

**RURAL ECONOMIC DEVELOPMENT ISSUES FOR
THE NEW FEDERAL FARM BILL**

HEARING
BEFORE THE
**COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY**
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

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AUGUST 2, 2001
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RURAL ECONOMIC DEVELOPMENT ISSUES FOR THE NEW FEDERAL FARM BILL

THURSDAY, AUGUST 2, 2001

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 2:33 p.m., in room SR-328A, Russell Senate Office Building, Hon. Tom Harkin, [Chairman of the Committee], presiding.

Present or submitting a statement: Senators Harkin, Baucus, Wellstone, Dayton, and Lugar.

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

The CHAIRMAN. The Senate Committee on Agriculture, Nutrition and Forestry will come to order. Today, we are having a full committee hearing on rural economic development issues for the new Farm bill.

We have a distinguished panel of witnesses. We apologize for being a little late. We just had two votes in a row and I thought it would be best to get our votes out of the way before we came over so that we wouldn't have to go back.

I will just make my opening statement and then I will yield to my friend from Minnesota for a statement and for introductions.

Today, we move ahead with development of the new Farm bill and this afternoon's hearing will focus on what I believe will be a critical component of the new Farm bill, and that is rural economic development.

There are steps we must take now to encourage growth and opportunity in rural America. We must help create the basic infrastructure required to do business and create jobs. In the 20th century, rural America requires miles of telephone wire and water lines for households. These are the conduits of commerce. We need farm-to-market roads. We have to have a continued commitment in these areas.

In the new century, the barriers to rural economic development are more complicated than just asphalt and wire. Our businesses need broadband to compete. Our family farmers need new markets for their products and they need help and support to fashion and shape their crops to meet these new markets. Entrepreneurs need greater access to capital, especially equity capital.

These are great challenges, but when we look at the challenges we faced when rural electrification came in in the 1930's, only 10

percent of the homes in rural America had electricity in the early 1930's—only one out of ten. It used to be said that if you wanted something newfangled like electricity, move to the city. Well, thankfully, we didn't do that and those days are long past us.

The barriers to rural economic growth in this century are new and we need to address those. We have only scratched the surface of developing farm-based sources of renewable energy, for example. Anything we can produce from a barrel of oil we can produce on our farms. It will increase farm income and decrease our dependence on foreign oil. That is just one area of adding value from processing and broadening the market.

We need to explore other ways of lifting up rural businesses. As I said, they are being choked by a lack of access to capital. Last year, I proposed legislation with Senator Craig—I guess he is not on this committee any longer—that would create a rural equity fund to address this issue.

What other steps can we take to structure financial assistance to generate the most good efficiently and within our limited resources? Well, we have to look at the poor coordination of current Federal programs in these areas, and do what we can to bring them together in a more cohesive, coherent pattern.

The current budgetary climate requires USDA rural development programs to leverage funds effectively from other Federal departments, from State and local programs, and most importantly from private sources. These areas to which we have to look in the new Farm bill.

There are three guidelines I believe we have to follow for rural development assistance. First, assistance must be targeted to where the need is great, but also where the funds can best be utilized.

Second, solutions must be community-based, not a top-down approach, but bottom up, and to a greater extent more holistic and not programmatic.

Third, programs must be rooted in the traditional values of rural America—hard work, no free rides. That is a recipe for more successful rural economic development assistance.

We have a lot of challenges. I look forward to hearing the thoughts and the comments and the views not only of my fellow members of the committee, but especially the distinguished panel before us. I can assure you that rural development is going to be a key part of the next Farm bill, one on which we are going to focus a lot of attention.

Just keep in mind that 1 out of 15 people who live in rural America farm. The rest live in small towns, communities, acreages, things like that, and to the extent they have a better quality of life, so do our farmers. If our farmers have better incomes from value-added, they can then support the other people who live in rural America. This is a very—I don't know whether the word is "synergistic" or what, but it is something that we have to pull together in both ways in the new Farm bill.

With that, I would recognize my friend and colleague from Minnesota for any opening statement and for purposes of an introduction.

**STATEMENT OF HON. PAUL WELLSTONE, A U.S. SENATOR
FROM MINNESOTA**

Senator WELLSTONE. Well, Mr. Chairman, I am going to be very brief. Let me just include my full statement in the record, if that is all right.

The CHAIRMAN. Without objection.

Senator WELLSTONE. I want to introduce David Kolsrud, and I want to first of all apologize, though, to everyone. Because of the votes, I got way backed up and don't get to stay very long.

Not only will your testimony be part of the record, but my Jewish guilt tells me I have to read every bit of what you say because I won't be here. I don't want you to think I am not interested, just the opposite. We got into a ridiculous schedule conflict.

Very, very quickly, only one comment about what you said, which is I love being in schools, but one of the things that really gets me down in what we call greater Minnesota, in the smaller-town, rural areas, is that quite often the students will talk about how the advice they have been given is to get ahead, you need to get a good education. So far, so good.

Actually, the rural translation of that is to get ahead, get a good education so you can get out of here because there is nothing left for you to do, there is nothing here, which is the exact opposite of what you want to have happen. That is what this hearing is all about.

I put a lot of emphasis on education, I put a lot of emphasis on entrepreneurship, I put a lot of emphasis on empowerment, the three E's, where people think what happens in the community is not going to be independent of what we do. This value-added agriculture and how we keep more capital in this process in our communities is great.

I am so interested in tele-work and the potential it has for citizens in rural Minnesota and rural America, and all the other issues that everybody seems to think somehow are urban—good education, good health care, affordable housing, transportation, affordable child care. Let's not forget that those are every bit as compelling issues in rural communities.

Ultimately, these young people stay on the basis of two considerations. Can I afford to? In other words, if I am going to farm, am I going to get a decent price? If I am going to work, am I going to get a decent job at a decent wage? If I am going to try to grow a business, can I grow a business? The second thing young people is "do I want to," and that is quality of life. Is there going to be good education for our kids, is there going to be good health care? This is a really important hearing, and I am very apologetic about being in and out.

A special welcome to you, David. David is from Luverne and is the manager and also a member of CORN-er Stone Farmers Cooperative, in Luverne. This is a farmer-owned cooperative that processes corn into ethanol through AgriEnergy LLC. David is also a farmer. He grows corn and soybeans on 500 acres, and in some ways that is what it is all about as we look to the future of Minnesota.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Wellstone.

Senator Baucus.

**STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM
MONTANA**

Senator BAUCUS. Thank you, Mr. Chairman. I appreciate your moving swiftly on the Farm bill. The plight in much of my State is very similar to that in Minnesota, and also other States. Our people are hurting, and they are hurting severely.

I might also say that the subject of today's hearing is of particular importance to my home State. We have the lowest wage per-capita income in the country, the lowest, 50th in the Nation. We rank 47th in earned and unearned per-capita income. We were 10th in 1946, we were 38th about 6, 8, 10 years ago; now, we are last, 50th. Yes, lower than DC. That includes DC. We are the lowest.

That is due primarily to a lot of reasons. I won't go into all the reasons, but a lot of it has to do with transition, with the pressures of globalization, transition from a natural-resource-based commodity State—agriculture, forest products, mining—to a modern society where those industries comparatively don't earn the same rate of return as do others, such as financial services and high-tech industries, software, and what not.

When we talk about a farm bill, which is our No. 1 industry, agriculture, still, thank goodness, it is not only the basic commodity provisions and support provisions, the safety net, et cetera; it is also all of the related development issues that are so important, so integral and so tied to, I am quite confident, not only my State, particularly eastern Montana, but all other rural areas in the country, and most particularly rural areas that are really rural; that is, with a great distance between communities, between farmers.

The population density of the State of Montana is six people per square mile. "Rural" west of the 100th meridian is really "rural" because it doesn't rain, and when it doesn't rain, there just aren't quite as many people. When there aren't quite as many people, it is harder to connect the dots and cross t's and develop the enterprises that boost incomes.

We are really struggling. I won't go into all the things we are trying to do in our State to try to turn that around, but one thing we did is I put together a large economic development conference and we highlighted Ireland. We brought some people from Ireland over because Ireland about 10, 15 years ago was a basket case. We brought the Irish who put this together in Ireland and they explained some of the ideas that they had that might be appropriate for Montana.

I might say that the essence of the Irish success story is really several-fold. One is they did get some assistance, but not a lot, from the EU. They attracted high-tech companies primarily through education. They trained their people to the next higher level of skill sets so they could attract the Microsofts of the world, and so forth, to come there.

Now, they didn't have any money to put into education, so what did they do? The "then" generation pulled themselves up by the bootstraps and they sacrificed. They just paid for it because they

knew Ireland was going to have to change and they knew their kids had to have better lives.

All I am saying here is that when we put together a farm bill, there are just so many ways where we have the obligation not to just turn the crank and put more dollars into various programs, but we have to think very creatively, recognizing how much the world economy has changed.

I might say that USDA rural development programs have been a lifeline in the meantime for our State's economy, even though I said our wage per-capita income is last in the Nation. Between 1994 and 1999, USDA successfully used its resources to provide over \$500 million for business development and for housing and community activities in our State.

I am the chief architect in the Senate, along with the late John Chafee, and John Warner, of the last highway bill, the 1990 highway bill. That makes a big difference to a State like Montana to have highways that aren't full of potholes and that work, and it has helped our State tremendously. We need a lot more. Highways alone aren't going to do it, and commodity support alone isn't going to do it.

Help for co-operatives and really being creative in helping co-operatives is one way, and securing the necessary capital. I hear over and over again how smaller entities, smaller entrepreneurs just can't find the capital to begin to put together something in a community, say, in eastern Montana, a canola plant or something just to get things going, get things started. We certainly need some technical assistance; that is helpful, too.

Equity and capital is one of the biggest stumbling blocks I am finding in our State. The assistance programs, the Business and Industry Guarantee Loan Program is widely used. It is very helpful. That program provides up to 80-percent guarantee. It does help, but I hear more and more the need to leverage to get still more capital available in Montana.

As we work together, Mr. Chairman, I just want to emphasize those needs and that our communities have great infrastructure needs, too. It is water, it is sewage; all of these come together.

I might also add help for our Indian nations. We have to work together, tribes and State, local and Federal Government. The days are past when we try to get into these big issues of who is more sovereign than the other, and so forth. Rather, the question is how do we work together because we all are part of America.

I encourage us, as well, to work not only on traditional programs, but also to spend some emphasis on Native American lands and our tribes. They are ready. They, too, are going through tremendous change and it is positive.

In summation, Mr. Chairman, I just want to thank you for holding this hearing. It is really critical. I just want to thank all of you who are here testifying. You have a lot of ideas and you have a lot of experience. My only suggestion is, as we move ahead, that we engage in some mind-bending here and really listen to people at home so we have a better idea how to make the fit and provide the resources that they really need.

Thank you.

The CHAIRMAN. I thank the Senator from Montana. I want to thank him for being a very great member of this committee, and recognize that the Senator from Montana also wears another hat as the chairman of our Finance Committee. Working together on some of these rural development issues will be most important in both of our areas, and you can help us develop what we can do in agriculture and hopefully some things may spill over into the Finance area and we can work together on that.

Senator BAUCUS. Sure. Thank you, Mr. Chairman.

The CHAIRMAN. We are glad to have the chairman of the Finance Committee on the Agriculture Committee, aside from being a personal friend.

Senator BAUCUS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Baucus and I came to Congress together in 1974.

Senator BAUCUS. Yes, Watergate babies.

The CHAIRMAN. I won't talk about that, but it is true.

Senator BAUCUS. Thank you.

The CHAIRMAN. Thank you, Senator Baucus.

Senator Dayton.

STATEMENT OF HON. MARK DAYTON, A U.S. SENATOR FROM MINNESOTA

Senator DAYTON. Thank you, Mr. Chairman. I don't have an opening statement. I would like to hear from the panel, but I would like just to thank you and congratulate you on really an outstanding set of hearings this month. The breadth and the scope of the topics we have covered, from conservation to economic development, as well as the essential underpinnings of the farm program, has been very, very enlightening and the breadth of it has been very impressive.

Thank you.

The CHAIRMAN. Well, I too want to thank the Senator from Minnesota for being such a diligent member of this committee and being present at almost all of our hearings that we have had here and having input into these hearings. I appreciate that very, very much.

Senator DAYTON. Thank you. It has been an excellent tutorial for me.

The CHAIRMAN. For all of us.

Senator Lugar's statement will be made part of the record.

[The prepared statement of Senator Lugar can be found in the appendix on page 34.]

Now, we turn to our panel and we will start here with Mr. Kolsrud and just work across. I will introduce each of you as you come up. I ask you, if you could, to limit your comments to about five minutes. We will use a light system here, I hope, if it works today. If you take about five minutes to just sum up what you think your major points are, all of your statements will be made part of the record in their entirety, and then at the end we can have time to open it up for a general discussion.

First, we will turn to Mr. Kolsrud. Senator Wellstone introduced him earlier, but I am told that he only lives about five miles from Iowa anyway. In Iowa, we say that it just as good.

Mr. Kolsrud, welcome to the committee.

STATEMENT OF DAVID KOLSRUD, CORN-ER STONE FARMERS COOPERATIVE, LUVERNE, MINNESOTA, ON BEHALF OF THE NATIONAL COOPERATIVE BUSINESS ASSOCIATION

Mr. KOLSRUD. Thank you, Mr. Chairman and committee members. It is a great pleasure to be here today and it is an honor to testify in front of this committee on behalf of the National Cooperative Business Association in support of new equity capital for rural America.

As I was introduced, my name is David Kolsrud. My wife and farm 500 acres of corn and soybeans in southwest Minnesota, and we live five miles from Iowa and one mile from South Dakota.

I am manager of CORN-er Stone Farmers Cooperative. It is a cooperative in extreme southwest Minnesota that has a corn-into-fuel ethanol plant, and we have members in South Dakota and Iowa who are working with us or our members to help make corn fuel ethanol in Luverne at a plant called AgriEnergy LLC, of which the co-op owns 68 percent.

CORN-er Stone is a member of the National Cooperative Business Association, which represents co-operatives across all industries, including agriculture. Last year, NCBA organized a coalition to build a consensus on a solution to the extreme shortage of equity capital in rural America. Several of those coalition members are also testifying here today.

The result of the coalition effort was the National Rural Cooperative and Business Equity Fund Act, introduced by Chairman Harkin, Senator Craig and several members of this committee in the 106th Congress. It was also included in S. 20, introduced by Senator Daschle and others earlier this year. The Act is supported by a diverse coalition, including organizations representing electric and telephone co-operatives, both co-operative and private lenders, and farmers.

Mr. Chairman, Senator Daschle and members of this committee who have cosponsored this legislation, we thank you for your leadership and your support. Now, we are asking you to include this legislation in the next Farm bill.

From my perspective as a farmer, a cooperative business owner and resident of rural America, I can tell you that this is one of the most important things this committee can do to have a lasting and positive impact on rural communities. Raising equity is a daunting task for all rural businesses, regardless of how they are organized or what they produce or where they are located, but it is particularly hard for new farmer-owned co-operatives.

In my view, the lack of equity capital is among the most significant barriers to further economic growth in rural areas. Let me illustrate by using a personal example. CORN-er Stone Farmers Cooperative is a new-generation co-op. New generation co-ops are different than other co-operatives or the traditional co-ops because the farmers commit cash and commodities to the co-op in order to process them, and they hope to get value back out of those products by owning the facilities in which they process them.

The bottom line is that farmers bear a disproportionate amount of risk in these new-generation co-operatives to receive a potential

reward for investing in them. As a result, high capital requirements coupled with a limited number of pool investors—that is, farmers who have limited resources that are stretched even thinner when the farming economy is depressed—that combination limits the ability of new-generation co-ops to generate equity, which creates barriers to developing value-added co-ops and other ventures.

Despite all these challenges, in 1995 a group of farmers in southwest Minnesota got together to form CORN-er Stone Farmers Cooperative, with the goal of building an ethanol plant. We spent two years trying to raise the equity and secure the financing for the \$21 million plant. It was nearly an impossible task.

The goal of our equity drive was \$9 million. We raised \$3 million from 201 farmers, or \$15,000 per member. It was not enough. Ultimately, with the help of Stearns Bank, local banks that provided subordinated debt, private investors, help from the city of Luverne, a guaranteed loan from USDA, and \$4 million in personal guarantees, some of which was done by farmers who put up their homes and farms as collateral in order to secure the loan to build AgriEnergy LLC, that is what it took to build our plant.

After we got it built and running, in our first three years of operation we have generated over \$50 million of additional revenue, most of which stays in the community. We have created 28 high-paying jobs and returned a dollar per bushel over the market price to our farmers. It almost never happened. Why? Because we couldn't raise the equity.

There are hundreds of examples of how equity barriers limit development of new rural businesses and expansion of existing ones. Fortunately, there is a solution, and part of the solution is including the authority for a new source of equity capital for rural America. Part of this would be in a new bill.

This legislation should contain the following provisions. It should provide a private corporation with the flexibility to manage the equity fund in a way that is both financially sound and good for rural communities.

It should provide for incentives to attract private investment in the fund, including a Federal match and guarantees on investment. It should be governed by representatives of the fund's investors and the Department of Agriculture.

It should target equity investments on a variety of rural businesses, both farm and non-farm. It should require that businesses applying for the equity be sponsored by a local entity, such as a bank or development council. It should require that the equity fund receive and invest a substantial amount of their own equity.

Mr. Chairman, my written testimony includes additional comments for legislation that would help expand the co-ops, but let me close by saying this. Members of rural co-operatives and other rural Americans are not asking for the Government to do it all. We want to own our own future. We want to capture downstream revenue through new ventures, and we want to invest our own financial resources and assets to make it happen. Too often, it isn't enough. A new source of equity capital will help fill that gap and make the difference.

Mr. Chairman, I want to thank you again for the opportunity to testify here today.

[The prepared statement of Mr. Kolsrud can be found in the appendix on page 41.]

The CHAIRMAN. Mr. Kolsrud, thank you very much for an excellent statement.

Now, we turn to Mr. Ron Phillips, of Coastal Enterprises, Inc., of Wiscasset, Maine. Welcome to the committee.

STATEMENT OF RONALD L. PHILLIPS, PRESIDENT, COASTAL ENTERPRISES, INC., WISCASSET, MAINE

Mr. PHILLIPS. Thank you very much, and thank you for inviting me to testify today as you craft development policy for the important 2002 Farm bill.

My name is Ron Phillips and I am president of Coastal Enterprises, a community development corporation and community development financial institution based in the rural coastal village of Wiscasset, Maine. I have submitted a written statement and I will make a few verbal remarks and offer some recommendations.

I am here today representing an informal coalition of rural non-profit organizations coordinated by the National Rural Housing Coalition that are working to promote Federal rural development policies. I also serve on the boards of the National Congress for Community Economic Development, the National Community Capital Association, and the Rural Advisory Council of Local Initiative Support Corporations. These organizations represent some 2,000 CDCs and CDFIs working in rural America to do the kind of development work we are talking about.

In fact, the Rural LISC organization, Senator Harkin, has a campaign going nationally called the Stand Up for Rural America Campaign. I have one bumper sticker here for you. Maybe we can get some more for the rest of the committee members.

The CHAIRMAN. I would like to have that.

Mr. PHILLIPS. This campaign alone has helped to generate a lot of attention, especially from the private banking system, to devote resources to rural America.

With over 20 years of rural economic and affordable housing experience, we have helped unleash entrepreneurial talent and created new jobs and housing for thousands of Mainers. We have invested and leveraged over \$350 million.

CEI has been involved with USDA programs since the early 1980's and one program very important to us in the Intermediary Relending Program. With \$11 million in what we call IRP financing alone, CEI has generated over \$60 million in capital for 117 rural businesses in wood products, seaweed and fish processing, manufacturing, child and foster care services, and new information and environmental technology firms employing over 2,500 Mainers.

One recent project in Washington County was Washington County Psychotherapy Associates. With support from the town of Calais, the IRP program, rural development, CEI and Key Bank, a financing package of over \$2 million was put together to create a 20-bed treatment center for troubled youth. The project not only met a much-needed service in the community, but created economic impact by renovating an idle former Hathaway shirt factory facility, keeping scarce dollars for the service in-State, and importantly

keeping the kids in a community familiar to them. This is the kind of impact USDA programs are having in our rural communities.

There are still huge challenges that lie ahead, however, and much-needed resources to meet these challenges. There are 54 million people living in rural America, 16.8 percent of whom live in poverty. While the Farm bill is a critical piece of legislation for American farmers, it must also address issues facing rural residents, 90 percent of whom derive their income from a non-farm economy.

A startling fact is that despite the recent economic boom, the average rural worker earns less than in 1979. Even as startling, of the 250 poorest counties in America, 244 are rural. Some 2,000 rural CDCs nationwide have vast potential to assist Federal efforts in revitalizing rural places. Our development financing is directed to value-added farm, fish and forest product enterprises, small businesses, affordable housing, child care facilities, education, job training, health care, nutrition and hunger reduction, elder care, and arts and cultural programs.

USDA is the only Federal agency with a mandate to provide comprehensive assistance to America's rural areas who can't simply turn to their tax base to fund their development. USDA's very good housing, business, water and utility programs are perennially underfunded and over-subscribed.

One statistic I came up with researching this testimony was that the USDA's appropriation has been reduced over \$500 million a year, and no other Federal agency has picked up the slack. In addition to dwindling Federal resources, private capital investments over the last decade have predominantly flowed to a few urban and suburban areas.

Let me try to go over some recommendations which are important for the committee to consider for the Farm bill. With this next farm bill, Congress has an opportunity to lay out a vision of rural America that captures our ideals of what rural America can be, a place where we live, a place where we work, and a place where we recreate. We must expand our way of thinking about resources we spend and the priority we place on how policies affect rural areas.

I have four recommendations for you.

We urge the committee to take a bold action to support what we are calling the rural endowment initiative. Our coalition is putting together this concept and we are very glad to work with the committee on this. We believe we could put together a funding program for mandatory funding building on decades from lessons learned from Government programs and community-based development strategies. This initiative could spur the creation of long-term assets in our farm and rural communities.

I read in the New York Times the other day on the front page that one of the biggest and hottest and fastest growing sectors for rural economies are State prisons. They quote a statistic here that of the 245 new State prisons that have been constructed in recent years, 212 of them are in rural communities. They are faster-growing than Wal-Mart. We need choices and the rural endowment initiative could give such choices.

We urge the committee to increase authorizations to USDA programs that they already have ongoing, such as the Intermediary

Relending Program, the Rural Business Enterprise Program for Micro Enterprises, and the Rural Business Opportunity Grant to help communities and organizations plan for their futures. Our own State Office of Rural Development has offered recommendations that are consistent with these that I am giving you.

We urge the committee especially to create a rural venture capital finance program. I am glad my colleague has brought that up, and it was mentioned by one or two Senators earlier. This could be similar to the SBA's investment program, the SBIC program, hopefully a little bit more flexible, or the United States Treasury's Community Development Financial Institute Program.

It really is astonishing that the USDA does not have an equity finance program. It really should do this. There is one bill, Senate bill 3242, that would establish a national rural cooperative and business equity fund, and we would simply urge that community development organizations have a way of participating directly in it. We would be very glad to work with you on that.

Finally, we urge the committee to mandate the establishment of an assistant secretary's working group on rural development. Rural issues, policies and programs that affect rural America are far too often relegated to the back burner in Washington.

We just got selected by the SBA to run their new Markets Venture Capital Program, a lot of which is affecting rural communities. Just as an example, the way they set up the rules and the criteria for what rural communities can participate don't really reflect how rural life exists. We just need some way to get access to and get people listening to us on how to create criteria, what eligibility is all about in rural America.

Basically, this concludes my testimony. Thank you very much for this opportunity.

[The prepared statement of Mr. Phillips can be found in the appendix on page 49.]

The CHAIRMAN. Thank you very much, Mr. Phillips, for your excellent testimony and for being here today. I will want to explore further with you the idea of the rural endowment initiative.

Next, we turn to someone who is not a stranger to this committee, Mr. Chuck Hassebrook, from the Center for Rural Affairs, from Walthill, Nebraska.

Welcome back to the committee.

STATEMENT OF CHUCK HASSEBROOK, CENTER FOR RURAL AFFAIRS, WALTHILL, NEBRASKA

Mr. HASSEBROOK. Thank you, Mr. Chairman and Senator Dayton. I appreciate the opportunity to testify today because this farm bill really presents an opportunity to make a profound difference for rural America.

We are in the midst of an opportunity crisis in the farm and ranch communities in our region. Farm and ranch counties in our region, in the States of Iowa, Kansas, Minnesota, Nebraska and the Dakotas have poverty rates that are 50 percent higher than our metropolitan counties.

Most people don't recognize this, but of the Nation's 20 lowest-income counties, half are farm and ranch counties in Nebraska and the Dakotas. The Nation's two lowest-income counties are Ne-

braska farm and ranch counties. That, in part, reflects the dependence of these counties on agriculture. They don't have the natural amenities to become tourism centers. They are not located so as to become centers for growth in manufacturing.

The contribution of agriculture to rural community development is declining. The farm and ranch share of profit in the food system is falling at a rate that, were the trend line extended to the year 2030, the farm and ranch share of food system profit would be zero. We are losing our young. The number of beginning farmers, of farmers under the age of 35, has fallen by 60 percent over the last 20 years.

There is also a positive side. There are opportunities for these communities. Segmentation in markets in creating opportunities for family farmers and ranchers to earn premiums for producing food in ways that make it worth more to consumers. There was a Successful Farming and Better Homes and Gardens survey of consumers reported recently that demonstrated that 57 percent of American consumers say they would pay a premium for pork produced on a small family farm, and 71 percent say they would pay a premium for pork produced on a farm that is environmentally responsible. That is an opportunity.

