment-population ratios below 35%, far below the US average of 45% in 2011.⁷

The ARC has also long been critiqued as failing to be participatory, bottom-up and well-targeted: Eller (2008) is among the scholars documenting it as a top-down, highly politicized agency, pursuing the “pet projects” of governors and other elected officials, and overseeing investments that enrich politically well-connected local elites.

Nonetheless, the region can no longer be claimed to be homogeneously poor, as some counties located on the region's periphery are quite strong (e.g. Pittsburgh, PA or Blacksburg, VA), as the core of the region still struggles. As noted by the ARC in 2013, “These gains have transformed the Region from one of widespread poverty to one of economic contrasts: some communities have successfully diversified their economies, while others still require basic infrastructure such as roads and water and sewer systems.”⁸

1.1.2 The Cause of Appalachia's Poverty: A Shortfall of Capital? Enter the ACC

Academics and policymakers have long debated the causes of the region's rural poverty, with competing theories lending support to policy interventions. Is the region's poverty a result of its isolation from and lack of integration in the global economy, i.e. a lack of economic development?

⁷ <http://www.arc.gov/images/appregion/Sept2011/EmploymentMapsSept2011.pdf>

⁸ <http://www.arc.gov/images/grantsandfunding/contracts/RFPStateoftheRegionExaminingChangestotheAppalachianRegionSept2013.pdf>

Critics of this view note that the region is highly linked to the world economy via the globalized coal industry. Is the region's poverty then due to the *nature* of its economic development, a function of *how* the region is integrated as a peripheral area or internal colony of the United States, with its assets extracted and controlled by external, absentee owners and landlords?⁹ Is it a case of “the resource curse”¹⁰, whereby natural resource wealth stunts development in other sectors and produces a lopsided and ultimately unsustainable economy? Does it reflect an entrenched “culture of poverty”? Or is it rather the product of dysfunctional local political and social structures, which promote corruption, reproduce an elite, resource-controlling oligarchy – all key characteristics of the resource curse – which “others” the local poor as a unique mountain subculture? Perhaps it is, as supported in this thesis, all of the above?

Or is the key problem a shortage of capital? In 2013, the ARC released a research study, conducted in conjunction with the National Community Reinvestment Coalition, documenting Appalachia's comparatively lower levels of small business and community development capital supplied by banks. In conjunction with this, they announced another novel policy approach, joining forces with the Clinton Foundation in backing the creation of Appalachian Community Capital (ACC) a new region-wide community development bank that will raise and distribute capital to 13 existing Community Development Financial Institutions (CDFIs) and community lenders operating in the region. The reason capital shortfalls matter is that levels of capital investment (as operationalized by loan volumes) have been shown to be positively associated with higher subsequent rates of employment growth¹¹. More detailed studies have shown that higher rates of government-sponsored or publicly enabled loan programs, such as the US Small Business Administration (SBA), result in stronger levels of employment growth specifically in low-income markets¹², including areas with conditions such as those prevalent in the ARC territory.

⁹ Dunaway in Pudup, 1995, Lewis, 1978.

¹⁰ Auty, 1993.

¹¹ Jayaratne and Strahan, 1996; Rajan and Zingales, 1998; and Guiso, Sapienza, & Zingales, 2004.

¹² Craig, Thomson and Jackson, 2008.

Aimed at plugging a capital shortfall, the new financial vehicle is meant to overcome the capital distribution challenges associated with the region's economic and political fragmentation, isolation and lack of scale. Backers of the new venture have posited that these factors keep the region from attracting large, institutional investors that are largely located outside the region, and that by creating a scaled vehicle, the region's purported capital shortfall can be reduced. As noted by Ray Moncrief of the Kentucky Highland Investment Corp. (one of the 13 recipient CDFIs) in the Wall Street Journal coverage of the ACC's announcement, "There's a stigma in Appalachia that says, 'You're profoundly rural, you're profoundly uneducated and you're remote, and we're not going to spend the time to get in there and provide you the financing.'" ARC federal co-chair Earl Goh noted, "We've recognized there is a chronic credit crunch in some of these distressed areas...This is a way to connect Wall Street with Appalachian Main Street. It gets access and capital into these communities."¹³

As this new vehicle is still in its infancy, there is, as of yet, little evidence as to its actual or potential effectiveness. This thesis will therefore explore the prospects of success for this new initiative by examining the assumptions and approach embedded in its structure and strategy: is there a capital shortfall in Appalachia? If so, why? And how will a new region-wide financial institution help solve Appalachia's capital shortfall problem and, ultimately, address its levels of economic underdevelopment and associated poverty?

1.2 THESIS OVERVIEW

In this thesis, I hypothesize that Appalachia, as a "region", if it can be understood to exist as such a coherent thing at all, cannot clearly be said to be poorly capitalized as a *whole*, based on existing available data. Claims to label it as undercapitalized in part reflect the Modifiable Areal Unit Problem (MAUP), in which characteristics of geographic parts or disaggregates are incorrectly attributed to the whole. The region does have sub-areas which are poorly capitalized (see Chapter 4 and 5), but so do

¹³ Wall Street Journal, 6/27/13.

all large regions, including those that are in the core of the highly interconnected, global capitalist economy of the 21st Century. Just as counties in Appalachia are undercapitalized, so, too, are counties in the well-capitalized New York City metropolitan area: in fact, Bronx County in New York City is the second-most underbanked county in the US.¹⁴

I posit that initiatives like the ACC may be beneficial in as much as they increase the capital flowing to low-income oriented community development opportunities. But they are at best *necessary, and not sufficient, to offset overall capital shortfalls and mitigate a dysfunctional civic culture in the region*; this dysfunctional culture (the roots of which will be explored in Chapters 2 and 3) undermines the impact of community development investments¹⁵.

Overall, based on research conducted for this thesis, three key limitations and challenges for the ACC emerge:

1.2.1 Appalachia's "Capital Problem": Far Larger Than Small Community Development Market.

Increasing External Investment in Community Development, A Small Subcomponent of Capital Flows and Stock, Does Not Address the Bigger Issue: Ongoing Export of the Broader Capital Base Out of the Region.

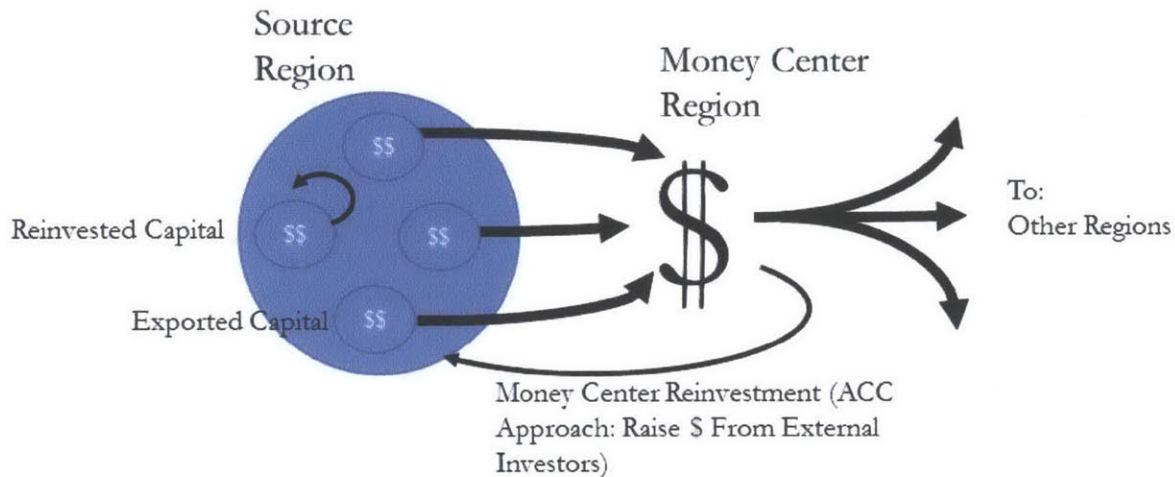
The community development investment space (see Chapter 5) remains an extremely small component of the overall capital markets, in both the region and the US overall. This means that the ACC, if successful, will at best be reimporting a small fragment of the capital that is shipped out of the region on a systematic, ongoing basis, through externally-based landlords, corporations and

¹⁴ <http://www.businessweek.com/articles/2013-05-09/bank-branches-disappear-from-poor-neighborhoods-like-longwood-bronx>

¹⁵ By culture, I mean the norms and practices accepted as “typical” in the reproduction of daily life in a given space, i.e. I am using it as would be understood by sociologists, acknowledging that such a use might be challenged by geographers working from Mitchell’s (1995) reconceptualization of culture as an ontologically artificial concept. Here, specifically, in referring to civic culture, I mean the accepted norms surrounding status, rank, access and privilege relating to common resources and public goods.

financial institutions, as well as through the investment patterns of Appalachia's internal investment institutions, such as state and local pension funds.

Diagram: Appalachia's Capital Export Problem



The ACC, by itself, cannot address the underlying structural reasons for the export of capital from the region. The exporting is a function of the historic legacy of external ownership of its natural resource base and land, regulatory barriers in the capital markets, inherent economies of scale across implicated global industries (e.g. financial services) which are under-represented in Appalachia, and the spatial separation and regional agglomeration of ownership and management functions in these industries.

Because of these dynamics, the region's rich, broad asset and capital base has not been harnessed to produce widespread prosperity, but instead its benefits flow to two key groups who control this base: external, absentee owners and investors, alongside a local, well-resourced, and oft-corrupt elite¹⁶, showing many of the hallmark characteristics of "the resource curse"¹⁷.

These two groups largely live in the region's urban centers¹⁸ and together, these two classes reap the benefits of most of the region's capital, which is largely exported out of the region to "money center"

¹⁶ Duncan, 2000; Billings and Blee, 2000; Pudup, 1995.

¹⁷ Auty, 1993.

¹⁸ Pudup, 1995; Duncan, 2000.

cities such as New York, where it is then invested around the globe, rather than back in Appalachia. The overall levels of capital being exported out of the region, as a function of all of these factors delineated above, dwarf current levels of community development investment volumes, which remain a marginal component of the overall capital market place in Appalachia and the United States overall. Exemplifying the magnitude of these larger capital flows, the case of the investment geography of the West Virginia Consolidated Pension Board is analyzed in Chapter 5, using the pension's publicly available financial statements, which were reviewed for this thesis.

Tied up in this are the broader shifts in the US political economy in the late twentieth century, which drove changes in how community economic development is financed and capitalized: the era saw the Treaty of Detroit era give way to the neoliberal Washington Consensus. This shift resulted in a reduction in direct public sector action and investment (which were "normal" approaches at the time of the ARC's founding), supplanted by the rise of indirect, publicly-enabled but privately-controlled market-based investment approaches, like the ACC.

This shift, which began more than thirty years ago, has only accelerated since the financial crisis of 2008, which has seen neoliberalism deepen through the "geography of austerity". This can also be construed as a shift in the balance of three forms of societal integration (in a Habermasian or Polanyian framework, the three forms are culture, political power and markets) away from political power and direct state investment, and towards markets and private debt. This will be explored in more depth in Chapter 4 and 5.

1.2.2 How The Capital Is Deployed Matters: The Role of Local Culture.

Higher Community Development Investment Volumes May Be Necessary, But Are Not Sufficient to Address The Problem of How Such Capital Is Deployed: It May Be Deployed in A Way That Reinforces, Not Ameliorates, Poverty.

Increased community development investment volumes, while necessary, are not sufficient to address issues in civic responses to poverty in the region: how the money is deployed is as important as the

amount of money. To ensure an effective deployment, the ACC intends on working with community stakeholders to improve demand for capital and enhance technical capacity, but beyond this, interviews revealed that effective deployment of capital would likely require continued and aggressive engagement from community organizers and activists to increase the transparency, accountability, and democracy of the civic culture in Appalachia. A current example of this issue, currently being worked on by an ACC recipient/member institution, a community organizing group, as well as MIT's Community Innovators Lab, can be seen in Benham, KY, where a corrupt mayor and his wife were ousted. The case is detailed near the end of Chapter 3.

The region remains marked by extreme levels of corruption, nepotism, and an "othering" of the rural, mountain-dwelling poor, who are still depicted in popular culture as living in "the big white ghetto"¹⁹ and often remain mired in a cycle of poverty. Unable to access or harness the power of the region's financial capital, they are nonetheless engaged in modes of resistance to economic domination by, for example, working through the subsistence and barter economies.

This "othering" of the mountain poor, which is embedded in the very roots of the idea of Appalachia as a region (see Chapter 2), occurs alongside and within a framework of extremely high levels of local inequality, a rigid class structure, corrupt politics, and a dysfunctional civic culture. These features can often pervade places of rural poverty and exacerbate the "rural poverty trap", as documented by sociologist Cynthia Duncan in her landmark study comparing the Mississippi Delta, Central Appalachia, and Northern New England²⁰. Duncan's study also highlights how topography is not destiny: Northern New England has a similar topography to Central Appalachia, and in fact is in the Appalachian range, and is similarly economically isolated and rural. Yet it lacks the pervasive, multigenerational poverty that pervades certain parts of Appalachia.

¹⁹ National Review, 1/9/2014 <http://www.nationalreview.com/article/367903/white-ghetto-kevin-d-williamson>

²⁰ Duncan, 2000.

1.2.3 The Limits of the Market in Solving Public Problems.

Because the ACC is a Private, Market-Based Entity, Subject to Market Dictates, It Cannot Ensure that Capital Will Be Deployed In the Poorest Areas.

As previously stated, the ACC operates using market logic (as opposed to culture or political power, again in a Habermasian frame) which means it will not interfere with the market. Specifically, it will not intervene to direct capital into the "neediest" of the eligible geographic areas or investment types. It cannot dictate where its recipients will invest or loan, nor can its recipients dictate what (beyond CDFI mandates for loan types) or how their loans will be locally deployed by borrowers. If market logic reveals that the "best" investment opportunities are located in the strongest sub-regions of Appalachia, such as Suburban Pittsburgh and Atlanta, there is little the ACC can or will do to offset this: it is beyond the scope of the ACC's mandate and beyond the reach of its organizational structure. These shortcomings highlight the problems endemic to using the market to solve public problems stemming from regulatory and market failures.

But implicated in this problem is the idea of Appalachia as a region itself, reviewed in Chapter 2. While the ACC uses the idea of Appalachia as a reified object, a tangible thing that investors can understand as a uniform and homogenous concept, Appalachia lacks such internal consistency in reality. This reflects a unique history of how the region has been socially constructed, often by outsiders, to fit an image that does not reflect its underlying nature as understood or internalized by residents.

More broadly, these issues related to the "limits of the market" will be reviewed in Chapters 4 and 5, which, as previously stated, will also review the transition in the US from direct intervention of the state, to market-based solutions to public problems, over the last 30 years.

These three issues, therefore, represent the key challenges and limitations that the ACC will face. Is it possible that additional capital as provided by the ACC could benefit low-income individuals? Yes. But it may not, as it may be deployed in a way that reinforces existing power dynamics in the region.

I conclude that while the ACC may be able to meet its target to provide capital so as to spur economic development,²¹ which helps alleviate poverty, an increase in capital flow alone may not yield the desired results. The capital will need to be invested and disbursed in a manner which does not reinforce existing patterns of political corruption and inequality of opportunity for the “othered” rural poor. The capital will need to be invested in the sub-areas of the region which are actually capital deficient (though this defies a growth center/growth corridor strategy), and not in the areas that have already reached “economic attainment”.

Overall, however, the levels of capital likely to be deployed by the ACC are merely a blip in the broader capital markets, which are structured in such a fashion that extraordinary sums of capital are exported out of the region to Wall Street and beyond on an ongoing basis. Until regulations are changed to promote and enable local retention of generated wealth and capital, Appalachia’s “poverty problem” will likely persist.

1.2.4 Methodology

The ACC is currently in its infancy, its creation having just been announced in summer 2013, its first leadership staff having been hired at the end of 2013, and its first fund raising close, at this writing, currently in process.

As there was virtually no information about its planned operation and strategy available in the public domain, interviews with both leadership staff at both ACC and the ARC were conducted, as well as with the Treasury Department’s CDFI Fund, to ascertain more details regarding its proposed approach, operating and fund-raising strategy, rationale, goals/expected outcomes, and industry operating environment. Interviews with key stakeholders, including other Appalachian community organizing and development entities, were also conducted, to glean information regarding concerns and expectations in directly affected local communities.

²¹ which is the given policy justification for the existence of CDFIs, which are publicly enabled vehicles to ensure that low-income communities, which the market might otherwise ignore, have access to capital.

Based on the information obtained of these interviews, I then analysed relevant sets of economic, financial and demographic data. The purpose of these analyses was to either confirm or question key aspects of both (a) the potential effectiveness of the ACC's organizational strategy and design in meeting the capital shortfall, and (b) broader underlying issues, which the ACC may be unable to address, in the region's capital shortfall and elevated intergenerational poverty.

2 WHAT IS “APPALACHIA”? THE SOCIAL CONSTRUCTION OF “THE REGION”

The ACC and the ARC both reference, in their name, a specific region: Appalachia. The existence of both of these entities is enabled by legislation (the ARC by the ARDA, and ACC by the Reigle Act, reviewed later) and supported by the public sector, as they ultimately serve a public purpose to benefit the residents of this region. Furthermore, the ARC is often held up as a model of broad-scale regional development led by the public sector. As stated in the introduction, the ARC “has been the longest serving place-based regional development program in the U.S. after the Tennessee Valley Authority, which was established by President Roosevelt during the Great Depression, and to this day remains the largest in terms of geographic scope”.²² Further, additional regional planning initiatives throughout the US have taken their inspiration from the ARC.²³

But, as a region, what exactly is "Appalachia" to begin with? As noted by Whisnant, “Appalachia’s boundaries have been drawn so many times that it is futile to look for a correct definition of the region”²⁴. Yet the idea that Appalachia is a region seems to be accepted, as a meaningful concept, as a given.²⁵

The history and notion of this conceptual term and idea of Appalachia as a region, and what it means, is critical to review. Why? Tied up in the idea that “the region” can be helped via a region-wide “Appalachian” regional planning commission and a region-wide “Appalachian” community development bank, is the assumption that there is something coherent, meaningful, and consistent referred to by the term “Appalachia”. Specifically, that “Appalachia” has a common set of

²² Ziliak, 2012.

²³ Boyd, 2006.

²⁴ Whisnant, 1980.

²⁵ Whisnant, like Gaventa who published his landmark work in the same year, had “difficulty finding publishers” (Cf. Fisher’s *Appalachian Journal* 1980 review essay) because he sought to provide people with “information about Appalachia’s political and corporate controllers” (ibid.).

characteristics, problems and challenges that can be tackled through a coordinated planning process and agency.

Further, as confirmed in interviews with parties directly involved with the ACC, the notion of the “region” will likely be critical to the marketing of the ACC to potential investors. In presenting the opportunity to large institutional investors, the new CDFI will use the *image and likeness* of the region, and in fact reify the region as an *object*, if not an outright commodity, to market the investment vehicle. Despite this image, the ACC will not be investing in initiatives or projects which are region-wide in nature. ACC’s recipients, which each operate within a section of one of the ARC’s member states, will likely only lend to and invest in a select bundle of projects in a subset of specific, localized areas of the region and of those specific sub-territories covered by the 13 recipient community lenders. On multiple levels, then, the idea of and operationalization of “the region” is central to the mission of both the ACC and the ARC.

Unlike US metropolitan areas (which are defined by the Office of Management and Budget (OMB) based on labor market commuting patterns), cities, and states (which are both defined by sovereign political jurisdiction), Appalachia is a large, unclear, and nebulous concept. Over the course of interviews with roughly a dozen stakeholders, a clear sense of the basis for thinking of a coherent, homogenous “Appalachia, or what it meant to be “Appalachian”, was not forthcoming.

So what, then, is Appalachia?

2.1 APPALACHIA AS A PHYSICAL REGION

Appalachia, as a physically distinct region, can be defined by its topographical features: the first geographer recognized for doing so was Arnold Guyot in 1861²⁶, who is generally credited “with establishing scientific and popular usage” for the entire mountain range, which he called the

²⁶ Raitz and Ulack, 1984.

Alleghanies²⁷. This work would inform attempts in the later 19th century to divide the US into distinct physiographic regions, led by the likes of John Wesley (1895).

Based on work first conducted in 1913, Fenneman and Johnson (1946) of the United States Geological Survey (USGS) divided the United States into eight major physiographic divisions or provinces (which are further subdivided into 25 subprovinces and 86 sections). One was the Appalachian Highlands, which runs from Maine to Alabama in the US, though its range also extends to the north beyond US borders into Canada. Called “a mountain with one side”²⁸, the region’s eastern mountains and valleys eventually give way to a high plateau, which merges in the west with the prairies.

As delineated by the USGS, “the Appalachian Basin province covers an area of about 185,500 square miles. The province is 1,075 mi long from northeast to southwest and between 20 to 310 mi wide from northwest to southeast.” For purposes of comparison, the total square mile area covered by US portion of Appalachia (as defined by the USGS) is slightly smaller than Spain, and larger than either Germany or Japan.

Common physical and structural features of this territory include:

1. Mountainous and/or rough terrain
2. High humidity and precipitation (among the highest annual amounts in North America)
3. Taken with the erosion implications of these two factors, soils poorly suited to agriculture, except in the valleys
4. Exceptional natural resources in the form of significant forest cover, coal and “scenic beauty” created by the varied terrain of rivers, mountains, and gorges.²⁹

Based on GIS analysis performed by the author overlaying the physiographic division with US Census population data estimates for 2012, this physically-defined region of Appalachia has a population of

²⁷ *ibid*, 1984.

²⁸ Smith and Phillips, 1942, p. 253.

²⁹ Raitz and Ulack, 1984.

more than 80 million people, or more than one-fourth of the entire US population, and is roughly equal to the population of Germany. The region technically encompasses parts of all of the large metropolitan statistical areas (MSAs) of the Northeast Corridor, including sections of the Washington DC, Baltimore, Philadelphia, New York, and Boston.

The physically defined region of Appalachia, however, contains many distinct sub-areas, with variable topographical features such as rivers, plateaus, valleys and sub-mountain ranges forming the basis for the USGS's seven provinces within its Appalachian Highlands division. These physical features historically did serve as mobility and transport barriers during European settlement, resulting in distinct sub-identities and cultures within the region that formed over time, as early settlers placed "their pioneer plastic lives into geographic molds".³⁰

But much of what is typically thought of, culturally and socially, as "Appalachia", does not include the Northeastern component (i.e. Adirondacks of New York; Berkshires, Green Mountains of New England) of the physically defined Appalachia. Similarly, the Appalachian Regional Commission's territory (which will be discussed in the next section) does not include this Northeastern component, and is not consistent with the USGS's definition of the physical region.

Further, the ARC's subcomponent areas (North, Central and Southern Appalachia) do not conform with the history of how these areas were settled, which was in turn a function of physical geography.³¹ Based on the physically-driven settlement patterns, topography forms the basis for an East-West, rather than a North-South, view of the ARC territory as Older (Central), Intermediate (Southeastern) and Newer Appalachia (Western). Settlers first displaced native populations in the central Great Appalachian Valley, moved southeast up into the Carolinas' mountains and Cherokee lands, then settled into the westernmost parts of Appalachia from all directions.

³⁰ Turner, 1932, page 38.

³¹ Salstrom in Pudup, 1995. Salstrom, 1991., Raitz and Ulack, 1984.