There is also opportunity, I believe, in the explosion of knowledge. We are becoming a knowledge-based society in which opportunity is primarily going to be—at least genuine opportunity is primarily going to be available to those who apply knowledge. To the extent that we focus on embodying knowledge in new products to sell to farmers, it is primarily going to be the input sector that benefits.

To the extent that we can focus our efforts on developing new knowledge and developing new production systems that enable farmers and ranchers to apply that knowledge by using more of their management and skills to cut input costs and produce products that are worth more to consumers, then we can create opportunity in rural America and turn that declining farm and ranch share of profit around.

The final opportunity, in my judgment, lies in entrepreneurship. The farm and ranch counties in our region have twice the rate of self-employment as metropolitan counties. In Nebraska farm and ranch counties, 70 percent of the net job growth over the last decade was in non-farm self-employment. That presents an opportunity, but by and large our rural development programs have not focused on promoting small-scale entrepreneurship.

We propose to change that. First, we propose an agricultural community revitalization initiative that would commit \$500 million of mandatory spending, less than two percent of what we spent last year on direct payments for relief, and commit that to long-term solutions for farm profitability, to initiatives that assist farmers and ranchers in earning a fair income from the marketplace by responding to consumer demand and initiatives that support new enterprise development in rural communities.

We are proposing that this be a regionally administered program that is regionally responsive and that makes competitive grants to the best ideas that come forward to increase the farm and ranch share of profit in the food system and to increase self-employment

opportunities in farming and ranching and in our agricultural communities.

Second, we propose a beginning farmer and rancher initiative that would include refining and strengthening some of our existing credit programs for beginning farmers, but that would also take some innovative approaches that provide technical assistance and training in business management and business planning and e-commerce for beginning farmers, and incentives for retiring farmers to work with beginning farmers by leasing their land or their facilities to the beginning farmer.

Finally, we propose a set of initiatives to support small business development in agricultural communities. We propose that the Intermediary Relending Program be expanded to \$100 million through mandatory funding, and that a portion of that be set aside for the smallest businesses, businesses with five or fewer employees, and that it not only be available to provide loans, but that it also be available to provide technical assistance and training in business management, business planning, e-commerce and things like that, because we can often get our biggest bang for the buck in those types of initiatives.

One other change in the Intermediary Relending Program is we would revise the prohibition on loans for agricultural production so it no longer prohibits loans to farmers and ranchers to add farm-related businesses like a cheese plant to their farming operation.

Finally, we propose an initiative to encourage savings to support small business development. As part of that, we would revise the Rural Business Enterprise Program to support individual development accounts so that the Federal Government could match money saved and placed in an individual development account by low- and moderate-income rural people to be used ultimately to start a new small business. We think these types of initiatives can really unleash some of the entrepreneurial spirit in rural America.

It is time to close, but my key point is that we have under-invested in entrepreneurial approaches, and by committing a small portion of the baseline of mandatory funding we can create a big increase in support for entrepreneurship and make a very big boost for rural community viability.

Thank you.

[The prepared statement of Mr. Hassebrook can be found in the appendix on page 60.]

The CHAIRMAN. Thank you very much, Mr. Hassebrook; as usual, a very provocative and strong statement. I appreciate that.

Next, we turn to Ms. Karen Dearlove, of the Indiana Association of Regional Councils.

Ms. Dearlove, welcome to the committee.

STATEMENT OF KAREN DEARLOVE, PRESIDENT, INDIANA ASSOCIATION OF REGIONAL COUNCILS, JASPER, INDIANA

Ms. DEARLOVE. Thank you, Chairman Harkin and honored members of this committee, for the opportunity to testify today on behalf of my rural local elected officials, the Indiana Association of Regional Councils and the National Association of Development Organizations on the importance of a strong rural development title within this next farm bill.

I am Karen Dearlove, seventh-generation Hoosier and Executive Director of Indiana 15 Regional Planning Commission for the past 11 years, during which time we have been awarded four national innovation awards. I am not serving my second year as the President of the Indiana Association of Regional Councils, and this fall I will start my seventh year on the board of the National Association of Development Organizations.

Serving a 6-county rural region, Indiana 15 develops and administers a variety of State and Federal grant and loan programs for communities facilities, economic development, rural transportation, comprehensive land use planning, historical preservation, tourism development, business development, and natural disaster recovery projects. We also provide technical governmental services, including mapping and geographic information systems and the codification of municipal ordinances.

On the local level, my board of 43 directors consists of county and municipal elected officials, business leaders and citizens to govern Indiana 15. This board structure inherently makes Indiana 15 and my peer regional development organizations responsive to local needs and accountable to local elected officials.

The Indiana Association of Regional Councils represents the 11 regional development organizations at the State level, while NADO represents a national network of 320 regional organizations that provide professional and technical assistance to over 2,000 counties and 15,000 small cities and towns.

This afternoon, Mr. Chairman, I want to briefly cover three main points on the Nation's current rural development programs.

First, the current structure of Federal assistance programs fails to adequately provide rural communities with the tools to develop sustainable economies. When examining the different types of Federal assistance targeted to urban areas versus rural areas, an alarming trend is revealed.

While urban communities receive a substantial amount of direct Federal grant funding for infrastructure development, such as HUD's Community Development Block Grant and the Department of Transportation's highway and transit programs, statistically the bulk of assistance to rural communities is in the form of loans and transfer payments, such as Social Security and ag payments.

By targeting billions of dollars in grants each year to urban areas, the Federal Government has provided our metropolitan areas with a distinct economic advantage not equitably afforded to our rural communities. While urban areas are building the communities and economies of tomorrow, rural areas are struggling to maintain the economies and legacies of yesterday, while trying to piece together ever-shrinking, competitive grant programs and loan programs to develop infrastructure and capacity for the future.

Second, Mr. Chairman, USDA rural development programs must be better funded, more streamlined and more flexible to meet local needs. Support for water and wastewater infrastructure still ranks as the overwhelming No. 1 need of rural communities by recent surveys of both the National Association of Development Organizations and the National Association of Counties.

Funding for transportation, advanced telecommunications and local capacity-building also ranked high on these lists. In addition,

rural areas also need quality schools, affordable health care and accessible child care to attract and retain viable, sustainable industries.

As a specific example of the assistance provided by regional development organizations, Indiana 15 brought together partners to establish the Crawford County Day Care and Youth Service Bureau Alternative School Project. This joint facility now provides over 170 children and youth with a variety of services for one of the most economically distressed counties in the State of Indiana, and after three years of development efforts the only public day care now exists. The programs of the Youth Service Bureau have been expanded, unfortunately without funding or in partnership with USDA due to a lack of sufficient funding for the Community Facilities Program.

Third, and finally, Mr. Chairman, the next Farm bill should include a new program focused on building the long-term capacity of rural areas. Study after study by Federal agencies and universities have concluded that additional funding for capacity-building and technical assistance programs is one of the most pressing needs facing rural local governments. It is often difficult for the Nation's 14,000-plus rural communities to access either public or private sector funds theoretically designed to assist in community and economic development efforts.

Unassisted, rural communities have an extremely time dealing with burdensome, complicated and frequently illogical paperwork or procedures required to apply for Federal funds. One solution is to implement the proposed rural impact program, a multi-county approach to local capacity-building that would ensure that Federal dollars are maximized in rural areas, while affording communities the flexibility and authority necessary to overcome the ever-changing challenges of rural America.

For example, from 1999 to present, Indiana 15 has assisted local governments and not-for-profits with more than 60 projects totaling more than \$40 million, while having only 6 full-time staff. Yet, Indiana 15 exists on the basis that only one-quarter of our operating budget is funded annually by county per-capita fees and an EDA planning grant, both of which are at the same funding level as 20 years ago. We do not, nor have we ever received operational support from USDA because such a consistent technical support and capacity-building program today does not exist. The bottom line is that USDA rural development programs need to be more focused on building long-term capacity in local communities and on providing more assistance directly to local communities.

In closing, Mr. Chairman and members of the committee, I want to thank you sincerely for inviting me here today on behalf of the Indiana Association of Regional Councils and the National Association of Development Organizations. I would sincerely welcome any questions you may have.

Thank you.

[The prepared statement of Ms. Dearlove can be found in the appendix on page 68.]

The CHAIRMAN. Ms. Dearlove, thank you very much. I look forward to looking more at the rural impact program that you have proposed. That sounds pretty interesting.

Next, we turn to Mr. Curtis Wynn, Chief Executive Officer of the Roanoke Electric Cooperative of Rich Square, North Carolina.

Mr. Wynn, welcome.

**STATEMENT OF CURTIS WYNN, CHIEF EXECUTIVE OFFICER,
ROANOKE ELECTRIC COOPERATIVE, RICH SQUARE, NORTH
CAROLINA**

Mr. WYNN. Thank you, Mr. Chairman. For the record, I am Curtis Wynn, CEO of Roanoke Electric Cooperative, in Rich Square, North Carolina. I am also representing the National Rural Electric Cooperative Association, NRECA, which is made up of 900 not-for-profit, consumer-owned electric utilities that provide central station electric service to more than 34 million mostly rural consumers.

I commend you, Mr. Chairman, and the committee for convening this hearing on rural development programs, and thank you for the opportunity to be here to testify before you. These programs are increasingly important to rural areas. Rural communities want and deserve the same opportunities for growth that our urban counterparts enjoy.

North Carolina's economy has seen phenomenal growth in the last decade. However, much of that growth has been concentrated in the urban areas. I believe that many of you have seen similar patterns of development in your respective States. Allow me to briefly paint a picture of one example, which is my rural northeastern North Carolina community.

For decades, several of our counties have been among the most impoverished and underdeveloped counties in the State. Bertie, Halifax, Hertford and Northampton Counties were also recently reclassified by the North Carolina Department of Commerce as distressed counties, and this category is more severe than depressed counties.

Our poverty levels range above 30 percent. In many of the counties, basic infrastructure, particularly natural gas, sewage lines and treatment facilities, is missing. The region is also isolated technologically. Television signals come in weakly from the relatively distant big cities. Many residents lack cable service and even telephones. Few T1 lines have been run to this area, resulting in minimal local service provider options. Northeastern North Carolina is thus on the wrong side of the digital divide, with less than 10 percent of our residents online. Legislation is needed to encourage private investment and projects that existing venture capital funds do not accommodate.

Electric co-operatives meet community needs through their economic and community development activities. These expanded efforts create jobs and opportunity in the community and are enabled through USDA's Rural Economic Development Loan and Grant Program, also known as REDLG. Over the lifetime of the program, REDLG has provided over \$140 million in loans and over \$66 million in grants to rural communities. These loans and grants have leveraged nearly \$1.2 billion in non-Federal capital for 851 projects. Over 25,000 jobs have been created.

Mr. Chairman, the REDLG program has brought significant economic development opportunities to rural America. Over the last decade, in North Carolina the electric co-operatives have provided

loans totaling more than \$20 million which have been leveraged to over \$150 million in commercial projects, creating over 4,600 jobs. The financing of these loans have come from private and public sources, including \$4.6 million in rural utility services loans and \$15.5 million from a cooperatively created statewide revolving loan fund. Projects have included the building of cotton gins, renovations and expansions of medical centers, water infrastructure facilities, and industrial parks and businesses to go with those.

The co-operatives' commitment to their communities is more than economic development and job creation. It is also about building and sustaining viable communities. In our region, Roanoke Electric Cooperative has taken full advantage of USDA's REDLG program. In just 24 months, we have closed two zero-interest loans for \$846,000. Through the REDLG program, we have helped to create nearly 200 jobs and retained another 150 jobs, and have raised another \$1.3 million from other publicly and privately funded sources. These funds have leveraged over \$11 million in investments.

Access to capital, along with a commitment to build human capacity through continuous collaboration with local governments, non-profits, community-based organizations and faith-based organizations are allowing us to reshape a community that time has forgotten. Preparing our community puts us in line for public-private partnerships that are so badly needed for sustained growth.

While the REDLG program has worked well over the last decade, the funds available for loans and grants have declined over the last six years. I believe certain changes will reverse this trend and make REDLG even more successful in the future. I, along with our national association, look forward to working with you, Mr. Chairman, and other members of the committee to adapt REDLG to current economic realities and to reinvigorate this very important program.

The health and vitality of rural communities is of great concern to me personally, and of great concern to the rural electric co-operatives that serve this population. Through encouraging capital investment in our rural communities and taking advantage of new opportunities, rural communities can remain a vital part of the American economy. Rural communities are worth our investment.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Wynn can be found in the appendix on page 80.]

The CHAIRMAN. Mr. Wynn, thank you very much for an excellent statement.

Now, we turn to Dr. Deborah Markley, the Chair of the Rural Equity Capital Initiative of the Rural Policy Research Institute, of Chapel Hill, North Carolina.

Welcome to the committee, Dr. Markley. Please proceed.

STATEMENT OF DEBORAH M. MARKLEY, CHAIR, RURAL EQUITY CAPITAL INITIATIVE, RURAL POLICY RESEARCH INSTITUTE, CHAPEL HILL, NORTH CAROLINA

Ms. MARKLEY. Thank you, Mr. Chairman and members of the committee. I am the Chair of the Rural Policy Research Institute's

Rural Equity Capital Initiative, which is a research project funded by USDA's Fund for Rural America.

I want to speak today about equity capital in rural America, and it has been mentioned several times during this hearing already. What I would like to do is to talk specifically about what we have learned as part of this research project, after spending the last 3 1/2 years in the dirt, so to speak, studying innovative venture capital funds that have focused investments on rural businesses and entrepreneurs in real rural communities all across the country.

There is a lot to be learned from these venture funds. We have learned that successful rural-focused venture funds are not one-size-fits-all. There is a great deal of innovation locally, regionally and at the State level that needs to be recognized and rewarded. These are not traditional venture capital funds, traditional Wall Street venture capital funds, and very often the funds that are focused on rural investments value both social as well as financial returns.

For successful rural-focused venture funds, local intelligence is really key. These funds have spent time and money identifying their rural market, looking at potential deals, and when deals did not exist actually developing entrepreneurs and businesses. Traditional venture capitalists don't operate in rural markets because, in part, of the lack of local intelligence that they have. It is much harder to make good investment decisions without it.

Successful rural-focused venture funds also have skilled management teams who are close to their investments, the rural businesses and rural entrepreneurs, so they can investigate the deals before the investment and they can provide the support and technical assistance after the investment is made. Venture capital investing is a hands-on process and it is often about providing much more than dollars.

We have also learned that there is an important role for the Federal Government to play in supporting existing institutions and creating new institutions within rural America. The funds we studied are small. The industry is not widespread. The cost of starting up a rural-focused venture fund is high, both in terms of time and money—things that are often in short supply in rural America.

What should the Federal role look like in helping to create a venture capital industry in rural America? First of all, scale is important. We need to get more venture capital into rural America. We need to help more entrepreneurs develop new businesses, we need to help more existing businesses in rural America grow.

Any Federal effort needs to be capitalized at a level that can help the industry achieve this scale, and also leverage private sector funds, a very important component of any effort. It needs to be recognized that innovation occurs at the local level. This is where the need for venture capital is identified, this is where the local intelligence is generated, and this is where the investment decisions need to be made.

We need to use the lessons that we have learned from looking on the ground at venture capital institutions that are making investments in rural areas to figure out how the Federal Government can best encourage new institutions and support the existing ones. Any Federal support needs to come with some strings attached.

The venture funds that receive Federal investment need to be able to demonstrate a comprehensive strategy for identifying rural deals and making rural investments, that they know how to get out there and identify deals, identify entrepreneurs develop the deal flow within rural America.

They need to demonstrate the commitment of an experienced management team, a plan for providing technical assistance and management assistance to their companies, and also evidence of entrepreneurial strategies for partnering with other programs and organizations across jurisdictions so that we can begin to reward a regional approach to creating solutions for getting more equity capital into rural America.

For any Federal program, rural targeting is really critical to increasing the supply of venture capital in rural America. Without explicit targeting of investments to rural-focused venture funds, investments are not going to occur in rural America. Whether it is by increasing the rural targeting in existing programs like the community development financial institutions funds or the new markets initiative or a new rural-focused venture capital initiative, there needs to be rural targeting so that the money gets out to rural-focused funds and rural businesses and entrepreneurs.

Supporting rural entrepreneurship and rural economic development contains a lot of ingredients, one of which is venture capital. Building venture capital infrastructure in rural America is not going to provide a silver bullet to rural communities across the country, but without expanded access to venture capital, it is going to be harder for rural entrepreneurs to start businesses and harder for existing rural businesses to grow and adjust and deal with the global economy.

There are innovative venture funds in Iowa, in Minnesota and in Maine that are doing creative equity investing in rural enterprises. We need to use what we have learned about their success to craft a Federal policy to support an expanded venture capital capacity in rural America.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Markley can be found in the appendix on page 83.]

The CHAIRMAN. Dr. Markley, thank you very much. We will get back to you. If you have a couple of specific examples, we might go over that if you have those.

Now, on behalf of the lifeline to so many of our farmers and rural families out there, on behalf of both the Iowa Independent Bankers Association and the Independent Community Bankers of America, Mr. Steve Lane, President of the Iowa Independent Bankers Association.

Welcome to the committee, Steve.

STATEMENT OF STEVE LANE, PRESIDENT, IOWA INDEPENDENT BANKERS ASSOCIATION, GOWRIE, IOWA, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. LANE. Thank you, Chairman Harkin, for today's hearing on rural development. Rural development is essential for farmers to have an economic opportunity off the farm as well as on the farm.

I am Steve Lane, President of the Iowa Independent Bankers, and also President and CEO of Security Savings Bank, a \$48 million ag bank located in Gowrie, Iowa. I also represent the Independent Community Bankers of America.

We hope the new farm program will secure significant new money for rural development. Statistics and trends reveal that off-farm jobs are of increasing importance to the farm sector. Counties dependent on agriculture are losing population. Farm programs and rural development need to be at center stage. Farmers are struggling to make their operating cash-flows. The big problem is profits and equity. Many farmers and their spouses are working off farms 40 hours a week to cover living expenses. Rural development is in crisis.

My town works very hard to try to attract new businesses. We offer many incentives, one of them being exemptions from property taxes. These incentives by themselves have not been enough. Basically, we need more money and some new programs. Success means keeping people currently there in the communities and attracting new ones to move in. Otherwise, at some point communities are falling below their critical mass of people needed to sustain a small community.

Let me suggest four principles of rural development: target scarce resources to rural areas based on population; provide tools to complement the private sector; target resources to various sizes and types of businesses, including individuals; and maintain a rural population base and infrastructure.

In regard to targeting rural communities, let's ensure that rural programs target rural areas with scarce Federal dollars. This creates new jobs in the local area where people live. A population criteria would be the key to deciding where scarce Federal moneys go. The B&I program targets loans to communities of 50,000 or less.

Second, let's complement the efforts of the private sector. There are about 3,000 ag banks and several thousand non-ag banks in rural areas. Let's be sure that these programs can be used by all these areas.

We need to focus particularly on value-added agriculture. If we can process more of these products in the local area rather than shipping the commodities across the country or to large cities for processing and packing, the local farmers will reap the benefits. The key is locally oriented value-added incentives that help create a better market for our farmers, and also create jobs for farmers who need off-farm income.

Mr. Chairman, I would like to applaud you for the legislation to establish a rural equity fund. A broad coalition supports this bill to spur businesses and cooperative development. The rural equity fund will encourage private investment in value-added agricultural enterprises and small business startups and expansions.

As you know, large venture capitalists are not interested in rural America. This legislation creates a private-public partnership designed to attract equity investment to co-operatives and other businesses and ventures in rural America. The funds would be capitalized by investments from private sector institutions, and the Government would match these moneys up to a specific level.

From a banker's perspective, there funds could provide equity financing to help complete the loan package or debt financing for the banks. The intent is to target rural businesses in rural areas. The need for more equity financing in rural America was highlighted by the Center for the Study of Rural America's 1999 report on the topic. Let's put this into the Farm bill.

My written statement has other suggestions. These include prohibiting USDA from raising fees on B&I programs to 3.25 percent, eliminating fees for all users of B&I programs, including targeted funding and authorities to B&I programs for smaller-size business loans with streamlined applications, and providing incentives for banks that promote and develop value-added agriculture.

Mr. Chairman, rural development should be a key part of our new farm bill, a working partner to build a stronger farm safety net. Off-farm jobs go hand-in-hand with a new and improved farm bill in accomplishing the goal of keeping farmers on the land and keeping Main Street vibrant and keeping rural America healthy.

Thank you.

[The prepared statement of Mr. Lane can be found in the appendix on page 91.]

The CHAIRMAN. Steve, thank you very much for your great leadership in my State and nationally, and thank you very much for a very excellent statement. I appreciate it very much.

Now, we will conclude with Mr. Jack Cassidy, Senior Vice President of CoBank, of Greenwoodville, Colorado.

**STATEMENT OF JACK CASSIDY, SENIOR VICE PRESIDENT,
CoBANK, GREENWOODVILLE, COLORADO**

Mr. CASSIDY. Thank you, Mr. Chairman. I appreciate the opportunity to appear before the committee today and testify on this important initiative.

My name is Jack Cassidy. I am Senior Vice President for Board and Corporate Relations with CoBank. We are headquartered in Denver, Colorado, but we operate throughout the United States, and also have an international program as well.

With \$24 billion in assets, CoBank is the largest bank in the Farm Credit System. We provide financial services to about 2,600 customers, who are also our member-owners. These member-owners are all corporate enterprises that include farmer-owned cooperatives, rural water systems, telecommunications companies, and electric systems. We also provide financing to support the export of agricultural products.

CoBank works with many other financial institutions, including commercial banks through syndicating and purchasing loans. These alliances with other financial institutions help us meet the growing needs of the many businesses we serve. In the past 18 months, CoBank has acted as the agent for \$4 billion in loans sold to other lenders. We also purchased \$2.5 billion in loans from other lenders.

I would add that that facilitates the flow of capital to these rural areas. Most of these businesses are very rural-oriented, and so our ability to work with other lenders on these activities helps move that capital to those communities.

This partnership of commercial banks and other lenders brings new sources of capital to meet the needs of rural businesses, while at the same time spreading risk among the lenders. We consider the development of these alliances with other lenders as critical, and have plans to place even greater emphasis on this area in the future.

Unfortunately, many rural communities have not shared in the prosperity of the 1990's. It has been difficult for many rural businesses to obtain the necessary equity capital, as others have already noted, and to grow and create new market opportunities and new employment. In addition, rural communities often do not have access to technology and communications systems that are vital to economic growth, as Mr. Wynn noted in his area.

I would like to comment on four areas of policy recommendations for the committee to consider.

First, we think it is important that the rural co-operatives be acknowledged in advancing the economic interests of rural America, and we would like to mention a few steps that can be taken to strengthen the role of co-ops, especially in the area of value-added initiatives.

Second, we would make a couple of comments about CoBank's authorities and adjustments that might make it easier for us to serve some of these rural businesses and communities; third, talk a little bit about equity capital in rural America; finally, improvements that might be made to the USDA B&I loan program.

With regard to value-added businesses and co-operatives, for decades CoBank customers have been leaders in marketing and processing agricultural products to obtain a greater share of the consumer food dollar for the American farmer. We believe strongly, as do our member-owners, that value-added initiatives are one of the keys to a prosperous farm sector.

We would suggest some adjustments to existing Federal programs that could help support farmer-owned value-added enterprises. For example, we would support expansion of the Value-Added Technical Assistance Grants Program. We would support making a separate agency in USDA called the Farm Business Co-operative Service that would be dedicated and focused on supporting farmer co-operatives.

As part of a revitalized farm business-cooperative service, we support funding for research, education and technical programs for farmers and co-operatives. We would recommend that not less than \$6 million annually for cooperative grants be provided to the Farm Business Cooperative Service.

In the international arena, we think there are some adjustments that could be made that would help make U.S. value-added products more easily sold overseas. We have joined a long list of commodity and exports organizations in recommending legislative improvements to the USDA's Supplier Credit Guarantee Program, in particular lengthening the authorized program tenors from 6 months to 1 year, increasing the guarantee coverage, and reducing the program fees and enhancing the effectiveness of this program to assist co-ops market their products in international markets.

With regard to our own lending authorities, we would have three specific recommendations. As noted earlier, we work with many

commercial lenders to sell and purchase interest in loans. All loans purchased by CoBank must be originated by commercial lenders that make loans to companies that are very similar to the types of loans that we make directly to farmer-owned co-ops. This excludes some transactions involving companies where food or fiber operations may be only part of a larger enterprise.

CoBank has been unable to participate in such loan syndications when asked to do so by commercial banks. By allowing us to participate in such transactions, we could strengthen our existing partnerships with commercial lenders and bring an additional source of capital to these rural companies and agricultural businesses.

Second, under current law CoBank may provide financing to communications companies that are eligible to borrow from the Rural Utilities Service. However, many of the communications companies interested in providing Internet, broadband and other types of advanced communications services to rural communities today do not borrow from the RUS and there are not eligible to borrow from CoBank. If we had the authority to finance such companies, we would help ensure that rural communities would be afforded greater access to the technology that is vital to their future.

Third, under current law CoBank can finance the export of farm machinery and other farm-related products that are used on-farm and in foreign countries. This on-farm requirement limits our ability to finance the sale of some U.S. agricultural-related products simply because the foreign purchaser plans to use these products someplace other than on the farm.

For example, we can only help a co-op sell its used packaging or processing equipment if the foreign purchaser is going to use that equipment on a farm. For a cooperative trying to get the best price for its outdated equipment, there is little concern about whether the equipment will be used on the farm or somewhere else, and we would recommend that change.

With regard to the equity capital and venture capital, many others have commented on that. I would just commend the chairman and this committee for the efforts that have been made in that area. We strongly support the rural equity legislation that has been introduced, the Harkin-Craig bill, and we are pleased to be part of the coalition that would like to see that legislation adopted.