2.2 APPALACHIA AS A SOCIALLY CONSTRUCTED REGION

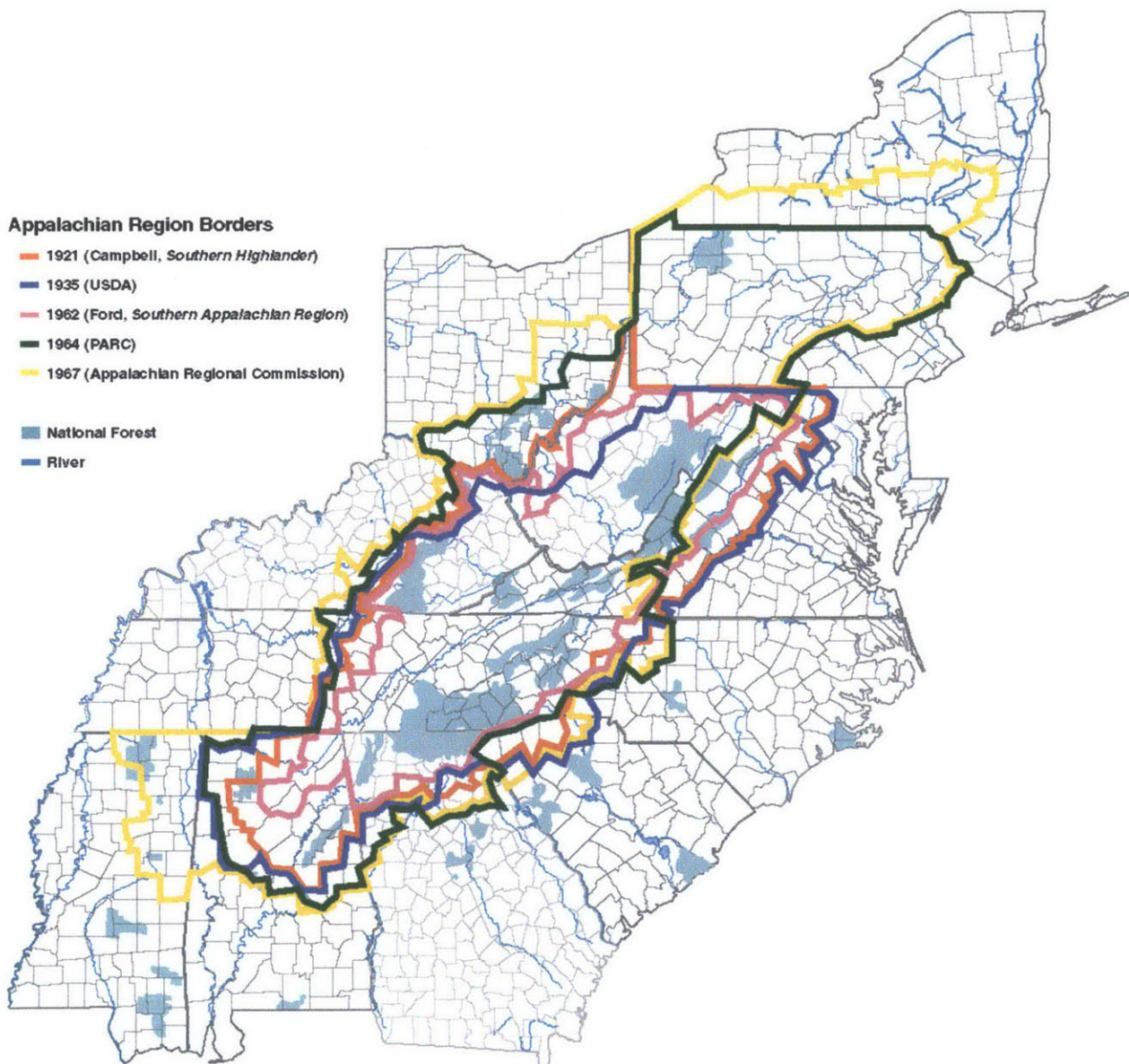
"I'm not sure we really think of ourselves as Appalachians. County identity is strong, state identity, too, and even a sense of ourselves as residents of the Eastern section of the state. But Appalachians? Maybe when we leave here. When my son went away to college in New York, he thought of himself as Appalachian there" – Community Organizer, Kentucky

The geographic reality of Appalachia as a region, however, is far more complex than a physical reading might suggest. A topographically-based understanding of the region and its subcomponent parts is but environmental determinism writ large: as stated above, a large portion of what is physically defined as "Appalachia" is not culturally understood to be in "Appalachia"³², nor is it contained in the ARC's operating territory. Furthermore, "discussion of Appalachia as a subculture, however, is based on material from southern Appalachia....whereas discussions of the coal industry focus on central Appalachia".³³

³² Raitz & Ulack. p. 26-29.

³³ Hurst, p. 52.

In fact, the smaller, socially-constructed concept of Appalachia as a coherent, homogenous region was created by nineteenth century journalists and writers who emerged as part of the post-bellum “local color” movement, which was a distinctive popular literature movement that arose after romanticism and before realism, as something of a transition between the two. Subsequent treatments of the area as a cohesive region by home missionaries from the North and East, followed by a series of foundation and government-led regionalization efforts, would serve to reinforce the idea of Appalachia as a "region", with the region’s boundaries changing over time, often to serve political ends. The



accompanying map (sourced from David Whisnant) demonstrates how these conceptions changed over time, ultimately leading to the ARC boundaries.

This century-plus process of socially constructing Appalachia as a region is imperative to review, because it sheds light on the fact that inherent in the history of the idea of something called “Appalachia” is the notion of the region’s backward, primitive, and “other” nature. Specifically, it reveals that tied up in the very idea of the region's identity is a belief that a portion of its population is somehow, endemically and intractably, different from everyone else. This has implications for any Appalachian-named regional efforts at modernization or development, as will be discussed in the conclusion to this chapter.

2.2.1 Local Color Writers and the Creation of “Appalachia”: 1870s - 1890s

Effectively, the idea of a region called “Appalachia” was “discovered”, or more appropriately, “invented”, by a group of non-local writers active beginning in the 1870s, specifically dating to an article in Lippincott’s Magazine in October 1873, with William Wallace Harney’s “A Strange Land and a Peculiar People”, as detailed by Shapiro (1978) in his seminal history of this process. The local color writers, who largely worked for newer magazines (e.g. Harper’s, Atlantic Monthly) based along the Eastern Seaboard, had a vested and material interest in highlighting and playing up regional variances and differences. This would attract and maximize readership³⁴ in their Eastern Seaboard hometowns: “. . . their assertions were made more often in New York and Boston and Philadelphia than in Asheville or Knoxville”.³⁵

In other words, they had reason not to be objective, but to subjectively and indiscriminately attempt to exaggerate the otherness of Appalachia, as they were paid to do so³⁶. These writers created the “myth of Appalachia” as a uniform region of homogenous peoples³⁷. At the time of the post-bellum

³⁴ Shapiro, 1978.

³⁵ *ibid*, p. xiv.

³⁶ *ibid*.

³⁷ Billings and Blee, 2000; Pudup 1995.

rise of the local color writers, there was no concept of “Appalachia” as a region at all; the word as understood today did not exist at that time, and the “region” was not seen as such, and was initially cast as the “mountainous backyard of eight or nine states”.

Even as the local color writers, largely based on the Eastern Seaboard, began to “other” the area and its peoples through their articles highlighting local peculiarities, they did not explicitly refer to a consistent “Appalachia”, but instead the people of the Cumberlands, or the Smoky Mountains, or the Blue Ridge. Shapiro documents that there was actually a local color writer for each state, because state identities were the primary way in which readers, writers and the public identified with the area; they did not yet conceive portions of these states as part of some unified region, an understanding which began to be constructed at this time through these popular writings.

At that time, while the term “Appalachia” was used intermittently to refer to the Mountain South, the terms “Alleghany Mountains” or “Alleghanies” were generally used to refer to what is now culturally called Appalachia³⁸. It was not until the color writers began writing about this “strange land and peculiar people” that the nebulous idea of a coherent region began to emerge, and even then, the word “Appalachia” was not consistently applied to it.

The word Appalachia itself, however, was not new at that time: dating to the 16th century, and DeSoto’s exploration of Florida, it was drawn from the Spanish-derived Apalache and Apalachen designations, in turn derived from the native word and tribe name Apalachi³⁹. The word originally referred to three things: a North Florida village, the Native Americans who lived just north of Spanish Florida, and the southernmost parts of what is today recognized as the Appalachian mountain range.

Why, however, did this idea, if not yet the name, of Appalachia as a region, take hold at this particular point in time? As noted by Walls:

³⁸ Shapiro, 1978.

³⁹ Walls, 1977, Drake, 1984.

“Three underlying social and historical forces contributed to the discovery of the traditional subculture of the Southern Appalachians in the period following the Civil War: the mountaineer's loyalty to the Union, the end of the frontier, and the rapid expansion of industrial capitalism. The first served to distinguish the mountaineer from other Southern whites, and the second and third made him appear an anachronism in comparison to the mythical mainstream American.”⁴⁰

The local color movement emerged at a pivotal time, then, as the US frontier was closing. Manifest destiny was largely achieved with the statehood of California (1850), the homestead acts (1862) had led to significant settlement west of the Appalachians, with the ultimate sale of 270 million acres, more than 10% of the US land area, and more than the entire region of Appalachia (as physically defined) itself.⁴¹

Further, the closing of the frontier had significant implications as to how and why the emergence of “Appalachia” became a problem. Shapiro expands on Wall's summary above, arguing that the continued existence of Appalachia as an “internal frontier” where “backwards” conditions persisted, despite the westward expansion beyond it, was threatening to the idea of a cohesive, progressive, and modern America. It was “untouched by the progressive and unifying forces that seemed to be at work elsewhere in the United States”⁴² and “would seem to place Appalachia and America in radical opposition”⁴³

How had “civilization” continued to sweep west while having leapfrogged over this entire region, contained people “descended presumably from the Revolutionary generation like the “best” of the American population”⁴⁴ (Shapiro, p. 118) Indeed, the superficial similarities between the population of Appalachia and the Northeast, along with their physical proximity, is a key factor of why Appalachian otherness and “backwardness” so unnerved outsiders, especially Easterners. “Unlike

⁴⁰ Walls, 1977.

⁴¹ <http://www.nps.gov/home/historyculture/abouthomesteadactlaw.htm>

⁴² Shapiro, 1978. P. 5

⁴³ Shapiro, 1978. P. 4.

⁴⁴ Shapiro, p. 18.

most of the areas described by local colorists, Appalachia was not in fact separated from America by ethnic, geographic, or chronological distance. The mountaineers were native-born, white, Anglo-Saxon, And Protestant. The mountain region was not only in America, but in that part of America which had been settled by the first generation of frontiersmen, hence where the rude conditions of the frontier ought long ago to have given way to the more sophisticated and “civilized” conditions of modern life. It was indeed this perception of the “otherness” of Appalachia despite this similarity and proximity which had seemed most intriguing to the first group of writers who followed Harney’s lead.”⁴⁵

Regardless of the specific reasons as to how and why the local color movement exerted such an influence over the construction of Appalachia as a region in the American consciousness, the critical point is that it established the “otherness” of Appalachia in asserting the very idea that the region existed at all. Inherent in the idea that such a region existed, then, was the notion of its “otherness”. Its “backwardness” was at the very core of the formation of its identity as a region:

"In the sketches and stories of the local color writers, assertion of the otherness of Appalachia was more critical than close description of its characteristics. In the literature on the southern mountains generated by the agencies of systematic benevolence, assertion of the mountaineer's "need" was more critical than close description of that need, or of the conditions which created it. Given the absence of hard information about the characteristics of mountain life, writers on Appalachia even at the turn of the century were thus free to offer metaphor instead of statement of fact, to speculate on the consequences of isolation on Appalachian otherness, to propose programs for the melioration of mountain conditions appropriate to their speculations, and to generalize broadly on the 'meaning' of Appalachia's existence for an understanding of American history..."⁴⁶

While not explicit in Shapiro’s seminal history of this process, primary interviews and secondary sources (relating to the local color movement) hint that the regional identity of Appalachia was not

⁴⁵ Shapiro, p. 17.

⁴⁶ Shapiro, p. 81-82.

just meant to distinguish it from America, but to establish it as a negative image or antithesis of the emerging idea of “The Eastern Seaboard” as a region. Technically, much of what is “the Eastern Seaboard” is located in what is physically defined by the USGS as being part of the “Appalachian Highlands”; some of the Seaboard metropolitan areas bleed seamlessly into the foothills of the mountain range. I have been unable to find any literature documenting the history and/or etymology of the concept of the “Eastern Seaboard”. In interviews with a range of Appalachian resident stakeholders in the ACC, I noted frequent mention, as per the opening quote for this chapter, of residents becoming aware of their Appalachian identity when outside of the region, with repeated references in relation to the East and Northeast.

2.2.2 Academia, Home Missions Movement and Foundation Work: Institutionalization of Appalachian “Otherness”: 1890s - 1930s

While the local color movement established the idea of Appalachia as a region, and specifically as a needy, lacking region, no one had actually asked or confirmed whether it was needy⁴⁷, nor had they clearly identified its boundaries. Beginning in the 1890s, however, a number of key actors engaged in a process of what Shapiro calls "the institutionalization of Appalachian Regionalism". Inherent in this process was also an institutionalization of Appalachian otherness, as key foundations, social (religious) movements, academic researchers, and finally, the government, came to see the region as inherently "other": needy, backwards, and intractably poor, and a "social problem area"⁴⁸ in need of "uplift".

With the referral of Berea College, KY’s President William Goodell Frost to “Appalachian America”, in a series of studies in the 1890s documenting conditions in the “region”, that the application of the term Appalachia as understood today began to take hold. Frost was “the first person to give a precise geographic definition to the southern Appalachians as a cultural region”, identifying 194 counties in Maryland, West Virginia, Virginia, Kentucky, Tennessee, North Carolina, South Carolina, Georgia and

⁴⁷ Shapiro.

⁴⁸ Walls.

Alabama⁴⁹. With Goodell Frost's studies, however, the previously undefined term came to be applied to the region, and it stuck⁵⁰. Frost's "intention, however, was to assert the coherence and homogeneity of conditions within these "mountainous backyards" rather than to acknowledge patterns of real diversity within the region".⁵¹ Frost, born in New York and then educated and on faculty at Oberlin, had moved to Kentucky to assume Berea's presidency, and his work often noted the cultural connections between New England and Appalachia, an observation which would diffuse throughout academia, civil institutions and even governments with the writing of Ellen Churchill Semple's "The Anglo-Saxons of the Kentucky Mountains". Semple, a trailblazing female geographer and the first woman to join the faculty of Clark University, would utilize the anthropogeographical frame common of the era to note the cultural similarities between Appalachians and New Englanders, with mountain topography prominently foregrounded as key to explaining the differences, with environmental determinism and human-environment interactions heavily featured.

Frost's naming of Appalachia was coeval with the treatment of the area as a region by the home missionary movement, in which Eastern Seaboard denominations sent proselytizers to the region. With the idea of "Appalachia" as a coherent, backward region established by the local colorists, the missionaries turned concept into action. They, too, saw the region as a social problem area and "sought to dominate the region as a whole, denying the boundaries of the separate states' jurisdictions even as they denied the jurisdictions of their sister denominations. Their emergence as principal authorities on the nature of mountain life during the 1890s thus had the consequence of establishing the basis for a regional definition for Appalachia, even though their own efforts looked to the legitimation of the "central South" as a mission field and the definition of the mountaineers as an appropriate clientele, on the basis of availability rather than upon any recognition of positive characteristics which defined the region and its people. These assumptions of coherence and homogeneity, which formed the justification for home-missionary work in Appalachia during the 1890s and which received explicit

⁴⁹ Walls in Raitz and Ulack, p. 19.

⁵⁰ Drake, 1965.

⁵¹ Shapiro, p. 116.

articulation in the twentieth century, were normally based on very scant evidence and/or limited observation of the conditions of mountain life. Even so “careful” and “scientific” an observer as the Chicago sociologist, George E. Vincent, for example, based his generalization upon brief visits to three Kentucky counties. In his seminal essay of 1898 in the *American Journal of Sociology*, “A Retarded Frontier”, Vincent felt qualified nonetheless to discuss the nature and causes of Appalachian otherness and to place the conditions of the region as a whole in a general context of American historical development. And Vincent was among the most conscious of the limitations of his own observation of mountain conditions. Few of those who wrote about Appalachia even during the 1890s and the first decades of the twentieth century cared even to indicate the basis for their comments on the nature and causes of Appalachian otherness...”

This treatment, in which Appalachia was assumed to be a widely troubled swathe by those lacking any evidence to the contrary, continued well beyond the early twentieth century: no less than the esteemed British historian Arnold Toynbee famously dismissed the Appalachians as previously civilized persons who had descended into primitive conditions, self-admittedly on the basis of no evidence whatsoever.⁵² To the contrary, however, Appalachia was neither uniform nor backwards as a region, but dissenting voices and evidence to the contrary highlighting its progressiveness did not resonate, and were dissonant with the emerging region of the image: as Northeastern universities remained racially segregated, for example, Berea College (KY) commenced coeducation of African Americans and Whites in 1870. In fact, the college viewed integration of the races as central to its mission, until it was forced to stop the practice by order of the Kentucky Legislature in 1904.⁵³

Regardless, it was not until 1912, when the Russell Sage Foundation’s new Southern Highland division was established, that any party actually sought to document and quantify poverty or social problems in the region. This effort, led by John C. Campbell, established “the central repository of data

⁵² Pudup, 1995.

⁵³ Shapiro, 1978.

concerning conditions in the mountains to which workers in the field might turn"⁵⁴, and used 1910 Census data to establish economic and social conditions in the mountains. Upon this basis, "the Southern Highland division of the Russell Sage Foundation thereby became the principal agency through which the implications of Appalachian regionalism were worked out, even as it represented by the mere fact of its existence an acknowledgment that the southern mountains composed a special field of benevolent work, and hence stood as a symbol of the legitimacy of Appalachian otherness."⁵⁵The foundation's efforts often worked in tandem with the efforts of religious groups in what became more broadly known as the "mountain benevolence works". These agents frequently theorized, based on interpretation of their experiences and nascent data, that the seeming problems of the region stemmed from a lack of social institutions due to the rural nature and isolating topography of the mountains. In fact, as shown by a host of other scholars⁵⁶, institutions did in fact exist in the region, but they operated at different scales and in a different manner than these analysts were accustomed to seeing in their home regions.

2.2.3 Government Regionalization and the Era of Acronyms: TVA, WPA Rural Regions, ARA, ARC, ACC 1930 - Today

The regionalization of Appalachia, then, moved from the local color movement, to external, non-Appalachian civil society institutions and social movements operating in "the region", finally, to the federal government.

The Weeks Act of 1911 created the Appalachian National Forest for timber and water conservancy: it allocated \$9 million to purchase 6 million acres across multiple states, conserving land around key navigable streams and headwaters. But in so doing it also defined, in federal law, Appalachia as a discrete economic and physical region. Debate over this act, which had occurred over a decade, occurred at the same time as Goodell Frost's, Campbell's (Russell Sage), and Semple's works were also

⁵⁴ Shapiro, p. 195.

⁵⁵ Shapiro, p. 196.

⁵⁶ Duncan, Billings and Blee, Pudup.

gaining currency, evidencing what institutional sociology might call the process of institutional cultural diffusion⁵⁷ and "institutional isomorphism"⁵⁸. The idea of Appalachia, originally based on a whim, then on scanty evidence, had taken hold not only and spread "like a mist", as ideas in culture are wont to do⁵⁹, it had become institutionalized and finally legally recognized. The Weeks Act developed the Appalachian National Forest, and a decade later, calls for the now-famous Appalachia Trail were underway.

Two decades after the Weeks Act, more federal agencies would define Appalachia as a region: in 1935 the U.S. Department of Agriculture would issue a seminal report "Economic and Social Problems and Conditions of the Southern Appalachians". Formally and officially distinguishing the Southern Appalachians from the Northern component (which today is not necessarily understood in mainstream culture as being Appalachian at all), Marschner at the USDA defined the region on the basis of its physiography, soil and climate characteristics⁶⁰, including 236 counties in 9 states. Five years later, in 1940, the New Deal agency, the Works Progress Administration (WPA), identified thirty four "rural cultural regions" in the United States. One was "Appalachia", which included 154 counties in Kentucky Ohio, West Virginia, Virginia, Tennessee, North Carolina and Georgia", and nearby was the region of "Allegheny", 125 counties in West Virginia, Pennsylvania, Ohio, Maryland and Virginia.

At the same time, of course, in 1933 the Roosevelt administration passed the long-proposed legislation created the Tennessee Valley Authority (TVA), which included 125 counties in six Appalachian states. The TVA, though not explicitly embracing an Appalachian-wide regional concept, nonetheless was a broad regionalizing government effort in an area overlapping with Appalachia, and is thus noteworthy in this review of the development of the idea of Appalachia as a region.

⁵⁷ Strang & Mayer, 1993.

⁵⁸ Dimaggio & Powell, 1983.

⁵⁹ Strang & Mayer, 1993.

⁶⁰ Raitz and Ulack, p. 23.

These early federal efforts would culminate, another two decades later, with the passage of the Area Redevelopment Act of 1961, an "effort to assist all depressed areas, including Appalachia...intended to provide low-interest loans to private investors who were willing to invest in an economic activity that was part of a locally planned community development program. It was also designed to assist in training working and producing financial assistance in creating necessary public infrastructure"⁶¹. This legislation's shortcomings would eventually lead to the passage of the Appalachian Regional Development Act (ARDA) of 1965, which would establish the Appalachian Regional Commission (see Chapter 4).

The ARC's territory originally included 399 counties across 13 states (New York, Pennsylvania, Maryland, West Virginia, Ohio, Kentucky, Tennessee, Virginia, North Carolina, South Carolina, Georgia, Alabama, Mississippi), and today includes 420 counties. West Virginia is the only state located entirely within the ARC's catchment area, with counties in or abutting the Appalachian range in the sections of the remaining 12 states included in the ARC's territory. The ARC territory is additionally divided up into three subcomponent regions: Northern, Central and Southern Appalachia; Central Appalachia, located in the core of the region and encompassing much of West Virginia, Eastern Kentucky and Western Tennessee, contained what were at the creation of the ARC, and still are, the economically weakest and most distressed counties and population. Notably, a study examining the objective criteria for inclusion in the ARC territory⁶² finds that the region was "well-conceived", in as much as the ARC region roughly corresponds to the metrics originally used to define it.

In recent decades, studies documenting Americans' cognition of Appalachia as a region have also found that the ARC's territory does indeed now roughly correspond to the general population's concept of Appalachia as a sociocultural region. The primary characteristic Americans most identify with the region? Poverty.⁶³

⁶¹ Shannon in Edward, p. 76.

⁶² Watts, 1978.

⁶³ Raitz and Ulack, p. 336.

2.2.4 The Diffusion of Appalachia as An Idea and The Riddle of "Appalachia": Definition Rooted in Backwardness, How Can It Ever Be Anything Else?

Clearly, the record supports the finding that the idea of Appalachia came out of the local color writing movement at a pivotal time in the development of the idea of America and the American psyche, in the postbellum years which saw the closing of the western frontier and the achievement of manifest destiny. The idea of America inherently conceived of Appalachia as "the other", and in many ways as the antithesis of a modern, progressive, forever advancing America. This spread to civil society social movements and institutions, before finally becoming formally recognized and legally fixed as a concept, as mediated through, reified and defined by federal law. These formally recognized definitions of the region, in an iterative process, have been reflected back through to the general population, which reconstitutes the idea of Appalachia as a coherent region.

Throughout this thesis, then, references to Appalachia, unless delineated otherwise, reflect this latter and smaller, socially constructed concept of the region, which roughly equates to the operating territory of the ARC. This definition of the region excludes the wealthier areas of the Mountain North, notably Northern New England, and much of the Adirondacks.

The definition of the region this way, however, presents a conundrum. Specifically, the social construction of "Appalachia" reflects part of the region's identity problem: if "Appalachia" has, since its inception as a region, been understood to mean a backwards place, do not regional planning and banking initiatives that use this name thereby reinforce this sense of backwardness and otherness? How can these initiatives, which are attempting to eliminate or reduce this backwardness through economic development, when embedded in their very name and operating level of geography is the idea that the place is backwards?

Interestingly, in interviews with the ACC, this paradox appeared to be merely an academic curiosity and was not seen as a problem, because community development investors are, by nature of the type of investment, already investing in distressed or disadvantaged areas with significant low-income populations, areas at high risk for social problems. This is, by definition, what community

development investment typically entails. As such, to some degree or another, they are already investing in spaces, places and people who have been "othered" as somehow backwards, be they urban or rural. Indeed, it was the urban vs. rural divide that appears most concerning for fundraising purposes: rural, then becomes a proxy for a distinct form of "other".

Nonetheless, longer-term and beyond the specific purpose of the ACC, the paradox of the use of Appalachia as a coherent regional concept remains troubling. Echoing the sentiments of interviewees, Walls noted that "'Appalachian'...has never become a symbol of self-identification for the vast majority of the region's people, for whom the community, county, state, and nation remain more important units of political identity". This is despite the success of "the social movement to obtain recognition for Appalachia as a problem area."⁶⁴ Instead, the historic roots and development of the term, as reviewed in this chapter, reveal it to be a concept primarily created for and by external groups. The term eventually took on a larger social, economic and legal meaning over the course of the twentieth century, and remained indelibly linked to the image and culture of the mountain hillbilly or rural poor, both externally, and in the minds of locally elites as a way to distinguish themselves from others, as will be discussed in the next chapter.

⁶⁴ Walls, 1977.

3 A REGION APART: THE POLITICAL, ECONOMIC AND FINANCIAL ROOTS OF APPALACHIAN POVERTY

If we accept the idea that such a thing as “Appalachia”, as a coherent region, exists, and that it can be said to be poor: why and how did it become so? And why is it still poor today? The roots of Appalachian poverty are critical to any understanding of today's efforts, as embodied by both the ARC and the ACC, to redress that poverty today.

Exemplifying the theory of path dependence⁶⁵ and spatial hysteresis⁶⁶, scholars of the region have documented several salient historic processes and features, which persist in shaping the region's conditions today, drawing on the approach pioneered by political sociologist Barrington Moore. Moore's "brilliant demonstration that social relations of the past have long-lasting impacts on the processes of economic, political, and cultural development in divergent national economies"⁶⁷ can be applied to sub-national geographies, such as Appalachia.