The final comments I would make relate to the B&I loan program. I associate myself with the comments that Mr. Lane has made. Our comments would be very similar. We have worked with the National Council of Farmer Cooperatives to come up with some other recommendations that would make the B&I loan program particularly more helpful to farmer-owned co-ops.

We would like to see the maximum loan guarantee increased. In today's environment, if you want to have a big job-creating company, a \$25 million limit is somewhat restrictive. We would like to see the minimum loan guarantee of 90 percent put in place for most co-ops and eliminate the geographic restrictions in the case of farmer-owned and value-added products.

Many of our farmer-owned facilities are located in areas that cannot really be described as rural, but because they are farmer-owned facilities, even if they are located in an urban area, the ben-

efits flow back to the farmers in the rural communities, and the current geographic and population limitations that exist create something of a problem.

Finally, as part of the Farm Credit System, I would note that CoBank is a key link in channeling private sector funds from the Nation's money markets to businesses operating in rural America. In recent years, Congress, through various initiatives, has greatly expanded the authorities of commercial banks and provided them with virtually unlimited access to GSEs through the Federal home loan bank system and the Federal Agricultural Mortgage Corporation.

Congress took these actions as part of an effort to make more capital available to rural America. Congress has an opportunity with this farm bill to take additional steps to make capital more available by providing needed updates to Farm Credit's charter and considering innovative ways to facilitate the ability of lenders to work together to meet the needs of our rural communities.

In closing, CoBank is committed to rural America. Our slogan is "CoBank-Rural America's Cooperative Bank." Those are more than just words to us. We live by that slogan and that is who our customers are. Those are the people who own the bank, and we appreciate this opportunity to be here today and present this testimony to the committee.

I would be happy to answer any questions. Thank you, Mr. Chairman.

[The prepared statement of Mr. Cassidy follows can be found in the appendix on page 101.]

The CHAIRMAN. Mr. Cassidy, thank you very much. Thank you all for very succinct and very pointed statements. As I said, your entire statements will be part of the record.

At the outset, I also want to request of each of you that as we proceed ahead into this fall that you continue to give us the benefit of your suggestions, advice and input as we develop this farm bill. We will, to the best of our ability, try to keep in contact with you either through the organizations some of you are representing here or individually, as the case may be, to try to keep you up to date as to what the progress will be on the Farm bill.

The House has finished their work on the proposed new farm bill. I have not really had a chance to look at it yet. I only know what I read about it, but it seems to me that there really wasn't a lot of attention paid to the rural economic development portion of a farm bill. It just sort of continues on with what we have been doing.

I read your statements before and looked at them again here while you were talking today, and as I understand it, most of you are saying we have had a fairly good basis in the past, we have done some good things in the past, but we have entered a new era and many of the programs and things we did in the past aren't keeping up; that we have to find some different ways of getting capital and getting support out to rural areas for value-added. That was not something that was around much either in concept or actuality a few years ago. The whole idea of Internet access, broadband access in rural areas is something that is new.

How we provide the kind of planning and support—a couple of you referred to that, about how it is not just important to get the money out, but many of these areas lack the kinds of resources to adequately plan, take an assessment of the possible areas of economic development in their areas and put together good proposals. A lot of these are kind of farmed out to different entities, I guess.

I am interested again in thoughts you have on how we provide more help and support for the planning process, on how to get people together with the private sector, because obviously the private sector has to be the engine that drives this. If you get the private sector in to meet with these people to say, OK, here is where you will have promising areas of economic development and growth in your geographic area and get them really involved in this process.

I might say this, Mr. Cassidy. I am always a little concerned about how we balance raising guarantees. Obviously, everyone would like to have a 100-percent guarantee. If you do that, do you really keep close tabs on what is happening?

Obviously, we want the private sector involved, but not to the point where if everything is gone, it is all written off and we pay for it anyway. We have seen debacles like that in the past. Somehow we have to balance that and I am not smart enough right now to figure it out. Some way of having that support, but we need to have the private sector keeping tabs on what is happening out there and to keep them towing the line on some of these projects.

Those are just my general thoughts in listening to this. I intend to make rural economic development a very integral part of the Farm bill on the Senate side. As I said in my opening, there has got to be more of a balance in this area of providing just straight support to our agricultural producers, but then balancing it by providing support for the infrastructure that is out there.

We have a basis on which to go. We have experience in this area. It is just that we have to change some of the ways we have been doing it and provide for avenues of getting more equity capital into rural America. That is why we have this fund up. Some of you mentioned the rural equity fund that Senator Craig and I have worked together on for quite a while, which I hope to put in the new Farm bill. Again, I ask you to take a look at it. Nothing is written in stone around here. If you have thoughts on how we should change it or modify it or improve it, we certainly welcome that from any of you in that regard.

The rural endowment initiative that Mr. Phillips raised is sort of what I have been talking about, getting Federal funds to support a planning process, and if it comes together, then a series of annual grants to keep them implementing the plans, as I understand it. It sounds like a good concept.

Can you tell me if there has been any basis for that in past programs or not? Is this building on something that we have been doing in the past?

Mr. PHILLIPS. Actually, if you look at some of the work that went on with HUD in the enterprise zones and communities, there is a lot of emphasis on bringing everybody together to plan strategies. Those are the good things.

The CDFI fund is sort of interesting because although they are investing in individual CDFI institutions, they are investing in a

business plan which represents a widespread market development or market strategy that involves a lot of different institutions, particularly the banking institutions. There is precedent for Federal agencies to really support local collaboration planning. That is the good news.

The bad news is that often communities are inspired to be brought together by some of the Federal programs and ideas, but there is no implementation money or flexible capital to then invest and followup. What happens then is all the entities that are participating have to go off and access—not to demean the value of silos, but to go after programs that are separately funded and try to do a patchwork of putting together the actual implementation of these local plans that come together, not that this is a perfect world and you are going to have just a single door to go through for the implementation grants.

For example, we have heard a lot here about individual things, the B&I, the IDA programs, tweaking different programs that USDA has, which are really good things to do to improve those. Those are all the pieces. The question is can we have some kind of way of looking at the whole as a more holistic way of following through with funding. If you do a rural endowment initiative and it has mandatory funding around it, it links with and coordinates with other types of things going on. You don't have to maybe make separate applications; you are funding something much more comprehensive in approach. While we want to support planning, the implementation funding for these might be separate tracks that then just help fragment local communities.

I would also say, too, that one of the panelists here mentioned the Federal Home Loan Bank, which is sort of an interesting thing because there is access. What we have been doing at CEI is trying to access private capital. We have leveraged up a lot. We have three equity funds going and all of those are principally targeted to northern New England, and especially Maine.

Now, most of the investment capital for those funds are private. They are small funds and we struggle with creating our own capacity to work on enterprises and new enterprise creation, which is actually what the real challenge is in rural America. We have had some success and we have a lot of banks to pay attention to this. CRA has certainly driven that.

The Federal Home Loan Bank is something like a \$700 billion network of 12 regions throughout this country. I am on the board of directors of the Federal Home Loan Bank of Boston and have been trying to move them toward more equity investment and encouraging their membership to make more equity investment in funds such as ours.

One of the local banks in Maine actually drew down what they call an advance, which comes from Wall Street, and borrowed money at a managed discounted rate so they can manage the interest rate payment back on those funds, and made an equity investment in our fund which doesn't have a current earning.

Now, this is, as I said, a \$600 or \$700 billion gateway to the private capital market. If, in the Farm bill, as someone suggested, you can focus on how we leverage those kinds of relationships through GSE-sponsored institutions, that is just one piece of how to help

empower what we are doing as grass-roots groups and then make sure implementation capital is there, which is the real problem for these kinds of comprehensive strategies we are trying to put together.

The CHAIRMAN. Steve Lane, the independent bankers that I know in Iowa and others I know across the country have been on the front line of being the source of lending not only to farmers, but to people in rural areas, small businesses in our small towns. It would seem to me, taking your idea of leveraging—these are the people who know the area; they know the people who bank there. Usually, these banks have been there a long time and they know the area.

It would seem to me that would be one way that we could leverage it by somehow getting it to our smaller community banks out there, who don't have a lot of deposits, by the way. They have a lot of need for loaning, but they don't have a lot of deposits. Somehow, if we could get access to that to get it to our banks, maybe that might be a way of doing it.

I don't know, Steve, if you have any thoughts on that or not.

Mr. LANE. Well, that is a good idea. Our community banks are always looking for different access to areas of funding to help these small entities. The problem that we have, and maybe this would help, is the expertise in these areas. We are not involved with a lot of these Government programs. Unfortunately, the time that our loan officers go through to work on these loans and applications is frustrating and they don't like to work with them.

The CHAIRMAN. I understand that. In fact, you made some mention about a low-documentation program, like SBA does.

Mr. LANE. Yes. We utilize the SBA low-doc quite a bit. It is a program that is a 2- to 3-page application that we can fill out. We have a 36-hour turnaround in response to other information needed or rejection or acceptance. Some of the USDA programs that we deal with may take three weeks to fill out the forms, and it may take another three weeks before we hear any response back. By that time, there is a new form that needs to be filled out. It is very frustrating sometimes to our loan officers, where they enjoy the low-doc SBA program. Unfortunately, the maximum is a dollar limit of \$150,000, I believe, on the small businesses.

The CHAIRMAN. What is the loan limit on some of our USDA programs?

Richard tells me that the loan guarantee is \$25 million. He also says we probably couldn't do low-doc up that high, but we could do it someplace up there. He says we can definitely do it in the Farm bill. There you go.

Mr. LANE. Great. We appreciate it.

The CHAIRMAN. That is a great suggestion. We could take that mirror image to the SBA program, make it a low-documentation program. I don't know how high we can get it, but we can work on that.

You say SBA is only \$160,000, though?

Mr. LANE. \$150,000, I believe.

The CHAIRMAN. \$150,000. Well, we would have to go considerably higher than that to make it worthwhile.

Mr. LANE. Yes.

The CHAIRMAN. It is a great suggestion. That is something we could do.

One other thing I wanted to bring up was targeting of funds and, how we allocate resources. One of the common criteria is income. The poorer you are, the higher priority. Again, a lot of logic to that, but then there is another proposal or another key, and that is who is going to use the funds in the best and most effective way, who is the most capable.

How we balance that and how we judge that, I don't know. If you just say what is the poorest area and put the money there, that may not be the most viable place right now. Maybe a place that is up a notch but they have the capability to use it and really use those funds and they have good planning, maybe this ought to have some weight. We are wrestling with that.

Do any of you have any thoughts on that?

Mr. Wynn?

Mr. WYNN. I would like to suggest, Mr. Chairman, that one of the things that we are seeing in our region is just that very same thing. We are wrestling with how do we create a capacity to handle those things, and one of the keys that we are seeing is collaboration where groups are coming together to prove that.

You are going to find that that capacity is being created all along, so that you can prove your case that you are ready to receive those funds once they come to your region. Some of the smaller entities that we deal with are not in a position to make the most benefit of some of the funds. We acknowledge that, but if they can be partnered with someone or another entity—

The CHAIRMAN. Regionalize it, you mean?

Mr. WYNN. Regionalized, and bring in collaboration. Some criteria that makes us prove that we are collaborating and working together to the greatest extent possible would be something I would love to see, if it is not already there. Co-ops can do a lot of that in terms of collaborating, bringing that capacity to a region.

Mr. HASSEBROOK. I do think that one of the factors in targeting needs to be looking at population loss because one of the best indicators that an area is devoid of economic opportunity is when it is losing its population. That needs to be a factor as well.

We find in some programs, in a State like Nebraska, like the Rural Business Enterprise Grant Program, because our rural areas are losing population and are not as populated as some other rural areas, those programs don't really extend to States like Nebraska in a meaningful way. We do need to find ways to direct some resources to rural areas that are facing the most severe opportunity crisis, and part of that is being measured by population loss.

The CHAIRMAN. Yes, Mr. Phillips?

Mr. PHILLIPS. Senator Harkin, the target issue is something that is very important and it is one that we have struggled with over the years at CEI on how to advise the Federal Government on policies in that direction.

For us, it ought to be a "both and" in terms of the answer to how one targets; that is, when ought to direct resources to the extent possible to distressed communities and regions that have the kinds of measures and metrics that show that more help is needed. Of

course, the way those resources are delivered in communities is important.

I also think people who are of low income on an individual basis—and also when you break down census tracts, they may be next to a more wealthy area, so pockets of poverty do not show up when looking at rural communities. Our way of looking at targeting is to target both benefiting people as well as a place or a region. I would really strongly recommend that when we do targeting that it is a “both and,” that it is not just a physical location, a place, which I do think is important, but it is also people who reside in these places.

I am from the town of Waldoboro, in coastal Maine, with a 5,000 population. It is a very distressed community within its own right, but it is part of Lincoln County, which is an affluent county and has some of the richest people in the State in that area. They will not show up on the distressed metrics when you look at that particular community.

The CHAIRMAN. Ms. Dearlove?

Ms. DEARLOVE. Another point on this is also where there is innovation going on and a lack of resources to actually bring it to fruition. Just recently, we have been a part of bringing together a coalition of a municipal electric utility, a rural telephone cooperative and a private utility provider to implement, if we can pull it off, actually a first of its kind telecommunications infrastructure in two of our rural distressed counties.

The comment was made earlier about those that are not participating in the Rural Utilities Service program. We have our rural telephone cooperative that also is not accessing those loan programs because of the bureaucracy of the paper. They will not do it. We are looking to fill that role and provide that administrative capacity, be the tamer of the paper tiger and pull this off.

I would like a brief opportunity to remark on telecommunications. This is an optional utility. It is high-risk when it is very rural, and current regulatory restraints on municipal electric departments on how rural telephone co-operatives can use their equity buildup in their telephone utility don't exactly mesh because at this point it is still an optional utility. There is a pivotal, critical role for the Federal Government—I would like to see it through USDA—in rural development, be able to bridge that gap.

High-risk loans are a difficult matter. There does need to be capital infusion to make telecommunications work in these areas. The writing is on the wall of where the private telecommunications providers are not out there. Timeframe is short, in my mind, for rural communities to take advantage and get that infrastructure in place because the corporation centers are already moving. Development is already occurring on this information highway and the rural areas are far, far behind the eight ball on this. There are opportunities, there is innovation at work, but there is a huge gap and there is no source at this time to bridge it.

The CHAIRMAN. One last thing before we close up the hearing. Mr. Hassebrook mentioned segmentation in markets and new markets. I see down the road in agriculture—now, I am getting back basically to farmers—that there are going to be opportunities for, I don't want to use the word “non-traditional,” but for farming that

is not just geared toward production of the major crops—corn, beans, wheat, cotton, rice—but other things.

Maybe now they are niche markets, but they may become bigger markets in the future for food, but also for non-food items, too. Regardless of how you feel about biotechnology—and I happen to be a supporter of biotech—there are going to be opportunities in the future for farmers to grow biotech-engineered crops for pharmaceuticals. In soybeans you are going to see all kinds of new opportunities because of the healthful aspects of isoflavins and the things they can derive from soybeans. I just think you are going to see areas going in that direction.

How do we provide the kind of, first of all, research support, but also the kind of technical and financial support for a farmer and their family who may want to change some of their operation to take advantage of these, but because their investments are already in equipment that is geared toward one type of production and their technical expertise is geared toward that production, they really don't know how?

If they want to, they may see an economic opportunity, but how do you shift a part of your operation over? What do you do? How do you operate it? How do you get access to the markets? All these things, plus the economic support for that, may hold for existing farmers today, but it is also true of young and beginning farmers. They may not have any kind of capital for the big combines and the big planters and stuff that they need to farm the 2,000 acres, but if they could start off with 3, 4, 5, 600 acres, make a good living and buildup their capital, maybe they can get into other things.

I am looking for suggestions along that line and any thoughts you have on how we provide that kind of support for farmers. I see that in a rural development mode, not just for farm income, but in a rural development mode.

You kind of touched on it, Chuck, so if you have any other ideas on it, let me know.

Mr. HASSEBROOK. Now?

The CHAIRMAN. Yes. I have to go vote here pretty soon.

Mr. HASSEBROOK. That is what we want to do with our Agricultural Community Revitalization and Enterprise initiative—

The CHAIRMAN. ACRE. I have read about it.

Mr. HASSEBROOK [continuing]. Commit funding to that so we can make grants to non-profits, to units of government that can be specifically set up to provide technical assistance in making those changes, training in things like e-commerce that help people make those changes. Also we could make grants to a non-profit that might be working with a network of farmers that could then turn around and re-grant some of those funds to those farmers to make those kinds of changes in their operations they need to make to produce for those new markets.

We talk about niches, but the mass market is turning to some extent into a collection of niches, and the niches that provide the greatest opportunities for family farmers and ranchers are those that enable them to add value to the product, to make it unique by what they do, by application of their own management. That is what we are seeing in these premium markets for natural meat, for example. Those are production systems that take more manage-

ment and skill by the farmer, and that is what creates an opportunity because if it is just producing the same thing but using a different seed, it is pretty easy for anybody to switch to that and pretty soon the returns get driven down, just like commodities.

There are great opportunities for farmers to use their management and skill to produce things in ways that make them worth more to consumers. To tap those we have to do what you are talking about, provide more technical assistance, more training, maybe some seed funds, and also funding to develop the new co-operatives to link those farmers with the consumers who want what they have.

The CHAIRMAN. I had a farm family in here last week testifying. I know this family. I was out to their farm; it has been probably 15, 20 years since I have been out to their farm, but they changed all their production practices. Ms. Roseman and her husband were here testifying. She and her husband have 600 acres in western Iowa, around Harlan, out in that area. They have changed their whole production practice.

They have 600 acres. Both he and his wife work on the farm. They have two sons, one in college and one in high school, who work there all summer, plus they have a year-around hired person who they pay to work there on 600 acres. She said they are doing pretty well, but she said it was pretty painful getting there because they didn't have the technical support, nor the expertise. They were production-oriented farmers, as everyone else is. It just took them a long time to get there. They said they didn't really have the kind of capital and stuff, but they just bore up under it for quite a few years and now they are doing all right. That is the kind of thing that maybe we can try to look at helping.

Yes, Jack?

Mr. CASSIDY. Mr. Chairman, if I can add to that, we think the farmer co-ops that are going to be survivors and prospering 5 and 10 years from now are going to fill some of that role.

The CHAIRMAN. You are right.

Mr. CASSIDY. They have to become more than just depository entities for what the farmer produces. They are thinking more and more in terms of the partnership with the farmer, providing the technical expertise. We need to make sure the support system that allows our co-ops to thrive is in place, whether it is the USDA programs or the credit programs that the Farm Credit System provides to those farmer-owned entities. We would encourage you to keep looking at those sorts of things.

The CHAIRMAN. We certainly will. In fact, she said that almost all of the marketing they have done and been able to do has been through co-operatives of one form or another.

Mr. CASSIDY. We are glad to hear that.

Mr. HASSEBROOK. Senator Harkin, I would draw your attention to this book that was handed out, "The New American Farmer," that details many examples of farmers who are doing just the kind of innovative things you are talking about.

The CHAIRMAN. There may be some opportunities out there. I will be very provocative here. We have been thinking for a long time that you have farmers who need off-farm income. Almost all farmers today have some form of off-farm income. Well, how about

maybe some of those who live in rural areas providing some on-farm income? Just turn it around. Those who live in rural areas may have a job or something, but they could, with support and some capital, some expertise and help, maybe provide some little niche areas like that that could be very helpful. I sort of turn it around like that, perhaps the other way, too.

I am going to have to go because I am going to have to vote, but I just want to thank you all very much for all the work you have done in this area of rural development. As I said in the beginning, as we proceed on with this legislation, any thoughts, suggestions, advice that you have we are more than eager to get as to how we really make rural development part of the next Farm bill, and really make it shine and have a major emphasis on it.

Thank you all very much for being here.

The committee will stand adjourned until the call of the Chair.
[Whereupon, at 4:15 p.m., the committee was adjourned.]

A P P E N D I X

AUGUST 2, 2001

Mr. Chairman, thank you for calling this hearing to consider rural economic development issues in preparation for the next farm bill.

I have repeatedly stated that the best rural development program of all is economic growth.

A healthy economy will generate jobs, investment and income in rural and urban areas alike.

Rural America can also gain access to some economic opportunities by connecting to the information technology infrastructure. The information highway offers rural America an unprecedented opportunity to compete on an equal footing with big cities and with other countries. Access to the information network is already bringing jobs, education, and health care services

to rural areas and bringing rural Americans more fully into the mainstream of the American economy and culture. Yet there is also a possibility that some parts of rural America-- which already have lower incomes and lower education levels than the rest of America-- lack access to "on-line" resources and will fall even further behind the rest of the country.

We also need to look at some more basic needs that some communities face. Simply providing drinkable water to residents and providing sewer systems can be financially outside the grasp of some communities. Modern utilities have been delivered to rural America through some of the most successful government initiatives in American history. But this work is

not complete.

The Rural Development title of the 1996

Federal Agriculture Improvement and Reform Act

recognized the need for more local involvement.

The Rural Community Advancement Program

gave states the flexibility to move funds between

the various USDA rural development programs.

However, not all rural places are equally small, remote, or economically specialized, nor are they all declining. Coordinating goals, objectives and funding from federal programs, combined with empowering state and local leaders through direct involvement in providing federal assistance is key to any successful rural community initiative.

I want to take this opportunity to recognize a fellow Hoosier, Ms. Karen Dearlove, of Jasper, Indiana who is here to provide testimony on behalf of the National Association of Development Organizations.

Again, thank you Mr. Chairman and I look forward to hearing today's witnesses.



**Testimony of David Kolsrud
Manager and Member-Owner
CORN-er Stone Farmers Cooperative, Luverne, Minnesota
on behalf of the
National Cooperative Business Association**

**Before the
U.S. Senate Committee on Agriculture, Nutrition and Forestry
Hearing on
Rural Economic Development Issues**

August 2, 2001

**National Cooperative Business Association
1401 New York Ave., NW
Washington, DC 20005
(202) 638-6222**

August 2, 2001

**Testimony of David Kolsrud
Manager and Member-Owner
CORN-er Stone Farmers Cooperative, Luverne, Minnesota
on behalf of the
National Cooperative Business Association**

Good afternoon and thank you, Mr. Chairman and members of this Committee, for the opportunity to testify on behalf of the National Cooperative Business Association about the need for a new source of equity financing to spur economic development in rural areas and other provisions that will help promote and advance cooperatives in rural communities.

I am David Kolsrud and I am the manager and a member of CORN-er Stone Farmers Cooperative in Luverne, Minnesota. CORN-er Stone is a farmer-owned cooperative that processes corn into ethanol through AgriEnergy LLC, in which CORN-er Stone members have a 68 percent ownership stake. I am also a farmer. I grow corn and soybeans on 500 acres. CORN-er Stone Co-op farmer-owners are located in Iowa, Minnesota and South Dakota.

CORN-er Stone is a member of the National Cooperative Business Association. NCBA represents cooperatives and cooperative service organizations across all industries including agriculture, food retail and distribution, childcare, energy, finance, housing, insurance, childcare and many others. NCBA worked throughout last year to build consensus around, and a broad coalition in support of, a new source of equity investment.

Senators in this room know all too well that rural America has not shared fairly in the unprecedented prosperity enjoyed by the rest of the country over the last decade. Median income for residents outside of metro areas is nearly \$10,000 lower than that of city dwellers and is growing at a slower rate.

Though the challenges for rural America are many, among the most significant include both the lack of diversity in our rural economic base and a lack of equity capital for rural business development.

Though I speak from my perspective as a farmer, a member of a cooperative and a co-owner of AgriEnergy, LLC, I can assure you that raising equity capital is daunting for all rural businesses regardless of whether they are owned by members of a farmer cooperative or by independent entrepreneurs, whether they process commodities or produce other goods and services, or whether they are located in the Midwest, on the East Coast or west of the Mississippi. That's made clear by the broad coalition supporting the National Rural Cooperative and Business Equity Fund Act, which would create incentives for investment in an equity fund for rural America and which I urge you to include in the upcoming rewrite of the Farm Bill.

It is absolutely critical for all rural communities that any legislation that seeks to improve the economic condition of rural areas include authority for a new source of equity investment for all rural businesses. And, in a moment, I'll tell you why.

New Generation Cooperatives

CORN-er Stone Farmers Cooperative falls in the category of "new generation cooperatives." NGCs differ from other farmer-owned cooperatives in many ways. Like many other co-ops, new generation cooperatives process commodity into value-added products and market those products on behalf of their farmer-owners.

But the most significant difference for the purposes of this hearing is that to get started, NGCs require their members to invest a significant amount of equity in the co-op and commit a fixed amount of commodity to the cooperative. New generation co-op members bear a disproportionate amount of risk for the potential reward they can expect to receive.

These requirements are necessary because we often sell our products in niche markets. That means the amount of commodity we can profitably process and sell for our members is limited, and therefore the initial number of member-owners and amount of commodity that we can accept is limited.

The result is the high capital requirements of value-added co-ops are coupled with a limited pool of investors – that is, a restricted number of farmer-owners. And particularly in this farm economy, the resources of those members are slim. These inherent equity challenges create tremendous barriers to the development of new value-added cooperatives and other ventures that farmers and others may wish to invest in to improve their income.

Indeed, the lack of equity investment in these types of businesses often means they can't get off the ground. Viable business plans are not the problem. Access to lucrative markets is frequently not the problem. Even access to a substantial portion of the equity needed for debt financing is not the problem; often rural businesses, and even farmer owned cooperatives are able to raise impressive amounts of equity, considering the state of the farm economy. But all too often, though, viable businesses that would bring jobs and income into rural areas either cannot get off the ground, or those that need to expand cannot, because they can't raise enough equity.

CORN-er Stone Farmers' Cooperative

CORN-er Stone's own experience is a perfect example of the problem.

In 1995, several farmers in Southwest Minnesota got together to form a cooperative with the goal of building an ethanol plant. As a group, we spent two years trying to raise equity and secure financing. Due to the capital requirements of the project, estimated at \$21 million, this turned out to be an almost impossible task.

The goal of our equity drive was \$9 million. We were able to raise only \$3 million from 201 farmers, or nearly \$15,000 per member – which is still a substantial investment for our family farm members.

Only with the help of Stearns Bank, local banks which provided subordinated debt, private investors, tax incremental financing from our municipality, a guarantee from USDA's Business and Industry Loan Program, and \$4 million in personal guarantees – some from farmers who put their homes and entire farming operations at risk as a guarantee – were we able to build enough equity to secure debt financing for our remaining capital needs.

In just our first three years of operation, AgriEnergy, LLC has generated over \$50 million in additional revenue through value-added processing, created 28 high paying jobs and returned to our co-op member-owners a dollar per bushel over the market price in the form of a value-added payment.

This success story almost never happened because of the difficulty we faced in raising equity capital. We came very, very close to abandoning the project.

Equity Challenges Facing Cooperatives and Other Rural Businesses

In order for more viable businesses like CORN-er Stone to get off the ground, rural America needs a source of equity investment. There are hundreds of examples of how equity constraints are limiting the ability of farmers and others in rural America to increase income and quality of life in our communities.

Here are just a few:

In 1996, Northern Plains Premium Beef Cooperative had a functioning board of member-ranchers, a CEO and full time staff who, together, put together a sophisticated business plan to build a value-added new generation co-op. The co-op's equity drive collected nearly \$12 million – a staggering amount – in equity from ranchers across the Northern Plains – just under half its drive goal of \$25 million. But in the spring of 1997, the co-op disbanded after it was unable to raise additional equity and state law forced it to return the equity it had raised.

There is no question that the co-op would have provided a new source of income for the ranchers who had committed equity capital, ranchers who were facing low cattle prices. A scaled down version of the co-op exists today as the Dakota Beef Co-op, but hasn't come close to the vision for the original co-op.

Natural Meat Cooperative, owned by ranchers in Colorado, Wyoming, Montana and Nebraska helps improve farmer income by targeting sales to the fast growing natural foods market at retail. Natural Meat Cooperative is currently looking for an equity partner so it can purchase an existing natural meat processing facility that already has strong market penetration and brand loyalty. Successful retail penetration is critical to the long-

term success of the co-op. But to do that, they need an equity partner. Their efforts to buy an existing facility have stalled because that partner has been hard to find.

And more recently, Mountain View Harvest Cooperative, a Colorado-based new generation cooperative owned by wheat farmers that produces baked goods, was able to raise the equity capital it needed to buy a facility several years ago. It has been wildly successful. But as the business has grown, the co-op needs another bakery. And that requires equity. Lots of it. The co-op has had to consider bringing in private investors, which could reduce the farmer-control and with it, the size of producer returns.

Though Mountain View was ultimately able to find an investment partner in a large federated farmer-owned co-op, that deal may not be realized as the partner has suffered from decline in the rural economy.

Rural businesses of all types face these challenges. The fact is, with a few exceptions, it is hard to attract equity investment to our rural communities in a manner that keeps income in the rural communities.

Fortunately, there is a solution.

The National Rural Cooperative and Business Equity Fund Act

Last October, Chairman Harkin and Senator Craig introduced the National Rural Cooperative and Business Equity Fund Act along with a bipartisan group of cosponsors. Similar legislation was included as part of S.20 introduced earlier this year by Senator Daschle. On behalf of NCBA and other members of the equity coalition, thank you Mr. Chairman, and members of this committee who cosponsored that legislation, for your support and leadership.

The legislation takes a unique approach to the economic challenges facing rural America. It would create a public/private partnership designed to attract equity investment into cooperative and other business ventures in rural America.

Why is this so critical?

As the above examples and hundreds of others like them make clear, often the most insurmountable barriers that would-be rural businesses and cooperatives face is obtaining equity investment needed to leverage both traditional and government sources of debt financing. Existing rural development programs administered by the U.S. Department of Agriculture provide some support in guaranteed loans, but still fall short of the need. And as evidenced by the support of the legislation by both the American Bankers Association and the Independent Community Bankers of America, and by our community lenders in Luverne, there is no shortage of lenders for rural business development. But lenders interested in investing in their communities must still require equity to secure their loans.

The National Rural Cooperative and Business Equity Fund Act, will encourage private investment in value-added agriculture enterprises, producer-owned and other

member-owned cooperatives, and other projects that existing venture capital funds do not accommodate.

Briefly, the legislation introduced last year and included in S. 20 does the following:

- Authorizes the creation of a private corporation that would operate the Equity Fund.
- Provides the Secretary of Agriculture and two of her appointees with seats on the Fund's 12-person Board of Directors. The remainder of the Board will be made up of representatives of authorized investors, such as commercial banks, cooperative banks and other institutional investors.
- Provides incentives to attract private investment in the Fund from entities listed above. Those incentives include a federal match to private investment, a 50 percent guarantee, and authority for the Fund to take out loans from private investors that are 100 percent guaranteed by the federal government.
- Requires a business applying for equity from the Fund to be sponsored by a local entity, such as a bank, a regional or local development council, a cooperative, or a community group.
- Promotes private investment in value-added agriculture enterprises, producer-owned cooperatives, and other projects in rural America that have difficulty attracting venture capital.
- Prohibits the Fund from competing with conventional sources of debt financing.
- Requires the Fund to invest in a diverse range of viable projects, representing a variety of business structures operating in rural communities of diverse size.
- Requires cooperatives and other businesses receiving equity from the Fund to invest a substantial amount of their own capital.

Investments made under this legislation will provide off-farm income, additional markets for agricultural products, and new business opportunities in rural communities.

Equity Capital Must Be Made Available to All Types of Rural Businesses

Now, a word of caution: Rural America will benefit most if any new source of equity investment is available to all rural businesses including co-ops and non-co-ops and both agricultural and non-agricultural businesses. It is not just a matter of geographical fairness to those areas of the country without a lot of crop production, it is a necessity if rural America is to diversify its economic base and withstand fluctuations in the farm economy. Farmers and others in rural communities should be able to invest in ventures that improve economic growth regardless of whether they involve processing agricultural commodities.

In my own community of rural Minnesota, I can identify several non-crop related needs for equity investment. A venture we're evaluating to augment farm income is energy production from wind turbines. Though a wind turbine operation would be capital intensive, it also has the potential to generate huge economic benefits for farmers. Wind is free and turbines can be located in economically depressed areas, and on farmland.

Forestry cooperatives create another source of non-commodity income for farmers and others who own small woodlots in the countryside. Several forestry cooperatives have been formed in Wisconsin to allow farmers to harvest the wood from their lots in a manner

that generates a sustainable revenue stream over time. Too often, farmers are given the choice by paper and wood companies of cutting all of the wood on their lots or none of it. But forestry cooperatives, particularly if they can build their own kiln and other facilities, can create new markets and a source of long-term income for farmers.

These are just a few of the types of businesses that rural Americans could develop if they had greater access to equity capital.

The National Rural Cooperative and Business Equity Fund Act is supported by a broad range of organizations, including the National Cooperative Business Association, the National Rural Electric Cooperative Association, the Rural Telephone Finance Cooperative, the National Rural Utilities Cooperative Finance Corporation, the Farm Credit Council, CoBank, Agribank, the National Cooperative Bank, the National Farmers Union, the American Bankers Association, and the Independent Community Bankers of America. Two of those organizations are testifying in favor of a new source of equity investment for rural America at today's hearing. Other members of the coalition have indicated their support in testimony before the House Agriculture Committee.

Resources Needed for Cooperative Development

The Committee should also include additional provisions in the upcoming Farm Bill that will enhance economic growth and promote the development of new cooperatives.

The Rural Cooperative Development Grants Program

Funding for the Rural Cooperative Development Grants program should be made mandatory. Currently, the program, the only one administered by USDA that is devoted solely to developing new cooperatives in rural areas, is subject to appropriations. Though it is authorized at \$50 million annually, it has yet to achieve appropriations that reach even 10 percent of that level. The program is too important to rural America, and subject to far too much demand to linger at these funding levels. We urge the Committee to make this program mandatory.

Housing for Rural Seniors

Another unmet need in rural America is senior housing. Far too often in our rural communities, our seniors, retired farmers and others, who no longer wish to maintain their own homes, are left with two choices: leave the community in which they've lived and raised their families in order to find affordable multi-family housing, or enter an assisted living facility that offers far more services than able-bodied seniors need.

Rural senior housing cooperatives are a proven method of ensuring that seniors retain equity ownership while remaining in their communities with family and trusted friends. My state of Minnesota is home to seven rural senior housing cooperatives. A recent USDA funded survey of those residents, carried out by the Cooperative

Development Foundation, indicates overwhelming satisfaction with the housing option, with nearly 80 percent of the residents stating that living in the co-op has positively contributed to both their health and life satisfaction. It is no surprise. Not only can they continue to socialize with friends and family, they control the co-op. The seniors, as owners, get to decide what services will be offered to them, when, and for how much; they make decisions on the financial management of the cooperative; and they hire and fire staff. They're in control.

Unfortunately, the pre-development cost of housing cooperatives is often prohibitively high, the expertise in cooperative housing is limited (few developers have it), and there are few sources of federal or state funding to help communities develop this type of housing.

Upcoming farm legislation should include a dedicated and mandatory source of grant funding to aid those experienced in cooperative development in the planning and other pre-development costs associated with creating new rural senior housing cooperatives.

Cooperative Coordination within USDA

Finally, we urge this Committee to include a provision within the Farm Bill that would establish a permanent standing intra-departmental cooperative council made up of all the USDA agencies that have missions that directly or indirectly affect cooperatives. The Council should evaluate how it can better make USDA programs available to cooperative business, how to address barriers associated with cooperative development, and develop a Department wide strategic initiative for cooperatives in rural America. This should include all of the agencies within Rural Development – the Rural Business Cooperative Service, the Rural Utilities Service and the Rural Housing Service – as well as agencies such as the Forest Service, which plays a role in forestry cooperatives, the Natural Resources Conservation Service, which can assist farmers and other cooperatives through its Resource Conservation and Development Program and the Foreign Agricultural Service which administers foreign aid and export programs that help cooperatives expand their markets overseas.

The Department has for too long lacked a unified strategy for advancing all cooperatives in rural America. A requirement to establish a Department-wide strategy for cooperative advancement across all types of co-ops (housing, electric, agriculture, utility, forestry, and others) would go far in helping the owners of rural cooperatives – the residents of rural America – enhance their income and improve quality of life in rural America.

Thank you, again Mr. Chairman and members of this Committee for this opportunity to testify.

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**Testimony of Ronald L. Phillips, President
Coastal Enterprises, Inc.
Before the
Agriculture, Nutrition and Forestry Committee of
United States Senate**

**Hearing on Rural Development Issues and the Farm Bill
August 2, 2001**

Introduction

Mr. Chairman and Ranking Member Lugar, thank you for inviting me to testify before you today as you debate and craft rural development policy for the 2002 Farm Bill re-authorization. My name is Ron Phillips and I am President and founder of Coastal Enterprises, Inc., based in Wiscasset, Maine.

I am here today on behalf of an informal coalition of rural non-profit organizations that are working together to promote federal rural development policies. Coordinated by the National Rural Housing Coalition, we are exploring ways to reinvigorate federal rural development policy and increased attention to the needs of our nation's farming communities and small towns.

Coastal Enterprises, Inc. is a rural community development corporation and financial institution providing financial and technical assistance to support the development of small businesses, community facilities, and affordable housing, primarily in the State of Maine. Founded in 1977, Coastal Enterprises, Inc. has been serving communities in rural Maine for nearly three decades. Our mission is to help people and communities, especially those with low incomes, reach an equitable standard of living, working and learning, in harmony with the natural environment. Since our founding, we have created or sustained 10,000 jobs, invested over \$200 million in economic development, and assisted over 8,000 small businesses. We understand how community development works, why it is important, and why it's important to rural communities.

Rural America warrants Congress's highest attention as it considers re-authorization of the Farm Bill. The Farm Bill not only is important to our nation's farmers, it is critical to the 54 million Americans who reside in our rural communities, 90% of whom rely on non-farm income to sustain themselves. In re-authorizing it, I urge you to seize the opportunity to provide rural America with a vision for the future and resources it needs to achieve it.

One new idea that I will discuss today with you is that of the Rural Endowment Act. The idea behind the Endowment is that rural community development works best when it is driven by local needs and considers not only the economic development needs of rural communities but also accounts for a communities' social and environmental needs. The

Endowment is about creating permanent assets in a community that will continue beyond the initial federal investment.

The state of Rural America is in decline. Far too many rural counties are beset by problems of isolation, crumbling physical infrastructure, a declining or radically changing agricultural sector, and lack of social, economic and professional opportunities. As a result, there has been a surge of out-migration from communities in America's heartland, overwhelming growth in regions that offer natural amenities, and haphazard growth into rural areas juxtaposed to metropolitan centers.

Consider these facts:

- Of the 250 poorest counties in America, 244 are rural
- America's richest food producing region – California's Central Valley - has an unemployment as high as 15%, triple the national average
- 1 million rural households in America lack indoor plumbing
- 28% of the housing stock in rural America is considered physically deficient, lacking adequate plumbing, heating, and electricity
- 22.7% of children living in rural America, live in poverty compared to 19.2% in urban areas
- During the 1990's one-third of rural counties captured three-quarters of all the economic gains in rural areas¹

The recent good economic times never made it to many rural areas. The downturn in many natural resource based economies has taken its toll on our small town and farming communities. Small, family farmers whose economic and social livelihoods are often tied to the communities in which they live have reaped far fewer benefits from reforms in federal agriculture support programs. Disinvestments in mining and logging and wholesale plant closings are now a regular part of the rural landscape. Persistently poor rural regions that provided incentive for America's "War on Poverty" continue to battle decline and poverty alone without a sense of national urgency or national leadership – and are close to giving up on ever turning things around.

As these trends have taken shape, there has been a stagnation or reduction in rural development programs that the Federal government provides to America's rural communities: programs that were once the bedrock of the Federal Government's commitment to rural America have seen diminishing financial and staff resources, such as USDA's housing, water and sewer, and electric utility programs. Over the last several years, federal support for rural development activities has been reduced by \$500 million annually at the U.S. Department of Agriculture and other federal agencies have not picked up the slack.

In addition to dwindling federal resources, private capital investments over the last decade have predominantly flowed to a few urban/suburban areas. For example, about 50% of the venture capital invested during the fourth quarter of 1998 went to just two

¹ Kansas City Federal Reserve Bank proceeding on Rural Development Policy, Mark Drabestott

regions – California’s Silicon Valley and New England’s high-tech corridors. Another 16% went to the greater New York, Los Angeles/Orange County, and Washington, DC, metropolitan areas. Only 5.7% of all venture capital investments went to the South central, Southwest, and Northwest regions combined.² Notably, all three regions have significant lower-income, typically rural populations.

So, it is very difficult for most rural communities, to assemble capital and prepare the infrastructure necessary to promote economic growth and community improvements.

Rural Development Leadership at the USDA is Important

USDA is the only federal agency with a mandate to provide comprehensive assistance to America’s rural communities. The programs operated by the Department provide invaluable assistance to small rural communities that do not have the tax base to raise these resources on their own. USDA has some very good programs serving rural America’s housing, business, water and utility needs but they are perennially under-funded and over-subscribed.

One of the key USDA programs that we at Coastal Enterprises use is the Intermediary Re-lending Program, known as the IRP, which is one of the principal sources of federal funding available to assist rural small businesses. IRP funds can be used to finance a range of activities including community development projects, new business capitalization and expansion of existing businesses. Funds can be used to cover the cost of construction, conversions or expansion of a business facility, the purchase or development of land or facilities, start up operations or working capital. The flexibility of the program allows IRP intermediaries, such as Coastal Enterprises, Inc., to respond to the unique needs of businesses in their service area. One suggested improvement for the program is to institute a preferred lender program through which intermediaries with a proven track record in lending performance and demand for funds can access IRP funding through an expedited process.

The IRP is a very good example of how federal government can partner with private non-profit community development organizations in a way that is efficient, flexible, and effective. Since USDA has administered the program in 1994, there have been no defaults of IRP loans to USDA. A recent survey of eight longstanding IRP intermediaries demonstrates the program’s successful track record: Of the \$30 million in IRP funds under management, \$173 million in additional financing, primarily from private banks, was leveraged; the eight intermediaries originated 974 IRP loans totaling \$52 million with an average loan of \$107, 613; and, as a result of IRP financing, these intermediaries created and maintained 16,551 jobs at an average cost of \$3,196 per job.

Over the last five years demand for IRP funds has consistently outweighed the availability of funds and the application process has become increasingly competitive. In FY 2000, USDA reviewed 144 applications for IRP funds totaling more than \$96 million in demand but had only \$38 million available. At the start of FY 2001, with \$38 million

² PricewaterhouseCoopers, Money Tree Survey Report, February 24, 1999.

available for the year, USDA already had 40 applications worth more than \$25 million in demand. Clearly the need for more assistance exists.

Additional USDA programs designed to provide business investment resources to small rural businesses include the Rural Business Opportunity Grant Program and the Rural Business Enterprise Grant Program. Both these programs should be maintained and if anything, authorization amounts should be significantly increased. I would also urge this Committee to reauthorize and seek funding for the Rural Venture Capital Demonstration Program permitting the use of federal funds to guarantee a certain level of investment in venture capital pools. Equity capital is the hardest type of investment capital to pull together in rural communities but is often the most necessary for small entrepreneurs just starting out. The Rural Venture Capital pilot would enable USDA to select up to 10 community development venture capital organizations to establish a Rural Private Business Investment Pools. These pools would be designed to attract private sector investments and funds from the pools would be used to make investments in private business enterprises in rural areas. Although authorized in the last Farm Bill, this program was never funded.

Another critically important issue for rural communities is that of safe and clean water supplies. In this area, USDA's water and environment programs provide core funding support for small rural communities of less than 10,000. However, the need continues to far outweigh the resources Congress dedicates to the problem. In a recent inventory of our nations' water infrastructure needs, the Environmental Protection Agency (EPA) estimated that \$33.3 billion is necessary to meet current drinking water needs of small community water systems serving rural communities of fewer than 10,000 and \$14.5 billion is required to meet future needs over the next 20 years; EPA further estimated that \$13.8 billion is required to meet clean water needs of small communities of 10,000 or fewer. In all, small communities will need to identify some \$61 billion in order to meet their water and wastewater needs.

These numbers are daunting for communities of less than 10,000. The numbers become even more daunting when one considers the disproportional burden small communities carry compared to larger urban systems: households in small communities bare four times the costs of installing and maintaining water and wastewater systems than do households located in larger communities. Small rural communities simply do not have the taxpayer base to support the amount of resources needed.

USDA's water and environment programs receive high praise for their flexibility and for targeting of small rural communities in greatest need of support. However, federal budget cuts in the USDA's Rural Utilities budget has resulted in a FY 2000 funding level adjusted for inflation worth only 85% of FY 1995 levels. A recent evaluation of USDA's Water and Environmental Programs conducted by the consulting firm of Rapoza Associates found that most USDA State Rural Development Directors have 1.5 to 2 times the number of applications for water and sewer funds than funds available. The study

also found that of those projects approved for funding, between 2 and 6 times the amount of funding actually available is required.³

An improvement on the way resources are allocated to small communities water and wastewater systems would be to authorize a revolving loan fund for pre-development and repair costs that intermediaries would administer and that would prioritize small communities of populations of 2,500 or smaller. These small communities have greater difficulty pulling together financing for pre-development costs associated with installing water and wastewater systems as well as costs associated with repairs and maintenance. The consequence is that they either forego installing centralized systems or forego repairing systems already installed. A way to address this financing gap would be to establish a separate revolving loan fund that could support individual project loans not exceeding \$300,000.

Quality, affordable housing is another major issue facing rural America. While much media attention has focused on the urban housing crisis, there is another housing crisis and that is in rural America. It is a crisis borne of a historic lack of resources to address the underlying problems of lack of decent housing and low incomes. However, the recent downturn in the natural resource based economies of rural areas when coupled with the dramatic reduction in federal rural housing assistance, have exacerbated an already serious situation. It is without exaggeration to say that most low-income rural families have virtually no option to improve their housing situation.

Rural areas have a disproportionate share of the nation's substandard housing. More than 1.6 million low income rural households live in moderately to severely inadequate housing. These are units without hot or cold piped water, and/or have leaking roofs, walls, rodent problems, inadequate heating systems, and peeling paint, often lead-based. Overall, more rural families live in inadequate housing than their urban counterparts, with 2.6 million rural residents living in inadequate homes compared to 2.4 million in cities and 1.3 million in the suburbs.

Some 28% of rural American households -- 10.4 million -- have housing problems. For rural renters, the rate of housing problems is higher. A third of all rural renter households are cost burdened, paying more than 30 percent of their income for housing costs, almost one million rural renter households suffer from *multiple housing problems* -- 90% are severely cost burdened, paying more than 50% of their income for rent; *60% pay more than 70% of their income for housing.*

In short, rural families are the worst housed in the country.

There is a high incidence of poverty in rural America. In 1996 the poverty rate in rural America was 15.9%, compared to 13.2% in urban areas. Minorities in rural areas have

³ Water and Wastewater Systems In Rural Low-Income Communities: An analysis of the USDA Rural Utility Services Water and Environmental Program's Loan and Grant Program for fiscal years 1995 to 2000 (Robert A. Rapoza Associates, January 2001)

much higher rates of poverty, with an average of 34.1% compared to urban minorities at 28.1%. Persistent poverty is also a major problem. Early data from the 2000 Census indicates that rural areas have made little progress in moving people from welfare to work.

There is also an inadequate supply of affordable housing. Many small, rural communities have only a limited number of available homes, and only a few that are affordable to low- and moderate-income households, with those often in need of extensive repair or improvements. While everyone agrees that there is a shortage of affordable housing in rural areas, there is less agreement on why the market does not produce the kind of housing to meet these demands.

Over the last decade, there was a substantial decline in federal support for federal housing programs. Spending for loans for low income single family home ownership was reduced by more than half and lending for rural rental housing is all but eliminated.

There is ample evidence that other federal agencies are not picking up the slack. FHA spending on rural areas is \$24 per capita versus \$240 per capita for big cities. Only about 10% of HUD section 8 resources get to rural areas.

There are a number of important steps that Congress can take to improve rural housing conditions. They include expanding funding for low income home ownership loans. The current lending is \$1 billion and there is a backlog of some \$5 billion.

Additional funding is also needed to preserve and maintain the existing portfolio of rural rental housing projects. There are over 450,000 units of rural rental housing, mostly occupied by low income and elderly households. Many of the developments need rehabilitation and Congress should provide funding for incentives for long term, low-income use.

Finally, there is a desperate need for additional, new rental housing units in rural areas. Congress should consider the enacting S.652, the Rural Rental Housing Act of 2001. This legislation, sponsored by Sens. Edwards, Jeffords, Leahy and Wellstone, authorizes flexible funding to states and other intermediaries to finance rental housing in our small town and farming communities.

**Community-based Non-profit Organizations:
An Important Partner for Rural America**

Community-based development organizations have proven to be innovative and entrepreneurial community leaders that can work with a broad array of community stakeholders to advance a community's economic development agenda. We have learned many lessons in what works and what doesn't in helping rural communities achieve vibrant communities: government alone is not the answer but federal commitments to an area can attract private investments; collaborative private/public partnerships do work;

and, community-driven strategies are often the best strategies for sustaining results over time.

Community development corporations are quickly becoming key partners in a community's development efforts. We number over 1700 nation-wide, 53% of which serve rural communities solely and 47% serving a mix of rural and urban communities. A handful of mature community development organizations began in the late sixties and early seventies, however the median year of incorporation for organizations serving rural communities is 1989.

Although fairly young as an industry, community development corporations (CDCs) have had profound effect in the communities they serve. In the area of housing, CDCs have developed over 40,000 rural homes, made nearly 10,000 loans to rural home-owners amounting to over \$100 million, and repaired nearly 50,000 rural housing units. In the area of essential facilities in rural communities, both industrial and non-industrial, CDCs have developed over 5 million square feet and have over \$44 million in loan capital outstanding. And, in the area of business creation and jobs the track record continues to be strong: rural CDCs have assisted over 7,000 businesses, created over 34,000 jobs and have made business investments totaling over \$160 million.

Aside from housing and business development, community-based non-profit development organizations provide a number of different services depending on the need of the particular community served. Our services often include childcare, education and job-training, healthcare, nutrition and hunger reduction, eldercare, and arts and cultural services. The services we provide is really driven by what a community needs.

One of the reasons for CDCs success is the financing package they are able to pull together. A recent survey of community development corporations by a national trade association serving the industry found that rural CDCs attract income from the private sector, generate income through fees on services performed, and receive funding from public sector programs. From the private sector alone, CDCs receive financing from banks, corporations, foundations, national intermediaries, religious institutions and the United Way.

CDCs often provide financing of last resort to businesses and individuals who do not have the credit history or the capital needs to receive conventional financing for their businesses or homes. Because CDC's mission is the double bottom line, to achieve a social as well as a financial return, we are often the only community institution that low-income populations can turn to.

One program designed to increase the capacity of community development corporations is the Rural Community Development Initiative that was first passed last year and is administered by the USDA. The program provides matching grant resources to help local organizations establish and develop community-based organizations where none exist. CDCs work particularly well in rural settings because they are able to fill a void that is created by lack of taxpayer resources to support a large government structure. Rural

communities typically have only one or two full-time clerks who handle everything from marriage licenses to building permits. Community non-profit development organizations help these communities meet development needs they otherwise could not meet themselves.