Appalachia, as it is thus commonly and socially (not physically) understood as a coherent region, has long been one of the poorest regions in the United States⁶⁸. A host of explanations, which will be reviewed herein, have been proffered to explain this. They include the region's experience with “the resource curse”⁶⁹, the paradox by which regions with abundant natural resources typically have lower rates of development and higher poverty, to its status as a peripheral area in the capitalist world-system, or internal colony of the United States⁷⁰.

⁶⁵ Myrdal, 1957.

⁶⁶ Spatial hysteresis is the idea that prior physical installations, buildings or man-made structures, which may no longer be used, have been abandoned, or destroyed, still nonetheless shape the current environment. Sam Bass Warner deployed this idea in his book, *Streetcar Suburbs* (1978), as well as by David Block-Schacter, in his doctoral dissertation at MIT's Department of Civil Engineering, entitled “Hysteresis and urban rail : the effects of past urban rail on current residential and travel choices “ (2012).

⁶⁷ Billings and Blee, p. 15.

⁶⁸ Rothblatt, 1971; Gaventa, 1980, Billings & Blee.

⁶⁹ Auty, 1993.

⁷⁰ Billings and Blee; Pudup.

3.1 EARLY SETTLEMENT HISTORY, 18TH AND EARLY 19TH CENTURY: FERTILE VALLEY DRAWS IN WHITE COLONISTS

But the region was not always poor. In fact, at the founding of the United States, it was an exceptionally fertile, wealthy area: in the eyes of early white settlers, Appalachia was originally perceived as a desirable, “promised land” full of fertile farming soil and abundant economic opportunity. As noted by Richard Salstrom⁷¹ in his economic history of the area, and as confirmed by other scholars⁷², migration into the region in the 18th and 19th century was driven, in part, by its valleys’ rich and fertile soils, and its potential to support a diverse range of crops and animals.

Specifically, the Great Appalachian Valley, which runs from southwest to northeast through the entire Appalachian mountain range, was already well settled along much of its length by the beginning of the 19th century. These early colonists and American settlers along the Great Valley had, of course, not been the first inhabitants of this fertile area. Native Americans, before their population was systematically decimated through European infectious disease and colonists’ active displacement of them from their historic lands, had long used the Valley as a transportation corridor. A portion of this was part of a system of paths the European settlers called the Great Indian Warpath or The Seneca Trail.

By the mid-1800s, however, the Great Valley’s open lands had largely been settled and occupied by farmers. Previously a self-sufficient subsistence economy⁷³, by the early 19th century and the nascent US industrialization, the region’s arable and most fertile land was already well settled. Specifically, population/land ratios in the Valley was reaching the levels that could be reasonably supported by an agricultural-based economy, given the prevailing production technology of the era.⁷⁴ This resulted in a need to supplement subsistence farming and home-based manufacturing with wage labor, mirroring

⁷¹ Salstrom, 1991, 1994.

⁷² Billings and Blee.

⁷³ Salstrom, 1991, 1994.

⁷⁴ Duncan, Salstrom (1991; 1994), Billings and Blee, Pudup et al..

a process that had occurred in the Northeast and New England⁷⁵ more than a century prior, when high and rising population/land ratios supported both outmigration and the development of a class of wage laborers to work in emerging factories.

3.2 19TH CENTURY INDUSTRIALIZATION, THE RESOURCE CURSE, AND WEALTH EXPORTED: OUTSIDE LAND OWNERSHIP, NATURAL RESOURCE ECONOMIES OF SCALE, AND THE RISE OF CORPORATE PERSONHOOD.

Even during Appalachia's early settlement, however, income from agricultural holdings and home manufacturing did not make the region's settlers wealthy *per se*. This is likely a function of the fact that Appalachian land holdings, in contrast to those to the East, had been the subject of speculative state and federal land auctions in the late 1700s and early 1800s⁷⁶, with a supermajority of the landholdings in the region owned by extralocal investors. Their efforts to control land were further abetted by poor recording practices and land records, outright graft and fraud by local county seats and land recording offices, as well as by the displacement and upheaval of the Civil War. This reduced local capacity and capital to acquire land, especially in the Southern Appalachians⁷⁷. Dunaway, who analyzed county records of all Southern Appalachian lands, not only quantified the degree to which such lands were held by out-of-county investors, she then categorized the investors into a typology, and found that the

Absentee Engrossment of Southern Appalachian Lands, 1790-1810

State/Territory	Resident		Absentee	
	Acres	%	Acres	%
Kentucky	56,856	43.8%	72,961	56.2%
Maryland	169,796	67.1%	83,410	32.9%
North Carolina	237,915	57.1%	178,676	42.9%
South Carolina	48,825	48.0%	52,852	52.0%
Tennessee	120,368	31.1%	266,201	68.9%
Virginia	328,995	10.7%	2,757,465	89.3%
West Virginia	324,389	6.7%	4,525,153	93.3%
Region	12,526,650	24.1%	39,451,150	75.9%

Source: Dunaway in Pudup, 1995.

⁷⁵ Billings and Blee.

⁷⁶ Dunaway in Pudup et al.

⁷⁷ Billings and Blee, Dunaway in Pudup et al, Dunaway in Lewis.

overwhelming majority of land acquisitions were made by distant merchant capitalists, not by small investors, heirs, or nearby planter or merchant capitalists. In West Virginia, a stunning 93.3% of the land was held by absentee investors.

The image of the land-owning subsistence farmer, then long the staple of American frontier folklore, did not play out in Appalachia as perhaps in other regions. There was no Homestead Act in Appalachia, and in fact, the Homestead Act would have the perverse effect of undermining the ability of Appalachian farmers to compete in emerging regional and national markets for agricultural crops, animal products, and commodities⁷⁸. Cheap Homestead Act land to the west allowed those settlers to undercut Appalachians on the basis of lower land rents, as well as lower transport costs to markets: Appalachia's topography again limited the ability of its residents to export in all directions in an efficient and effective manner⁷⁹.

As a result, with land and mineral rights in the hands of a small group of investors, Appalachia's delayed, post-bellum US industrialization, however, did not produce local, broadly distributed wealth and economic development across industries, as it had in the Northeast, and as was occurring around much of the rest of the United States. To be sure, income inequality rose in the 19th Century, reaching a fevered pitch in its final decade during the era of Robber Barons and the Gilded Age, but for much of the era, industrialization in the North produced growing income and economic opportunity for whites and, to a lesser degree, free blacks, in contrast to patterns in Appalachia. Two critical features appear to play a key answer as to why: the "resource curse" paradox associated with natural commodity wealth, and the timing of the development of the concept of corporate personhood, which went hand-in-hand with large-scale, jurisdiction-crossing and export-oriented industrialization.

⁷⁸ Salstrom, 1991, 1994.

⁷⁹ *ibid.*

In the post-bellum era, Appalachia became one of the nation's key sources of energy and natural resources, most notably coal and timber, opening up the region to the paradox of what is known in international development theory as "the resource curse". First named as such by Auty (1993), the phenomenon is a "paradox of plenty". Countries seemingly abundant in wealth-generating natural resources typically have lower economic outcomes, with higher poverty, reduced incomes, reduced rates of economic development overall and in non-resource industrial sectors, increased levels of government corruption, and reduced investment levels and outcomes in social and physical infrastructure. Though long analyzed in non-domestic contexts, recent scholarship has turned towards reviewing the phenomenon in the United States: studies⁸⁰ have found a significant negative correlation between mining and economic outcomes (at the county level) across the nation. But how, precisely, did this dynamic develop and unfold in Appalachia?

In two startling accounts, Billings and Blee's *The Road to Poverty* (2000), and Pudup, Billings and Waller (1995) document in detail various aspects of how extralocal, corporate control over natural resources and land in the postbellum era transformed the region from one dominated by subsistence farming and home-based manufacturing to one dominated by out-of-region corporations.

While the industrial transformation occurred around the US, the key difference in regional outcomes flows from the nature and timing of its occurrence in Appalachia. Resource extraction lends itself much more readily to larger economies of scale, as large corporations with greater operational and capital investment capacity are efficiently able to extract these resources. Of course, for them to profit from this opportunity, large corporations of scale had to exist in the first place. This point often seems overlooked in the literature: Appalachian resource extraction did not occur at scale until after the legal removal of long-standing restrictions on corporate activities had begun in earnest in the mid-19th century, culminating in the definitive establishment of corporate personhood via the Supreme Court case, *Santa Clara County vs. Standard Pacific Railroad*, 1886⁸¹. The railroads, which had pushed for

⁸⁰ James & Aadland, 201.

⁸¹ Korten, 1995.

post-bellum anti-slavery Constitutional amendments (13th, 14th and 15th amendments) establishing former slaves' rights to due process and equal protection to be applied to corporations as "natural persons", were also key force in the extraction of Appalachian resources⁸². This is not surprising giving the obvious links between railroads and resource extraction: coal and timber needed to be transported out of the region to reach its ultimate markets.

The timing of Appalachia's economic development, therefore, occurred alongside the post-bellum emergence of the concept of corporate personhood and the subsequent "race to the bottom" between states to eliminate and reduce the long-held restrictions on corporate charters and corporate taxation, which limited the activities of corporations to the "common good" and had set charter expiration dates⁸³. The removal of these restrictions, as corporate personhood and corporate rights became legally enshrined by the Supreme Court and enabled the excessive heights of the 1890s Gilded Age, brought with it waves of mergers and acquisitions. This further served to consolidate corporate power and, in the case of Appalachia, *extralocal* corporate power. In his history of the Consolidation Coal Company, Buckley (2004) details the rise, fall, rise, and acquisition of the nation's and Appalachia's largest coal company, which eventually became controlled by a New York and Boston-based board before formally being acquired by extra-regional corporations and investors.

The case of Consolidated Coal, reviewed above, is not an anomaly: In 1856, Kentucky ranked first in the country of all states in term of number of chartered corporations ranking in the top 500 nationally⁸⁴, reflecting the prominence of transportation and resource companies in the nation at that time. Today, Kentucky ranks in the bottom half of state in terms of the number of Fortune 500 companies whose headquartered it houses.

⁸² Billings and Blee.

⁸³ Kortzen, 1995.

⁸⁴ Sylla and Wright, 2012. Also: <http://post.nyssa.org/nyssa-news/2012/09/early-corporate-america-the-largest-industries-and-companies-before-1860.html>

Neo-Marxists and dependency theorists might frame the issue as one of “profit extraction” out of the region by absentee owners and investors. Even mainstream social scientists and economists, however, have also documented how this phenomenon is detrimental to local economies. Out-of-market companies, not surprisingly, are less likely to reinvest in their region, as has been shown in multiple modern studies⁸⁵ quantifying how a loss in corporate headquarters typically results in a decline in local donations and/or investments to philanthropies and community groups. This is to be expected intuitively, given the associated reduction in network connections and access when corporate executives are located out of the region.

The roots of Appalachian poverty can thus be seen as a mix of structural factors rooted in history, culture and geography: the region reached maximum threshold levels of subsistence agriculture, driving people to seek out supplemental wage labor, at a time when large industrial corporations were able to use nascent technologies to drive the process, and in a place where the assets – natural resources – were of a nature that most naturally lent themselves to control and development by such corporations. Specifically, large and growing corporations could use their size to most efficiently leverage the economies of scale and capital-intensive nature of resource extraction. These companies, perhaps initially based in the region, came to be subsidiaries of non-local entities with a more limited stake in the long-term health of the region.

3.3 THE RESOURCE CURSE AND COMPANY TOWN LEGACY: PATERNALISM, DYSFUNCTIONAL CIVIC CULTURE AND “THE OTHER”

Coupled with the historic control of local government in the region by a small number of large families⁸⁶, the factors delineated above produced a dynamic in the region of a dysfunctional civic culture: in which long-standing, resource-enriched local families engaged in rent-seeking behavior

⁸⁵ Hughes, 1994; Card, Hallock and Moretti, 2008

⁸⁶ These families quarrels for control of the state and of local resources were cast by outsiders as the legendary “family feuds” of Appalachia.

through control of local government, resulting in patronage and cronyism⁸⁷ with “clientilism and corruption in a manipulated, stunted public sphere”⁸⁸. In fact, many of Appalachia’s famous family “feuds” can be recast and understood as battles for control of the local state⁸⁹ by these families, and are consistent with the “resource curse” phenomenon discussed previously. These dynamics were exacerbated by the impact of coal company towns, in which workers were housed, fed and cloth in company-owned towns and company-owned stores; goods were often sold at a mark-up, and workers, though they often resisted, had to accept living in corporate-controlled communities in which democratic participation, horizontal civic culture⁹⁰, and Putnam’s “bridging” social capital were virtually non-existent. A spirit of corporate paternalism, in which the coal companies provided for needs beyond wages, dominated these towns. But with everything provided by these companies, when they shuttered operations, closed mines, and disinvested in areas, the in-place population lacked capacity or experience in the provision of a wide range of public and private services, from local retail to land use planning⁹¹.

The institutional legacy of these company towns, as well as the broader cultural and political aspects associated with extreme inequality and the resource curse, have been documented by Duncan, who through interviews and quantitative analysis of conditions in Central Appalachia, details a civic culture which is not horizontal, with different members of the community coming together to participate in civic institution building, but rather vertical, with local elites controlling resources and excluding the local poor, who are frequently “othered” as “mountain folk” and “hillbillies”. Elites, who live spatially segregated from the “hillbillies”, may use control of local rules to create small public school catchment zones which only serve “their” children, and use connections to local political office holders to secure jobs and patronage for “their” friends and relatives. Duncan contrasts this to the situation in Northern

⁸⁷ Duncan; Billings and Blee.

⁸⁸ Billings and Blee, p. 136.

⁸⁹ *ibid.*

⁹⁰ Duncan.

⁹¹ Perry, 2011.

New England, which is also rural, mountainous and poor, but lacks the history with the resource curse and forms of investment which undermine local democratic capacity-building and a horizontal culture.

Duncan's study, though now a decade and a half old, highlights how this is not a problem of history, but one that has persisted to the present day. Interestingly, while interviewees noted that the region's public sector faces these issues of cronyism, corruption, clientilism, and fraud, those located within the region seemed less phased by these issues than those outside the region. While longtime residents of the region were of the view that corruption was no less prevalent locally than elsewhere, external stakeholders operating across the region noted that this was, in their estimation, a far more serious problem locally. While the data indicates that the incidence of arrest for such crimes is no higher in the region⁹², it is unclear whether the underlying prevalence is higher, or whether or not the degree or severity of individual incidents in Appalachia is comparable to those in other regions.

Nonetheless, the historic evidence demonstrates that the public civic culture's failure "to produce public institutions with the capacity to address local problems effectively"⁹³ has clear material roots in the extractive and externally controlled nature of the economy⁹⁴. Ruling elites in these towns justify their control through culture, deploying the external image of the mountain hillbilly, reviewed as essential to the region's identity in Chapter 2, to "other" the poor. These individuals are perceived as somehow fundamentally "different" and ultimately "unhelpable"⁹⁵. Such characteristics are used to justify corruption and fraud by ruling elites, to cast their constituents as "the other".

A current example of many of these dynamics can be seen in the town of Benham, KY. One of the ACC's 13 recipient community development institutions is working with the town's municipalized electricity utility to introduce energy efficiency measures, which could save community residents significant income in the form of reduced energy bills. The town was built as a "company town" for Integrated Harvester's subsidiary, the Wisconsin Steel Company, as a coal mining settlement. Though

⁹² NBER study

⁹³ Billings and Blee, p. 136.

⁹⁴ *ibid.*

⁹⁵ Duncan.

the town has long since been abandoned by the company (exemplifying the region's struggle with corporate disinvestment), the town's stock of homes, largely constructed by the company in the early 1900s, today have major energy inefficiencies, resulting in high electric bills.

The town is home to the Kentucky Coal Mining Museum, housed in the former Company Store Building, which supplied the town's retail needs (this legacy underscores how and why entrepreneurship and small businesses are under-represented in the region). The town's mayor recently resigned due to corruption/embezzlement charges and attempted to install his wife as mayor, but community organizing groups (including one interviewed for this thesis) were successful in helping local citizens gain control of the town council and the power board. Nonetheless, the legacy of the "company town" is evident in places like Benham, where a dysfunctional civic culture and captive local government often undermines the effectiveness of public investments, and hampers economic development efforts. Community-led efforts to reclaim the public discourse and public offices themselves, however, such as is occurring in Benham, offer a glimmer of hope.⁹⁶

As in Benham, overall, the region's abundance was systematically extracted by external investors and local elites, as Kentucky, West Virginia, and the remainder of the Appalachian region became integrated into the US corporate economy⁹⁷. The wealth of these resources were not, therefore, used as a base upon which to build local, forward-linkage industries to process these resources, or on which to develop a functional, horizontal civic culture. As stated above, having spent decades building homes, providing retail services, often paternalistically performing some public sector functions, and being the source of employment, natural resource corporations abandoned their operations, effectively leaving behind a post-colonial legacy that is both economic and cultural. This legacy includes a lack of public and private organizational capacity, as well as a lack of investment capital.

⁹⁶ Information on Benham is based on work conducted in 2013-2014 by MIT DUSP Graduate Students Ryan Cook and Brian Bowen as part of the Community Innovators Lab-sponsored Benham Energy Project.

⁹⁷ Hennen, 1996.

Benham, KY "Company-Built" Homes⁹⁸



As a result of these factors, by mid-century, Appalachia was the poorest region in the US: outside investors had acquired and consolidated mining operations⁹⁹. Absentee land ownership reached an extremely high rate¹⁰⁰. Despite unionization, many workers were often paid poor wages in dangerous conditions. Overexpansion, mechanization and the development and viability of other energy sources coalesced to produce sustained economic contraction, capital withdrawal, and seemingly intractable poverty, as a “stunted” local public sector lacked the capacity to respond, paving the way for state-federal intervention in the form of the ARC.

But what has been the legacy of the ARC? Has it escaped the issues of a dysfunctional civic culture? And how will the ACC’s approach differ? These issues will be explored in Chapter 4.

⁹⁸ <http://www.coalcampusa.com/eastky/harlan/harlan.htm>

⁹⁹ Buckley, 2004.

¹⁰⁰ 4/4/1981, Appalachian Regional Study Finds Absentee Ownership Of 43% Of Land, New York Times.

4 THE ARC AND THE ACC: REGIONAL ECONOMIC PLANNING, BEFORE AND AFTER THE DAWN OF THE NEOLIBERAL ERA

This chapter will review the creation and operating structure of the ARC, and contrast it with the planned operation and structure of the ACC. I will also draw conclusions as to the challenges that may be faced by the ACC resulting from its operating structure, which in turn reflects broader social and political forces of the specific time and place of its creation. Both the ARC and ACC are products of a specific moment in time and space, resulting in different challenges for each arising from their associated structure. Specifically, as a private, non-profit entity, how can the ACC engage the communities in which it operates to ensure that the capital they raise and deploy is invested in an accountable manner which enhances its public mission?

4.1 THE ARC AND THE ACC: THE TREATY OF DETROIT GIVES WAY TO THE WASHINGTON CONSENSUS AND THE “AGE OF AUSTERITY”?

When Appalachia's state of deprivation and rural poverty burst into the national media, and thereby into the nation's collective consciousness, in the presidential campaign of 1960, the reaction was swift and compelling: President Kennedy and Congress commissioned a study to diagnose the root cause and propose action to remedy the situation. The result was the creation of the ARC, which is an explicitly public agency, enabled by legislation, whose direct expenditures are funded by different geographic scales of the state (both the federal and state-level governments).

Five decades later, 2013 saw the creation of the ACC, an explicitly private entity, conceived of and structured not by Congress or elected officials embodying the will of the people, but by private interests working in conjunction with appointed officials at public agencies.

These contrasting “creation stories” of the ARC and the ACC are striking, as a theoretically compelling case exemplifying the structural shifts over the course of the second half of the twentieth century in how the state and civil society engage to solve social problems. Specifically:

(a) **Privatization of the State.** The mid and late-twentieth century saw the rise and decline of direct public action and interventions, as the "grand bargain" of a particular worker-state-capital coalition¹⁰¹ in the Treaty of Detroit era, was followed by the rise of neoliberalism and the Washington Consensus¹⁰². This shift resulted in direct public interventions being replaced by private, market-based solutions to social problems. These market-based solutions have frequently involved a "shadow state"¹⁰³ of non-profit organizations¹⁰⁴. In moving away from direct intervention, and in partnering and/or promoting private, market-based solutions, the state has also become entrepreneurial, developing programs to incubate private development in what has been termed "the rise of the entrepreneurial state"¹⁰⁵;

(b) **Bottom-up Replaces Top-Down Approaches.** Over the same time period, there was a shift from top-down, centralized planning efforts, such as Urban Renewal programs enacted by the Office of Economic Opportunity, as well as the ARC, to localized, bottom-up, community-based approaches to economic and community development planning¹⁰⁶. Taken with the above, this has resulted in a fragmentation in the operational scale of the rising “shadow state” of non-profit organizations, as referenced above: local, community non-profits frequently operating at neighborhood scale, have multiplied as a result.

(c) **Geographic Rescaling of the State.** In conjunction with the shift from top-down to bottom-up and privatization of state functions in the US, there has been a territorial "rescaling of state capitalist

¹⁰¹ Fligstein, 2001.

¹⁰² Levy and Temin, 2007; Voss and Sherman; 2000.

¹⁰³ Wolch, 1990.

¹⁰⁴ DeFilippis et al, 2010.

¹⁰⁵ Eisenger, 1988.

¹⁰⁶ Teaford, 2000.

regimes", as conceived of in the framework of Brenner (2004). In community and economic development in western democracies, this has involved a "devolution of the state from the national scale down toward the regional, provincial, state, municipal, council and ultimately, the community scale".¹⁰⁷ This devolution in scale mirrors the same process in non-profit organizations, as referenced above.

Taken together, the result of these dynamics has been a move towards "community as decentralized social policy"¹⁰⁸, which has had four components: "These are:

1. the retrenchment of the state;
2. the devolution of state functions, and the shrinking of the scale of state interventions
3. policies that redirect and restructure activities to community-based non-profits; and
4. community-based practices that adjust and respond to the state policies and *market imperatives*."

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Consistent with this theoretical framing, the ARC's funding levels have precipitously declined: Based on research conducted for this thesis, during the Carter administration, the ARC had a nominal annual budget of \$120MM for its non-highway programs. In 2013 inflation-adjusted dollars, this would amount to \$340MM. The ARC's non-highway annual budget has held at around \$65MM for at least the last decade, meaning that in real terms, the ARC's non-highway budget has fallen by roughly 80% since 1980, which saw the election of Ronald Reagan and the full transition from the Treaty of Detroit to the Washington Consensus neo-liberal era. With President Bush's signature of the ARDA amendments of 2002, the ARC's focal areas were expanded to include areas such entrepreneurship development and capital markets access, ultimately allowing the ARC to undertake the work created to form the ACC.

¹⁰⁷ DeFilippis et al, 2010.

¹⁰⁸ *ibid*.

¹⁰⁹ *ibid*, emphasis added

Against this backdrop of non-profitization of public functions, emergence of bottom-up practices, and devolution of the state itself, the private, for-profit industrial sectors, including the financial services industry, has achieved previously unforeseen levels of scale and scope in its operations (Chandler, 1990).

I theorize that the ACC can be understood as an effort to bridge the gap in scale that has opened up between small, fragmented non-profits, such as the CDFIs which the ACC represents, and large capital sources and banks, a main source of CDFI funding, which operate at unprecedented scale. I also theorize that the ACC represents an “age of austerity” example of a private market solution to geographically multi-scalar problem, which leverages private debt motivated by public regulation and legislation. These frames will be explored in greater detail, however, in the next chapter, after a detailed analysis of the approaches of both the ARC and the ACC.

4.2 The Appalachian Regional Commission, 1965 - Present.

Appalachian poverty did not seemingly register in national consciousness until the presidential campaign of 1960. John F. Kennedy’s visits to what came to be called “The Other America” (Harrington, 1962), vaulted the region’s abject poverty into the national spotlight. To combat the area’s poverty, Kennedy, upon assuming office, commissioned a report (check). At the same time, Eastern Kentuckian Henry Caudill’s infamous expose of the devastating impact of strip mining, which he termed the “rape of the Appalachians”, was published in the Atlantic in 1962, with a follow-on piece in Readers Digest and eventually a book, *Night Comes to the Cumberlands*. The broad readership of these publications reacted with outrage, and after Kennedy’s assassination, Johnson launched the War on Poverty from the home of an Appalachian family, indelibly linking the region with rural poverty and environmental degradation in the minds of many Americans.

Coming out of Kennedy’s commissioned report and in conjunction with Johnson’ War on Poverty, a federal-state regional planning and economic development partnership, the Appalachian Regional

Commission (ARC), was created in 1965 to operate across a multi-scalar geography, which currently encompasses 420 counties in 13 states (originally 399 counties).