The Maine Story:

The state of Maine is famously beautiful, but it poses contrasts as sharp as the ledges along its rugged coast. With a population of 1.2 million, Maine is the 3rd most rural state in the nation and the only state to become more rural in recent years. Fully 35% of Maine's households are within 200 percent of the poverty level and face the lack of opportunities and community disintegration that have become the hallmarks of rural poverty. Changes in the structure of the Maine economy, most notably the decline in the manufacturing and natural resource sectors, have had a dramatic impact on Maine workers.

Between 1989 and 1999, Maine's manufacturing sector had a net loss of about 21,000 jobs, many of them defense-related. Many of these lost jobs have been replaced by low-wage, part-time jobs, leading to an erosion of Maine's middle class. In Maine during 1998 alone, 35,079 jobs were created in industries paying an average annual wage of less than \$20,000, while only 12,645 jobs were originated in industries paying \$30,000 or more in average annual wages. As a result, an increasing number of Maine households find themselves in higher debt, without health benefits, and low or no retirement savings.

Agriculture and natural resource-based sectors have fueled much of rural Maine's economy, however these industries are under severe pressure and are in decline. The lumber industry is experiencing the pangs associated with declining prices. Mills in northern Maine have been shut down recently, if only temporarily. The lumber industry is facing an even more uncertain future with the recent expiration of the Softwood Lumber Agreement with Canada. U.S. lumber prices are at a nine-year low and sales of softwood lumber have fallen precipitously. Depending on the outcome of trade negotiations, Maine sawmills may be faced with intense competition from their counterparts in Canada.

Farming has been a way of life for Maine families for hundreds of years and employs over 60,000 Maine people. However, increasing land development pressures and global competition from larger farming enterprises in recent years have made small farm ownership uneconomical, forcing many Maine farms out of business. In 1950 there were about 35,000 farms in operation throughout the state; today there are just 7,400. Maine farms generate about \$500 million in sales each year, with another \$800 million in associated food processing. Those farms occupy 600,000 acres of cropland and about 600,000 more acres of forests and other land. However, in the last 20 years, the amount of Maine land used for farming declined by over 350,000 acres.

When the land is no longer used for agricultural production, farm-based jobs and lifestyles disappear, and the rural landscape becomes fragmented by development.

Coastal Enterprises, Inc. works with communities and businesses to find ways to sustain these sectors that Mainers have relied on for years. Our investments are guided by our commitment to serve low-income people who require not just a paycheck but a livable wage with benefits.

Coastal Enterprise investments include:

- Maine Coast Organic Products that recycles salmon, blueberry and mussel waste into high-end, value added garden compost;
- Cuddledown of Maine, a manufacturer of premium-quality bed-and-bath merchandise;
- Misty River Trucking, a woman-owned and operated long-haul trucking brokerage firm;
- Maine Farms Projects that supports local Maine Farmers and raises awareness of the importance of agriculture and food systems in our lives; and,
- Ward Brook, a nine unit affordable housing complex for single mothers in transition from welfare to work.

One of the main reasons we have been so successful is that we have aggressively found ways to provide affordable financing for deals that larger financial institutions would not serve. As such, we understand the critical need for flexible capital that can provide alternative ways for entrepreneurs and rural communities to finance projects they would otherwise be unable to afford. I would especially like to emphasize the need for rural equity capital that I spoke of earlier in my testimony. This type of financing is critical to small entrepreneurs who cannot leverage debt financing.

The Rural Endowment Initiative: Building Permanent Assets in Communities

Recent federal policy has moved away from giving rural communities the resources needed to improve housing, infrastructure, economic opportunity and environmental quality. In particular, the demise of federal rural development programs, when coupled with the downturn in many natural resourced based economies has made life in rural America increasing difficult.

We have developed a Rural Endowment program that is designed to make a permanent resource available to our nation's small town and farming communities. The Rural Endowment combines lessons learned from decades of government programs with lessons learned from decades of work with community-based development strategies. It is designed to spur the creation of long-term assets in a community, grow capacity among community leaders to conduct on-going community development efforts beyond the initial federal commitment, and create real opportunities for improving the quality of life outlook for residents of rural America.

In particular, the Endowment is designed to take advantage of the skill and expertise of the network of rural community based organizations that are increasingly at the center of community development activities in rural America. The success we have had in Maine

is replicated in many other communities across the country by other important local organizations. For example, in the San Joaquin Valley of California, Self Help Enterprises has constructed more than 4,000 homes for low income and farmworker families using the self help housing method of construction. In Eastern Kentucky, Kentucky Highlands Community Development Corporation administers the enterprise zone in three extremely poor counties. The most recent statistics indicate that one in three households in those counties have someone employed by a private business enterprise that has received financing from Kentucky Highlands.

The Rural Endowment Initiative has the following features: a flexible source of funding that would support various development projects including business investments and job creation, real estate projects, community facilities programs, and conservation measures; enables communities to create of a permanent fund to remain after the initial government investment period concludes thus creating a long-term local financial asset; it requires an inclusive, community-driven investment strategy that incorporates economic, social, cultural and environmental matters is required; it promotes accountability by requiring clear, performance-based outcomes for continued federal investment; and, it would provide capacity-building assistance for a community to establish a non-profit community development entity.

The Endowment would be targeted to communities that make balanced community development investments according to their unique situations. Communities that are able to sustain themselves over time will be those communities that successfully incorporate environmental health and cultural and social well-being measures to meet quality of life goals for its residents. Far too many rural communities lack the resources to address the range of social and economic needs they confront. Far too many rural communities are unable to get such flexible resources from other federal or state agencies.

We urge this Committee to adopt this initiative as a centerpiece for the Rural Development Title of the Farm Bill.

Conclusion:

In this next Farm Bill, Congress has an opportunity to lay-out a vision of rural America that captures our ideals of what rural American can be: a place where we live, a place where we work and a place where we recreate. This involves expanding our way of thinking about resources we spend and the priority we place on thinking about how policies affect rural communities.

Our first recommendation is to urge this Committee to take a serious look at the Rural Endowment program and adopt it as the centerpiece of rural development policy in the reauthorized Farm Bill. Communities that are able to sustain themselves over time will be those communities that successfully incorporate environmental health and cultural and social well-being measures to meet quality of life goals for its residents. The Endowment is about helping rural communities build permanent assets in a way that is both comprehensive and community-based. It also recognizes that rural areas differ from

region to region and face a variety of challenges including economic development, social well-being and environmental health. The Rural Endowment initiative would provide rural communities with flexible resources to achieve their development goals.

Second, the current housing, infrastructure and business development programs at the USDA are working and should continue as they are. The USDA has developed the skills and experience to administer these programs well. Some improvements to these programs are warranted and are discussed in our testimony. I would be happy to provide more information on ways to improve these programs' efficiency and effectiveness. One common denominator among all of them is that more resources are needed and we would urge the committee to increase authorizations for them and work with appropriators to meet the targets.

Finally, rural America's issues, policies and programs are far too often relegated to the back burner in Washington. We urge the Committee to mandate the establishment of an assistant secretaries working group on rural development. The purpose of such a group would be address over-arching policy issues, improve coordination between federal agencies and ensure that rural issues do not get lost in federal policy deliberations.

CENTER *for*
RURAL AFFAIRS



**Testimony of Chuck Hassebrook
Center for Rural Affairs
Walthill, Nebraska**

**Before the
Committee on Agriculture, Nutrition and Forestry
United States Senate**

Hearing on Rural Development in the Farm Bill

August 2, 2001

**Testimony of Chuck Hassebrook
Center for Rural Affairs
On Rural Development in the Farm Bill**

Mr. Chairman and members of the Committee, thank you for the opportunity to testify on how the new farm bill can create genuine opportunity in the farm and ranch communities left out of the nation's prosperity.

The farm and ranch communities of the nation's heartland are in the midst of an opportunity crisis. Our study, *Trampled Dreams*, analyzed income and opportunity in the farm and ranch counties – those with more than 20 percent of income earned from farming or ranching – in the states of Iowa, Kansas, Minnesota, Nebraska, North Dakota and South Dakota.

We found that poverty rates in farm and ranch counties exceeded those in the region's metropolitan counties by 50 percent. Incomes were 17 percent lower than in metropolitan counties. Over 1/3 of households had incomes below \$15,000.

Those problems persist. In 1999, half of the nation's 20 lowest income counties were farm and ranch counties in Nebraska and the Dakotas. (Four of the Dakota counties also included reservations.) The nation's two lowest income counties were Nebraska farm and ranch counties. Nationally, 243 of the 250 poorest counties in the nation are nonmetropolitan.

These low-income rural areas – particularly low-income agricultural counties - are suffering continuous population loss. There is a near continuous streak of decreasing population from the Canadian border of Montana and North Dakota south through Texas in addition to areas in the Mississippi Delta, Appalachia and northern New England.

Most troubling, there is growing momentum for this rural population loss. According to Census Bureau data, 600 nonmetropolitan counties lost population from 1990 to 1995; from 1995 to 1999, 855 nonmetropolitan counties – a 42.5 percent increase – lost population.

Roots of the Problem

The growing concentration of the nation's lowest income counties in agricultural areas reflects several facets. First, these areas remain agricultural because non-agricultural development strategies have not worked for them.

They lack the natural environmental amenities to become tourist or retirement economies. They are too remote to become manufacturing centers. Their only natural economic asset is their agricultural land base and by and large, their fortunes have risen and fallen with the contribution of agriculture to the rural communities.

The contribution of agriculture to these communities is falling. The farm and ranch share of profit in their food system and the role of farmers and ranchers and their communities in food production is shrinking. The role and profit share of other sectors of the food industry – especially the farm input sector – are growing. Were the farm and ranch share of food system profit to continue falling at historic rates, it would reach zero by 2030, according to research by Stewart Smith, agricultural economist at the University of Maine and former senior economist with the Joint Economic Committee of the United States Congress.

This decline stems from several sources. Both public and private agricultural research have focused on developing expensive new products and production systems that enable the input sector to sell more to farmers and ranchers to enable farmers and rancher to do less. The input sector does more to control weeds today and farmers do less. Thus, the input sector gets paid more to control weeds and farmers earn less. Largely, those products are produced and profit captured not in the rural community but in larger population centers or distant metropolitan areas.

Changing structure also threatens the contribution of agriculture to rural community development. The age distribution of farmers and ranchers is a ticking time bomb for rural communities. In 1978, there were about 350,000 farmers and ranchers 35 years or younger in the U.S. In 1997 there were fewer than half – 150,000.

Historically in the nation's heartland, agriculture was a source of middle-class self-employment opportunity. But today, the industrialization of agriculture is replacing self-employment opportunities with low wage labor.

In a background paper for the former Congressional Office of Technology Assessment, University of California-Davis anthropologist Dean MacCannell summarized the research on the implication of that change for life in the rural community.

Everyone who has done careful research on farm size, residency of agricultural land owners and social conditions in the rural community finds the same relationship: As farm size and absentee ownership increase, social conditions in the local community deteriorate.

We have found depressed median family incomes, high levels of poverty, low education levels, social and economic inequality between ethnic groups, etc., associated with land and capital concentration in agriculture.... Communities that are surrounded by farms that are larger than can be operated by a family unit have a bi-modal income distribution, with a few wealthy elites, a majority of poor laborers and virtually no middle class.

That is not progress. That is social decay.

Strategies for the Future

We must focus on where opportunity will reside in the future.

The day is past in which raw commodity production will provide middle class income and genuine opportunity for enough farmers and ranchers to provide a stable economic base for agricultural communities. However, opportunity is growing for farmers and ranchers to increase their incomes by producing products in ways that meet the unique demands of particular market segments.

In agriculture, there are growing opportunities to tap higher value markets. The nationwide Hartman Survey found that over half of consumers would pay a premium for food produced in an environmentally sound way. A *Better Homes and Gardens* and *Successful Farming* survey found that 57% of consumers would pay a premium for pork produced on small family farms and over 70% would pay a premium for pork produced on environmentally responsible farms.

Cooperatives like Oregon Country Beef have demonstrated that family farms and ranches can tap those markets to earn consistent premiums by producing a high quality product in ways consumers support – in their case natural, hormone-free beef produced in humane conditions on environmentally responsible ranches.

Others would pay a premium for meat and livestock products cut in a certain way to meet their cultural traditions. Others will pay a premium for grain with certain milling characteristics.

These markets present an opportunity for farmers and ranchers to add more of the value to agricultural products and capture more of the profit. For the most part, however, we lack the cooperatives and small businesses to link consumers looking for these products with the family farmers and ranchers who have what they want while capturing the profit in the rural community.

The second opportunity resides in the explosion of new knowledge. The actual impact of the knowledge explosion on agricultural communities will depend on our role in it. In a knowledge-based economy, generally only those who apply knowledge enjoy genuine opportunity. Returns to unskilled labor have fallen precipitously.

To the extent that new knowledge is principally embodied in products sold to farmers – rather than applied by farmers – it will simply reinforce the current trend toward a shrinking farm and ranch share of food system profit. But to the extent that we create new knowledge and production systems that enable farmers and ranchers to cut input costs or add value to their products by applying more management and skills we can reverse the farm share trend line. We can restore opportunity in the agricultural community as well as on the farm and ranch, and help raise farm income.

The hoop house for hog production provides an excellent example of how agricultural research and the application of knowledge can enhance producers' returns. It has a four or five foot wooden wall, on which rests a half circle steel hoop, covered by a durable plastic tarp and is deep bedded. Hoop houses require about one-third of the capital of total confinement hog finishing systems. But they require more management. Because they do not provide a controlled environment, they require the daily presence of a highly knowledgeable and motivated manager who understands hogs and is able to exercise judgment. That is the strength of the family farm.

The total cost of hog production in hoop houses is comparable to total confinement, according to Iowa State University research. But there are two key differences. Hoop houses are most cost effectively applied at a very modest scale. Second, when a farmer sells a hog out of a hoop house more of the check remains in his/her pocket to compensate for his/her skills and management; and less goes to pay off the note on the building.

Finally, and perhaps most important, to tap new opportunities – whether in agriculture or in non-farm pursuits – we must do more to support entrepreneurship. Perhaps the greatest asset of agricultural communities is the entrepreneurial bent of their people.

The farm and ranch counties in our study had twice the rate of self-employment as the metropolitan counties. Over the last decade, 70 percent of the net job growth in Nebraska's farm and ranch counties was in non-farm proprietorships – non-farm self-employment. But in spite of the entrepreneurial spirit of rural people and the importance of new small business start-up rural economic vitality, small entrepreneurship has historically received short shrift in rural development policy. We must change that.

FUTURE ORIENTED PROPOSALS FOR THE FARM BILL

Establish the Agricultural Community Revitalization and Enterprise Initiative (ACRE) to make grants to increase farm, ranch and rural income by supporting market development, research and outreach.

ACRE is designed to promote agricultural-based and entrepreneurial rural development. It is inspired by farmers, ranchers and small business people seeking to earn a better income from the market by applying new knowledge and responding to consumer demand.

Funding would be provided competitively to proposals that offer the greatest potential to increase the farm and ranch share of food system profit, increase self-employment opportunities in agricultural communities, encourage more effective use of natural resources to support genuine economic opportunity while conserving them for future generations and support revitalization of agricultural communities through entrepreneurship.

ACRE grants would be available to cooperatives, universities, producer associations, small business associations, non-profit organizations, community development corporations, and units of government. Collaboration would be strongly encouraged. Grants would range from three to five years in amounts from \$250,000 for single entity grants up to \$1.5 million for more collaborative proposals. Examples of projects that might be funded under this program include those that:

- Support development of cooperatives, networks and associations that enable producers to access premium markets for premium products.
- Support cooperative development that helps farmers and ranchers gain control over the processing and marketing of their products.
- Provide research that enables producers to increase their share of food system profit by cutting capital and input costs or producing products in a manner that increases their value.
- Provide technical assistance, training, mentoring, business incubation and planning for start-up food-related businesses and other enterprises in rural communities.

Funds would be allocated across four regions and grants would be awarded by four regional councils to ensure that the program is responsive to regional needs- from the needs of dairy farmers in Vermont, to corn and soybean producers in Iowa, to fruit and vegetable producers in the South to cattle and sheep producers in the Mountain states.

We propose providing mandatory funding for ACRE. Like the innovative Initiative for Future Farm and Food Systems, we look to mandatory funds because there is simply not adequate funding in appropriated accounts to get the job done. We believe it is entirely appropriate to spend a portion of the farm bill mandatory funding pool on future oriented, forward looking rural and agricultural development. We propose \$500 million annually - less than two percent of the amount we spent last year on direct payments to farmers.

The Center for Rural Affairs strongly supports direct payments to farmers for income support. But we must also invest in long term solutions – solutions that enable farmers and ranchers to earn a fairer share of the consumer dollar from the market and that help revitalize rural communities.

Today we under-invest in long term solutions relative to short-term relief. Commitment of a very small portion of the baseline could free up funding for a dramatic increase in support for entrepreneurial initiatives. Shifting two percent of the baseline to long term solutions would create far greater bang for the buck in enhancing farm, ranch and rural community income and opportunity.

Initiatives to Establish a New Generation of Farmers and Ranchers

A new generation of family farm and ranch businesses is crucial to the survival of rural America. Rural communities will survive only if a stable number of people work and live there.

It matters not that the same or that a greater amount of raw agricultural commodities are produced if there are fewer people contributing to the production of those commodities and to the life of our communities. Without a new generation of farm and ranch families, urban areas throughout the nation will become caretakers of vast, empty states.

Establish a Beginning Farmer and Rancher Development Program.

Such a program would support and help fund new and established local and regional training and technical assistance initiatives for beginning farmers and ranchers. Initiatives would include mentoring programs; land link assistance for retiring and new farmers and ranchers; entrepreneurship and business training; financial management training; risk management education; and diversification strategy training.

Beginning Farmer and Rancher Research and Extension Initiative.

A new Beginning Farmer and Rancher Research and Extension Initiative should be established, with resources dedicated to researching, developing, and disseminating farm transfer, finance, development, management, production, and marketing models and strategies that foster new farming and ranching opportunities.

Create a credit access and assistance program that fosters opportunities for beginning farmers and ranchers.

One of the greatest challenges facing beginning farmers and ranchers is access to land and operating capital. Current credit and assistance programs could be amended to promote greater opportunities.

- Amend the beginning farmer and rancher loan program to expand down payment loan program options, extend the duration of loans, and establish performance goals for states to increase total farm and ranch ownership loans to beginning farmers and ranchers.
- Remove the prohibition on USDA loan guarantees being used in conjunction with state beginning farmer “aggie” bonds to dramatically expand the availability of land and loans to beginning farmers and ranchers. Combined with federal “first time farmer bonds,” which make interest income tax exempt if earned on loans or contract land sales (seller financed) to beginning farmers and ranchers, this would provide a powerful incentive to lend and sell land to beginners and would mitigate the risk to lenders and land sellers.
- Amend federal programs to specifically authorize loan guarantees for contract land sales from qualified sellers to qualified beginning farmers and ranchers.

- Reform the interest assistance program on guaranteed loans to focus more of the interest rate break on beginning and limited resource farmers and ranchers.
- Create opportunities for beginning farmers and ranchers to participate in value-added activities. Establish a low-interest, limited-duration, federal loan program in combination with private financing for assisting beginning farmers' and ranchers' entrance into value-added agricultural cooperatives.

Enhance risk management, conservation, and rural business and cooperative development programs for beginning farmers.

Current risk management, conservation, and rural business and cooperative development programs should be amended to advance farming and ranching opportunities.

- Provide beginning farmer risk management strategies through the risk management education program.
- Provide up-front, lump-sum payments to qualifying beginning farmers and ranchers in new and existing conservation programs in return for full term contracts for conservation practice installation and environmentally-sound management.
- Direct USDA to provide incentives in its cooperative development and value-added programs for cooperatives to include beginning farmers and ranchers.

These methods of ensuring access to land, capital, and management resources would provide opportunity for beginning farmers and ranchers. The 2002 Farm Bill must cultivate the innovative influences of new and vibrant farmers and ranchers in American agriculture. Nowhere is it more evident than in farming and ranching that renewal is the eternal lesson of nature.

Support for Establishing Farm-Related and Non-farm Businesses

We believe that policies that recognize agriculture as a cornerstone of rural development in concert with policies that support small business and that seek to alleviate poverty can work to improve the well being of rural communities.

Establish a pilot program to integrate SBA programs with USDA programs.

Agricultural enterprises are increasingly part of the "New Agriculture" – creating new markets, participating in direct marketing, and developing farm/rancher-owned cooperatives and businesses. They are in need of much of the business training offered non-agricultural entrepreneurs. The Small Business Administration (SBA) could provide assistance to those farmers and ranchers and cooperatives seeking to take advantage of these opportunities. However, one barrier in many places is the lack of coordination between SBA and USDA programs and the lack of recognition by many federal programs that agricultural and agriculture-related enterprises are crucial rural development strategies. In conjunction with the Henry A. Wallace Center for Agricultural & Environmental Policy at Winrock International – and as proposed in their report *Making Changes: Turning Local Visions Into National Solutions* – we propose that Congress authorize and provide funding in the 2002 Farm Bill for a five-state pilot program that would integrate the SBA and Department of Commerce programs with USDA programs to provide a coordinated package to rural areas.

Revise USDA Rural Development Programs to Focus on Small Business Development and Farm Related Enterprises.

Agriculture and small business comprise the economic foundation of agricultural communities. Yet current federal rural development programs do little to promote small businesses and many do not even recognize agriculture. We suggest:

1. Revise the prohibition on agriculture production from USDA Rural Development lending programs to allow for lending to small, family-owned agriculture-related businesses.
2. Increase the authorization for the Intermediary Relending Program to \$100 million. Authorize a portion of its funds to be used for grants to provide technical assistance and borrower training to businesses owners. Target 50 percent of its lending to small businesses and microenterprises – those with five or fewer employees, and 50% to farmer/rancher-owned, value-added businesses and cooperatives.
3. Revise the USDA Rural Development Business and Industry program and the Rural Business Opportunity Grants and Rural Business Enterprise Grants programs to set aside 25 percent of loan funds and program funds for cooperatives primarily benefiting small- and moderate-size farmers and ranchers.

Help Rural People to Build Assets and Wealth for the Future

Persistent low-income work in rural areas does not allow people to save for the future or build assets that create wealth. According to *Michael Sherradan and Deborah Page-Adams in What We Know About the Effects of Asset Holding*, a 1995 publication of the *Center for Social Development at Washington University* in St. Louis, the pathway out of poverty for the vast majority of households is not through consumption but through saving and accumulation of assets.

One policy tool that has proven effective for an asset building strategy is the Individual Development Account (IDA). The IDA is similar to an IRA, 401(k) or other individual asset account. An IDA allows a low-income family to establish an account with matching funds from the state or federal government; the funds may only be withdrawn to start a business, buy a home or obtain education. We propose that a percentage of grant funds in the USDA Rural Development Rural Business Opportunity Grants and Rural Business Enterprise Grants programs be targeted to establish Individual Development Account programs in rural areas.

Provide Rural People Access to Telecommunications Technology

High-speed internet access holds promise for rural agricultural and non-agricultural businesses. A “digital divide” exists between rural and urban areas. We propose that Broadband Direct Loans be provided that allow for the construction, improvement and acquisition of facilities and equipment to provide broadband services in rural areas.

Conclusion

The economic distress faced by many rural communities of the nation is chronic and long-standing, and deepened by the neglect of the type of economic development that is needed in many rural areas. The policy recommendations we propose are rooted in the type of economy that will flourish in rural areas, and will allow new generations of rural people to become self-reliant and chart their own course of economic prosperity.



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Statement for the Record
of
Karen Dearlove,
Executive Director of the
Indiana 15 Regional Planning Commission
and
President of the
Indiana Association of Regional Councils
on behalf of the
National Association of
Development Organizations

Before the
Senate Agriculture,
Nutrition and Forestry Committee

Washington, DC
August 2, 2001

**NADO Statement on USDA Rural Development for the
Senate Agriculture, Nutrition and Forestry Committee**

Thank you, Chairman Harkin, Senator Lugar and members of the committee for the opportunity to submit testimony today on the importance of a strong and comprehensive rural development title in the upcoming Farm Bill. My name is Karen Dearlove, and I am the Executive Director of the Indiana 15 Regional Planning Commission in Jasper, Indiana. I also currently serve as the President of the Indiana Association of Regional Councils.

ABOUT NADO AND REGIONAL DEVELOPMENT ORGANIZATIONS

The National Association of Development Organizations (NADO) provides training, information and representation for regional development organizations serving the 82 million residents of small metropolitan and rural America. The association, founded in 1967 as a national public interest group, is a leading advocate for a regional approach to community and economic development.

NADO members—known locally as councils of government, economic development districts, local development districts, regional planning commissions and regional councils—provide valuable professional and technical assistance to over 2,000 counties and 15,000 small cities and towns. They also administer and deliver a variety of federal and state programs, based on local needs. Programs include aging, census, community and economic development, emergency management, small business financing, transportation and workforce development. Each region is governed by a policy board of elected officials, business leaders and citizen representatives. Associate members of NADO include state, county, city and town officials; educational and nonprofit organizations; utilities; and businesses and individuals.

Since 1999, the Indiana 15 RPC has assisted local governments on 60 different projects totaling over \$40 million. Established in 1973, Indiana 15 Regional Planning Commission serves a six-county region in southern Indiana. In addition to providing planning and technical assistance to local communities, Indiana 15 delivers and assists local communities with EDA, USDA and HUD Community Development Block Grant proposals, solid waste projects, historic preservation efforts, business and tourism development and natural disaster recovery. Indiana 15 is also acting as the lead organization in meeting the tertiary needs facing local businesses such as childcare and quality schools for their employees' children. Through three recent cooperative projects involving both the public and private sectors, Indiana 15 has been able to ensure the area has quality daycare facilities for almost 200 children.