The ARC's original focus, as documented in its seminal 1964 report to Congress, was to address the "realities of deprivation" and "legacy of neglect"¹¹⁰ in the region. It was designed to do so by enhancing the productivity and competitiveness of its economic base through key access/connectivity and infrastructure improvements at scale, including large-scale projects such as highways, airports, water resources, housing, and workforce development (then called human resources) programs, with coordination across state and local boundaries. In so doing, the hope was to overcome the problem of "small, technically inadequate jurisdictions"¹¹¹, or what in today's language would be termed insufficient economies of scale and scope¹¹² in small, fragmented local economies. By addressing these issues, according to the above-referenced 1964 report, the investments might spur development and in the process reduce the rate of poverty in the region.

The ARC, funded by federal appropriations, state matching funds, and often leveraged by private investments, originally included 399 counties across 13 states (New York, Pennsylvania, Maryland, West Virginia, Ohio, Kentucky, Tennessee, Virginia, North Carolina, South Carolina, Georgia, Alabama, Mississippi). West Virginia was and is the only state located entirely within the ARC's catchment area, with counties in or abutting the Appalachian range in the sections of the remaining 12 states included in the ARC's territory.

The ARC is technically run by the 13 member state governors, or their designee, along with a federal co-chair appointed by the US President. Local participation occurs through the 73 multi-county local development districts (LDDs), which were designated by the ARC. Congress has repeatedly amended the ARC's enabling legislation, to place restrictions and requirements on the types of projects it funds, the level at which it can be funded, and the geographic distribution of its funds.

¹¹⁰ Appalachian Regional Commission's Report to the President, 1964.

¹¹¹ *ibid.*

¹¹² Chandler, 1990.

While the LDDs offered the possibility for local, bottom-up participation, ultimately the focus of the ARC was set by federal legislation, repeatedly amended by US Congress to direct and change priorities for the agency. After focusing initially on a mix of highway, water/sewer, and human capital development programs, the ARC has in recent decades developed telecommunications connectivity and entrepreneurship initiatives, as reflected in the aforementioned amendments to its enabling legislation.

4.2.1 ARC: Outcomes and Results

With project and investment efforts totaling in excess of \$15B in its first 25 years alone, and \$23.5B in its first 45 years – enabling, among other infrastructure initiatives, the subsequent completion of nearly 2,500 miles of roads and highways - the ARC has commissioned frequent studies showing that these projects have made a significant improvement in the region’s economic conditions. Nonetheless, the ARC acknowledges the region’s continued state of economic distress: though the share of population living in poverty has halved, even as the US poverty rate has remained fairly constant.

Academics have also completed studies to address critiques that perhaps some or all of these gains might have been completed without the ARC. Most famously are Isserman’s¹¹³ twinned counties studies. As noted by Ziliak, “Isserman and Rephann found that earnings grew 48 percent faster in Appalachia than the control counties, per capita incomes grew 17 percent faster, and population grew 5 percent faster. They infer that these income growth differences imply an additional \$8.4 billion in income for Appalachia in 1991, a huge return on the \$13 billion spent as of that year.”¹¹⁴

Contrasting this is finding of Glaeser and Gottlieb, who reviewed growth of counties just within the ARC territory with those just beyond it. They concluded that “The ARC may or may not be cost effective, but there is little chance that its effectiveness will ever be evident in the data.”¹¹⁵ Though

¹¹³ Isserman and Rephann, 1995.

¹¹⁴ Ziliak, 2012.

¹¹⁵ Glaeser and Gottlieb, 2008.

criticized for failing to control for spillover effects of highways and other diffused investments of the ARC, which would benefit counties beyond the ARC, nonetheless the critique is often cited in efforts to defund regional/place-based public investment programs like the ARC.

Nonetheless, Appalachia's poverty level remains elevated as compared to the US overall. Further, while some counties located on the region's periphery are quite strong (e.g. Pittsburgh, PA or Blacksburg, VA), the core of the region still struggles, and contains one-fourth of the nation's economically weakest counties, according to the ARC's analysis of BEA and Census Bureau data.

4.2.2 ARC Critiques: Top-Down and Undemocratic Territorial Definition, Growth Corridors, Project Selection

The ARC's approach has been critiqued from the academy and across the political spectrum as being too top-down and undemocratic, failing to fully incorporate local needs and feedback. Three specific examples of this critique are considered here:

1. **Territorial Definition.** Interestingly, and arguably evidencing the lack of a strong basis for conceiving of as Appalachia as a coherent region, as detailed in Chapter 2, the territory has been subdivided into different subregions in different ways over time. The ARC in 1967 divided the territory into Northern, Central and Southern Appalachia, along with the Highlands; Central Appalachia, located in the core of the region and encompassing Southwestern West Virginia, Eastern Kentucky and Northwestern Tennessee, long contained the economically weakest and most distressed counties and population (see maps which follow). The "Highlands" was turned into overlay area, for conservation purposes¹¹⁶ and

¹¹⁶ Pollard, 2005.

merged with the other three in 1975¹¹⁷. The ARC then reclassified the subregions again in 2009, for research not funding purposes only, into five sub-areas, creating a Northern, North Central, Central, South Central, and Southern Appalachia¹¹⁸.

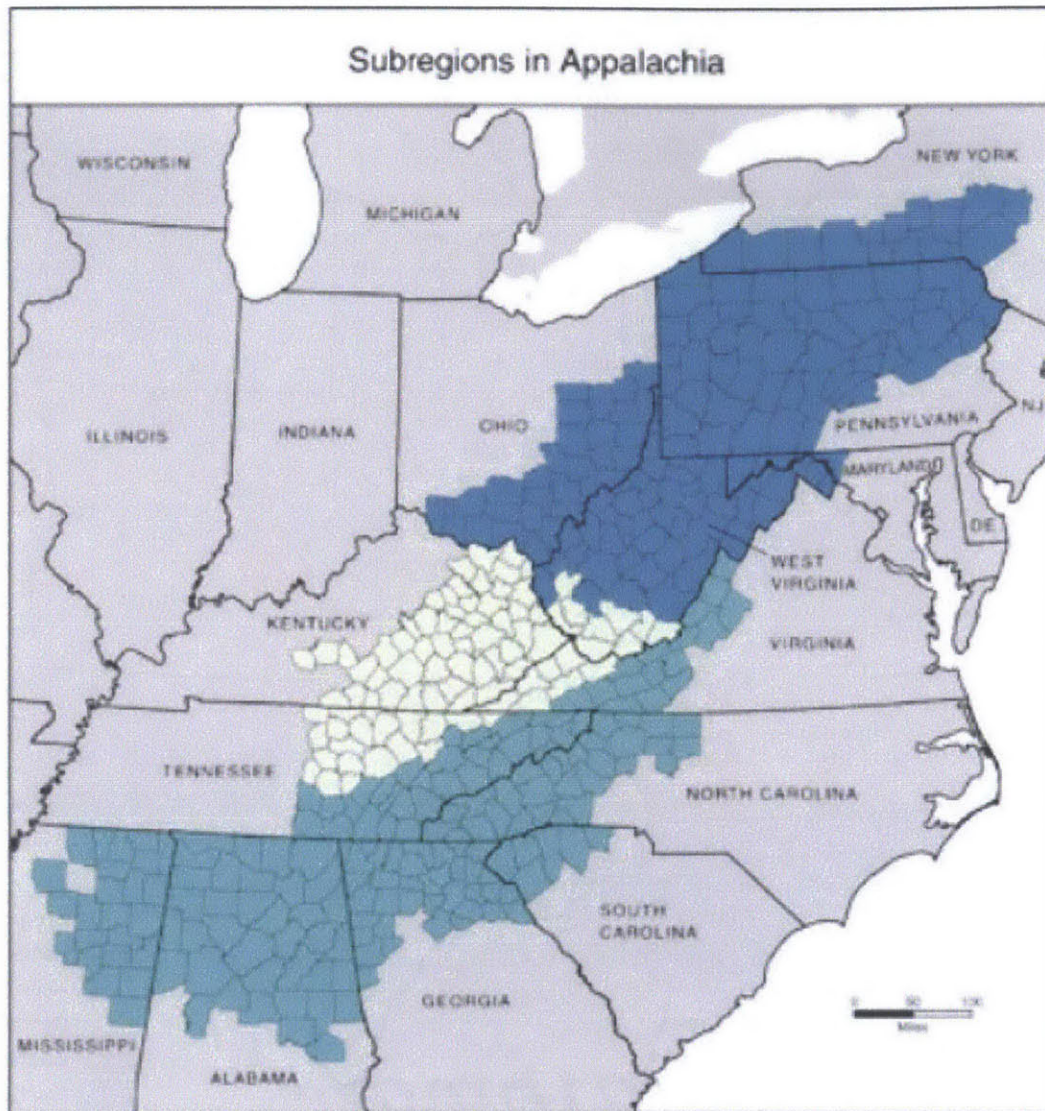
These sub-regional definitions, ostensibly based on objective criteria of economic similarity, nonetheless did not take into account local perceptions of regional and Appalachian identity. As previously noted in Chapter 2, "'Appalachian'...has never become a symbol of self-identification for the vast majority of the region's people, for whom the community, county, state, and nation remain more important units of political identity", despite the success of "the social movement to obtain recognition for Appalachia as a problem area"¹¹⁹.

¹¹⁷ Walls, 1977.

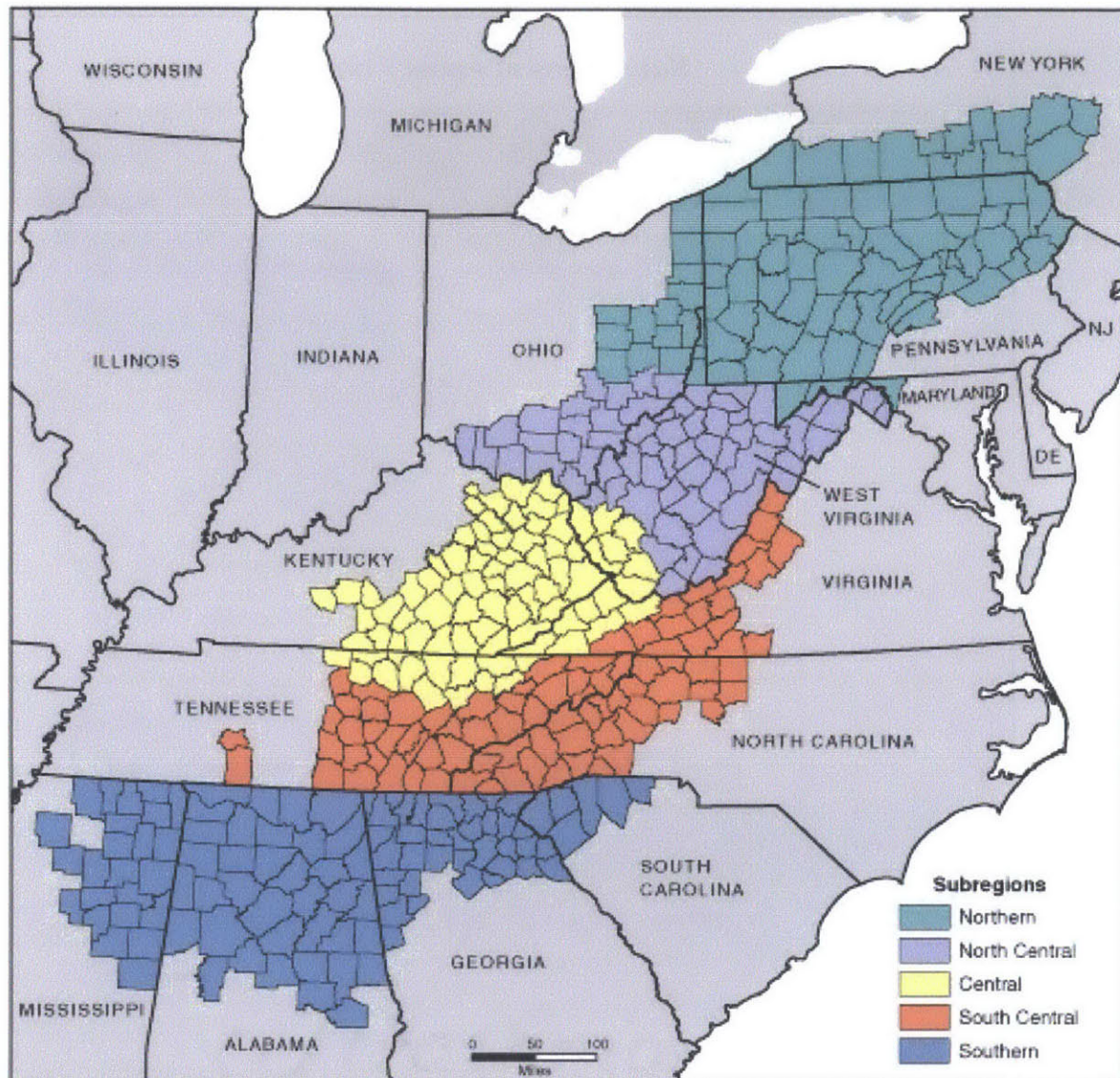
¹¹⁸ <http://beautifuluponthemountains.weebly.com/1/post/2014/01/defining-appalachia-the-appalachian-regional-commission-part-ii.html>

¹¹⁹ Walls, 1977.

Original Subregions in ARC Service Area



Current (Post-2009) Subregions in the ARC Service Area



Map by: Appalachian Regional Commission, November 2009.

The ARC also saw its boundaries redrawn to include additional counties for political reasons, as more governors and Congressional representatives sought to access the federal dollars flowing into the region via the ARC. This top-down and instrumental treatment of territory and territorial definition has resulting in criticism of the ARC as a wasteful and/or pork barrel prone agency.¹²⁰

¹²⁰ Raitz and Ulack, 1984.

2. **Growth Corridor Strategy:** Reflecting the popularity of central place theory at the time of the ARC's creation (an early neoclassical economic development theory) to encourage highway development along key corridors which would improve connectivity within the region and to outside of the region. To wit, funds not designated for highway use were funnelled into "growth corridors" and centers, roughly mapped over to the Local Development Districts (LDDs). This meant that the poorest rural areas often received little funding¹²¹¹²², and were effectively left to their own devices in a "triage" strategy, in which investment dollars "fell back" to Federally-designated growth corridors . This was consistent with theories, such as those advanced by Isserman, that a lack of urbanization was the problem and a root cause of poverty. But as noted by critics, the question then becomes: why isn't the region sufficiently urbanized? Was it really simply a lack of connectivity? Regardless of the merits of the growth corridor strategy, it left the poorest rural areas depressed and unassisted, a challenge that remains today¹²³. Indeed, analysis of conditions based on the subregional definitions, as referenced above, evidence just how different conditions are in different areas of the region: unemployment, educational attainment, poverty and income measures are all far weaker in Central Appalachia than in the other regions.

3. **Pet Project Selection.** According to these critics, the ARC's efforts have often been perceived as part of this dynamic, as it directs money from Washington, DC to "top-down" targets which benefit local elites¹²⁴, or invests in political "pet projects" of governors which are defunded or shifted with election cycles. Because these projects were earmarked by leaders, and not determined by priorities as set by residents of the region, as might be expressed by referenda or through the ARC's Local Development District structure or through bottom-up regional planning initiatives, the ARC's process has been critiqued as undemocratic and highly

¹²¹ Glasmeier and Farrigan, 2003

¹²² Billings and Blee.

¹²³ Eller, 2008.

¹²⁴ *ibid.*

politicized. Eller has noted that these “pet projects” have been defunded as state administrations and governorships changed, though that is not always necessarily a problem if the project does not reflect the input, engagement and interests of local residents. Examples of such projects include a stadium in Spartanburg, SC, and auto plant in Tuscaloosa, AL.¹²⁵

To wit, while the ARC’s Local Development Districts in theory could have offered the promise of bottom-up participation in project selection and fund use, they did not. They were ultimately run and had priorities set by the local elected officials in that region. “ARC views the LDD as the indicator of local will because it includes all the major elected officials in a development district; but some local citizen call the LDD an impediment to local will precisely because of that make-up. They contend that it’s hard enough to deal with their own “courthouse gang”; merge six or eight or ten of them together in a single LDD and “you simply just don’t have a chance”, as one LDD observer put it recently.”¹²⁶

These critiques are not without merit, but ultimately, they reflect the centralized, top-down and appointed nature inherent in the ARC’s organizational structure. The budget is not decided or allocated through a direct participatory process; it is set through legislation, formulas, and negotiations among different sub-national state actors, namely agency bureaucrats and presidential and gubernatorial appointees¹²⁷. The shortcomings of “state-led”, top-down economic development planning, then, are as much a function of (a) the potential disconnect between top-down decision-making and bottom-up interests, and (b) who is controlling “the state” that is leading the process. Is it a broad swathe of citizens whose interests are being directly expressed, or is it elite private interests who have captured the state?

¹²⁵ http://www.sullivan-county.com/nf0/june_2004/arc.htm

¹²⁶ P. 298 *Hidden Traps of Regionalism*, Phil Primack, *Colonialism in Modern America*

¹²⁷ Boyd, 2006.

4.3 Appalachian Community Capital, 2013 - Present.

In 2013, with the backing of the Clinton Global Initiative, the ARC announced the creation of the region-wide Appalachian Community Capital (ACC), a new community development bank designed to overcome the problems of scale endemic in attracting capital to cities and towns within the politically fragmented, isolated, and unevenly populated Appalachian Region.¹²⁸

4.3.1 Overcoming The Economies of Scale Barrier to Finance Job Creation

Initially, as per press releases published in 2013, the ACC will raise money from large investors who purportedly might otherwise ignore the region, due to the lack of sufficiently large CDFIs that can leverage the power of economies of scale. This rationale and strategy was confirmed for this thesis in conversations with representatives of both the ARC and the ACC: the focus is on external and/or new investors in Appalachia, specifically, large institutions.

The ARC's existing entrepreneurship initiative and venture capital development efforts, added as a focal elements the 2002 amendments to ARC's enabling legislation, were designed to address the region's chronic lack of equity capital¹²⁹. The creation of an entity such as the ACC appeared to be a logical next step to scale efforts to reduce the region's capital shortfalls, according to an ARC interviewee. The idea, according to the interviewee, came out of conversations with local development lenders and the ARC's Capital Policy Advisory Committee, which consists of local community lenders, frequently CDFIs, located in all 13 states in which the ARC operates.

Community lenders, particularly those operating in small rural areas, claimed that they faced a difficult time attracting investments from larger, non-local/external institutional investors. As confirmed with thesis interviewees, as the amount of invested capital per transaction declines, both the opportunity costs (as measured by other transactions the investor is unable to vet while they underwrite these smaller deals) and transaction costs (legal services, accounting services, banking services and investor's

¹²⁸ "New regional bank aims to grow Appalachian economy", The Wall Street Journal, 6/14/2013.

¹²⁹ Daffner and Bischak, 2000

staff's salary costs allocated to the deal) per dollar of invested capital rise. According to traditional economic theory, this problem of scale should result in either the level/amount of capital dropping, or the cost of capital (as measured by the return requirement) rising in these areas.

Further, the economies of scale problem is exacerbated as it carries through the supply chain. Larger banks and investors, who operate utilizing operational technologies and organizational processes of scale, will prefer to invest in entities which also operate at scale. Small CDFIs, for example, may lack the organizational and operational capability to engage with large banks and other mission-oriented investors, as they lack the financial, accounting, reporting, and loan servicing technology and processes to meet banks' reporting requirements.

The ACC seeks to overcome these challenges of scale, theorized to in part be a function of the current lack of an appropriately large institution, by creating a region-wide entity. This entity will then distribute the money to a number of Appalachian community development lenders, including some large community development financial institutions (CDFIs) with a strong performance record and existing organizational capacity (e.g. Kentucky Highlands Investment Corporation). Given the documented shortage of community development capital specifically available for small businesses (see next chapter), the recipient institutions also have a strong track record in small business (as opposed to, for example, mortgage lending) lending and investment.

Reflecting this rationale, in conversations with the ACC and the ARC, the issue was framed entirely as a market issue: because of the fragmentation among community lenders, and because the region lacks a major banking “money center”, the largest capital sources for community development do not consider investment Appalachia. By providing a vehicle by which such investors can place capital into small businesses in Appalachia, the ACC hopes to enable job creation in the region.

4.3.2 Bottom-Up, But Where, And For Whom?

The broader implications of the region-wide CDFI model, meanwhile, may be significant and reach

beyond Appalachia. If the ACC succeeds in attracting new sources and volumes of capital into the region, it could conceivably become a model for the creation other regional CDFIs in the United States, perhaps overlaid with the existing other Regional Commissions, in areas which are similarly struggling to attract capital for investment into projects which traditionally benefit lower-skilled, lower-income populations.

How, whether or not, and why such an approach may or may not succeed, however, remains an open question: while CDFIs offer the potential of community-based, bottom-up approaches to investment, there is no guarantee that they will operate in such a fashion. These entities operate, as highlighted at the beginning of this chapter, as part of the "shadow state", as non-profit entities that are not fully regulated (in the way that a bank is regulated by state and federal regulators, in terms of strict oversight of scope of activities, or in terms of financial soundness) or beholden to public processes. Though the US Department of the Treasury does offer a certification for CDFIs, Certified CDFIs are not public or fully regulated entities. They can be non-profit and/or for-profit, but are ultimately private organizations. Their activities cannot be directly impacted by public and/or community action. Further, many community development institutions, such as many community development loan funds, may not be certified as CDFIs at all, and regardless have little in the way of mandated mechanisms for public accountability.

Reflecting this concern, in undertaking research for this thesis, there were virtually no public documents available on the ACC. One interviewee, who works on initiatives with one of the intended recipient CDFIs of the ACC but is not directly involved with the ACC, had attempted to research the ACC in the months immediately after its creation, and was unable to obtain any information using public records. Similarly, public records and internet searches for documentation of the ACC throughout the fall of 2013 and spring of 2014 yielded scant information. Only through direct social network referrals by individuals with a long working history with these organizations was direct contact with the ARC and ACC achieved. This is not to say this is somehow an intentional or nefarious effort to hide the intended approach of the ACC: rather, it is indicative of the ongoing shift away from

public solutions to social problems to private, market-based approaches which are often carried out by private entities. The ACC does not need to release information about its operation, because even though it has a public service mission, it is not an explicitly public institution. As of this writing, it has no public website, public brochure, or other public information about its operating structure. While this might be considered unusual for a public entity, this is not atypical for a private "start-up" company operating in industry.

Further, documentation and interviews provided by the ARC and ACC for this thesis reveal a concerted effort to reflect the needs of its member institutions and be a responsive, locally embedded organization, while also effectively leveraging existing economies of scale. The ACC, which will raise capital to invest in its recipient community development lenders, many of which are Certified CDFIs, will have a board that will largely consist of its members, along with a few community leaders. Its office will be located in Christiansburg, VA, 263 miles southwest of Washington DC near the state border with WV. This is also within the operating area of the ARC at the edge of the Blue Ridge mountain range, and it will initially co-locate and share back-office, accounting, loan servicing, and reporting services with Virginia Community Capital, one of its recipient member institutions. The ACC did not see this as a conflict of interest, given the VCC will be joined by all other recipients on the ACC's board. Therefore, if the VCC was perceived by other member institutions as being unfairly "favored" for funding, the member institutions, who are a majority of the Board of Directors, could act to remedy the situation. The location also benefits from being immediately adjacent to Blacksburg, VA, home to Virginia Tech. According to the ACC interviewee, the ACC hopes to leverage on the benefits of the proximity to a major research university, such as knowledge spillovers and an educated labor pool, for its mission.

In addition, when asked about how it will be responsive to the needs of the communities which its recipient members serve, the representative of the ACC stated that this was a major component of its strategy and approach. It would not just be lending money to recipient institutions, but working with these institutions and their communities to spur demand and provide technical assistance to their

recipient's ultimate borrowers, with the ultimate goal of creating jobs in Appalachia. They have not yet determined how much of the budget will be dedicated to this, or how this will be carried out, which is a cause for concern.

Geographic distribution of the funds the ACC will raise remains a potential shortcoming of the organizational structure, design and logic. Initially, press releases stated that the ACC would distributed the money to 13 CDFIs, assumedly one for each state. The designation of 13 recipients by the Washington DC-based ARC and ACC may appear to be yet another top-down approach. But these locally-based and community controlled community development lenders and CDFIs offer the potential of a more bottom-up and targeted approach to the financing of economic development than a centralized, regional planning agency or Washington-based agency might. They can use their on-the-ground knowledge of local opportunities and conditions to be more effective in meeting the capital needs of recipient projects and organizations serving the most disadvantaged people and neighborhoods in their local economy. CDFIs do not traditionally invest in large infrastructure projects of the scale and profile of the ARC's signature highway and water projects, but rather invest in smaller scale and highly localized strategies which target underinvested sectors directly benefiting lower-income households. CDFIs typically invest in affordable housing, community facilities, small businesses, and workforce development programs, and are primarily funded by a mix of socially responsible (e.g. foundations) and legally mandated (e.g. Community Reinvestment Act) private capital sources. They may also be funded by some public-sector capital in the form of aid, grants and loans¹³⁰. Some CDFIs in the US have also been at the forefront of financing the deployment of equitable economic development strategies (such as anchor institution supply-chain leveraging methods, microenterprise loans and technical assistance for employee-owned business, and other self-sustaining and sufficiency-oriented low-income business development initiatives) in the process.