POLICY PRIORITIES FOR THE UPCOMING FARM BILL

In crafting the next Farm Bill, Mr. Chairman, the members of the National Association of Development Organizations strongly urge the committee to develop and support a comprehensive rural development title. **We believe there are three main points that support our position.**

1. Rural communities need federal development assistance programs and policies that allow them to identify, address and meet local needs.
 2. USDA rural development programs should remain focused on supporting the basic needs of local communities, such as water and wastewater systems, small business development finance, telecommunications and housing.
 3. Local capacity building and technical assistance programs, such as the proposed Rural IMPAC program, are essential to the long-term stability and recovery of rural communities.
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First, Mr. Chairman, rural communities need federal development assistance programs and policies that allow them to identify, address and meet local needs, whether they are basic infrastructure, education, health care, small business development, telecommunications or transportation related. As the following data demonstrates, rural America is a diverse, complex and constantly evolving place. That is why a "one-size-fits-all" federal rural development policy is impractical, unreasonable and ineffective.

Home to almost one-third of the nation's population (equivalent to the urban population), small town and rural America is a diverse and constantly changing place. Rural America comprises 2,192 of the nation's 3,066 counties (counties of 50,000 and below), 75 percent of all local governments and 83 percent of the nation's land.

While the common perception is that rural Americans only live in the South, Midwest and Great Plains, more rural Americans live in New York, for example, than rural Idaho, Montana, Nebraska, Nevada, North Dakota, South Dakota, Utah and Wyoming combined. States with the largest total rural populations include Pennsylvania, Texas, North Carolina and Ohio.

While no one industry dominates the entire rural economy, the service sector now accounts for almost 50 percent of employment, with manufacturing employing twice as many people as all natural resource production activities combined, including agriculture, forestry, fishing and mining. While still an important fabric of rural life, farming represents less than eight percent of rural jobs and 50 percent of farm families rely heavily on off-farm income.

Demographic trends also suggest that rural Americans are proportionally older, more likely to live in poverty and less educated than their urban counterparts. However, individual rural communities are constantly changing and evolving, as many are becoming booming retirement destinations and tourist attractions, while others are struggling to diversify away from a one-industry town.

Unfortunately, the current structure of federal assistance programs fails to fully recognize and address the complex set of challenges facing rural communities. In comparing federal assistance for urban and rural communities, for example, one quickly discovers a troubling trend that explains the perpetual problems plaguing some rural communities.

While urban communities receive a substantial amount of federal grant money for infrastructure development, the bulk of rural assistance is in the form of transfer payments such as Social Security, Medicare and agriculture payments. Furthermore, urban counties and cities are more likely to receive economic development, housing and transportation funding directly from federal agencies, while rural communities must compete on a national, state or regional basis.

The US Department of Housing and Urban Development's (HUD's) \$4.8 billion Community Development Block Grant (CDBG) program is one of the largest federal domestic assistance programs. Under the program, approximately 1,000 of the nation's largest cities and counties divide over \$3 billion each year in entitlement spending. This flexible funding allows them to meet important local needs. Meanwhile, the other 30 percent of funding is distributed to states for the small cities program. While an essential and effective program, the nation's 14,000-plus rural communities must compete within their state for these CDBG funds.

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Another example is the \$32 billion annual federal highway program, where urban areas directly receive millions of dollars for planning and infrastructure development activities while historically rural communities have had to work through state departments of transportation. With the bipartisan leadership of the Rural Caucus, however, Congress has made significant strides in recent years to correct this inequity.

Adding further to the discrepancy between urban and rural areas is the type of assistance available to rural communities. Many of the federal economic development programs targeted to urban areas are in the form of grant assistance, while many rural programs, including USDA rural development programs, rely heavily on loans and loan guarantees instead of grants. Urban communities typically also have more access to capacity building and technical assistance dollars from HUD and other agencies, whereas most rural economic development planning is funded through the US Economic Development Administration's effective but small program.

Without a greater commitment by this committee and Congress to a stronger USDA rural development program, rural communities will continue to be at a marked disadvantage in trying to build and sustain viable local economies. This statement was recently endorsed by over 117 members of the Congressional Rural Caucus who pledged their support for a comprehensive rural development title as part of the Farm Bill rewrite.

Second, Mr. Chairman, USDA rural development programs need to remain focused on supporting the basic needs of local communities, such as water and wastewater systems, small business development finance, telecommunications and housing. All of these are essential building blocks for local economic development efforts, which eventually result in better paying jobs and an improved quality of life for local residents.

In December 2000, the NADO Research Foundation surveyed the 320 regional development organizations serving small metropolitan and rural America about their existing programs, organizational structure and regional needs. Nationally, the overwhelming response for the area of greatest need was for water and wastewater improvements, with transportation and workforce development rounding out the top three. The other most commonly mentioned needs involved funding for capacity building and access to advanced telecommunications.

Other areas of local need could be for quality childcare and healthcare facilities as well as adequate schools. Studies by the Rural Research Policy Institute have shown that largest employers in rural communities are many times the local schools and the health sector. However, these areas are also a part of the critical infrastructure that businesses require for development and expansion. Therefore, federal programs, including USDA, need to be more elastic to meet the local challenges of rural communities.

NADO survey respondents were also asked to identify the USDA rural development programs they use most frequently to assist their rural communities. The top three programs were: water and wastewater program, rural business enterprise grants (RBEG) program and intermediary relending program (IRP). Other key programs included: community facilities, rural business opportunity grants (RBOG), solid waste management and rural housing programs. However, a common complaint from NADO members is that too much of USDA rural development funding is set-aside for specific communities, whether for the handful of rural Empowerment Zones and Enterprise Communities (EZs/ECs) or specific areas such as the Delta and Tribal communities.

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It is also important to note that the vast majority of rural local governments rely on regional development organizations to help them understand the complex menu of USDA programs, required matching requirements and, often times, burdensome paperwork. *(Note: Over 33,000 of the nation's 39,000 units of local government have populations below 3,000 and 11,500 employ no fulltime professional employees.)*

When regional development organizations have been eligible to compete for, and receive, USDA rural development funding they have made major strides for their communities. Following are just a few examples of the impact regions are making with the RBOG and IRP programs:

- In Alabama, the Alabama-Tombigbee Regional Council, headquartered in Camden, received a \$28,000 RBOG grant to develop a strategic plan for their ten-county region. This project enabled local leaders to work together on a regional basis to identify their strengths and weaknesses. The end product will be a strategic plan that will serve as the local roadmap for future development.
- In Maine, the policy board members of the Northern Maine Development Commission identified business development and retention as a top priority during their comprehensive development strategy planning. In response, USDA awarded them with a small RBOG grant to establish a technical assistance support center for small businesses. By addressing this locally identified need, the technical assistance center is investing in the start-up, retention and expansion of local businesses, all resulting in the creation of new jobs in this distressed rural region.
- Headquartered in North Fort Meyers, the Southwest Florida Regional Planning Council is leveraging a \$95,000 RBOG grant to support a \$250,000 regional strategic initiative for rural development. This multi-faceted program is helping the region assess the skills of the local workforce and identify areas of needed training; pinpoint new industries to complement the area and develop a marketing plan for attracting those new businesses; and establish a business development specialist in the local Small Business Development Center to assist local entrepreneurs.
- In Pennsylvania, the loan programs of the North Central Pennsylvania Regional Planning and Development Commission have helped create or retain over 3,000 jobs since 1984, including its highly successful IRP fund. The local company Gasbarre Products, for example, has used five loans over the past 12 years to expand from 55 employees to almost 300.
- In South Dakota, the Northeast Council of Governments uses its IRP program to support local small businesses, including one loan in Eureka that helped establish a local convenience store, the only one within miles of the town.

NADO strongly believes that the RBOG and IRP programs are valuable tools for regional development organizations. However, the effectiveness of the RBOG program, which has grown from less than \$1 million in FY1998 to \$8 million in FY2001, has been restricted by congressional mandates and USDA practices. By earmarking almost 50 percent of RBOG funds for rural EZ/ECs and REAP zones, each state is typically left with between \$50,000 and \$200,000.

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Congress should either increase funding to ensure each USDA state rural development director has sufficient funds or eliminate set-asides and make it a national discretionary competitive program.

The IRP program would also be more effective at reaching higher risk businesses if intermediaries were awarded grants instead of loans that need to be repaid to USDA. Otherwise, they will generally continue to make lower-risk loans that are less likely to go into default in order to make interest and principal payments over the life of the loan from the intermediary to USDA.

Another important comment on existing USDA rural development programs relates to the 1996 Farm Bill requirement that each USDA state rural development director develop a five-year strategic plan. Recognizing that Congress failed to provide additional funding for this activity, it is still disheartening that the vast majority of state directors failed to consult with rural local officials in crafting their development strategies. In rewriting the Farm Bill, we urge the committee to build on and strengthen this important process by calling for more local input and control.

Third, Mr. Chairman, local capacity building and technical assistance programs, such as the proposed Rural IMPAC program, are essential to the long-term stability and recovery of rural communities. Without professional staff to facilitate the development of local action plans and to understand the complexities of federal assistance programs and rules, most rural communities will remain at a substantial disadvantage to their suburban and urban counterparts.

Fortunately, a relatively small federal investment in local capacity building can be stretched a long way in rural America, particularly if implemented on a multi-county basis. Before describing the concept of the proposed Rural Investment Program for Area Capacity (Rural IMPAC) program, I want to highlight a sample of successful partnership programs between USDA rural development and regional development organizations.

- In the mid-1990s, the USDA state rural development director in Iowa recognized the intense need for additional training and outreach on USDA programs at the local level. Instead of further extending the workload of USDA officials, the director awarded four regional councils \$50,000 each to establish the "Reaching Out to Rural America Pilot."

As part of the pilot project, the regional councils of government provided educational seminars for local officials, business leaders and private nonprofits about the menu of rural development programs, explored alternatives for using programs such as IRP, and developed electronic means for facilitating local communications. They also met regularly with USDA officials to identify additional ways to help local organizations fund and complete needed projects.

- USDA officials in four other states (Michigan, Ohio, Tennessee and Virginia) have also signed agreements with individual regional development organizations to help with local outreach, training and grant applications. However, most do not receive funding for their efforts. In the early 1990s, for example, the state of Tennessee had 80 USDA offices that provided financial assistance to its 95 counties. By realigning the rural development offices along the boundaries of the nine regional development districts, USDA streamlined their overhead from 80 offices to nine, and its staff from 261 employees to 170. It also allowed the USDA rural development offices in Tennessee to work more effectively with the development districts to meet local community needs.
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Study after study by federal agencies and universities have concluded that additional funding for capacity building and technical assistance programs is one of the most pressing needs facing rural governments and communities. This stems from the fact that most rural local governments simply do not have the financial resources to hire professional economic development practitioners. And, presently there are few federal programs designed specifically for their needs—unlike urban areas that receive millions of dollars in direct funding from HUD and Department of Transportation.

As a result, it is often difficult for the nation's 14,000-plus rural communities to access both public and private sector funds designed to help them address basic infrastructure, housing, small business development finance, technology and transportation needs, all essential building blocks for creating a sustainable local economy. As a further consequence, most rural communities lack the professional expertise and financial resources needed to fund, develop and implement a comprehensive plan of action.

A sound and proven alternative for USDA rural development is to partner with the national network of 320 regional development organizations, who have almost daily contact with cities, counties, towns and other community organizations, in addition to decades of experience in combining and leveraging resources to meet local needs.

In implementing a program such as the proposed Rural Investment Program for Area Capacity (Rural IMPAC) program, Congress would be moving a step closer to helping local communities overcome the fractured system of federal rural development programs. The program would place communities in a better position to address local issues on a regional basis, whether it relates to water treatment facilities, technology upgrades, closing of a major plant or cleanup after a natural disaster. Rural communities will also be more capable of taking a proactive approach to economic development, instead of the traditional reactionary model.

Whether a region is currently enjoying economic stability or coping with long-term challenges such as declines in traditional industries, they must plan for tomorrow, or risk falling far behind in the competitive global and high-tech marketplace. History has clearly demonstrated that communities who fail to adjust are often left behind. In the late 1800s it was those disconnected to railroads, in the 1960s it was the interstate highway system and today it is high-speed Internet connections.

Just developing advanced telecommunications systems alone, however, will not be enough for rural America. Industries and residents will still need basics assets such as quality infrastructure, schools, health facilities and seamless transportation networks. Following are brief examples of how NADO members are helping local communities respond to local needs and prepare for the future.

- In Oklahoma, the South Western Oklahoma Development Authority (SWODA) is using its Geographic Information System (GIS) and Global Positioning System (GPS) to develop capital improvement plans for local governments, a process that requires an inventory of all public assets. By cataloging and mapping every road, bridge, water line, public building and other assets, SWODA can develop visuals for local elected officials and business leaders who are developing infrastructure investment strategies. The data can also be used for zoning decisions, land use management, transportation planning and an almost endless list of other activities.
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**NADO Statement on USDA Rural Development for the
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- Examples of technical assistance provided by the 24 regional councils of government in Texas include financial management, planning and community development, joint data and computer services, cooperative purchasing, development of 911 systems, regional training programs for local officials and law enforcement officers, establishment of housing finance corporations, organization of legal services and credit unions for small cities, preparation of grant applications and local ordinance writing.
- In eastern Kentucky, several regional development organizations are involved in a life-changing program that is providing area residents with clean and safe drinking water, many for the first time in their lives. Due to the natural landscape, it is often extremely costly for local residents to install water and waste treatment systems such as septic tanks. Historically thousands of Appalachia residents have used straight pipes to dispose of waste, usually directly into creeks, streams and rivers.

With the leadership and support of Congressman Harold Rogers, the regional development organizations have developed maps of the straight pipe locations and educational programs about their environmental impact. They have also created revolving loan funds for area residents to obtain low interest loans for septic tank purchases. This model program has helped improve the quality of drinking water in the region and protect the environment, while also restoring pride in the communities.

- Faced with overcrowding jails, an overflowing landfill and growing debt, McMinn County officials in Tennessee learned firsthand the benefit of regular strategic planning sessions with the Southeast Tennessee Development District. Over a ten-year period, the county has worked with the district to address these pressing needs while also planning for the future. As a result, the county will be debt-free by 2002 and plans to implement a new pay-as-you-go policy.
 - In North Carolina, the Upper Coastal Plains Council of Government helped the rural town of Scotland Neck secure a USDA rural development grant to update and modernize the public library. By leveraging the USDA dollars with additional private sector and foundation funds, the town will add computers with high-speed Internet access to allow citizens and students to gain new opportunities and upgrade their skills.
 - In Virginia, the New River Valley Planning District Commission continues to shepherd four counties through a decade-long economic recovery. The district helped create, and staffs, the area's first regional industrial park authority. The district is also providing ongoing support to the planning and design of a new technology magnet school, a partnership preparing high school students for careers in high technology fields.
 - The Kankakee-Iroquois Regional Planning Commission in Indiana established a multi-county Intergeneration Facility by leveraging local resources with funds from HUD's Community Development Block Grant in response to a community needs assessment. Once fully constructed, the new facility will host Head Start classrooms, full senior activity services, childcare services and English as a second language classes.
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- The Meramec Regional Planning Commission in Missouri has been working for two years with various partners to build a child care center that will serve a nearby industrial park that employs 1,200 people in 10 businesses, a Wal-Mart distribution plant that will employ 600 people and a local hospital. Once the state-of-art facility is built it will be able to provide childcare for 90 children.
- Through an annual local business roundtable session, the Boonslick Regional Planning Commission in Missouri became aware of the increasing difficulty area workers were having in finding quality childcare. In response, the RPC pulled together community stakeholders to build a 100-child daycare center in 1999. The facility current hosts 83 children and, in conjunction with the local school district, provides before school and after school programs, as well as services for small children.
- In 1995, the Northeast Council of Governments (NECOG) in South Dakota first brought broadband technology to the area through a Department of Commerce grant for educational purposes. NECOG, however, then extended the use of two-way audio/visual feed to support telemedicine activities. The project now connects area residents with specialists in world-renown hospitals such as the Mayo Clinic.

In addition, NECOG answered a local call for improved childcare services in 1999 when it provided the administrative link between the AmeriCorps program with a local Bridges program. This partnership has enabled single parents and others to be gainfully employed while their children are being supervised in a suitable before-school and after-school environment.

By further strengthening regional development organizations through the Rural IMPAC program, Congress would be ensuring that the nation's most rural communities could set goals, priorities and make more informed and effective decisions. We urge the committee to support the creation of the Rural IMPAC program

In closing, Mr. Chairman, I want to thank you and the committee for the opportunity to comment on USDA rural development programs, and federal rural development policies in general. I also want to reiterate our three main points: (1) Rural communities need federal development assistance programs and policies that allow them to identify, address and meet local needs. (2) USDA rural development programs should remain focused on supporting the basic needs of local communities, such as water and wastewater systems, small business development finance, telecommunications, and housing; and (3) Local capacity building and technical assistance programs, such as the proposed Rural IMPAC program, are essential to the long-term stability and recovery of rural communities.

Thank you again for the opportunity to comment on this important matter.

Rural IMPAC

Rural Investment Program for Area Capacity

Meeting Local Needs Through Regional Capacity Building

Overview

The new **Rural Investment Program for Area Capacity (Rural IMPAC) program** will provide seed capital through USDA rural development to support regional capacity building, technical assistance and strategic planning efforts in rural America.

By leveraging limited federal dollars, the region-based program will help regional development organizations assist local governments, community-based organizations and other key rural stakeholders in identifying and meeting local community and economic development goals.

Need for Federal Assistance for Regional Capacity Building

Study after study has concluded that one of the most pressing needs in rural communities is funding for basic capacity building and technical assistance. In most cases, however, rural local governments simply do not have the financial resources to hire professional economic development

practitioners. And, presently, rural communities do not have a federal program designed specifically for their needs — unlike urban areas that all receive millions in direct funding from HUD and US DOT.

As a result, it is often difficult for the nation's 14,000-plus rural communities to access both public and private sector funds designed to help them address basic infrastructure, housing, small business development finance, technology and transportation needs, all essential building blocks for sustainable development. As a further consequence, most rural communities lack by themselves the professional expertise and financial resources needed to fund, develop and implement a comprehensive action plan.

With the downsizing of USDA rural development staff over the past decade, it has also become increasingly difficult for rural communities to tap into existing federal rural development programs. Local challenges range from simply understanding the complex menu of available USDA rural development programs to complying with burdensome federal redtape and funding match requirements.

A sound alternative for USDA rural development is to partner with the national network

Regional Development Organizations provide valuable professional and technical assistance to over 2,000 counties and 15,000 small towns and cities. Governed by a policy board of local elected officials and community leaders, these organizations also deliver a myriad of federal and state programs on a regional basis, such as aging, census, community and economic development, emergency management, housing, small business financing, transportation and workforce development programs.

**Programs vary depending on local needs.*

**Regional Development Organizations
are known variously as:**

- Area Development Districts
- Councils of Government
- Economic Development Districts
- Local Development Districts
- Planning and Development Districts
- Regional Planning Commissions
- Regional Council of Governments

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Adopted by the Board of Directors – June 2001**

of 320 regional planning and development organizations, who have almost daily contact with cities, counties and other local entities in addition to decades of experience with federal programs such as HUD CDBG, EDA, EPA, USDA and DOT.

By leveraging the existing programs and services of these regional organizations with USDA, Congress would be moving a step closer to helping local communities overcome the fractured system of federal rural development programs. A primary function of regional development organizations is to help communities identify local needs, then use their knowledge and experience to tie a variety of funding sources together to meet local needs. While the federal system remains fragmented, locals can still retain the flexibility necessary to address self-identified local needs.

As a 1997 Rural Policy Research Institute report states, "After all, it is at the community level where the uniqueness and diversity of communities must be accommodated in order to avoid the 'one-size-fits-all' policy assumptions of the past."

By investing new USDA Rural IMPAC funds into regional development organizations, communities will be better positioned to address local needs, whether it is water treatment facilities, technology upgrades,

Benefits of Using Regional Development Organizations

Regional development organizations provide USDA with a unique and effective network for working with the nation's 14,000-plus rural communities. As public entities created by state law or executive order, these regional organizations have:

- ★ close ties to local officials, community leaders, private sector and the public.
- ★ 30 years of planning and program implementation experience, including extensive knowledge of community and economic development issues.
- ★ the organizational framework and experience for coordinating local government activities within a region, including an extensive track record in serving as the local service deliver entity for many federal and state economic development, human services and transportation programs.

closing of a major plant, shift in the local economy or a natural disaster. They will also be more capable of taking a proactive approach to economic development, instead of the traditional reactionary model.

Functions of Rural IMPAC Program

The new USDA Rural Investment Program for Area Capacity (Rural IMPAC) program would provide financial assistance to regional development organizations to:

- Provide professional staff assistance on a regional basis, to help rural communities develop and implement economic development strategies. (Includes using GIS/GPS technology to help identify areas of greatest need, areas for targeted development, etc)
- Perform regular analysis of current infrastructure assets and needs, including water and waste water systems, transportation, telecommunications, housing and other basic infrastructure.
- Educate rural local officials and other key stakeholders (bankers, private nonprofits, educational institutions, etc) about the existing menu of USDA RD programs, including the types of projects eligible under each program, match requirements and the selection process.
- Hold regular strategic planning meetings with local stakeholders (and USDA district and state office staff) to evaluate regional and local priorities, progress and targets.

Distribution of Rural IMPAC Funds

The **Rural Investment Program for Area Capacity (Rural IMPAC) program** is intended to strengthen regional capacity efforts that will ultimately result in improved and more focused economic development programs in rural America. **Rural IMPAC**


funds will be distributed through USDA state rural development directors to existing regional development organizations. Regions will be required to provide a 10 percent local match to the annual \$75,000 grant.

General Comments on Value of Strategic Planning in Rural America

- Strategic planning, infrastructure improvements and small business assistance are essential building blocks for creating private sector jobs and viable communities.
- Strategic planning helps a community identify its assets and liabilities. Local officials and the private sector can then determine the best approach to development for their region. *This applies to both persistent poverty communities and those currently experiencing economic stability or prosperity, as local economies are constantly evolving (i.e. manufacturing and natural resource dependent to tourism and service industry or from agriculture to manufacturing.)*
- The remarkable diversity of rural America dictates that for rural development to be effective, it must be locally based. In setting goals, priorities and making decisions, a regional intergovernmental approach is essential. Rural communities simply do not have the resources to “go it alone” and federal assistance in public investment is also essential.
- Establish regional staff capacity to assist rural communities in developing, implementing and planning activities intended to spur business development, infrastructure improvements and civic leadership enhancement.
- Establish a consolidated rural service delivery system that builds on existing technical assistance, capacity building and training efforts (strategic planning, financial management, regional cooperation of local governments, project financing, land use and environmental planning, project management, benchmarking and regulatory compliance).



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**Testimony of
Curtis Wynn
Chief Executive Officer
Roanoke Electric Cooperative
Rich Square, North Carolina**

**Before the
Senate Agriculture, Forestry and Nutrition Committee**

August 2, 2001

INTRODUCTION

Chairman Harkin, Members of the Committee - for the record, I am Curtis Wynn, CEO of Roanoke Electric Cooperative in Rich Square, North Carolina. I am also representing the National Rural Electric Cooperative Association (NRECA), which is made up of 900 not-for-profit, consumer-owned electric utilities that provide central station electric service to more than 34 million consumers, most of whom live in the nation's rural areas.

I commend you, Mr. Chairman, and the committee for your leadership and support for rural development programs. These programs are increasingly important to rural areas. Rural communities want and deserve the same opportunities for growth that their urban counterparts enjoy.

From my fifteen years experience of working with rural economic development, I have found that the biggest payoffs come when rural economic development projects are oriented to building local capacity, infrastructure and the community's economic base.



INVESTMENT CAPITAL

North Carolina's economy has seen phenomenal growth in the last decade. However, much of that growth has been concentrated in urban areas. In North Carolina, the state's rural and suburban areas continue to lag far behind in job creation and economic prosperity. I believe many of you have seen similar patterns of development in your respective states.

Allow me to briefly paint a picture of one example, which is my rural Northeastern North Carolina community. For decades, several of our counties have been among the most impoverished counties in the state. Bertie, Halifax, Hertford, and Northampton Counties were all recently reclassified by the North Carolina Department of Commerce as "**Distressed**" counties, a more severe category than "**Depressed**".

In many of these counties, basic infrastructure (particularly natural gas, sewage lines and treatment facilities) is nonexistent:

- Television reception from distant urban markets is of poor quality.
- Many residents lack cable and even telephone service.
- Few T1 lines have been installed, resulting in few local service provider options.
- Cable modem service, DSL and other high speed, broadband delivery systems are not on the immediate horizon.

Consequently, Northeastern North Carolina is on the wrong side of the "digital divide".

Legislation is needed to encourage private investment in projects that existing venture capital funds do not accommodate. Mr. Chairman, we appreciate your leadership on this issue and will continue our work with various rural associations to address this need through a rural equity fund. In addition, the Rural Utilities Service \$100 million broadband pilot program is one example of a way to help rural Americans bridge the digital divide. I urge the Committee to expand this program and make it a permanent function of RUS's telecommunications portfolio.

RURAL ECONOMIC DEVELOPMENT LOAN AND GRANT PROGRAM

Electric cooperatives address community infrastructure needs through their economic and community development activities. Many of these community development activities are accomplished through the USDA's *Rural Economic Development Loan and Grant Program* (REDLG).

Over the lifetime of the program, REDLG has provided over \$140 million in loans and over \$66 million in grants to rural communities nationwide. These loans and grants have leveraged nearly \$1.2 billion in non-federal capital for 851 projects. Over 25,000 jobs have been created.

Mr. Chairman, the REDLG program has brought significant economic opportunities to rural America. Over the last decade in North Carolina, the cooperatives have provided loans totaling more than \$20 million dollars, which have been leveraged over \$150 million in commercial projects, job creation and community development. Since 1989, North Carolina's electric cooperatives have assisted in the creation of over 4,600 jobs in rural communities.

The financing of these loans has come from private and public sources – including \$4.6 million in Rural Utilities Services (RUS) loans and \$15.5 million from a cooperatively created statewide revolving loan fund. Projects have included the building of cotton gins, renovations and expansions of medical centers, water infrastructure facilities and industrial parks. In our region, Roanoke Electric Cooperative has taken full advantage of USDA's REDLG programs. In just 24 months, we have finalized two zero interest loans for \$846,000. In addition to the REDLG program, we have helped to create nearly 200 jobs and retain another 150 jobs. Over \$1.3 million has been raised from other private sources such as our statewide cooperative organization. These funds have leveraged over \$11 million in investments in our five-county region.

While the REDLG program has worked well over the last decade, the funds available for loans and grants have significantly declined over the last six years. I believe certain changes would reverse this trend and make REDLG even more successful in the future. I look forward to working with the Chairman and other Members of the Agriculture Committee to adapt REDLG to current economic realities and reinvigorate the program.

The health and vitality of rural communities is of great concern to me and to the rural electric cooperatives that serve this nation. By encouraging capital investment in our rural communities and taking advantage of new opportunities, rural communities can remain a vital part of the American economy. Rural communities are worth our investment.



rural policy research institute

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**PREPARED STATEMENT OF
DEBORAH M. MARKLEY, CHAIR
RURAL POLICY RESEARCH INSTITUTE
RURAL EQUITY CAPITAL INITIATIVE**

before the

**COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
UNITED STATES SENATE**

August 2, 2001

Chairman Harkin, Senator Lugar and Members of this Committee, I appreciate the opportunity to appear before you today to discuss rural economic development issues for consideration in the next farm bill. Specifically, I want to focus on the importance of equity or venture capital in rural America. The availability of venture capital, risk capital from outside investors, is recognized as a critical ingredient for new business start-ups and business expansions. Yet venture capital markets are unorganized and often non-existent in rural communities (RUPRI Rural Finance Task Force, 1997). Filling this venture capital gap is an important component of any strategy to create a more entrepreneurial rural economic development policy in the U.S.

Background

For the past three and a half years, I have served as Chair of the Rural Policy Research Institute's Rural Equity Capital Initiative, a research project funded by the U.S. Department of Agriculture's Fund for Rural America. The research team, including Dr. David Barkley, Clemson University, Dr. David Freshwater, University of Kentucky, Dr. Ron Shaffer, University of Wisconsin-Madison, and Julia Sass Rubin, Harvard University, completed case studies of venture capital institutions and programs across the country. These institutions, some successful and others not, provide insights and lessons learned that can guide future consideration of how best to encourage expanded venture capital access in rural America.

The most significant capital gap faced by rural entrepreneurs and businesses is the lack of equity or venture capital. In a paper presented at the Federal Reserve Bank of Kansas City's 1998 conference on *Equity for Rural America*, Brophy and Mourtada show that entrepreneurial firms within rural America received a very small share of equity capital financings between 1985 and 1998. It should be noted that this period was associated with increased venture capital investments and IPO (initial public offering) activity for the U.S. as a whole.

Nationally, venture capital investments are concentrated in a small number of regions and industries. According to the 1999 PriceWaterhouseCoopers Moneytree survey, 67.1 percent of U.S. venture capital investments were in four states (California, Massachusetts, New York and Texas), and 91.0 percent of the investments were in technology-based companies, including Internet related businesses. The distribution of venture capital investments across states indicates that many regions of the country are relatively underserved by traditional venture capital institutions. For example, per capita venture capital investments for the United States were approximately \$143.00 in 1999; yet only six states exceeded the national average (Massachusetts, \$597.00; California, \$522.00; Colorado, \$335.00; Washington, \$215.00; New Hampshire, \$199.00; and Connecticut, \$159.00). Alternatively, 24 states had per capita venture capital investments of less than \$20.00, or less than one-seventh of the national average. These states were concentrated in the Plains, Midwest, and South Central regions.

The lack of well-developed rural venture capital markets may be a response to limited good investment opportunities. However, it also may reflect market failures that result from

imperfect information and high transaction costs. Specifically, traditional venture capital institutions do not aggressively seek investment opportunities in small urban areas and rural communities because of:

- **Limited Deal Flow.** The economic base of most rural areas is relatively concentrated in low-tech, slow-growth sectors. These sectors do not provide the numerous investment opportunities with the high rates of return favored by traditional venture capital funds. As a result, even rural firms in sectors favored by traditional investors do not have access to venture capital.
- **Higher Costs Per Investment.** Limited and spatially dispersed deal flow results in high search costs for identifying prospective deals and higher time and transportation costs for conducting due diligence and monitoring investments. As a result, traditional venture funds are not willing to look outside their established urban markets, even if some good investments exist in rural America.
- **Limited Opportunities for Exiting Deals.** Many businesses in rural communities are family owned with the goals of transferring ownership to the next generation and/or maintaining the current business location. Such goals limit exit strategies and reduce the attractiveness of investments to traditional venture capitalists. Even high tech businesses in rural areas may be tied to the local area, by family or lifestyle concerns, in ways that limit exit opportunities.
- **Lack of Favorable Local Business Environment.** Rural areas offer relatively limited business infrastructure and human capital to facilitate management of new companies, particularly firms that may require more sophisticated services such as patent attorneys. Thus venture capitalists may have the additional expense of acquiring business services and managerial and technical personnel from outside the area, or providing extensive technical assistance to existing company management.

The Importance of Nontraditional Venture Capital Institutions for Rural America

To meet the venture capital needs of rural businesses and entrepreneurs requires the creation of nontraditional venture capital institutions that represent an adaptation of the traditional model to the constraints of investing in rural markets. As part of the RUPRI research project, 23 case studies of nontraditional venture capital institutions or programs were completed between July 1998 and November 2000.* The institutions range from a community-based angel investor group to a statewide, publicly supported venture fund; from a community bank Small Business Investment Company (SBIC) to a statewide private SBIC with community bankers as investors; from a community development venture fund operating in depressed Appalachian counties to a community seed fund in the heartland.

All these institutions have one thing in common. They are nontraditional venture capital institutions that reflect important innovations or adaptations of the traditional venture

capital model. These institutions differ from more traditional venture capital funds because they:

- Operate outside of regions and industrial sectors where venture capital investments are concentrated such as in rural communities and non-high tech industries.
- Expect a financial return on investments that is less than the annual return anticipated by traditional venture capital institutions.
- Generally operate with a geographic focus or geographic restrictions such as a specific community, state, or region.
- May have a dual bottom line of acceptable financial returns and social and economic benefits to the service area. Thus, nontraditional institutions are capitalized by funding sources that value economic and social returns in addition to financial returns, such as state government, local government, nonprofit foundations, Community Development Financial Institutions Fund, Small Business Administration, commercial banks, pension funds, and civic-minded individuals.

Lessons Learned and Policy Implications

While nontraditional venture capital institutions are making investments in small urban centers and rural places, the industry is relatively new and, as a result, is not widespread across rural America. However, these innovative institutions provide important lessons for policy makers considering ways to encourage the creation or expansion of nontraditional venture capital institutions in rural America.

Lesson One. There is no single best model for establishing a nontraditional venture capital institution. The RUPRI study considered a variety of institutional types including publicly funded and managed programs, publicly funded and privately managed programs, public incentive or tax credit programs, and privately funded programs including community development venture capital institutions. Some models were independent, stand alone funds while others were established as part of existing organizations. Each alternative has advantages and disadvantages that must be considered. The choice of a model depends on the goals of the program founders, whether they are focused on financial returns or economic development impacts; the funding sources available, whether private or public; the existing venture capital infrastructure; the specific industries or stages of business that are targeted; and the current political environment, whether there is public support for the creation of venture capital programs or institutions.

Policy Implication: Any federal policy encouraging the creation of nontraditional venture capital institutions should recognize the limitations of a "one size fits all" approach. The federal role should be to support innovative institutions at the local, state, and regional levels that have a well-defined business plan for providing venture capital to rural businesses and entrepreneurs.

Lesson Two. There are important advantages to a privately managed venture capital fund, including management decisions that are insulated from political influence, a salary and incentive package attractive to experienced fund managers, and greater opportunities for attracting private capitalization or co-investments with other private funds. However, some form of public involvement, either the provision of capital or incentives, may be necessary to create a nontraditional venture capital fund with a primarily rural focus. Public funding can help to offset the higher operating costs many nontraditional funds face because of the higher costs of operating in rural places and the greater technical assistance needs of rural portfolio companies and entrepreneurs. However, there may be a trade-off between private management's focus on rate of return and the public sector's interest in economic development returns from program investments.

Policy Implication: Public support of privately managed venture capital institutions provides a way of tapping the advantages of privately managed funds while leveraging positive economic development impacts through targeted, restricted public investments and incentives.

Lesson Three. To get increased venture capital into rural America will require explicit targeting to rural areas. However, imposing a rural or strict geographic constraint on the operation of a venture fund means that other constraints need to be relaxed. For example, a strictly rural fund may need to be capitalized by patient capital, investors that do not expect to achieve high levels of return over a relatively short time horizon. These investors may include the public sector, foundations, or individuals motivated by social returns. In addition, rural-focused funds must operate to overcome both limited deal flow and lack of a supportive business environment. As a result, higher operating costs are likely and must be factored into the design of a rural-focused venture fund.

Policy Implication: Federal policies to increase venture capital access in rural America should be explicitly targeted to rural areas. At the same time, public policy should encourage and reward a regional or interjurisdictional approach to the creation of nontraditional venture capital institutions. While a single rural community may be able to create a small angel network, a multi-county region or a statewide angel network is likely to face fewer operating constraints, have access to greater deal flow and, as a result, have a greater likelihood of success.

Lesson Four. Establishing a nontraditional venture capital institution is a complicated, time consuming, and expensive process. This process includes analysis of the market, estimation of potential deal flow, identification of potential investors and partners to provide technical assistance, consideration of alternative models for the institution, and identification of the fund management team. Venture fund managers estimate that one year and \$300,000 - \$400,000 is required to complete this process. For some organizers, such a capital commitment presents a significant obstacle to the creation of a nontraditional venture capital institution.

Policy Implication: One means of federal support for the creation of venture capital capacity in rural America is through the provision of grants to cover the start-up costs associated with establishing nontraditional venture capital institutions.

Lesson Five. Successful nontraditional venture capital institutions generally shared the following characteristics:

- A skilled management team was rewarded through an appropriate incentive structure recognizing sound investment behavior that achieved institutional goals.
- Adequate resources were devoted to deal flow development and/or creation.
- Capitalization of the fund was optimal to provide for a diverse portfolio and follow-on investments.
- Managers gave significant, but not always primary, attention to fund rate of return to maintain the long-run sustainability of the program.
- Fund managers conducted rigorous due diligence prior to investments and adequate technical and management assistance post-investment.
- Fund was structured to minimize political interference in investment decisions, even when public capital was used.

Policy Implication: To encourage the creation of new nontraditional venture funds in rural America, public policy should reinforce these success factors. Public support should be directed toward existing or new institutions that:

- **Have devoted the time and resources to identifying and developing deals in their rural regions.**
- **Have strong, experienced managers capable of investing in and providing support to rural businesses and entrepreneurs.**
- **Operate within the rural environment, permitting close contact and interaction with portfolio companies.**
- **Give significant attention to fund sustainability while targeting resources to rural businesses.**

Concluding Comments

In conclusion, Mr. Chairman, one part of a strong rural economy is a dynamic, entrepreneurial small business sector. Future rural economic development policies must recognize the importance of the small business sector, both farm and nonfarm, to rural communities and reward innovative, entrepreneurial strategies to grow and sustain this sector. While access to venture capital will not ensure the success of rural businesses and entrepreneurs, its absence presents a significant constraint on the growth prospects of these rural enterprises.

While the impetus for creating rural venture funds is likely to come from the local level, the

federal government can play a supportive role in this process. This federal role may be direct or indirect. The federal government can be involved in the creation of nontraditional, rural-focused venture capital funds through direct public investment in partnership with private investors and managers. Since many nontraditional venture capital institutions must rely on patient sources of capital, expanding or maintaining federal financial support for these initiatives is one way to support the development of new or expanded rural venture capital investment activities. The Community Development Financial Institutions (CDFI) Fund is an ongoing federal program that provides support to community development financial institutions. Several of the funds included in the RUPRI study received CDFI grants to support their deal flow development and technical assistance activities. The New Markets Venture Capital Program is another federal program that has the potential to support the creation of new venture capital capacity in rural America.

There is also an indirect federal role through programs that support the start-up process, deal flow development and technical assistance activities of nontraditional venture funds. One public policy option is to establish a fund that can make grants to cover the costs of this process. Without such a fund, smaller rural areas will be less likely to undertake the rigorous start-up process and will either (1) decide against pursuing the creation of a venture fund without adequately investigating the potential or (2) jump into the creation process without doing the groundwork necessary for success. Supporting this start-up process would help encourage the thoughtful creation of rural venture funds.

Local communities, regions and states have already taken the lead in designing innovative models for nontraditional venture capital institutions that can overcome the constraints on venture capital investing in rural America. The RUPRI study has identified the lessons learned from these programs. Federal support of these efforts, both direct and indirect, is a vital component of the set of policy options needed to promote economic development throughout rural America.

Thank you, Chairman Harkin, Senator Lugar, and Members of the Committee, for the opportunity to share these policy ideas with you today. I would be pleased to share more detailed information from the RUPRI study with you and your staff if desired. I commend your consideration of these innovative rural economic development policies as part of the next farm bill.

*For more information about the RUPRI Rural Equity Capital Initiative research project, a four-part final report is available on the RUPRI website, www.rupri.org.

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Statement Of

Steve Lane

On Behalf Of The

Iowa Independent Bankers

And On Behalf Of The

**Independent Community Bankers
of America**

Before The

SENATE AGRICULTURE COMMITTEE

August 2nd, 2001

**Statement of Steve Lane
Senate Agriculture Committee
August 2nd, 2001**

Rural Development In The New Farm Bill

Thank you Chairman Harkin and other members for holding today's important hearing on rural development in the new farm bill. I applaud you for the work you have done on this issue. Your focus on rural economic development is essential given the difficulties our farmers and ranchers face in these stressful times and the need to diversify our rural economies so that so that farmers and ranchers have economic opportunities off the farm as well as on the farm.

My name is Steven Lane, and I serve as President of the Iowa Independent Bankers Association. I'm also President and CEO of Security Savings Bank, an agriculture bank located in the small community of Gowrie, Iowa. Security Savings Bank is a \$48 million asset bank and most of our loans are agricultural credits. Our town of 1028 people relies heavily on the agricultural economy.

I'm also representing the views of the Independent Community Bankers of America (ICBA). ICBA is the only national trade association that exclusively represents the interests of our nation's community banks. Over two-thirds of ICBA's member banks are located in small communities of under 10,000 population. Over three-fourths of our membership serves communities of under 20,000 people. Eighty-six percent are in communities of less than 50,000 population. Clearly community bankers across the nation have a long standing interest in ensuring credit availability to our nation's farmers, small businessmen and women and other consumers in our nation's rural communities. We also have a strong interest in rural development initiatives that can underpin a strengthened farm safety net and help diversify our rural communities.

Challenges Of A Difficult Farm and Rural Economy

Let me say at the outset that we hope the new farm bill can have some significant new money for rural development. The statistics and trends reveal that off-farm jobs are becoming increasingly important to the health and viability of the farm sector. Census numbers also reveal that counties dependent largely on agriculture have been losing population. My point is that our farm programs and our rural development programs need to both be on center stage in terms of enhancing the overall farm safety net. We should put some real money into rural development.

We do work hard in our small community to try an attract new businesses. It is a difficult challenge. With the low prices we've seen in agriculture, farmers are struggling to make their farm operations cash flow. The government farm aid packages have allowed many farmers to hang on from one year to the next. The big problems of course are profits and equity. Profits are often non-existent and farmers' equity has eroded severely.

Farmers may be able to stay in good standing with their lenders by paying their yearly operating loans, but they're not able to upgrade their equipment as needed. The profits are not there and unfortunately their net worth continues to drop. Most of our area farmers and their spouses are working off the farm 40 hour a week to cover living expenses. Others that are not working off-farm are incurring large amounts of debt. Each year cash flows are harder to keep positive and financial statements are slipping.

Many farmers have had to turn to off farm jobs to keep their farms afloat. That is why diversifying the economic base of our rural communities is so important and why rural development, which encompasses value added agriculture, is such a crucial issue. But some farmers are just giving up and selling out. Others continue to hope for better prices and continued government support. I believe this year we will see more farmers quitting than any other time since the 1980's in our area.

We are actively searching for solutions to this difficult challenge. For example, our community offers new businesses an arrangement where they pay no property taxes. Unfortunately, that incentive – by itself - hasn't worked well, simply because it is hard to attract new businesses to small rural towns. Rural communities do offer people a lot of benefits, including a high quality of life, low-crime rates, a clean environment and friendly neighbors. What we need to be successful is a much larger funding commitment from Congress and some new legislative initiatives in this arena.

One concern we have, Mr. Chairman, is that recent statistics show that communities relying largely on agriculture have declining populations. To be successful in rural development, we need to both keep the people we currently have in our rural communities and attract new ones as well. Because at some point communities can fall below the "critical mass" of people needed to sustain the town's infrastructure and services. That leads the town to an irreversible decline because they lack the human resources needed to remain viable. The per capita cost of providing services becomes too expensive. Ultimately, keeping people, leaders, workers, and citizens in rural communities is essential to keeping a healthy rural social infrastructure in place, which is the foundation of a diverse economic base in our rural communities.

Maintaining the social infrastructure in terms of human resources is key to maintaining a viable physical infrastructure-- adequate roads, schools, health care services, utilities, Main Street businesses and locally owned community banks focused on meeting local financial needs.

This morning I first would like to offer a few general principles to help guide rural development policy and then make some specific legislative recommendations.

Key Principals To Drive Rural Development Policies

I suggest four basic principals that should underlie the federal government's approach to a sound and broad-based set of rural development policy initiatives. These principals are:

- 1) Target Resources to Rural Communities based on population;
- 2) Provide Tools To Complement – Not Compete With -- the Private Sector;

- 3) Target Resources to Various Sizes and Types of Businesses, Including Individuals; and
- 4) Maintain the Population Base and Infrastructure of Rural Communities.

1) Target Resources to Rural Communities -- We need to ensure that programs first and foremost truly target rural areas and lead to the creation of new jobs and to business start-ups and business expansions. This means there should be a population-based criteria as the first component of deciding where federal monies go, such as the Business and Industry (B&I) loan program's requirement that loans go to communities of 50,000 or less.

This population limit should apply to all types of rural businesses including farmer-owned cooperatives, contrary to action by the House Agriculture committee to provide an exemption, which would allow dollars intended for rural areas to flow to large cities. The House bill did not provide any additional funding to offset this loss for rural areas. When the decision is whether to finance a business or processing facility in a rural setting versus an urban setting, the rural community will almost always lose that decision due to factors such as a smaller workforce and less access to technology. Rural development needs to have a jobs component in order to truly revitalize and diversify the local rural economic base.

There are many benefits of targeting rural areas based on population. These include:

- 1) Providing off-farm jobs for farmers;
- 2) Maintaining the local tax base;
- 3) Maintaining the population base which is necessary to keep experienced local leadership and a skilled workforce in our rural communities; and
- 4) Maintaining the infrastructure and services available to our rural communities.

2) Recognize and Complement the Efforts of the Private Sector -- We should compliment and add to the efforts of the private sector, especially private sector financial institutions. Many residents in rural communities will tell you that their community bankers are the leading catalyst to bringing together the people and leveraging the resources necessary to attract new businesses to the rural community.

Specifically from the standpoint of community banks there should be a recognition that there are thousands of community banks in our rural areas that can help stimulate our rural economy if they are given the right tools. For example, there are approximately 3,000 "agricultural" banks alone and several thousand non-ag banks all in rural areas. These banks are keenly aware that the future of their institutions are directly tied to the future of their rural communities. Rural development policies need to be intricately tied into this vast network of private sector lenders if these policies are to be successful.

3) Target Resources to Various Sizes and Types of Businesses, Including Individuals -- In addition to targeting rural communities based on population, we need to ensure that credit is available to individual entrepreneurs as well as larger corporate and cooperative ventures.

Obviously it may be easier to get financed if you are a multi-million dollar business. But we need to also ensure that individual entrepreneurs can thrive in a rural environment.

For example, a banking colleague of mine has a farm customer who started a business that uses flax straw to make 20 foot long erosion control logs that are shipped all over the country to minimize erosion after flooding or forest fires. He is further expanding his business to make hanging basket liners for horticultural use out of absorbent and environmentally friendly flax blankets. He bought a closed-up schoolhouse for the manufacturing site. This is value-added agriculture. He wasn't a large cooperative or a large corporate business, just a single individual involved in value added agriculture.

4) *Maintain the Population Base and Infrastructure of Rural Communities* -- Diversifying rural economies is important because more and more farm families appear to be relying on off-farm income to support the farming enterprise. USDA statistics indicate that a significant part of the total income of farm households comes from off-farm sources. Unfortunately, trends indicate that counties which have relied largely upon agriculture as the main industry lost significant population in the last decade. The recent 2000 census revealed that while the general population grew 13 percent in the 1990's, 676 counties, primarily rural counties, lost population. Those counties losing population are largely dependent on agriculture. This shows the importance of diversifying rural economies because doing so will help keep people in rural America and will help farm families have additional sources of income thereby reducing the need to rely solely on farm programs for survival in rural America.

From the standpoint of the community banks in these rural areas, the loss of population, with its subsequent result of fewer depositors and fewer deposits, is a critical problem since fewer deposits mean fewer funds available to make loans to local businesses and citizens and therefore less investment in the physical and social infrastructure of rural communities.

Adopting Viable Solutions

Obviously an important goal for our rural areas should be to focus on value-added agriculture. If we can process more of what we produce in the local areas, rather than shipping our commodities across the country for processing and packaging, then local farmers will reap the benefits in their local communities. These benefits would include greater income from the local business if they have an ownership stake in the business, but even more significant would be the off-farm jobs created to keep local townspeople employed where they live. We've seen a lot of farmer-owned cooperatives get involved in producing ethanol and this is a future growth area that shows great potential because we can use our surplus ag commodities to meet the growing demand for energy in our country.

Businesses other than cooperatives, such as individual proprietorships and other small businesses are also important to building a stronger rural economic foundation. But the key is locally oriented, value-added initiatives that help create a better market for our area farmers and also create jobs for those smaller farmers that need the off farm income.

This also strengthens the small, locally owned community businesses on Main Street. I learned a long time ago that when the farmer struggles it has a major effect on every business in town. As more farmers disappear, so do our local businesses.

Equity Financing in Rural America

Rural Equity Fund – Mr. Chairman, I want to applaud you for introducing legislation last year to establish a rural equity fund. A broad coalition of organizations have joined together in support of this legislation to spur business development in rural communities. These organizations include the ICBA, the American Bankers Association, the National Cooperative Business Association, the Farm Credit Council, the National Rural Electric Cooperative Association, the National Cooperative Bank, the Rural Telephone Finance Cooperative, the National Farmers Union, CoBank, Agribank and others.

The “rural equity fund” would encourage private investment in value-added agriculture enterprises and small business start-ups and expansions. A healthy rural community obviously needs many types of rural businesses. This includes both cooperatives and non-cooperative businesses and both large and small businesses, and credit tools that encourage individual entrepreneurship. Unfortunately, large venture capital funds are not interested in focusing on rural America.

So this legislation creates a public/private partnership designed to attract equity investment into cooperative and other business ventures in rural America. The fund would be capitalized by investments from private sector institutions and the government would match these monies up to a specified level. From a banker perspective, this fund could provide equity financing to help complement loan packages put together by the private sector and would therefore complement the debt financing offered by private-sector lenders. Projects could be brought to the attention of this fund by a variety of sponsors including cooperatives, banks and community development groups.

Investments made by this fund will provide off-farm income, additional markets for agricultural products and new business opportunities in rural communities. The intent of the fund is to target rural business recipients in rural communities, defined as those with 50,000 people or less.

In addition, by investing in an equity fund, rather than individual projects, private sector lending institutions would also avoid the mixing of banking and commerce, which has traditionally been prohibited by Federal law.

The issue of bringing more equity financing to rural America has had increasing attention in recent years. A couple years ago the Center for the Study of Rural America, headquartered in the Federal Reserve Bank of Kansas City, and a national rural outreach committed to illuminating the issues and challenges facing rural America, conducted a national conference on this issue. The Center’s 1999 report, *Equity for Rural America – from Wall Street to Main Street*, offered a number of important observations. These included:

- Few companies with high growth potential are located in rural areas;
- Some initial public funding for rural equity projects is necessary because returns are too low to attract venture capital investments to small rural companies;
- A greater degree of management assistance is likely needed for rural firms;
- Urban areas can attract equity capital much more efficiently than rural areas;
- Investors naturally migrate to larger deals;
- The key question is what degree of emphasis will be placed on economic development in rural areas versus earning a high rate of return?;
- An equity capital fund's goals and its institutional structure have a big impact on which deals are funded and how the fund exits from those investments;
- Creating local wealth that is locally controlled should be an essential goal;
- A **double-bottom line is needed** – both a good rate of return but also providing the rural communities with a major economic boost (jobs, etc);
- Community banks can play a vital role in leveraging the capital resources of local businesses; and
- Any serious attempt to boost the supply of equity capital in rural America has to include banks in the plan.