¹³⁰ Seidman, 2005.

In actuality, the designated recipients do not, in fact, cover all states. While it remains unclear if the intent was 1 recipient for each state, several states lack CDFIs or other types of community lenders (the ACC will also raise funds for and distribute to other, non-CDFI forms of community development debt and equity) with a sufficiently strong or high-quality track record to be included in the ACC. Two states, Alabama and Ohio, are targeted for the development of new institutions to meet this need, due to a lack of existing institutions. The ARC portion of these states contain roughly 20 percent of the entire ARC service area population, and poverty rates in the ARC portion of both states are higher than in the ARC as whole, evidencing greater need. Regardless, the ACC will only distribute funds to high-performing track records, because weaker recipients would make it more difficult to raise money from investors.

Another geographic problem involves the mismatch between the ARC's county-based territory and some CDFI's state or sub-state regionally based operating areas. Some of the ACC's member institutions operate in areas which go beyond the borders of the ARC and Appalachia itself, as they might be statewide or other regional entities. To ensure that ACC's capital is not used to benefit areas beyond Appalachia, however, the ACC confirmed in its interview that member institutions had agreed that any ACC capital the members received would only be deployed in the ARC service area, and not be deployed in other non-ARC parts of their operating area.

Despite this restriction, reflecting the market logic that the ACC operates under, there is also no "quota" for each of the various recipient lenders operating in each state, as confirmed in interviews. This means that it is entirely possible, if the strongest lending opportunities happen to come out of the strongest sub-areas within Appalachia, that these areas could receive all of the capital raised. This is a limitation of the market-based approach: there is no guarantee that additional capital will flow into the most impoverished areas. In fact, if these sub-areas lack small business borrowers with demand or the technical capacity needed to apply for these loans, they may not receive any of the capital at all.

Not all of the money raised entirely can flow to non-distressed areas, however: it is true that Certified CDFIs must invest 60% of their proceeds, by statute, in their identified target market. Target markets are also restricted to include:

1. Investment area with high poverty rates, high unemployment rates, or be part of an Empowerment Zone or Enterprise Community.
2. Low-income targeted populations (80% of the area median family income).
3. Other targeted populations:
 - African Americans
 - Alaska Natives residing in Alaska
 - Asian Americans
 - Hispanics
 - Native Americans
 - Native Hawaiians residing in Hawaii
 - Women
 - Other Pacific Islanders residing in other Pacific Islands
 - Other (reviewed and approved on a case-by-case basis)

Nonetheless, these restrictions only apply to Certified CDFIs. Not all of ACC's member institutions are certified CDFIs, nor, at this time, is the ACC a certified CDFI. A non-certified community development lender operating in a stronger area could, for example, receive a significant share of the ACC capital raised, based on stronger conditions in that area. The ACC recipient member for New York State's ARC service area counties, none of which are designated as either "distressed" or "at risk" by the ARC, could in theory receive a large share of ACC capital raised. This is the case even though the "poor" and "underdeveloped" areas being serviced by it, as compared with portions of West Virginia, Kentucky, and Tennessee, are far wealthier. The ARC's subregional definitions evidence this, with significant differences across a wide range of socioeconomic indicators: though Central

Appalachia is clearly the center of distress in the region, there is no guarantee that the ACC’s capital raised will flow to it, rather than the stronger regions to the North and South. (see chart below)

Key Socioeconomic Indicators: ARC Territory by Subregion, 2007-2011

	Labor Force Participation Rate	White, Not Hispanic %	All Other Races, %	% Age 25+ Less Than High School Diploma	% Age 25+ BA or Higher	Mean HH Income	Median HH Income	Per Capita Income	Poverty Rate
United States	78.1	64.2	35.8	14.6	28.2	72,555	52,762	27,915	14.3
Appalachian Region	73.7	83.9	16.1	16.5	21.0	57,866	43,354	23,252	16.1
Northern Appalachia	76.0	89.8	10.2	11.8	21.9	59,193	45,245	24,362	13.8
North Central Appalachia	70.3	93.4	6.6	16.5	17.7	54,549	41,198	22,121	17.1
Central Appalachia	60.4	95.5	4.5	27.2	12.2	45,186	32,887	18,197	23.5
South Central Appalachia	74.3	85.8	14.2	17.8	21.7	55,705	41,087	23,076	17.0
Southern Appalachia	75.2	70.4	29.6	18.3	23.0	62,109	46,462	23,763	15.9

Source: ARC, Population Reference Bureau and Census Bureau (Five Year ACS)

Further, the ACC can only trust that, on the basis of the strong track record of its recipient institutions, that embedded in their historically strong financial performance is a fair, non-corrupt, and transparent lending process to borrowers who achieve positive results in their local communities. But there is no way, due to the lack of public accountability, to ensure this. According to the ACC, the strong track record of these high-performing CDFIs and other community lenders reflects that they are typically tied-in to the local needs of their communities. That means, in theory, they deploy these funds not only in a financially viable way, but in a fair way, otherwise they would not be high performing. Specifically, they assume this means they do not deploy funds in a manner which exacerbates or engenders nepotism, corruption, or other such problems which have often plagued public and public-private initiatives in Appalachia’s smaller jurisdictions. But this seems to be an extraordinary and large assumption. Actual evidence of this was unavailable.

While they may not suffer from these problems, ACC's member institutions may not choose to deploy the proceeds in pursuit of equitable, local wealth generating, community-led economic development initiatives, but rather continue to pursue extractive industries. A community organizer interviewed for this thesis noted the example of the Clinton administration's Enterprise Zone program, which saw proceeds used to develop a low-wage, chicken processing plant that was polluting and owned by a non-local entity, and generated little in terms of local employment, income and capital. Though the

focus on small business loans should preclude investment in larger operations such as these, it nonetheless remains a concern, especially given the nature of the member institutions. Further, many businesses which may appear large (and larger businesses are less likely to be locally owned) to citizens are technically considered “small” for financing purposes. SBA loans, for example, can be made to businesses with fewer than 500 employees. A firm with 500 employees would not necessarily meet a popular definition of “a small business”, but based on this definition the noxious chicken plant would likely be eligible for SBA loans, for which banks might receive CRA credit.

Meanwhile, another ACC member institution, for example, has a strong track record for pursuing infrastructure and economic development investments in wealth-generating, locally owned industries and functions that their local communities want to encourage. Another member, however, has a less impressive track record on this front. There is nothing to guarantee, in the ACC's structure, that this more “progressive” institution will get more proceeds than other institutions lending to low-wage chicken processing plants.

Notably, however, there was nothing to guarantee results in locally determined focal areas, and in a manner which does not reinforce corruption, with the ARC's more "top-down" approach, either. Even the ARC itself acknowledged, in an interview for this thesis, corruption remains a huge challenge in many of the more impoverished areas, where public sector work offers more stability and income than the limited private sector opportunities on offer.

Unlike the ARC, which was effectively a top-down creation of the federal government, in conjunction with the states, the ACC has been constructed as a bottom-up institution, in as much as its creation stems from ARC working with existing local community development lenders spread throughout the region; the ACC is not a mandated institution created by a legislature. But unlike the ARC, it is not a public agency funded directly with public monies. Instead, it is a non-profit entity, funded with a mix of public sources and private investors, who have return expectations on their investments. The primary obligation of the ACC, as a fiduciary for these investors, is to ensure return of their capital, with investment. It has no direct public obligation, nor can the public participate directly in shaping

its decisions. This is despite the fact that it is indirectly being funded with public monies, is funded by tax-exempt institutional investors whose tax-exempt status is created by public act, and it itself benefits from its legal status as a tax-exempt non-profit, which is created by public legislative acts. Specifically, federal legislation has repeatedly been enacted to shield certain types of organizations from paying taxes, and to treat donations and/or investments in them as tax deductible. This began in the US with the Tariff Act of 1894, and includes a double-digit number of legislative acts since, most notably the Revenue Act of 1954 which established Section 501 (c) of the Internal Revenue Service, creating an entire legal class and set of statuses for non-profit organizations.¹³¹

In sum, the ACC may offer the potential to be more bottom-up and community-based, but because it is a private, non-profit corporation, and it is not a public entity, there is no way to guarantee that its activities will help meet the public mission of one of its chief sponsors, the ARC. There is no way to guarantee that its monies will flow to those geographic and functional areas that might need it most. Given the stated justifications¹³² for public intervention to legislatively enable and directly fund community development institutions, how can the ACC reconcile this paradox? Specifically, it exists to serve the neediest of the public, but due to its private, market-based nature, it can only serve a small segment of that needy public in Appalachia.

¹³¹ <http://www.irs.gov/pub/irs-soi/tehistory.pdf>

¹³² The stated justifications are an unmet public need, and specifically the market's failure to meet those needs.

5 CDFIS AND CAPITAL MARKETS IN BROADER CONTEXT: THEORY, REALITY AND THE APPALACHIAN CASE

In justifying the role and mission of the ACC, both (a) publications covering of the creation of the ACC and (b) interviewees for this thesis, frequently cited the ARC and NCRC's 2013 study documenting the shortage of community development capital in Appalachia. In attempting to interpret the causes of this shortfall, they have also frequently stated insufficient existing economies of scale among the region's current financial institutions as the primary cause. While the referenced study does offer evidence of such a shortfall, it does not fully attempt to explain why such a shortage exists to begin with. It certainly does not show that insufficient economies of scale is the reason for the region's shortfall. In fact, interviewees at both the Treasury's CDFI Fund and the ARC confirmed that due to a lack of data it is extremely difficult to systematically track overall shortfalls at all, let alone explain why they occur, using limited existing data.

Why is there a lack of capital in Appalachia? Is it a lack of community development capital specifically, or capital in general? Are economies of scale the key issue?

In this chapter, I will attempt to frame the capital shortfall, reviewing how economists claim that capital markets, and markets in general, should, in theory, function, before turning to how they actually function in reality. I will then develop an analytical frame for CDFIs and community development financing in general, which I will then apply to the Appalachian case.

I argue that there is a shortfall of *retained* capital in the region, both community development capital and capital in general. I also argue that the ACC, like CDFIs in general, can be understood as an attempt to bring back some of the capital that "leaks" out of the region. Specifically, the ACC and CDFIs in general are an attempt to:

- a. Offset the realities of imperfect competition. Specifically, I frame CDFIs as a market-based solution to the problems generated by:

- i. Negative externalities: specifically, unpriced negative capital mobility externalities, as the search for profit results in the (a) abandonment of employment sites and (b) a less-mobile, “stuck in place” labor pool, in both rural and urban settings, which CDFIs seek to make productive again.
 - ii. Positive externalities: imperfections in the broader capital markets, which result in underinvestment in community development in general, due to a failure to internalize the social benefits or positive externalities of community development into private markets’ pricing of capital.
- b. Reduce the place-based impact of the scaling, globalization and centralization of economic and financial activity, and associated exporting of financial capital out of the region to global capital centers. This is accomplished by repatriating some portion of the financial capital that is exported out of “losing” regions that do not proportionately benefit from the agglomeration economies of scale that drive concentration of industries and functions¹³³. These agglomerating industries and functions include highly remunerated executive management/headquarters functions disproportionately concentrated in global financial capitals like New York and London (ibid). In contrast to these “winning” regions, “losing” regions, like Appalachia, fail to develop such agglomeration economies in growing or high value-capturing industries and/or functions, such as finance.

Put in the framework of Castells¹³⁴, CDFIs are as an effort led by the state to transfer some of the private capital concentrated in “the spaces of flows” back into the “spaces of places” which produce, but do not retain, that capital.

While led by the state, this effort is not executed by the state. This transfer is accomplished using state-backed, but ultimately private, circuits of capital (through CDFIs), rather than directly through the

¹³³ Sassen, 2002.

¹³⁴ Castells, 1989.

state itself. Ultimately, the state is seeking to reimport the capital using the very same private circuits that export the capital to begin with. This framework, though deploying different language and analytical tools, does not necessarily contradict the view produced through the economist's lens, which sees CDFIs as a response to market “imperfections”.

I also detail the transformation of community development finance that occurred as the Treaty of Detroit era gave rise to the neoliberal Washington Consensus and today's Age of Austerity. I theoretically frame the emergence of CDFIs as a market-based solution to the ongoing problem of a shortage of community development investment and capital (from any and all sources or sectors) in the United States.

I hypothesize that need for such investment is greatest in regions which have seen the greatest systematic disinvestment as a result of the territorial rescaling of capital inherent in the capitalist imperative, as capital has become increasingly mobile¹³⁵. While this often includes urban neighborhoods which have suffered from industrial and residential disinvestment and abandonment¹³⁶, it also includes rural areas, such as Appalachia and the Upper Midwest¹³⁷. These areas saw massive investment by corporations in natural resources and manufacturing, respectively. When that investment ceased to be as profitable as it could be, the physical plants and other sunk costs and “fixed capital” were abandoned, resulting in disinvestment.

Finally, I conclude that, ultimately, vehicles like CDFIs remain limited in their potential to reverse or fully offset the broader capital shortfall, as economies of scale in the capital markets remain supported by regulations which can act as barriers and make it difficult for regions like Appalachia to retain their existing stock of capital. This will be demonstrated in the following Chapter (Chapter 6) by tracing the flows of capital out of the region from the \$10B West Virginia public sector pension system.

¹³⁵ Storper and Walker, 1989; Harvey, 1982

¹³⁶ This has occurred as capital has moved productive/employment sites to newly constructed suburban and urban “fortress cities” (Davis, 1995), often subsidized by public infrastructure investment from captive state regimes.

¹³⁷ Storper and Walker, 1989; Bluestone and Harrison, 1982.

Yes, Appalachia has a capital shortfall. But the problem is not that Appalachia lacks capital, but it is that Appalachia's "native" stock of capital is systematically shipped out of region to "money centers" and into the global economy, never to return, as regulatory barriers supporting economies of scale for large financial institutions ensure that the regions' capital continues to flow out of the region. Even if the region could successfully compete in offering high risk-adjusted returns, capital is unlikely to remain in the region due to such barriers. While CDFIs like the ACC may, on the margins, help bring some of this leaked or exported capital back into the region, they do not address the underlying dynamics that result in the region's ongoing loss of capital.

5.1 HOW NEOCLASSICAL ECONOMICS CLAIMS CAPITAL MARKETS (SHOULD) WORK:

MODEL OF PURE COMPETITION

Neoclassical economists have historically argued that, in theory and in a developed, capitalist system of production, the state should play a minimal role in private markets¹³⁸, including in the markets for capital raising and distribution. Any state intervention, beyond basic rule enforcement and provision of basic public goods, is theorized to be inefficient and to reduce total societal welfare: the state is likely to over or under-allocate resources to sectors where they are not most efficiently utilized, and discourage or stifle entrepreneurs and innovators from achieving productivity-enhancing technological advancements. Such a view, notably, was not always dominant within economics. As noted by Katznelson (2013) in his trenchant new history of the New Deal era, the centralized economic planning, resource allocation schemes, and capital market restrictions implemented in response to the Great Depression were often endorsed by leading economists of the era as a needed antidote to the volatility and irrationality of free markets. Nonetheless, neoclassical economics in the post-New Deal era posits that markets are more efficient in allocating resources.

¹³⁸ Friedman, 1962.

Neoclassical economists' assumptions about such efficient markets are deeply flawed, however, and do not correspond to how capital markets, in actual practice, function. In reality, market "imperfections", i.e. deviations from economists' stringent assumptions and expectations of the ideal market, are significant and consistent in their occurrence and appearance: as noted in one standard graduate economics textbook today "Externalities are everywhere. Externalities occur throughout the economy."¹³⁹ These market imperfections, which are the basis for public actions such as the legislation creating the ARC and creating CDFIs in general, are frequently grouped into several key types; all are relevant here.

As delineated by Seidman (2005), these causes of imperfection all interfere with the operation of microeconomists' picture of "perfect competition" in pure markets, which assume: many suppliers and users of capital (perfect competition); perfect and cheap information; transaction costs insignificant compared to size of transaction; transactions have no externalities; participants are rational benefit maximizers.

In reality, none of these conditions are met in the capital markets as they are structured and constructed in the United States or Appalachia today. There are only a few lenders/suppliers of capital in many markets, as evidenced by the prominence and market share of the Big Four banks in the US financial sector, which can account for as much as three-fourths of insured banking activity in many large metropolitan areas today, according to FDIC data. Information about investment opportunities is limited and expensive, in part a function of federal and state regulatory barriers, and must be purchased from expensive financial information providers. Transaction costs, especially for small-business and low-income related investment opportunities, are high as compared to the deal size, with origination/acquisition, disposition, legal and accounting costs representing significant costs for all parties and counterparties, resulting in economies of scale as these costs can be spread over a large investment. Transactions have benefits and costs that are externalized, often borne by the public

¹³⁹ Baumol and Blinder, p. 286

sector. Participants may not be rational, using subjective perceptions, both consciously and subconsciously, about small loans and certain geographic areas, to inform their decisions; physical and social proximity to certain districts and borrowers may give them more familiarity, information and comfort, causing them to underinvest in areas at a greater distance, even if it could be done profitably.

These imperfections above, all generalizable to the US capital markets, were all confirmed as issues in Appalachia in interviews with community development lenders and associated stakeholders. These issues impact community development investment in general, and Appalachian investment specifically, in two key ways. First, banks underinvest in small businesses in general, and specifically small-amount loans in distressed census tracts, as confirmed in the aforementioned 2013 NCRC and ARC capital shortfall study. These physical areas, lacking access to capital, are at risk for seeing economic and social conditions accordingly deteriorate, requiring publicly financed programs to ameliorate these conditions, which are in effect an externality of underinvestment. This has given rise to state action to compel banks to invest in such areas, e.g. the Community Reinvestment Act (discussed later in this chapter). Second, requisite community development investments themselves are subject to the same market imperfections, with high transaction costs producing benefits to economies of scale, for example. This means that smaller areas and/or regions not served by larger financial institutions benefiting from such economies of scale have an underprovision of community development capital.

Implicit in the neoclassical framework, which mimics the positivistic hard sciences of chemistry and physics (Stillwell, 2006), is nonetheless a normative assumption. They assume that markets will inherently, if perfected, always more efficiently and “better” allocate resources compared with other mechanisms. In applying the framework of neoclassical economics, then, I argue that CDFIs might be justified as a regulation-enabled means by which to overcome the significant unpriced and/or mispriced negative and positive externalities in the capital markets today.

Notably, this perspective is not inconsistent with a view coming out of radical political economy and Marxian economics, as best articulated by the regulationist school and Aglietta (1976). This school

argues that economic regulations by the state are a means by which to ensure that capital and capitalism can be sustainably reproduced: CDFIs can be framed as a means by which to offset the negative social consequences of market failure (and associated social instability) or underinvestment by financial institutions in certain spaces and places.

5.2 HOW CAPITAL MARKETS ACTUALLY WORK: CONCEPTIONS OF GEOGRAPHY, DISTANCE AND AGGLOMERATION

Beyond these imperfections and externalities are the distinctly spatial and geographical aspects of markets: until recently, mainstream economists ignored geography entirely in its specifications of markets: where, exactly, do markets play out, in space and time? As noted by Krugman (1995), who won the Nobel Prize in part due to his work on this front, economists assumed market activity occurred “on a featureless plain”, having ignored for thirty years Isard’s (1956) stinging critique that their approach presumed a “wonderland of no spatial dimensions”.

Issues of scale and geography are particularly noteworthy for Appalachia. Throughout the global economy, time and space has been dramatically compressed over the last century¹⁴⁰ by deploying information, communication and transportation technologies; these technologically-enabled compressions of time and space enhance economies of scale. This entire dynamic, however, is somewhat stunted by the mountainous terrain of Appalachia: transportation and building technologies that enable faster movement of goods and services in ever-denser cities, for example, are more difficult to deploy at steep physical gradients, undermining the formation of agglomeration economies in the region. Towns separated by as little as twenty or thirty miles, due to terrain, can require one to two hours’ travel time.

¹⁴⁰ Harvey, 1990.

"Money Centers" in the US: MSAs with >25k Financial Activities Jobs

Geography	Employment by Sector, Thousands of Jobs, 2013:			
	Financial	Total	Fin as % of Total	Location Quotient
	Activities			
US	7,880	136,368	5.8%	1.00
New York-Northern New Jersey-Long Island, NY-NJ-PA MSA	738	8,692	8.5%	1.47
Los Angeles-Long Beach-Santa Ana, CA MSA	324	5,567	5.8%	1.01
Chicago-Joliet-Naperville, IL-IN-WI MSA	289	4,439	6.5%	1.13
Dallas-Fort Worth-Arlington, TX MSA	252	3,090	8.2%	1.41
Philadelphia-Camden-Wilmington, PA-NJ-DE-MD MSA	203	2,749	7.4%	1.28
Miami-Fort Lauderdale-Pompano Beach, FL MSA	165	2,347	7.0%	1.22
Phoenix-Mesa-Glendale, AZ MSA	159	1,811	8.8%	1.52
Atlanta-Sandy Springs-Marietta, GA MSA	156	2,405	6.5%	1.13
Washington-Arlington-Alexandria, DC-VA-MD-WV MSA	151	3,079	4.9%	0.85
Houston-Sugar Land-Baytown, TX MSA	142	2,788	5.1%	0.88
Minneapolis-St. Paul-Bloomington, MN-WI MSA	142	1,796	7.9%	1.37
San Francisco-Oakland-Fremont, CA MSA	126	2,104	6.0%	1.04
Detroit-Warren-Livonia, MI MSA	102	1,864	5.5%	0.95
Tampa-St. Petersburg-Clearwater, FL MSA	100	1,177	8.5%	1.46
Seattle-Tacoma-Bellevue, WA MSA	97	1,785	5.4%	0.94
Denver-Aurora-Broomfield, CO MSA	96	1,294	7.4%	1.28
St. Louis, MO-IL MSA	86	1,315	6.5%	1.13
Baltimore-Towson, MD MSA	76	1,333	5.7%	0.99
San Antonio-New Braunfels, TX MSA	76	906	8.4%	1.45
Columbus, OH MSA	75	979	7.7%	1.33
Charlotte-Gastonia-Rock Hill, NC-SC MSA	75	874	8.5%	1.48
Kansas City, MO-KS MSA	74	1,007	7.4%	1.28
Pittsburgh, PA MSA	71	1,158	6.2%	1.07
San Diego-Carlsbad-San Marcos, CA MSA	71	1,312	5.4%	0.94
Orlando-Kissimmee-Sanford, FL MSA	70	1,065	6.5%	1.13
Cincinnati-Middletown, OH-KY-IN MSA	66	1,024	6.4%	1.11
Portland-Vancouver-Hillsboro, OR-WA MSA	63	1,036	6.1%	1.06
Cleveland-Elyria-Mentor, OH MSA	63	1,026	6.1%	1.06
Jacksonville, FL MSA	61	608	10.0%	1.74
Indianapolis-Carmel, IN MSA	59	934	6.4%	1.10
Milwaukee-Waukesha-West Allis, WI MSA	54	826	6.6%	1.14
Des Moines-West Des Moines, IA MSA	53	336	15.7%	2.71
Nashville-Davidson--Murfreesboro--Franklin, TN MSA	51	808	6.3%	1.09
Salt Lake City, UT MSA	51	662	7.7%	1.33
Sacramento--Arden-Arcade--Roseville, CA MSA	50	864	5.7%	0.99
Austin-Round Rock-San Marcos, TX MSA	48	864	5.6%	0.97
Richmond, VA MSA	48	633	7.5%	1.31
Las Vegas-Paradise, NV MSA	43	849	5.1%	0.89
Louisville-Jefferson County, KY-IN MSA	43	626	6.9%	1.19
Riverside-San Bernardino-Ontario, CA MSA	42	1,226	3.4%	0.59
Omaha-Council Bluffs, NE-IA MSA	42	476	8.8%	1.53
Birmingham-Hoover, AL MSA	41	507	8.1%	1.41
Virginia Beach-Norfolk-Newport News, VA-NC MSA	38	753	5.0%	0.86
Oklahoma City, OK MSA	34	607	5.6%	0.97
San Jose-Sunnyvale-Santa Clara, CA MSA	34	962	3.5%	0.60
Buffalo-Niagara Falls, NY MSA	32	548	5.8%	1.01
Columbia, SC MSA	30	361	8.2%	1.42
Madison, WI MSA	29	358	8.0%	1.38
Memphis, TN-MS-AR MSA	27	605	4.5%	0.78
New Orleans-Metairie-Kenner, LA MSA	27	546	5.0%	0.86
Raleigh-Cary, NC MSA	27	541	5.0%	0.86
Albany-Schenectady-Troy, NY MSA	25	448	5.7%	0.98
Top 52 Metros	5,097	75,971	6.7%	1.16
% of Total	65%	56%		

*MSAs which are partly in Appalachia are in bold

Source: Bureau of Labor Statistics , author calculations

Specifically, however, Appalachia has a limited financial sector, which means that assets and surplus
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income generated in the region are often shipped out of the region, to "money center" banks and regions that house large concentrations of banks and financial institutions, which possess the scale and expertise to invest this capital. As a result, even if Appalachian households and businesses wanted to keep capital in the region, rather than export it, the region's institutions are underdeveloped and have a limited ability to invest it in the myriad instruments available today. Capital markets activity in the United States is concentrated in a handful of cities, and is underdeveloped in Appalachia. The chart above, for example, shows that there are just 52 metropolitan areas in the United States with financial activities employment of more than 25,000 in 2013. These metros, which account for 56% of employment in all sectors in the US, account for 65% of financial activities employment. Of Appalachian MSAs, only Pittsburgh and Birmingham make the list, along with Atlanta, which is only partly in the ARC service area.

Within financial activities, however, concentration in the securities and investment industry (NAICS Code 523) is even higher: as detailed by Wojcik (2011), just six metropolitan areas account for half of all US employment in securities and finance: New York, Boston, Chicago, Philadelphia, Los Angeles and San Francisco (in rank descending order). While this sub-industry excludes traditional banking, this concentration is problematic, as capital being generated for investment by Appalachia is effectively sent to these regions, as will be further discussed in Chapter 6.

This reflects both internal and external economies of scale: the capital markets industry, just like any other, occurs in space and place, and is subject to the same agglomeration economies and economies of scale and scope, as with many other industries¹⁴¹. A review of these internal and external economies of scale and scope are in order.

Internally, as banks grow larger and focus on larger loans, deposits, and investments, their transaction costs and systems cost per dollar of revenue are predicted to decline. Even if they do not focus on larger individual transactions, booking large numbers of small transactions also yields economies of

¹⁴¹ Mitchell and Onvural, 1996; Berger, Hanweck and Humphrey, 1987; Clark, 1988

scale¹⁴². Systems costs and administrative costs, many of which have large “up-front” fixed components, are spread across more and larger transactions, resulting in lower costs per loan and per revenue dollar. Similarly, banks can use their infrastructure in “core” basic banking functions to expand into complex financing and investment instruments: as these infrastructure costs get spread across these other products, they realize economies of scope as well. These benefits of internal economies of scale and scope disproportionately accrue not to the investors in the bank, but to the bankers themselves¹⁴³. This underscores the importance of geography, because if these highly paid bankers are disproportionately located in certain regions, so too will their excess income gains be concentrated there.

Externally, banks benefit from positive Marshall-Arrow-Romer (MAR) externalities associated with co-location in the same city, including knowledge spillovers, shared labor force, shared supplier/client base, and other features of urbanization economies in industry. These “natural” external economies of scale are reinforced by federal and state banking policies which enhance the competitiveness of the largest firms, most notably the moral hazard created by the perception of “too big to fail” bailout policies, and the lack of enhanced capital requirements on large financial institutions¹⁴⁴.

These theories regarding economies of scale and the ensuing spatial agglomeration do not just apply to the financial industry, and can be witnessed in law, accounting, entertainment, and a host of other industries. As noted by Storper (2013), these theories reflect the combined efforts of scholars working across multiple interrelated traditions, seeking to work across disciplines to answer the question of why cities and urban areas are again seeing gains in population and economic activity. These traditions include, in the framework of Storper (2013), the new neoclassical urban economics, (NNUE) led by Glaeser, and new economic geography (NEG), whose proponents include the aforementioned Krugman, as well as Storper. While these traditions may differ in their view of some of the specifics

¹⁴² Mester, 2010: https://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4535&

¹⁴³ Anderson and Joveer, 2012.

¹⁴⁴ Stern and Feldman, 2004

of urban agglomeration (specifically, whether jobs follow people, or people follow jobs, i.e. does capital migrate to labor or does labor migrate to capital), there is widespread agreement that internal and external economies of scale supports agglomeration of industries and functions in certain regions.

Meanwhile, sociology and geography also offer some alternate heuristics to conceive of these issues. Castells (1989), as stated above, conceives of a globalizing economy as connecting otherwise bifurcated spaces of flows and the spaces of places. Global decision-making is conducted by social elites who live in insulated neighborhoods which constitute the spaces of flows, as it is from and through these areas which global capital, information, and activity emanate. Sassen (2002) clarifies how such spaces of flows also may house concentrations of both industries and functions, including executive and management occupations. These spaces also house the requisite infrastructure (e.g. private schools, social clubs, specialized medical practices, luxury retail, etc.) need to socially reproduce these elites.

Similarly, the frame of world-systems theory, colonial studies, dependency theory, and Marxian political economy, would all conceive of an economic core and a periphery. In core-periphery models of development¹⁴⁵, capital is abundant in the core, but labor is scarce. Capital is scarce in the periphery, but labor is abundant, for a host of reasons¹⁴⁶. Further, even in an era of fairly mobile capital¹⁴⁷, capital may persistently be overinvested in specific regions and industries, and underinvested in others¹⁴⁸ in a manner which defies traditional models of “rational” return-maximizing behavior.

One of the key “irrationalities” relates to distance: when companies headquartered in two different regions merge to achieve economies of scale, and one region’s headquarters is lost, that region loses far more than just the headquarters functions: it also loses all of the indirect investment into the region that was driven by the headquarters operations. As stated in Chapter 3, out-of-market companies are

¹⁴⁵ Myrdal, 1957, Friedmann, 1966, Wallerstein 1974, Arrighi, 1994.

¹⁴⁶ (e.g. distance from the core breeds unfamiliarity and increased perception of risk, peripheral capital surplus leaks or is extracted to the core rather than reinvested locally, cf. Chinitz, 1960, 1961)

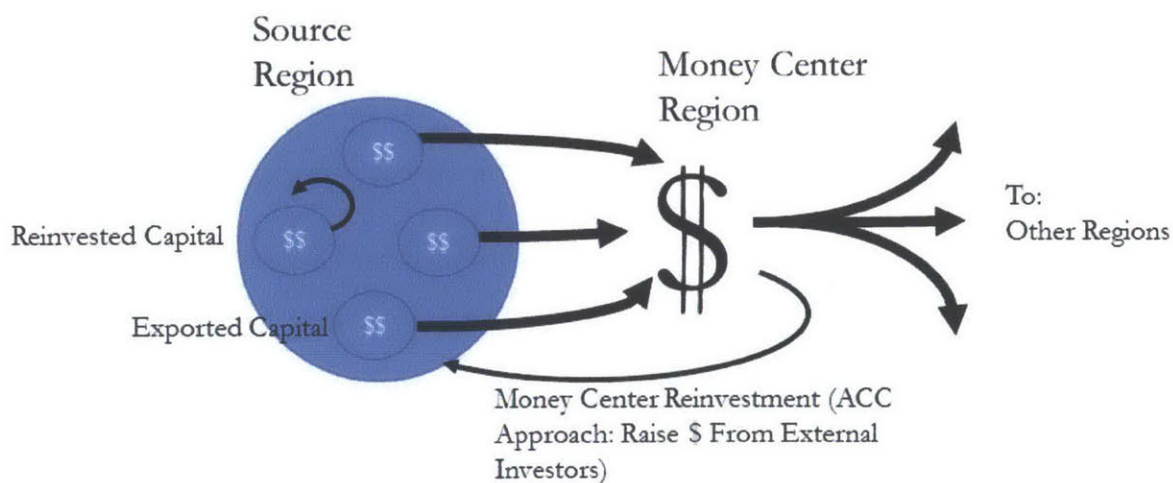
¹⁴⁷ Harvey, 1982; Storper and Walker, 1989.

¹⁴⁸ Bluestone and Harrison, 1980; Storper, 1984

less likely to reinvest in their region, as has been shown in multiple modern studies¹⁴⁹ quantifying how a loss in corporate headquarters typically results in a decline in local donations and/or investments to philanthropies and community groups. This is a function of the associated reduction in network connections and access when corporate executives are located out of the region. This becomes a very real community development investment “side effect” of agglomeration economies.

Utilizing the insights of these various traditions, the ACC is not just an attempt to correct for underinvestment as a result of mispriced market “imperfections”: rather, it is an attempt to correct for underinvestment resulting from markets working “normally”, subject to the economies of scale and spatial agglomeration. As a result of these dynamics in the financial industry, Appalachia’ capital is exported as an input into the financial industry, which is concentrated in city-regions largely outside of Appalachia¹⁵⁰. CDFIs like the ACC can therefore be understood as an attempt to offset the scale and externalities-induced underinvestment and exporting of capital out of the region to banking centers and beyond into the global economy.

Diagram: Appalachia’s Capital Export Problem



¹⁴⁹ Hughes, 1994; Card Hallock and Moretti, 2008.

¹⁵⁰ Pittsburgh does have a concentration of financial sector employment, but largely in traditional banking. As such, though it is in Appalachia, investment capital is not necessarily flowing from the rest of Appalachia into Pittsburgh.

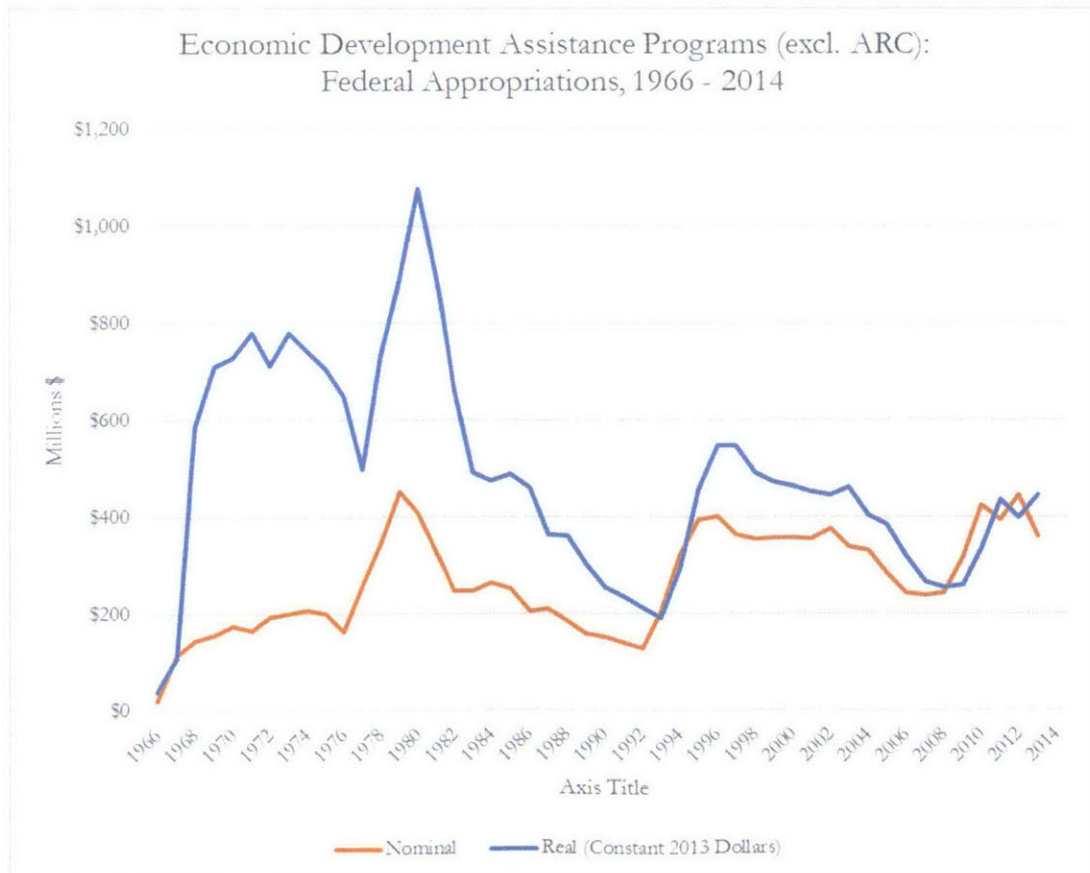
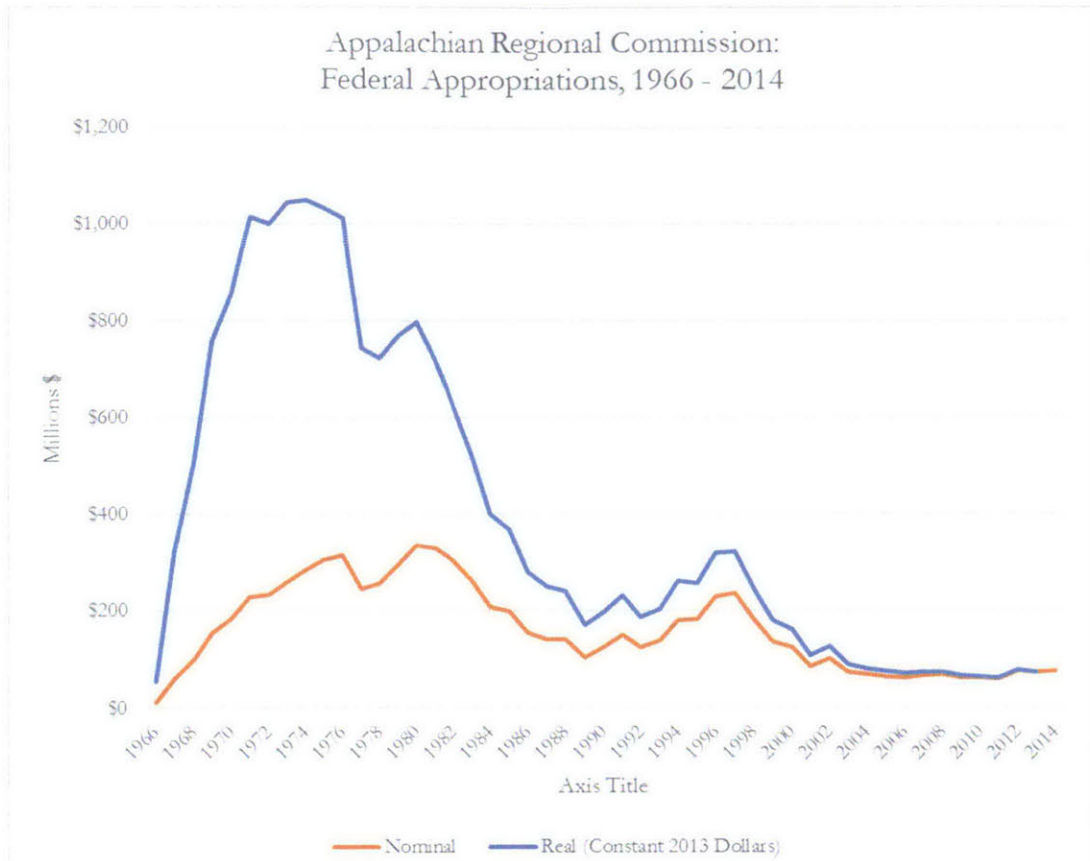
Geography and sociology, then, reveal that Appalachia's capital shortfall might be in part a function of the internal and external economies of scale and scope in the financial sector: these activities agglomerate in money centers, which are largely outside of the region, and they pull Appalachia's capital to it. Once there, it is not sent back to Appalachia for investment, but rather it is redeployed out to the rest of the world.

5.3 CDFIs IN CONTEXT: COMMUNITY DEVELOPMENT FINANCING TRANSFORMED

Regardless of the theoretical or academic justification for CDFIs as a means by which to achieve community development investment, there have been significant changes in the reality of how such investment occurs. Over the last several decades, the field of community development has been transformed, as a direct result of the decline of direct state funding and intervention, and its replacement with private sector, market-based capital investment and mechanisms. CDFIs emerged in conjunction with such private, market-based paradigms.

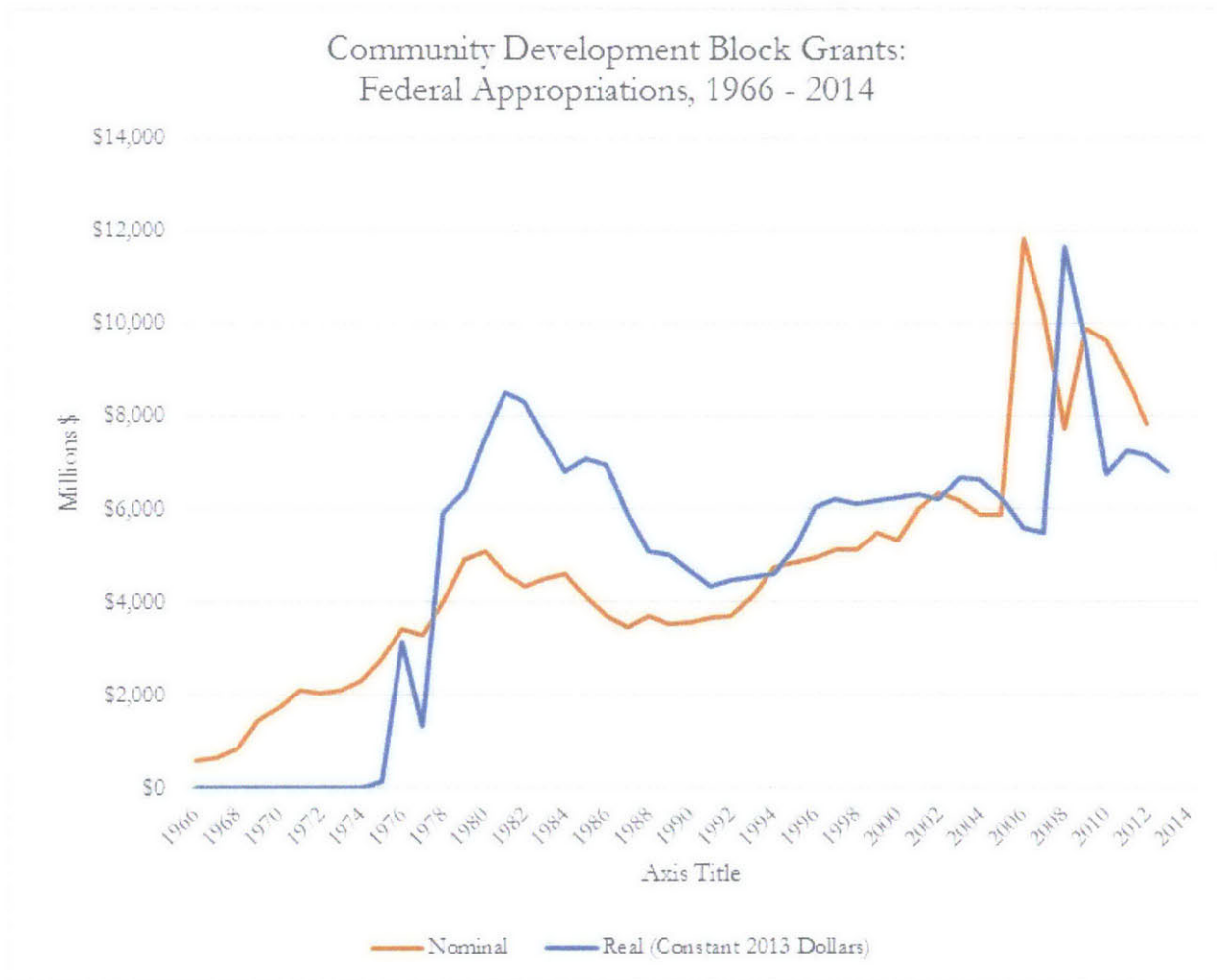
Specifically, an extraordinary decline in direct federal grants via HUD and other agencies, most notably through the Community Development Block Grant (CDBG) program, has been offset and/or replaced by private market sources. This was spurred by a range of acts such as the 1977 Community Reinvestment Act (CRA), which requires regulated banking institutions to reinvest in their local communities through qualified activities, one of which is making loans, donations or investments in entities such as Community Development Financial Institutions (CDFIs) and Revolving Loan Funds (RLFs). Similarly, the Tax Reform Act of 1986 created Low Income Housing Tax Credits (LIHTC), and the Community Renewal Tax Relief Act of 2000 established the New Markets Tax Credits (NMTC) Program. Both use tax avoidance and/or mitigation to encourage private market capital investment into demand segments of the housing and small business capital markets sectors that had previously been met with direct public sector expenditure. The effect has been a move away from

direct public sector intervention and investment towards indirect public sector action focused



regulatory changes to spur private investment.¹⁵¹

Federal investments into Appalachia are no exception to this: as previously stated, the ARC has, in recent decades, seen its real, inflation-adjusted budget decline precipitously: Under the “finish-up” program and an attempt to eliminate federal involvement in economic development, Reagan slashed the budget in 1981. Highway funding was moved out of the Congress'



¹⁵¹ Both LIHTC and NMTC, programs largely run by the US Treasury, effectively raise private capital for specific types of underinvested sectors (affordable housing and low-income tract business investment). They do so by selling a tax credit to private investors. These tax credits are used by investors, who competitively bid for a set number that are allowed by law to be sold each year, to offset their federal tax liability. The money they pay to acquire this credit is then invested by private affordable housing developers and private low-income business operators. Private investors thus not only reduce their tax burdens, they then becomes part owners and/or lenders to affordable housing developments and low-income businesses.

ARC appropriations, and subsequent administrations have left the budget largely unchanged. The result is a more than a two-thirds real decline in funding levels over the past 30 years.

The ARC's activities, then, have been constrained by a decline in federal appropriations. This shift that is part of the larger transition against "big government" that took place starting in the 1980s, which was the end of the "Treaty of Detroit" era. It has been replaced by the emergence of the neoliberal "Washington Consensus" era, in which direct state intervention into regulating private markets and correcting private market failures and other externalities, has declined in favor of private sector, market-based solutions, as discussed in the previous chapter.

This represents a sea change in traditional views of the role of the state in intervening to address market failures, invest in public goods, and ensure social stability, and is a hallmark feature of the Washington Consensus. This term, originally coined by British economist John Williamson in 1989 to refer to Washington DC's and the IMF's programs for policy reform in developing countries, originally referred to a host of structural adjustment programs, most notably the privatization of state enterprises, and reduction of state interventions in trade, taxation, and legal property rights. It has since more generally come to be applied to neoliberal policies in general, which promote market solutions to public problems.

These market-based efforts, often falling under the poorly and inconsistently defined emerging rubric of "social enterprise", run across a range of public fields. They range from education, where charter schools are seen as a solution to the problems in publicly run school districts, to housing, where private provision and management of affordable housing has emerged to replace publicly owned and managed low-income housing¹⁵². Backing the development of a social enterprise infrastructure are a range of wealthy private individuals, who have on the record stated that "non-profits can do this work better than the government."¹⁵³ Is the creation of the ACC merely the latest example of this dynamic at

¹⁵² Vale, 2013; Amin, 2009.

¹⁵³ Ganz, Kay, and Spicer, forthcoming 2014.

work, as a decline in direct government funding for the ARC is being replaced with private sector funding from the ACC?

This does not necessarily seem to be the case, as the ACC's mission is, ostensibly, focused on attempting to offset a shortcoming in private, not public, market capital. Appalachian Community Capital is a CDFI. This type of vehicle was created by law to address shortcomings and imperfections in the private capital markets, which, as reviewed in the last section, do not behave the way that neoclassical economists' traditional theories claimed they should, and result in underinvestment in disadvantaged and under-resourced areas and neighborhoods.

Nonetheless, fifty years ago, when the ARC was created, such a private approach to solving the problems of neighbourhood dis- and underinvestment was not the norm, if it even existed at all. Johnson's War on Poverty, which led to the creation of the ARC, also resulted in the Economic Opportunity Act of 1964, and the establishment of the Office of Economic Opportunity. A signature element was the Community Action Program (CAP), which allowed community organizations in disadvantaged neighborhoods to bypass city government control and access federal funding. These and other signature "Great Society" programs in some ways represent a high water mark of the "Treaty of Detroit" era.

Threatened by this scaling and level of neighborhood community power, as well as the approach of many community groups to engage in confrontational and Alinsky-style methods¹⁵⁴ led to Model Cities, Special Impact Amendment¹⁵⁵ and eventually the 1974 creation of Community Development Block Grants, (CDBG)¹⁵⁶. This consolidated a host of federal programs and gave control over funding decisions to local governments. Nixon and Ford both tried to eliminate and/or dramatically scale back the amount of federal community development funding, and Carter, while a proponent, faced deficits and fiscal austerity requirements related to the recessionary environment, the oil crisis, and foreign

¹⁵⁴ DeFilippis, 2003.

¹⁵⁵ Bratt, 1989.

¹⁵⁶ As well as UDAG, Urban Development Action Grants.

geopolitical risks that limited his latitude. Reagan, similarly, attempted to eliminate many of the programs¹⁵⁷.

In conjunction with these changes, the 1975 Home Mortgage Disclosure Act and 1977 Community Reinvestment Act placed further restrictions on mainstream financial institutions and encouraged them to invest in previously redlined and ignored areas, typically minority, low-income and disadvantaged. This resulted in the growth of Community Development Loan Funds.

While the introduction of the CDBG restricted political activities and spurred the development of CDCs, funding quickly declined: between 1977 and 2003, for example, the CDBG budget in real dollars fell by 48%¹⁵⁸, while HUD's overall budget fell from 7% to 1% of the total federal budget between 1976 and 2005. CDFI Funding has stepped into the breach created by the retrenchment and retreat of the public sector, and specifically by the reduction in CAA and CDBG funding over the last three decades.

This connection is often ignored or underexplored in analyses of community development financing. CDFIs, like the ACC, can be framed as a publicly enabled and stated-backed institutional responses to one or both of two key features:

- (a) market imperfections which result in the underprovision of capital to low-income and historically disadvantaged communities, or
- (b) ongoing extraction of wealth and resources from areas lacking concentrations of “winning” industries, or functions that form the basis of urban agglomeration economies today. The ACC, which is focused on attracting external investors to the region, embodies this: it will attempt to attract investors and resources from “winner areas” to invest into the region (see prior section for discussion of agglomeration of financial industry).

¹⁵⁷ DeFilippis and Saegert, 2008.

¹⁵⁸ DeFilippis and Saegert, 2008, p. 330.

Certified CDFIs were created by the Riegle Community Development and Regulatory Improvement Act of 1994. In reality, however, this act merely formalized and created institutional structures, certification, and accreditation mechanisms for many existing community development banking and finance organizations, typically non-profit Community Development Corporations (CDCs) or Community Development Loan Funds (CDLFs). Both types of organizations had emerged in the 1970s at the end of the “Treaty of Detroit” era and the emergence of the “Washington Consensus” during the great retreat of the state.

The 1994 Riegle Act also created the CDFI Fund, which falls under the auspices of the US Department of the Treasury, and oversees CDFI compliance, monitoring, funding and regulation. At the same time of the creation of CDFIs and the CDFI fund, the multiple federal agencies charged with oversight of CRA enforcement issues new regulations in 1995, clarifying that bank investments in CDFIs, RLFs, and small business lending programs such as the SBIC/SBA-7 would qualify for CRA "credit".

Certified CDFIs must have a mission of promoting community development, and have 60% of its activities and 50% of assets directed to low-income target markets. Donations, investment and loans made to CDFIs by financial institutions subject to the 1977 Community Reinvestment Act are eligible for “CRA credit” or as CRA qualified activity, meaning that the financial institution’s investment in the CDFI is considered by its regulator (FDIC, Federal Reserve, or OCC) in determining its CRA rating. When regulated banks seek to merge, expand or otherwise substantively change their business model or operations in a manner which requires regulatory approval, its CRA rating is considered by the regulator in granting or denying approval to the requested change. Banks with poor CRA ratings can also be the target of community groups seeking to expand or improve access to capital. As such, financial institutions subject to CRA regulations have a host of reasons to invest in CDFIs or any other comparable institutions, such as CDLFs, Community Development Credit Unions (CDCUs).

As per the Treasury's CDFI Fund webpage, "As of December 15, 2013, there are 808 certified CDFIs, including 434 CDFIs that were recertified in 2013. The list includes 492 loan funds, 177 credit unions, 76 bank or thrifts, 50 depository institution holding companies, and 13 venture capital funds."¹⁵⁹

While the CDFI Fund provided technical assistance and seed capital to these institutions, which may also be eligible for other federal and state grants, they strongly rely on private sector investment to do their work. Who provides this working capital for these CDFIs, and why? According to Pinsky (2001)¹⁶⁰ three types of investors are key, and this was confirmed in interviews for this thesis: mission, regulatory, and yield-oriented investors: Specifically:

- "Capital motivated by regulatory concerns includes banks and other insured depositories subject to the Community Reinvestment Act (CRA); non-insured financial institutions seeking to demonstrate their commitments to community development proactively to discourage imposition of CRA-like coverage on their sectors; and other corporations subject to regulations which directly or indirectly lead to involvement in community development.
- Mission, or socially, motivated capital includes religious investments, government loans and grants, individual investments, foundation program related investments (PRIs) and grants, and socially responsible investments. The Social Investment Forum, a membership association of social investment professionals, recently launched a "1% in Communities" campaign to encourage socially motivated investors to put 1 percent of their investment portfolios in below-market community investments.
- Yield-motivated capital includes capital markets and capital-market type activity. Some community development banks and community development credit unions offer Certificates of Deposit at or very near to market rates. Otherwise, there is little market rate capital in community development."

¹⁵⁹ http://www.cdfifund.gov/news_events/CDFI-2013-58
CDFI_Fund_Releases_Updated_Certified_CDFI_Results.asp

¹⁶⁰ <http://www.brookings.edu/research/articles/2001/12/metropolitanpolicy-pinsky>

Regulatory capital, however, has become less available over time: troubling for CDFIs is that far less of American's assets today are held in CRA-covered institutions:

“In 1977, approximately two-thirds of Americans' long-term savings (including investments) were in banks and other insured-institutions in accounts that were subject to CRA. Today, approximately one-quarter or less are in comparable accounts. As a result, the overall share of American wealth that is subject to CRA has declined precipitously. At the same time, of course, the asset size of insured institutions and the financial services industry overall has skyrocketed.”

Also potentially troubling is the lack of transparency of this sector, reflecting its inherently private nature: certified CDFIs currently hold, based on data from the U.S. Treasury, approximately \$50B in assets, evidencing significant growth in recent years. But this only encompasses certified CDFIs, and not any other form of community development institution. While most are ostensibly non-profit and therefore must file IRS Form-990s, detailing their capital holdings, such filings are not necessarily clearly classified in a manner in which it is easy to tell (a) which non-profits are engaged solely in community development (b) which parts of multi-sectoral, diversified non-profits are engaged in community development.

Further, CDFIs, like traditional banks and financial institutions, are also subject to economies of scale. As noted by a recent industry study by the Carsey Institute:

“The analyses strongly support a finding that CDFIs with larger assets are much more likely to achieve high self-sufficiency ratios than institutions with smaller assets. There is a powerful scale effect among loan funds, as well as among CDFI banks and credit unions.

Among CDFI Loan Funds, the results show that larger funds outperform smaller ones along a range of factors that may result in greater self-sufficiency:

1. Drastically lower combined interest and operating expense ratios
2. More leverage on their balance sheets

3. Generally higher deployment ratios

4. Substantially lower levels of charge-offs as organizations progress from \$1 million in assets and up

At the same time, larger loan funds are able to achieve greater self-sufficiency despite operating at lower margins (smaller pricing mark-ups) than smaller funds, as can be seen in Tables 3 and 4, showing three-year averages.”

This means, then, that larger CDFIs may benefit from economies of scale and be more stable: but this comes with a potential trade-off: if scale is achieved by operating over a larger geographic area, does not that result in an organization which is less directly tied into the communities which it serves?

Such features, however, reflect the logic of the market, which is increasingly prevalent as the Washington Consensus has deepened in the post-financial crisis “age of austerity” (CITE). Specifically, the Consensus has taken a deeper turn since the onset of the financial crisis in 2008, in the form of public sector fiscal austerity, led by proponents of neoliberalism. The way austerity has played out in the US reflects the geography of the state, in particular in the American form of “fiscal federalism”, whereby state and local governments are responsible for financing a large share of public services, as compared to other developed Western states, where national government expenditures figure more prominently.

With calls for continued cuts in state and local spending as part of the continued financialization of the state¹⁶¹ and the economy overall¹⁶², CDFIs in general and the ACC specifically, might, be framed in the way that Peck has analyzed post-crisis developments in the local government financing and municipal bond markets. Specifically, using Peck’s approach, they might be “understood as one facet of a wider and deeper financialization of urban development and governance in the USA, in which an early phase of free riding on the inherited infrastructures of the Keynesian period has given way to an

¹⁶¹ Foster and Holleman, 2012

¹⁶² Krippner, 2011.

increasingly speculative, debt-leveraged, and risk-prone model in the course of the last two decades.”¹⁶³ Instead of public appropriations and outright state expenditures, the ACC uses borrowed money, which it in turns lends, to provide capital to small businesses that the market is failing to reach.

Rather than focus on redistribution between jurisdictions, austerity calls for all jurisdictions to be self-sufficient based on revenues at the bottom of the economic cycle, resulting in a minimalist “nightwatchman”¹⁶⁴ state. Yet pension funds and private financial markets are not self-contained within individual jurisdictions, nor are many public infrastructure works, such as roads. As both private and public markets move freely across jurisdictions, so too mustn’t public revenues, as needed? But as the tea party and other austerity advocates call for a reduction in the state and self-sufficiency of all public jurisdictions, movement of revenues across jurisdictions is increasingly confined to private sector vehicles like CDFIs, which rely more on debt than on outright grants: the ACC’s chief form of capital, for example, will be debt, not equity or grants.

5.4 APPALACHIAN CAPITAL MARKETS TODAY: CURRENT CONDITIONS

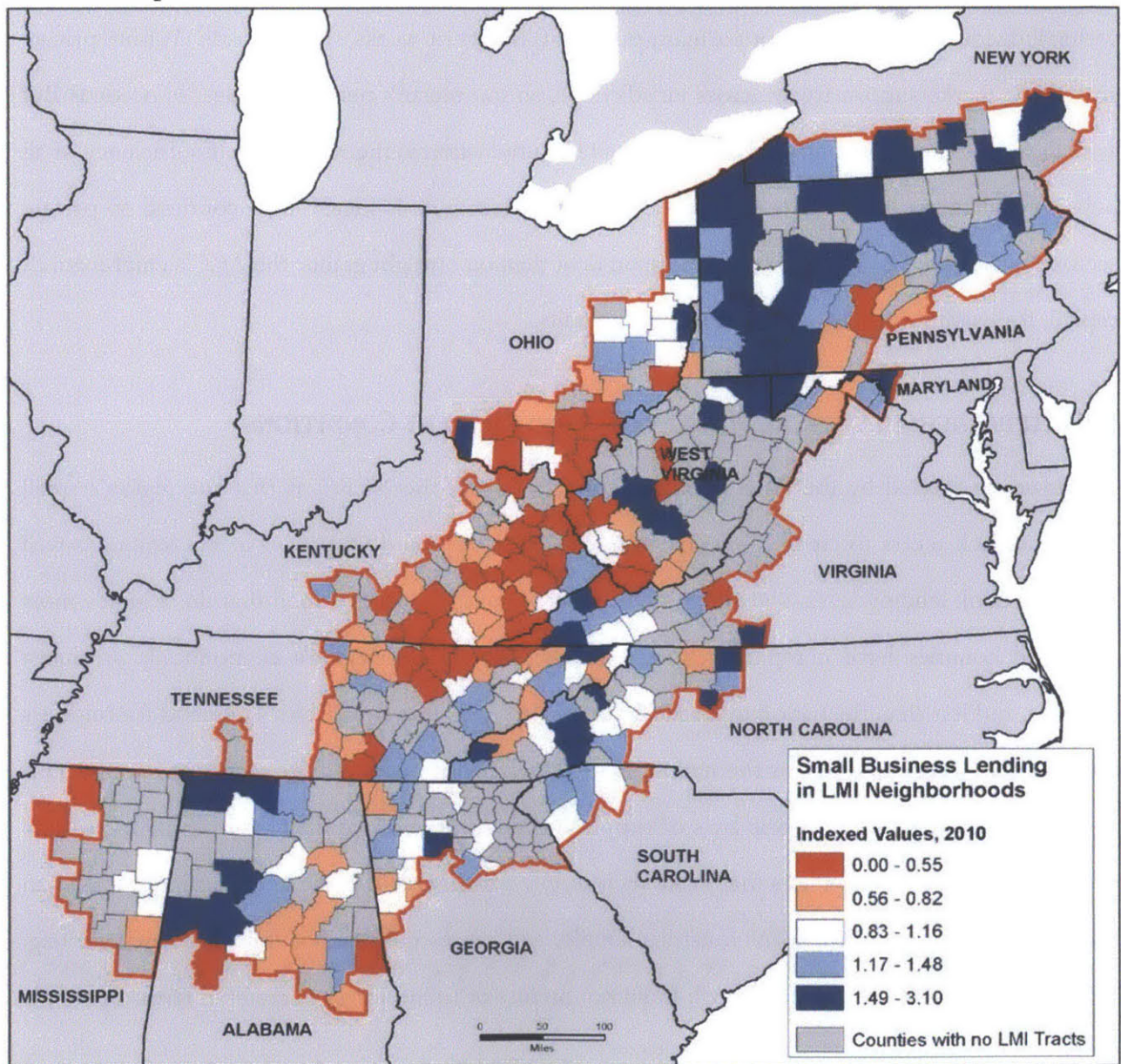
The issue, as framed by the ARC in their joint report with the NCRC, is that the region’s small businesses lack access to credit. Using data on CDFIs, NMTC, and SBA loans in the region, as well as overall bank lending levels and surveys on credit demand, the study found that the region's most distressed counties have comparatively less activity than in the region's economically strongest counties, and less than the nation overall. The study also finds that Appalachia’s demand for business credit, while lower than that of the nation, is nonetheless not being met by sufficient supply. This should either, according to classic laws of supply and demand, result in the credit supply increasing, or if it cannot due to constraints that make such supply fairly inelastic, result in higher interest rates in the area, as the demand for loans outstrips supply, and causes the price of a loan to increase (e.g. higher interest rates). The study, though it did not discuss or frame access to credit in terms of supply

¹⁶³ Peck, 2014.

¹⁶⁴ *ibid.*

elasticity, found that interest rates were indeed higher, largely a result of its base of smaller loans: smaller loans are more expensive to underwrite, disburse and service, again reflecting due to economies of scale.

The study found that small business lending and access to credit was not randomly distributed throughout the region, and exhibits marked spatial autocorrelation: counties in Northern Appalachia and in metropolitan areas had better access to credit than rural counties, and counties in Central and



Map Title: Small Business Lending in LMI Neighborhoods, 2010
Source: ARC and National Community Reinvestment Coalition, "Access to Capital and Credit in Appalachia" 2012
Data Source: CRA small business loan data and Dun and Bradstreet (D&B), 2010

Southern Appalachia. In fact, as seen in the map below, many of the strongest counties have access to small business loans that is better than the US overall: the counties in darkest blue on the map below had small business loan activity which was 33% to 135% higher than the US overall in 2010.

On the basis of the reality behind this data, the ARC's Capital Policy Advisory Committee advocated for the creation of a regionwide development bank. In interviews with the ARC and with the Treasury's CDFI Fund, both noted that the data does evidence a lack of such capital, but that such data only tells part of the story. The reality is that "there are a host of different (types of) capital which are difficult to track locally, such as overall bank lending volumes, and pools of savings and other capital which might be converted into debt and equity investments in the region".

Ratio of Small Business Loans to Small Businesses in Appalachia

Area	<u>2007</u>			<u>2010</u>		
	# Small Business Loans	# Small Businesses	Ratio	# Small Business Loans	# Small Businesses	Ratio
United States	13,437,779	21,808,201	61.6%	4,197,610	21,530,378	19.5%
Appalachian Region	808,877	1,607,645	50.3%	255,231	1,577,370	16.2%
Subregions						
Northern Appalachia	265,062	477,301	55.5%	93,452	482,014	19.4%
North Central Appalachia	59,519	128,944	46.2%	19,678	124,926	15.8%
Central Appalachia	38,372	115,266	33.3%	12,085	109,122	11.1%
South Central Appalachia	156,224	307,059	50.9%	47,760	304,728	15.7%
Southern Appalachia	289,700	579,075	50.0%	82,256	556,580	14.8%
County Types						
Large Metro (1 million+)	233,652	395,470	59.1%	71,892	404,330	17.8%
Small Metro (< 1 million)	325,376	613,330	53.1%	103,484	604,234	17.1%
Nonmetro, Adjacent to Large Metro	46,778	109,171	42.8%	14,654	103,911	14.1%
Nonmetro, Adjacent to Small Metro	136,848	301,104	45.4%	43,204	291,784	14.8%
Rural	66,223	188,570	35.1%	21,997	173,111	12.7%
Economic Status						
Distressed	25,190	89,777	28.1%	7,461	86,870	8.6%
At Risk	52,515	145,503	36.1%	18,619	138,028	13.5%
Transitional	448,203	887,755	50.5%	147,088	905,985	16.2%
Competitive	176,965	305,587	57.9%	57,498	292,327	19.7%
Attainment	85,936	135,857	63.3%	24,565	154,160	15.9%

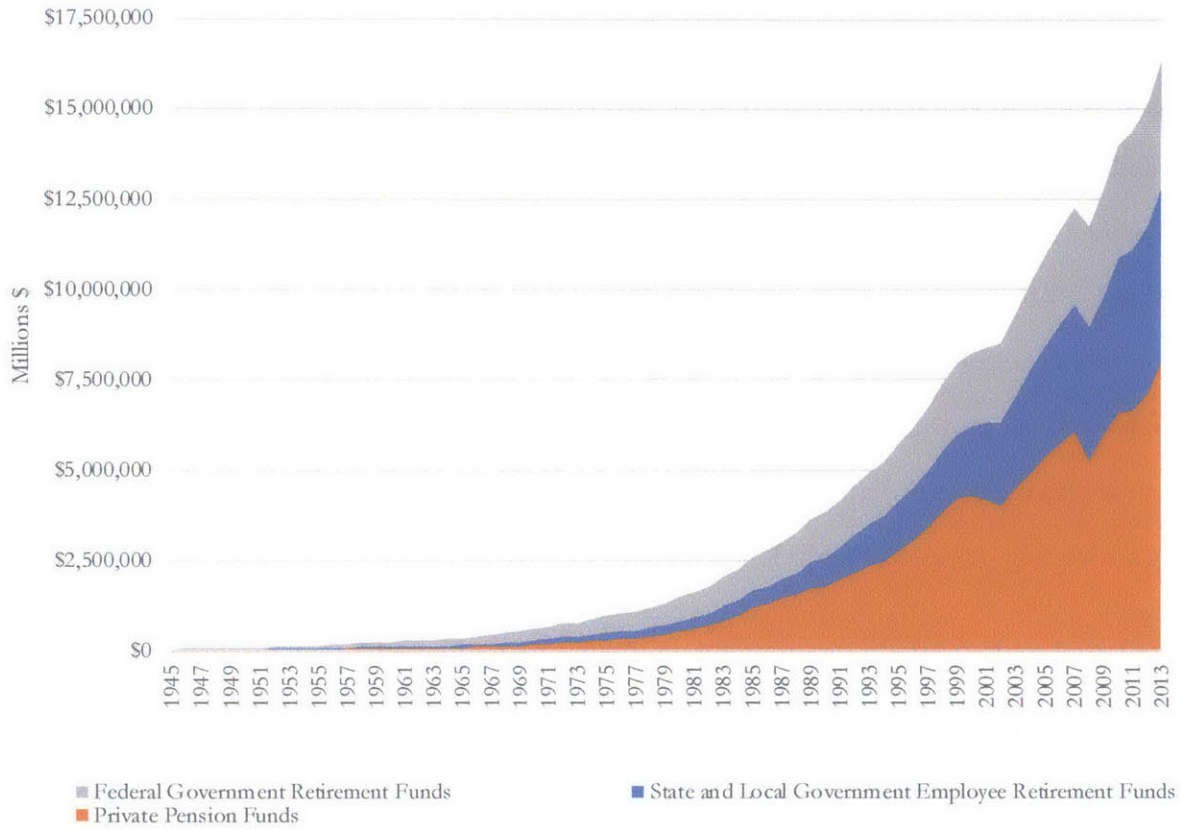
Source: ARC and NCRC 2013 Capital Study

I do not take umbrage with their conclusions: the data do indeed show a lack of this particular type of capital being issued in the region. But the study is extremely narrow in the types of capital reviewed: it analyzed CDFI investments, New Market Tax Credits (NMTC) investments, AND Small Business Administration (SBA) Lending, as well as generalized CRA-related small business lending. NMTC, which have a regulated minimum size which is quite large, however, almost by definition winds up excluding rural areas and non-urban economies. Further, the study does not examine traditional overall bank lending volumes by county. It does not examine institutional or retail/household investment volumes, which are not covered by CRA, by county. It does not examine business loan volumes by non-CRA banking institutions, such as commercial finance companies. It does not examine insurer investments by county. It does not examine private and public (i.e. stock market, not government) corporate investment by county. Finally, it does not examine direct public sector (government) investment or lending at all. Nationally, the size of these latter capital pools dwarf that of the aforementioned specialized CDFI, NMTC, SBA and generalized CRA-related small business markets, all of which are created or supported by regulation to correct the market imperfections that result in underinvestment in small businesses and distressed/disadvantaged communities. But as previously mentioned, the share of long-term savings held in CRA-covered institutions is declining. These specialized, regulation-enabled markets, are effectively a "rounding error" in the broader capital markets, based on data from the Federal Reserve Flow of Funds data.

The size of these specialized low-income markets may eventually be surpassed by the emergence of new online loan platforms, such as civic crowd funding (Davies, forthcoming, 2015) and lending clubs like the Lending Club and Prosper, which effectively disintermediate financial institutions by connecting individual sources of capitals with borrowers online. In a few short years, the Lending Club, for example, has already loaned \$4B in the US and in excess of \$1.2B in the 13 Appalachia states, according to the state-level summary data produced on their website. These platforms, not the ACC, represents a more truly private market-based solution to the shortage of capital in the region.

I theorize that the issue, then, is not that regions like Appalachia remain unable to attract external or retain internal capital investment due to any shortcoming in the region, or due to "superior" opportunities elsewhere. Further "market imperfections" – which are often assumed to be "at the margins" by economists and which are used to justify state intervention in private markets – may be relevant, but they may also not be at the heart of why Appalachia's small business lack access to credit to grow and create jobs. They may merely be a rounding error. Focusing on the "rounding error" of small business, CRA, CDFI or related lending misses "the big picture" created by the far larger capital flows. While CDFIs have experienced significant asset growth in recent years with total assets of about \$50 billion today, (according to the CDFI Data Project), US retirement market assets today total in excess of \$16 trillion, more than 325 times larger than the entire CDFI industry, and about the size of the current annual GDP of the US. In the context of retirement market assets, then, the CDFI industry is literally a rounding error of roughly 31 basis points, or .31%.

US Retirement Assets in Pension Funds, 1945 - 2014



Source: Federal Reserve Flow of Funds

6 THE GEOGRAPHIC IMPLICATIONS OF CAPITAL MARKETS ECONOMIES OF SCALE: BARRIERS TO LOCAL INVESTING - THE CASE OF US AND WEST VIRGINIA PENSION SYSTEMS

An instructive case demonstrating the underlying, broader problem in the capital markets can be seen in retirement assets. They show that both (a) institutional and regulatory structures, and (b) the spatial impact of economies of scale, create obstacles for Appalachia's native stock of capital to be directly reinvested in the region, even if it was more efficient and attractive for investors to do so. These two factors above are also not distinct or mutually exclusive, but interact: economies of scale, notably in the capital markets industry, are sometimes reinforced by barriers to competition and market exit/entry created by institutional and regulatory structures.

After reviewing these factors, the investment geography of West Virginia's pension system will be explored as a representative case of these dynamics.

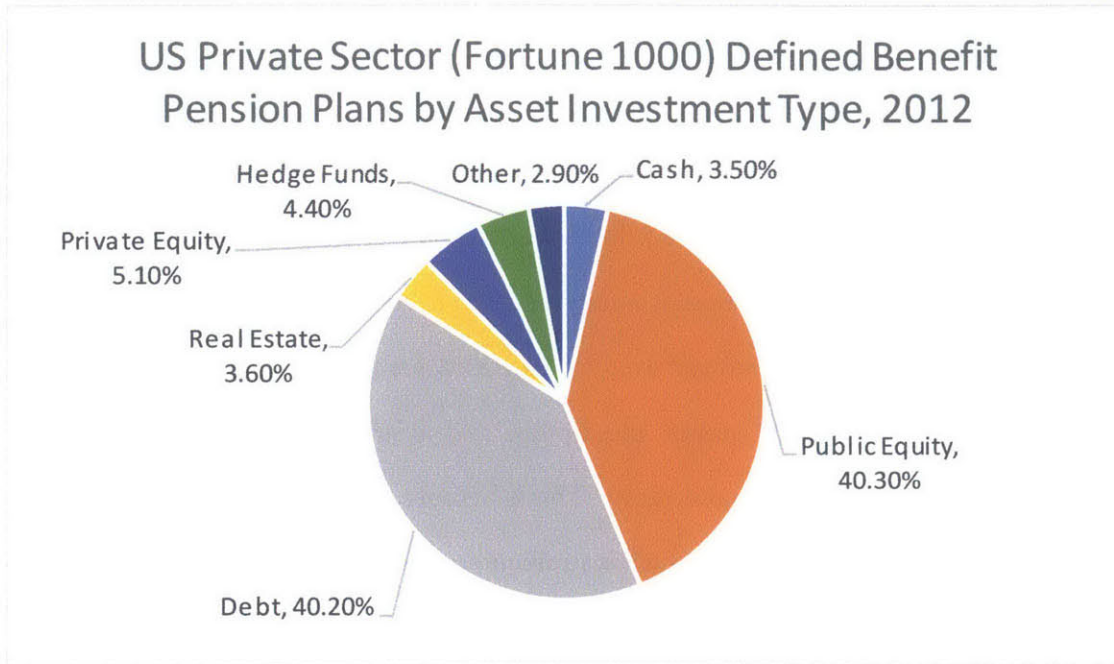
6.1 HOW US PENSION/INVESTMENT REGULATIONS DISCOURAGE LOCAL INVESTING AND ENHANCE ECONOMIES OF SCALE

Specifically, institutional (e.g. defined benefit retirement plans) and retail (e.g. defined contribution or 401 (k) participants) investors who are resident in Appalachia cannot readily reinvest savings into the local economy. Retirement assets are protected by federal law (e.g. Employment Retirement Investment Security Act (ERISA) of 1974). They can only be invested in a select range of investment vehicles, which are often not held in CRA-covered institutions and are not subject to CRA requirements (hence the coeval decline of savings held in such institutions since the passage of ERISA, which enabled the growth in today's popular 401(k)).

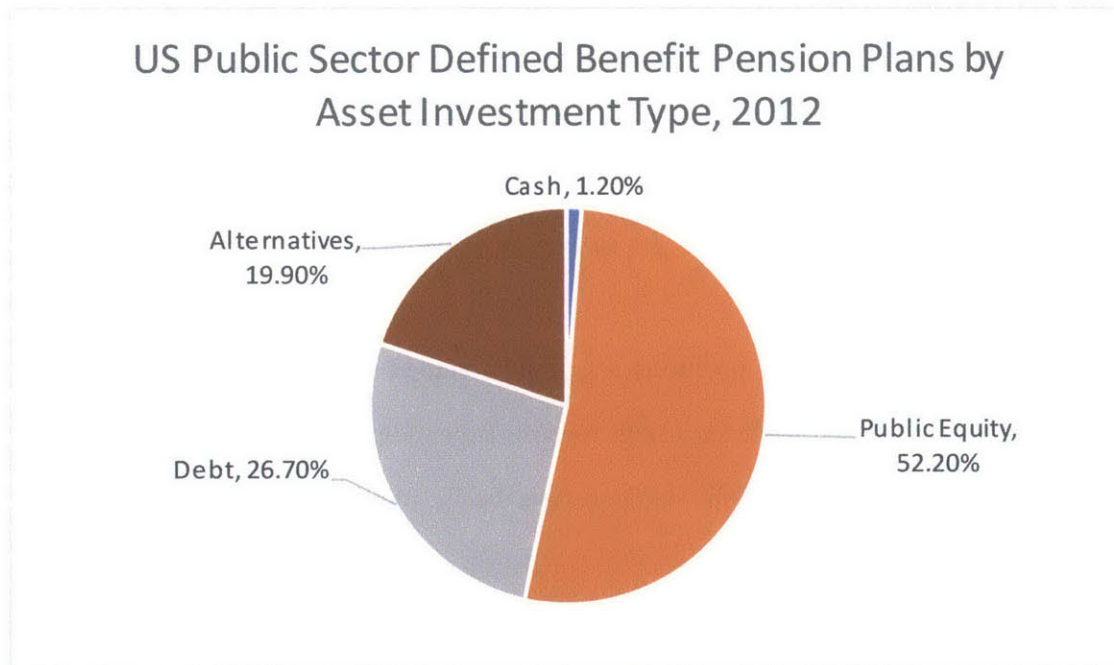
Even when the law does not explicitly restrict investment, concerns by the fiduciary regarding "financial prudence", or as called by interviewees "the prudent man rule", limit the range of options

that will be presented to investors. Defined benefit pension plans, in which the retiree is guaranteed a predetermined annual pension amount for their remaining life after retirement (the benefit is defined), are therefore managed by a professional staff employed or contracted by the “plan sponsor”. While large private employers have continued to switch from defined benefit to defined contribution plans, in which the employee is responsible for managing their retirements, most public sector workers in the US remain covered by defined benefit plans. Because these defined benefit pension funds cover public sector workers in specific states or cities, they are thus also covered by their state’s laws, in

addition to federal laws, and these state laws often further restrict both (a) the range of asset types they can invest in, and (b) the level of investment in these asset types.



Source: Towers Watson



Source: Pensions & Investments

The result is that the overwhelming majority of assets held by both public and private sector defined benefit pension plans, which in total control more than \$11 trillion in assets (Federal Reserve table L. 117 c flow of funds GRAPH) skew towards publicly-traded equity (stocks) and debt (bonds). These are viewed as the “safest” investments because they are regulated by the SEC and/or other relevant federal financial agencies.

According to Towers Watson, more than 80% of the Fortune 1000’s \$1.7 trillion in defined benefit pension plan assets are held in publicly-traded equity and debt. Again reflecting the impact of economies of scale, the largest pension plans surveyed by Towers Watson have a smaller share of their assets accounted for by publicly-traded stocks and bonds, and a larger share accounted for by alternatives like real estate and private debt and equity. This is because these larger plans can invest in such alternatives, which could in theory include such instruments as CDFIs, at a sufficiently large scale to offset the transaction costs associated with these more specialized investments. The smallest pension funds in the Fortune 1000 have roughly 88% of their assets in publicly traded stocks and bonds, while the largest plans are at 79%.

Similarly, and reflecting the strong weighting towards publicly-traded assets, for the 99 largest state and local public pension plans, which covers 85% of the total public sector pension space, holding \$2.6 trillion in assets on behalf of 13 million public workers, roughly 75% is held in publicly-traded stocks and bonds.¹⁶⁵

These publicly-traded debt and equity positions in publicly-traded companies are in turn not representative of the overall economy itself, but skews towards larger employers, due to the transaction costs driving economies of scale in the public markets. Specifically, due to the costs associated with

¹⁶⁵ <http://www.pionline.com/gallery/20121129/SLIDESHOW/112909999/3>

<http://www.towerswatson.com/en-US/Insights/Newsletters/Americas/insider/2013/2012-asset-allocations-in-fortune-1000-pension-plans>

<http://www.publicfundsurvey.org/publicfundsurvey/scorecard.asp>

regulatory approval, and legal and banking fees, economies of scale matter tremendously in shaping the types of investments that are available via the publicly-traded markets. “The high transaction costs required to access these markets and the profit requirements of investment banks make them infeasible for most firms or projects that need less than several million dollars on capital”¹⁶⁶ As a result, larger employers (and the geographies that house them) are overrepresented in the public markets.

GRAPH

Beyond these managed plans, however, are trillions in retirement assets held by “retail” investors, aka household investors, who control their retirement assets in private market securities in defined contribution plans, such as 401(k), 403(b), IRA and other such vehicles, in which the up-front and ongoing contribution, not the ultimate level of benefit, is what is defined and set. In total, there is currently nearly \$5 trillion held in defined contribution plans in the US. While investment decisions here are not controlled by a professional fiduciary, such as an SEC-registered investment advisor or investment manager, the plan sponsors (i.e. employers) typically only offer publicly-traded stocks or mutual funds as investment options.¹⁶⁷ Thus, as with defined benefit plans, these defined contribution investment plans tend to only offer invest options in larger, scaled investment targets¹⁶⁸.

Plan sponsors can offer self-directed 401(k) plans, and many defined contribution plans do now offer participants the option to make their own investment, but this requires specialized investment skills, time, and effort. As a result, recent surveys have shown just 1% of such planholders with a self-directed option choose to use it, and when they do, the most common investment is to purchase stock in Apple. Thus, few participants are seeking out ways to invest in small businesses or community development. But even if participants were interested, they would have a difficult time investing debt or equity in community-oriented small businesses in their local area, be it via a local CDFI vehicle,

¹⁶⁶ Seidman, p 11.

¹⁶⁷ <http://money.usnews.com/money/personal-finance/mutual-funds/articles/2012/06/18/some-401k-plans-let-you-take-the-wheel-if-you-dare?page=2>

¹⁶⁸ *ibid*

which are typically not set up to receive small, individual investments, or via a community development venture capital fund.

Notably, self-directed IRA plans exempt investors from the “accredited investor” provision, which is another limitation on smaller investors’ ability to access the non-publicly traded assets. Only “accredited investors”, which are very wealthy individuals or organizations, can invest in hedge funds, private placements, or other private equity offerings in the United States.

The federal securities laws define the term accredited investor in Rule 501 of Regulation D and as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act as:

1. a bank, insurance company, registered investment company, business development company, or small business investment company;
2. an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of \$5 million;
3. a charitable organization, corporation, or partnership with assets exceeding \$5 million;
4. a director, executive officer, or general partner of the company selling the securities;
5. a business in which all the equity owners are accredited investors;
6. a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds \$1 million at the time of the purchase, or has assets under management of \$1 million or above, excluding the value of their primary residence;^[2]^[3]
7. a natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year;^[4] or
8. a trust with assets in excess of \$5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes."

This means that unaccredited individual investors cannot place their general savings into such vehicles. There is an exception to this rule, as mentioned above. Unaccredited individuals can, however, invest their retirement assets in such vehicles through a self-directed 401(k) or IRA plan, and they should still be able to invest either retirement or non-retirement investments in specialized publicly-offered securities which might in turn invest in small businesses or community development initiatives. The Calvert Funds, for example, one of the largest social impact investment firms, offers through its Foundation a publicly traded CDFI debt product for retail investors: individuals can invest in small denominations, and the proceeds are distributed to CDFI.

For this thesis, however, I tried to explore using my own IRA and personal proceeds to invest in either the Calvert Fund's specialized CDFI product, as well as other community development vehicles. After spending six hours contacting my account's custodian, fund sponsors, and individuals with significant experience investing in such vehicles, I had not yet succeeded in being able to place retirement savings into any type of private market or specialized, small business or community-oriented public vehicle.

These restrictions, however, may wind up being somewhat circumvented or skirted by increasing efforts to enable crowdfunding to occur as an investment vehicle for use by unaccredited investors for all types of uses, including community development (Rodrigo Davies et al, 2014 forthcoming). At this writing, the Federal Reserve had just concluded a conference¹⁶⁹ on how crowdfunding might be harnessed to enable more community development investment. This would build on recent Federal JOBS legislation in 2012, in response to the "crowdfunding exemption movement" to allow small denominations of public securities to be invested in by unaccredited investors. The SEC is currently implementing the rules by which this legislation will be implemented. In conjunction with this federal legislation (which is necessary to allow interstate securities offerings), many individual states are

¹⁶⁹ <http://www.federalreserve.gov/newsevents/conferences/crowdfunding-agenda.htm>

<http://www.federalreserve.gov/newsevents/speech/stein20140324a.htm>

enacting similar laws to enable small investors to place small amounts of capital into crowdfunded investments and other peer-to-peer lending programs.

It is unclear, however, at this writing whether and how such investments will be made from retirement accounts: even if controlled by an individual, the bank custodian of the account would need to create a user interface, as well as a back-end infrastructure and clearinghouse, to process payments to such crowdfunding platforms. Retirement accounts, unlike traditional bank accounts, cannot simply be drawn from: one cannot simply insert an ABA routing number and account number and withdraw funds from a retirement account to invest in a crowdfunded vehicle, or a local CDFI.

Nonetheless, these new options are not yet a reality. This means that, regardless of whether retirees are covered by a defined benefit or a defined contribution plan, smaller businesses and investment opportunities are likely missing in the portfolio of a typical saver or retiree. This is because the investment size and scale of such offerings is too small for the administrators and/or trustees of a retirement plan to effectively invest in or offer them.

6.2 THE CASE OF THE WEST VIRGINIA CONSOLIDATED PUBLIC RETIREMENT BOARD

Beyond the issue of scale, which results in underinvestment in smaller businesses, are the geographic implications of the investment process and supply chain itself. Most defined contribution systems exported these pools of capital to major “money center” investment consultants, mutual fund managers, and banks, who then invest the proceeds in a range of publicly-traded securities and products that are diversified to reduce risk across a number of metrics, including geography. Through these channels, West Virginia’s Consolidated Public Retirement Board is managed, for example, by consultants and investment firms based out of the region, who in turn acquire stocks, bonds, options and futures traded in public exchanges in New York, Chicago, and London, that represent investments in companies spread and located throughout the globe.

The table below shows the structure of West Virginia’s public pension system, which systematically ships \$10B billion in assets, invested on behalf of the state’s public sector workers, to firms in New York, Boston, Philadelphia, South Florida, and London, who are paid millions of dollars per annum in fees for their services. This is consistent with the securities industry concentration discussed in the preceding chapter: New York, Boston and Philadelphia are three of the top six metros which account for half of the US securities industry. Fees from the Retirement Board, alongside fees from countless other retirement and investment fiduciaries, flow out of West Virginia and Appalachia each year. These out-of-market firms in turn invest these assets in companies located around the world: the pension system’s largest holdings are in Exxon, Apple, AT&T, Chevron, Google, IBM, Johnson & Johnson, GE, Pfizer and Microsoft. Excluding retail outlets (e.g. Exxon filling stations) none of these companies have significant employment operations in West Virginia. But nonetheless the retirements of workers in states like West Virginia are going to fund these companies, which produce jobs in other regions around the US and the world.

West Virginia Consolidated Pension Board

Investment Style/Type	Investment Adviser	Adviser's Location	Office in Appalachia?
US Public Equity (Large Cap)	State Street	Boston, MA	No
US Public Equity (Large Cap)	INTECH	West Palm Beach, FL	No
US Public Equity (Small/Mid Cap)	AJO	Philadelphia, PA	No
US Public Equity (Small/Mid Cap)	Westfield Capital Management	Boston, MA	No
Non-US Developed Public Equity	Silchester International Investors	New York, NY	No
Non-US Developed Public Equity	LSV Asset Management	Chicago, IL	No
Non-US Small Cap Public Equity	Pictet Asset Management	Geneva, Switzerland	No
Non-US Emerging Markets Public Equity	Brandes Investment Partners	San Diego, CA	No
Non-US Emerging Markets Public Equity	Axion International Investors	Greenwich, CT	No
Core Plus Debt	Western Asset Management Company	New York, NY	No
Core Plus Debt	Dodge & Cox	San Francisco, CA	No
Core Debt	JPMorgan Investment Advisors	New York, NY	No

Source: West Virginia CPB filings, Author research on advisers

Interestingly, when economists analyse pension plan decisions, they fail to consider that favoring in-state or local companies might be a legitimate purpose or mission for these public-sector investors. In a 2009 NBER paper¹⁷⁰, several economists note that those pension plans that manage their

¹⁷⁰ <http://www.nber.org/aging/rrc/papers/onb09-12.pdf>

investments in-house, i.e. do not use outside consultants and investment advisors the way West Virginia does, tend to disproportionately favor in-state investments, and consider that justifications for this might be better information about local companies, more familiarity with local companies, or corruption. They fail to consider that investing in local companies could be cast as a legitimate economic development strategy, which in turn could reduce the externalities of underinvestment, such as state unemployment and workforce development costs, as well as other social safety net costs. They also fail to consider the unpriced environmental externalities which can be eliminated by local, in-state investing. This has been a key benefit touted by proponents of the local food movement, who claim that environmental degradation associated with long-haul movement of food can be reduced through “locavesting”¹⁷¹ to spur more trade within, not between, regions, as well as enable import substitution. Locavesting, however, remains ignored or dismissed by mainstream economics, which views it as irrational, non-benefit maximizing, and inefficient because it foregoes the gains of comparative advantage.

As noted by local economic development policy expert Michael Shuman, however, “Locally owned businesses currently generate half of the private economy, in terms of output and jobs. Add in other place-based institutions—nonprofits, co-ops, and the public sector—and we’re talking about 58 percent of all economic activity. So in a well-functioning financial system, we’d invest roughly 58 percent of our retirement funds in place-based enterprises.

Yet local businesses receive none of our pension savings. Nor do they receive any investment capital from mutual, venture, or hedge funds. The result is that all of us, even stalwart advocates of community development, overinvest in the Fortune 500 companies we distrust and underinvest in the local businesses we know are essential for local vitality. This situation represents a colossal market failure.

¹⁷¹ Cortese, 2011.

The good news is that much of the problem could be solved by modernizing securities laws. Today these laws place huge restrictions on the investment choices of small, “unaccredited” investors—a category in Securities and Exchange Commission vernacular that includes all but the richest 2 percent of Americans. The regulations prohibit the average American from investing in any small business, unless the business is willing to spend \$50,000 to \$100,000 on lawyers to prepare private placement memoranda or public offerings—thick documents with microscopic, all-caps print that no human being has ever actually been observed reading.”¹⁷²

While individual investors remain thwarted in efforts to invest locally, as per Shuman’s quote above and until the SEC fully implements the JOBS legislation, some institutional investors have taken note: in 2011, for example, CalPERS (California Public Employees Retirement System), the second largest pension fund in the US with \$260B in assets in 2013, voted to invest \$800M in California infrastructure over the next decade¹⁷³. Similarly, the Caisse (Caisse de dépôt et placement du Québec), the second largest pension fund in Canada and largest in Quebec, created the Quebec Manufacturing Fund in 2006, investing \$100M, and announced the injection of another \$100M for phase II at the end of 2013¹⁷⁴; the fund invests in developing manufacturing enterprises in Quebec. Appalachia’s state and local pension funds could, in theory, band together to support regional development bank initiatives via the ACC or through another vehicle, but lack a convener and lack regulatory incentive to do so. Further, many of the pension funds in the region lack a full professional staff and are not managed in-house, and may lack the capacity for such initiatives.

For example, the State of West Virginia’s Pension Fund is not managed in-house, and as such it is not skewed towards in-state investments but rather invested in very large stocks, which are typically in large companies not based in the region. The state’s \$210M investment in just its four largest public

¹⁷² <http://www.yesmagazine.org/issues/the-new-economy/invest-locally-put-your-money-where-your-life-is>

¹⁷³ <http://heartlandnetwork.org/blog/34-nations-largest-public-pension-funds-focus-on-urgent-need-for-infrastructure-investments>

¹⁷⁴ <http://www.lacaisse.com/en/news-media/press-releases/caisse-injects-another-100-million-quebec-manufacturing-fund>

equity holdings – Exxon, Apple, AT&T and Chevron – which represents less than 2% of the total assets held by the Pension Fund, is larger than the entire contemplated size of the ACC. Similarly, the West Virginia Pension Fund overall is as large as the entire size of the CDFI industry was as recently as a decade ago. And public pension funds for California, New York, Florida, Ohio, Michigan, Virginia, Oregon and Minnesota all continue to dwarf, in terms of total asset size, the entire CDFI industry nationally, based on analysis of assets conducted for this thesis. This is indicative of how marginal in scale the community development investment industry is today.

Even if West Virginia wanted to invest in local businesses, however, it cannot, because the state and the Appalachian region lacks a supply of large, publicly-traded businesses which can most readily raise capital from the public markets, and because it lacks a large banking/capital markets center to which and through which it can ship and distribute capital. It also lacks an in-house managed pension fund, which might seek to redeploy capital into the state. Instead, Appalachia has an extraordinary supply of capital and assets which cannot be readily invested in the region. This is due to a host of regulatory barriers specific to community development investing, as well as due to the regulatory barriers related to investment activity in general, and the "natural" barriers created by an industry's inherent economies of scale and resulting concentration in specific markets.

7 CONCLUSIONS AND POLICY IMPLICATIONS

As I have argued in this thesis, Appalachian Community Capital (ACC) can be understood as an effort to solve a region's capital shortfall by bridging a disconnect between global capital markets and local community development in a region. This disconnect is multifaceted: as financial institutions are increasingly global in scale, they concentrate their operations in certain cities, but not others. Regions which do not contain these financial centers not only fail to benefit from the jobs and income these financial centers create, they also wind up exporting their own capital to them, where it is dispersed and deployed into the global economy, rather than retained in the region. Capital thus becomes an input into a globalized financial service industry, subject to agglomeration economies of scale, both internal and external, like many other productive industries.

ACC's approach may succeed in bringing some capital from these financial centers back into the region, but I have argued that this is ultimately a stopgap measure and will not, in the long-term, solve the capital shortfall. Why? The ACC:

1. **Addresses a consequence, not the cause, of the capital shortfall.** The ACC does not address the underlying and ongoing export of capital out of the region. To do so would require changing the financial regulatory framework to discourage, not encourage, capital to exit the region, and would require easing the way for mechanisms which enhance the retention of locally created capital and be "locavested". Focusing on CDFIs, which are effectively a rounding error in the capital markets and only appeal to regulatory and mission capital, will likely be insufficient to fully offset the capital exporting. Instead, changes such as the in-process JOBS act, which will allow unaccredited investors to place their savings in crowdfunded vehicles, as well as state-led efforts following CalPERS' in-state investment program, could be deployed by individual and institutional investors already within the Appalachian region, to great impact. They can fund local businesses which might be more likely to keep capital in the region.

2. Lets **“the market” dictate where the money is invested, even if that exacerbates the region’s economic unevenness.** Further, even in as much as the ACC succeeds in increasing levels of community development capital circulating in the region, its private, market-based nature may limit its ability to direct where, both spatially and functionally, the capital flows. There is nothing to stop most of the money being raised flowing to the strongest counties in the region, such as those surrounding Pittsburgh, Atlanta and Asheville, rather than into the region’s poorest counties. This underscores the problems and shortcomings embedded in using private market solutions to public problems.
3. **Uses the private market to solve the underinvestment problem, but cannot solve the public part of that problem, which involves building a more horizontal, democratic civic culture.** The ACC can bring money from outside of the region in, and it can distribute it. It cannot ensure that it is distributed through agents or to entities which fairly and equitably invest the money in people and projects. In a region where corruption, nepotism, and an “us vs. them” mentality others the rural poor, the ACC cannot ensure that the money will not be used in a manner which ultimately exacerbate such dynamics in the region. But how can the private sector solve the problem of a dysfunctional public civic culture? It is through the public civic culture that community priorities (and the manner in which investment will be directed to meet those priorities) is determined.
4. **Cannot guarantee how the money will be invested: will it be invested in a manner that reflects communities’ priorities for the future?** While business borrowers from community development lenders are more likely to be smaller, locally-owned employers, and not large, externally-owned and controlled institutions, the private nature of community development financing today also reduces the likelihood that the money will be deployed utilizing an intentional strategy which promotes sustainable industry clusters in key industries targeted for growth by local civic leaders. The region has long struggled with “business as usual” investments which are of an extractive nature and do not support a clustered ecosystem of locally-owned businesses, are not likely going to be sustainable in a region where the long-time economic

driver in rural areas, the coal industry, continues to experience employment declines. ACC funds, being distributed based on market logic to firms with up to 500 employees, may not distinguish between business as usual and new, sustainable initiatives, because many of the benefits of such projects may have mispriced or unpriced positive externalities (water quality, land restoration, etc.) that the market does not reward. Because it operates in a market paradigm, CDFIs don't necessarily distinguish between these types of investments, as market decisions are today not explicitly embedded in such social considerations.

5. **May exacerbate the paradox embedded in the idea of “Appalachia”.** The ACC leverages the concept of “Appalachia”, which has limited depth and meaning internally within the region, to raise money to promote development. Yet the very idea of “Appalachia” as a region is rooted in it being externally defined as a backwards place. With its backwardness as its unifying theme, how can this regional concept be effectively used to transform the area from being perceived as backwards? In conjunction with this, even the ARC acknowledges that Appalachia's increasing economic unevenness underscores changes to the meaning of what was already a “region” in only a very limited sense. Given that Appalachia is not really a homogenous region, if it is or ever one was at all, should economic development financing vehicles using the idea of it as a region, which is inherently constructed as a backward, rural place, be promoted? Or is it time to retire the idea of Appalachia as a region for economic development purposes?

What type of institution might promote access to credit and community development investment in Appalachia in a manner that avoids these shortcomings? Such an institution would likely need to:

- (a) Leverage internal, not external, capital stock in the region's existing pension funds, retirement accounts, and liquid bank accounts, through pension plan strategic partnerships and civic crowdfunding platforms.

(b) Focus on lending in key sectors that reflect communities' priorities for economic development, which may focus on locally owned, wealth-generating export and import substitution strategies that are not extractive or pollutive.

(c) Not be fully "regional" in its catchment area, but rather focus on the distressed core of the region in Central Appalachia, as to ensure that capital is directed to areas where it is most needed, not further concentrated in the strongest part of the region.

An institution meeting these conditions, however, is unlikely to be constructed in the current structural environment of the neoliberal age of austerity, in which private, market-based solutions to ostensibly public problems are privileged, and in which regulations to enhance local retention of generated capital are slow to be enacted, if at all.

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