Mr. Chairman, we look forward to working with you on this important initiative. We hope this measure, as outlined above can be made a part of the farm bill in an effort to help rural America.

Other Rural Development Recommendations for the Farm Bill

In the context of what this committee can do in the farm bill to promote rural development, I would like to also offer these suggestions.

- 1) Pass legislation to prohibit USDA from raising fees on the Business & Industry (B&I) loan program unless Congress specifically authorizes the increase. The FY-2002 budget states USDA intends to raise fees from the current 2 percent level up to 3.25 percent through administrative action.
- 2) Establish a pilot program where fees are eliminated for all users of the B&I program in rural areas. (An expanded program could also apply to SBA loans.)
- 3) Include targeted funding and authorities for a program in the B&I authorities specifically targeted at smaller-sized small business loans, perhaps with a cap of \$250,000 to \$500,000. USDA currently targets a portion of FSA guaranteed loans to small and beginning farmers; this would be the same concept.
- 4) Include a "Low-Doc" loan program for loans of \$150,000 in the B&I program to speed up loan approval and reduce paperwork on small rural development loans.
- 5) Provide special incentives for community banks that help promote and develop value-added agricultural investments in their rural areas, thus tapping the vast rural community bank network. Any incentives to promote value-added agriculture should ensure that

rural community banks are part of the financing equation through loan guarantees, loan participations and combinations of any other programs including tax incentives and grants.

- 6) Enhance the Aggie Bond program to help young farmers by passing two changes: *exempt Aggie Bonds from state volume cap formulas on industrial revenue bonds and allow aggie bonds to be used with FSA loan guarantees.*

Let me address a few of these issues.

Increase funding for USDA's Business & Industry Guarantee Loan program -- We were pleased that Congress last year provided the USDA Business and Industry (B&I) program with a significant funding increase of 50 percent, bringing the budget to \$1.5 billion for the current fiscal year. This program lends money to any rural business that provides economic opportunity to people living in towns with populations of less than 50,000 people, including gas stations, factories, and other local businesses. USDA reports that B&I loans reportedly saved or created more than 29,000 jobs last year.

This is good news for banks in their efforts to help stimulate slow-growing rural markets. However, we are told that only about 400 banks are able to use the program and more are trying to get in. The main problem has traditionally been that the B&I program is under-funded. Last year almost \$1 billion in guaranteed loans, for nearly 400 projects, could not be approved due to lack of funding. Remember that the lenders are the ones providing the funding, the government's expense comes only in cases of a loan default.

Limit/Eliminate Fees on Guaranteed Loan Programs in Rural Areas -- USDA's FY 2002 Budget included an increase in the loan origination fees on B&I guaranteed loans to 3.25 percent, well above the current 2% level. USDA stated they would implement this through a regulatory change since legislation was not necessary to accomplish the higher fee. This increase to the guarantee fee will have an adverse impact on access to credit for many rural businesses as it will make the costs of credit greater. Bankers won't be able to absorb these costs and they will be passed on to borrowers in the form of higher interest rates. The increased fees being proposed would jeopardize needed credit to small business at the worst possible time as our economy has slowed dramatically and small business lending has become more difficult.

Obviously, in the next budget cycle, new and higher fees could again be proposed. To deal with these issues, for USDA (and SBA) loans on a more permanent basis, we suggest:

- 1) Congress should pass legislation prohibiting USDA (and SBA) from raising loan fees without approval from Congress;
- 2) Establish a pilot program that would eliminate fees on small business loans in rural areas;
- 3) Increase funding for B&I (and SBA) loan programs;
- 4) Make SBA loan programs and related information available through USDA loan offices since USDA has a physical infrastructure in rural areas that SBA does not.

We point out that some of the demand for small business loans in rural areas is limited due to high fees. Eliminating these fees *for all borrowers* would attract greater participation and enhance the strength of the portfolio and the viability of the program as a whole. If the fees are too high, only high-risk ventures will seek financing, thus weakening the loan portfolio.

Other Rural Development Issues Outside the Committee's Jurisdiction

Greater Broadband Capacity in Rural Areas -- We also need to find the right mix of policies that will spur greater investment in telecommunications technologies in rural America to help us bridge the "digital divide" between our rural and urban areas. Not only do we need to create more jobs in rural areas, we need to ensure that rural areas have access to the latest technology to make them less isolated from larger metropolitan areas and to attract people with the kind of leadership and job skills necessary to help our rural areas survive and thrive. Rural America's future rests with our ability to compete in the new economy. We need the technological infrastructure to line up at the starting gate.

Increase Deposit Insurance & Index it to Inflation -- Another key ingredient to providing more funds for investing in our rural communities would be to significantly increase deposit insurance and index it to inflation. Many rural banks are having difficulty growing their core deposit base which forces them to seek other sources of funding to meet the lending needs of their rural communities.

While American agriculture is undergoing dramatic changes resulting in fewer and larger farms as well as larger corporate and agribusiness interests, deposit insurance hasn't been raised since 1980 and its value has been eroded in half, to approximately \$50,000 based on 1980 dollars. Increasing the deposit insurance level and indexing it to inflation would be a quick and efficient way to immediately help infuse more funds into our rural areas and ultimately benefit rural citizens, including farm families that depend on off-farm income to survive.

Subchapter S Reform -- ICBA supports the Small Business and Financial Institutions Tax Relief Act of 2001 introduced in both the House and Senate (H.R.1263) and (S. 936). This legislation would help ease the tax burden on thousands of small businesses and community banks and free up capital to reinvest into the local communities they serve.

This legislation would afford many small businesses, including community banks, needed relief from punitive double taxation and would improve the viability of our nation's small banks and the communities they serve. When Congress passed the Small Business Job Protection Act of 1996, it made community banks eligible to elect S Corporation status for the first time in tax year 1997. Unfortunately, many community banks and small businesses are having trouble qualifying under the current rules and cannot benefit from Congress intended tax relief. The key focus is on expanding the number of eligible shareholders for Subchapter S tax status from 75 to 150.

Conclusion

Mr. Chairman, we appreciate the Committee's efforts. Strengthening the agricultural economy and creating business investment opportunities in our rural communities is key to a viable future for many family farmers and local area businesses.

Again, I want to emphasize that rural development should be an integral part of the new farm bill and should be considered a working partner, not an outsider, to a broad based farm safety net. Off-farm jobs go hand in hand with a new and improved farm bill in accomplishing the goal of keeping farmers on the land, keeping Main Street vibrant and keeping our rural communities healthy.

Obviously, there are a number of issues that are important to rural America that may go beyond the scope of this committee. Issues that include tax incentives for greater ethanol production, subchapter S reforms, and increasing the deposit insurance coverage levels and indexing them to inflation. We will be working within other congressional committees to achieve these needed changes. These are all very important issues to rural America and although outside of this committee's jurisdiction, I hope each committee member will support community bank positions on these issues.

ICBA and its Agriculture-Rural America Committee will be discussing farm policy and rural development issues in more detail during their two days of committee meetings next week. I'm sure they will be happy to pass along additional recommendations from those meetings. Community bankers look forward to working with the committee and others in Congress to ensure enactment of a new farm bill that has a stronger farm safety net -- one in which rural development plays a major role.

Thank you.

**STRENGTHENING RURAL AMERICA – RECOMMENDATIONS FOR
THE RURAL DEVELOPMENT TITLE OF THE FARM BILL**

**TESTIMONY PRESENTED BY
JACK CASSIDY
SENIOR VICE PRESIDENT OF COBANK**

**BEFORE THE
UNITED STATES SENATE
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY**

AUGUST 2, 2001

Mr. Chairman and members of the Committee, my name is Jack Cassidy. I'm the senior vice president for board and corporate relations at CoBank. In response to the Committee's invitation, we are pleased to testify on initiatives to enhance rural economic opportunities and rural communities for your consideration in conjunction with the Farm Bill.

With \$24 billion in assets, CoBank is the largest bank in the Farm Credit System. We provide financial services to about 2,600 customers, who are also our member-owners. These member-owners include farmer-owned cooperatives, rural telecommunication companies, and electric systems. We also provide financing to support the export of agricultural products. CoBank's business is entirely focused on rural America and in working with small, mid-sized and large cooperatives that are an important and integral part of the fabric of rural America.

CoBank's lending portfolio includes \$10.3 billion in agribusiness loans primarily to farmer-owned cooperatives and Farm Credit associations, \$5.8 billion in communications and energy loans to rural electric cooperatives and communications companies, \$2.5 billion in agricultural export financing loans and \$900 million in leases to farmers, cooperatives and other rural businesses through our affiliate Farm Credit Leasing. CoBank operates on a cooperative basis and returns a significant portion of bank earnings to the bank's customer-owners in the form of patronage refunds.

It is important to note that CoBank also works with many other financial institutions including commercial banks through syndicating and purchasing loans. These alliances with other financial institutions help us meet the growing needs of many of the businesses we serve. In the past 18 months, CoBank has acted as the agent for \$4 billion in loans sold to other lenders. We also purchased \$2.5 billion in loans from other lenders.

This partnership with commercial banks and other lenders brings new sources of capital to meet the needs of rural businesses while at the same time spreading risk. We consider the

development of these alliances with other lenders as critical and have plans to place even greater emphasis on this area in the future.

Unfortunately, many rural communities have not shared in the prosperity of the 1990s that benefited many urban and suburban areas. It has been difficult for many rural businesses to obtain the necessary equity capital to grow and create new market opportunities and new employment. In addition, rural communities often do not have access to the technology and communications systems that are vital to economic growth.

Various studies have shown that while the on-farm credit needs of producers are largely being served, there are gaps in financing for other rural businesses. In particular start-up companies and farmer-owned cooperatives have difficulty raising equity capital. Venture capital is scarce for these projects as most investors seek higher returns than most rural projects have been able to offer. In addition, financing for product sales into international markets presents special challenges to cooperatives and other rural businesses.

CoBank looks to address the opportunities and challenges in rural America through our focused commitment and expertise on rural businesses, making better use of technology to deliver financial services, structuring new alliances and partnerships with other financial institutions--thereby increasing the bank's capacity to carry out our mission. Most recently, for example, we announced the formation of a business services unit to provide technical assistance for start-up and existing cooperatives. Our Board of Directors, which is comprised of farmers and managers of cooperatives, along with management is committed to ensuring that our customers have access to the financial services they need--either directly through CoBank or through alliances with other parties.

I would like to comment on four areas for policy recommendations:

- (1) The important role that cooperatives play in advancing the economic interests of rural America and steps that can be taken to strengthen cooperatives and enhance value-added agricultural initiatives;
- (2) Adjustments to CoBank's authorities that would better enable us to serve rural America;
- (3) Making equity capital more available in rural America; and
- (4) Improvements to the USDA Business and Industry Loan program (B&I) to make it more useful for rural cooperatives.

Value-Added Initiatives and Enhancing USDA Programs in Support of Cooperatives

For decades CoBank customers have been leaders in marketing and processing agricultural products to obtain a greater share of the consumer food dollar for the American farmer. We believe strongly, as do our member-owners, that value-added initiatives are one of the keys to a

prosperous farm sector. We also know that there are limitations and challenges to successful value-added enterprises.

The keys to success for value-added entities include strong management, a reliable source of raw product and member commitment, a strong understanding of the marketplace, a comprehensive business plan and proper capitalization. In order to encourage value-added business development, USDA programs that enhance the ability of farmers to join together successfully in cooperative efforts need to be revitalized and strengthened. Farmers must have better tools available through USDA programs. Recommendations include:

- CoBank supports expansion of the Value-Added Technical Assistance Grants Program to help farmers capitalize on new market opportunities.
- We support making a separate agency in USDA called the Farm Business Cooperative Service that is dedicated and focused in support of farmer cooperatives.
- As part of a revitalized Farm Business Cooperative Service, we support funding for research, education and technical assistance programs for farmers and their cooperatives. We recommend not less than \$6 million annually for cooperative grants provided by the Farm Business Cooperative Service.
- CoBank has joined with a long list of commodity and export organizations in recommending legislative improvements to USDA's Supplier Credit Guarantee Program. In particular, lengthening the authorized program tenors from 6 months to 1 year, increasing guarantee coverage, and reducing program fees will enhance the effectiveness of this program in assisting cooperatives and rural businesses to market their products in international markets.

Adjustments to CoBank's Authorities

We have three specific recommendations that we think would promote a modest amount of economic development in rural areas.

- (1) As noted earlier, we work with many commercial lenders to sell and purchase interests in loans. By law, loans purchased by CoBank but originated by commercial lenders must be to companies very similar to the types of marketing and processing entities served directly by CoBank. This excludes some transactions involving companies where food or fiber operations may be only part of a larger enterprise. CoBank has been unable to participate in such loan syndications when asked to do so by commercial banks. By allowing CoBank to participate in such transactions, we could strengthen our existing partnerships with commercial lenders, bring an additional source of capital to companies that are in an agricultural business and further spread risk within the financial community.
- (2) Under current law, CoBank may provide financing to communication companies that are eligible to borrow from the Rural Utility Service. However, many of the communications

companies interested in providing Internet, broad band and other types of advanced communications services to rural communities today do not borrow from the RUS and therefore are not eligible to borrow from CoBank. By financing such companies, we could help ensure that rural communities are afforded greater access to the technology that will be vital to their future.

- (3) Under current law, CoBank can finance the export of farm machinery and other farm-related products that are used on the farm in foreign countries. This “on-farm” requirement limits our ability to finance the sale of some U.S. agricultural related products simply because the foreign purchaser plans to use them some place other than on a farm. For example, we can only help a cooperative sell its used packaging or processing equipment if the foreign purchaser is going to use that equipment on a farm. For a cooperative trying to get the best price for outdated equipment, there is little concern about whether the equipment will be used on farm or somewhere else.

Availability of Venture/Equity Capital for Rural Businesses

One of the major limiting factors for rural development is the ability of existing and new companies, including cooperatives, to access equity capital. Lack of equity capital is a problem that hinders economic growth and the business expansion for many of our customers. The reality is that cooperatives often are unable to go to financially stressed farmers to seek equity capital for projects that would open new markets and create economic opportunities in rural areas. New and improved approaches involving public-private sector partnerships are needed to foster the flow of equity capital to rural America.

CoBank and other Farm Credit System lenders are working with a coalition consisting of the American Bankers Association, the Independent Community Bankers Association, the National Cooperative Business Association, the National Cooperative Bank, and the National Rural Electric Cooperative Association to support a proposed National Rural Business and Cooperative Equity Fund. This bill introduced last year by Chairman Harkin and Senator Larry Craig and others provides the necessary framework to help generate venture capital for rural America.

The Harkin/Craig bill (S. 3242 in the 106th Congress) would establish a fund to raise equity capital and invest it in support of cooperatives, value-added agricultural enterprises and other businesses in rural America. The fund is designed to harness the financial power of the U.S. capital markets and direct it to building the job base and production capacity of our rural economy. Ultimately the fund, through its investment in rural business, will enhance farm and rural incomes, increase opportunities for small and minority businesses, and generate greater economic vitality and business innovation in rural communities.

Key provisions in the proposal include:

- Authorizes private sector investors to establish a venture capital fund to make equity investments in rural cooperatives and other rural businesses.

- Authorizes USDA to match private investments into the Fund to a specified level. Authorizes USDA to guarantee securities issued by the fund to maximize the amount of capital available to invest in rural businesses.
- Encourages private sector investments in the Fund from a broad range of financial institutions and other institutional investors.
- Requires the Fund to set aside a portion of its earnings to pay for technical assistance necessary to facilitate projects.
- Requires cooperatives and other businesses that receive an equity investment from the fund to invest a substantial amount of their own capital in the project.

It is our view that a program with appropriate incentives to help bring venture capital to rural America should be an important component to the new farm bill. We strongly support the Harkin/Craig bill and urge the committee to include it in the farm bill.

Enhancements to USDA's Business and Industry Loan Guarantee Program

Earlier this year CoBank participated in a task force of the National Council of Farmer Cooperatives (NCFC) to develop initiatives to strengthen farmer-owned cooperatives and increase economic opportunities in rural America. As a result of that effort, NCFC has proposed a number of initiatives, which we support, to modernize and strengthen the USDA Business and Industry Loan program. With revisions, the B&I program can be an important tool of cooperatives and other rural businesses. Changes that need to be made include:

- Eliminate the current \$25 million maximum loan guarantee for farmer cooperatives. The investment required to compete in the global economy and ensure effective operations are often much greater than \$25 million.
- Provide minimum loan guarantees of 90% in the case of farmer cooperatives, with additional authority for higher guarantees in some situations.
- Eliminate the geographic restriction in the case of farmer-owned, value-added projects.
- Eliminate the 2 percent loan origination fee, which simply adds to the cost of using this program.
- Modify the current authority providing guaranteed loans to farmers for the purchase of stock in a farmer-owned cooperative for value added purposes to include existing as well as new start-up farmer-owned cooperatives.

CoBank and the Farm Credit System – Building a Stronger Rural America

As part of the Farm Credit System, CoBank is a key link in channeling private sector funds from the nation's money markets to businesses operating in rural America. In recent years, Congress through various initiatives has greatly expanded the authorities of commercial banks and provided them with virtually unlimited access to funding from GSEs through the Federal Home Loan Banks and the Federal Agricultural Mortgage Corporation (Farmer Mac). Congress took these actions as part of an effort to make more capital available to rural America.

Congress has an opportunity with this Farm Bill to take additional steps to make capital more available by providing needed updates to Farm Credit's charter and considering innovative ways to facilitate the ability of lenders to work together to meet the needs of our rural communities.

In closing, CoBank is committed to rural America. Our slogan: "CoBank – Rural America's Cooperative Bank", is more than words to CoBank. Our business is rural America and we look forward to working with the Committee to find ways to strengthen rural communities and foster successful rural business opportunities as part of the new Farm Bill.

Thank you for the opportunity to testify. I look forward to your comments and questions.

DOCUMENTS SUBMITTED FOR THE RECORD

AUGUST 2, 2001



Senator Debbie Stabenow
Opening Statement
Senate Agriculture, Nutrition, and Forestry Committee
August 2, 2001

Chairman Harkin and Ranking Member Lugar, thank you so much for convening today's hearing on the Rural Development component of the Farm Bill. Rural Development programs are critical for preserving our heritage of rural communities across the nation.

Michigan is an incredibly diverse state, ranging from the urban centers like Detroit to remote rural communities like Copper Harbor at the tip of the Keweenaw Peninsula. While the bulk of our state's population lives in our cities, most of our state's land mass is dotted with many small towns that are the center of rural life. Preserving these communities and helping them to remain vital are an important part of protecting family farms.

Rural Development funding through grants and loans to communities help provide basic necessities like fire trucks, housing, and emergency storm sirens. However, these funds also can also be the catalyst for innovation and new business development when they are used to support value-added business ventures like cooperatives. Value-added projects are of particular importance because they both add to the local economy and provide new opportunities for agricultural commodities. Michigan benefits from all of these types of Rural Development funds and I have seen

how those dollars provide real help to communities. I am very interested in proposals that we have discussed in this Committee that would increase funding for Rural Development as well as expand the scope of the program. I agree that Rural Development is not just about preserving farms, it is about helping communities.

As an aside, I would like to note that I was thrilled to discover that two Michigan teenagers are featured on the USDA website as a “Rural Development Success Story.” Their experience is a wonderful example of some of the innovative ways that Rural Development dollars can be used.

I would like to share an excerpt from the USDA Rural Development website:

“Not too many teenagers have their own businesses. But with the help of Rural Development, two Michigan teenagers established a lawn care company under the Youth Business Loan Program. Learning responsibility and how to support them will be a vital tool in future successes for these

With a \$550 loan, Shamica and Willie Williams established the Williams Lawn Care in Baldwin, Michigan. ‘I am elated to have my own business at the age of 16,’ said Shamica Williams. The loan helped her and her brother purchase a lawn mover, weed whacker, and a leaf blower and become striving entrepreneurs at such a young age.

The Youth Business Loan Program encourages teenagers to apply for a business start-up loan. Applicants must have a sponsor and submit a business plan. The USDA Rural Development Office in Baldwin sponsored Shamica and Willie Williams. The program allows young people to start their own business and give them the opportunity for self-employment. This is especially important in rural areas where often there is a lack of job opportunities for young people.

In addition to learning vital job skills, the program also provides the opportunity for young people to learn financial responsibility at a young age. These are all tools that are crucial to young people and help them become successful adults.”

I am so proud of Shamica and Willie. I think that is a wonderful success story.

Mr. Chairman, thank you for granting me the time to make my statement and to share my story. I look forward to hearing testimony from the witness.



NATIONAL COUNCIL OF FARMER COOPERATIVES

01 AUG 14 PM 01:02

August 2, 2001

The Honorable Tom Harkin
 Chairman
 Senate Committee on Agriculture, Nutrition and Forestry
 328-A Russell Senate Building
 U.S. Senate
 Washington, DC 20510

Dear Mr. Chairman:

On behalf of the National Council of Farmer Cooperatives (NCFC), I would like to take this opportunity to submit the attached statement to be included as part of the official record with regard to the hearing on the Farm Bill held on August 2, 2001 by the Senate Committee on Agriculture, Nutrition and Forestry.

NCFC is a national trade association that represents America's farmer-owned cooperatives. Our members include nearly 100 regional marketing, supply and credit cooperatives whose members, in turn, include over 3,500 local cooperatives which are owned and controlled by a majority of America's nearly 2 million individual farmers.

These farmer-owned businesses handle, process and market virtually every type of commodity grown and produced in the United States; manufacture, furnish and sell seed, feed, fertilizer and other farm inputs; and provide credit, including export credit, and other financial services for and on behalf of their farmer owners. Earnings derived from these activities are returned to their farmer owners on a patronage basis, helping improve their total income, and adding to rural stability. With approximately 300,000 seasonal and full-time employees, these farmer-owned businesses also provide a significant source of employment that further contributes to the economic health of rural communities.

We believe policies and programs are needed to enable farmers to earn more of their income from the marketplace and capture a larger share of the consumer dollar, while promoting sustainable economic growth and related opportunities for rural America. To help achieve these objectives, a key component of any strategy must include helping farmers help themselves by enhancing their ability to join together successfully in cooperative self-help efforts.

Again, we appreciate the opportunity to share our views and look forward to working with you and your Committee on this important issue.

Sincerely,

A handwritten signature in cursive script that reads "David Graves".

David Graves
 President

STATEMENT OF DAVID GRAVES
PRESIDENT
NATIONAL COUNCIL OF FARMER COOPERATIVES
BEFORE THE
SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
WASHINGTON, DC
THURSDAY, AUGUST 2, 2001

Mr. Chairman, the National Council of Farmer Cooperatives commends you for this hearing and the opportunity to share our views and recommendations.

NCFC is a national trade association that represents America's farmer-owned cooperatives. Our members include nearly 100 regional marketing, supply and credit cooperatives whose members, in turn, include over 3,500 local cooperatives which are owned and controlled by a majority of America's nearly 2 million individual farmers.

These farmer-owned businesses handle, process and market virtually every type of commodity grown and produced in the United States; manufacture, furnish and sell seed, feed, fertilizer and other farm inputs; and provide credit, including export credit, and other financial services for and on behalf of their farmer owners. Earnings derived from these activities are returned to their farmer owners on a patronage basis, helping improve their total income, and adding to rural stability. With approximately 300,000 seasonal and full-time employees, these farmer-owned businesses also provide a significant source of employment that further contributes to the economic health of rural communities.

As this Committee begins the task of writing a new farm bill, we want to take this opportunity to strongly urge support for policies and programs that will enhance the ability of farmers to join together in such cooperative efforts to:

- Improve their income from the marketplace,
- Better manage their risk,
- Capitalize on new market opportunities, and
- Compete more effectively in a rapidly changing global economy.

Strengthening the ability of farmers to join together in cooperative self-help efforts is critical to the success of any long-term strategy to achieve these important goals.

This is the 4th year in a row that Congress has been faced with the need for short-term emergency assistance to meet the immediate income needs of farmers. Thanks to the leadership of this Committee and the generous support of Congress, such assistance for many farmers has meant the difference between survival and going out of business. This is reflected in the fact that government payments now account for as much as two-thirds or more of farm income.

The farmer's share of the consumer food dollar has declined to just 20 cents – its lowest level ever. There are many reasons why this has happened. Low commodity prices clearly are one reason. Other factors include changing consumer preferences and demographics, as well as changes throughout the entire marketing chain beyond the farm gate as businesses seek to gain efficiencies, increase market share, enhance their profitability and meet consumer demand.

There is no question, however, that reversing the decline in the farmers' share of the consumer food dollar would help improve the farmer's economic well being. For example, increasing the farmer's share of the consumer food dollar by just one cent to 21 cents would help farmers generate an additional \$6 billion in gross income from the marketplace. The challenge of course is how to accomplish this given the current business environment and ongoing trends.

Again, we believe the answer involves providing farmers greater opportunity to join together in cooperative self-help efforts. There are two main areas where public policy and related programs should be focused to help achieve this important objective.

First, there is a critical need for improved access to capital to help farmers and their cooperatives gain ownership in value-added activities beyond the farm gate, to invest in new equipment, to modernize and expand, and meet costly environmental and other regulatory requirements. Second, there is an overwhelming need to revitalize USDA programs in support of farmer cooperatives, including research, education and technical assistance, and make them a high priority.

I. Need for Improved Access to Capital

Access to capital is the major challenge facing farmers and their cooperatives. Instead of being able to look to Wall Street and outside investors for capital, farmer cooperatives, which are farmer owned and controlled, are largely dependent on their farmer members as a source of capital. This limited pool of capital becomes even more limited when economic conditions are as challenging as they are today.

A. Enhance USDA's Business and Industry Loan Guarantee Program for Farmer Cooperatives

To help meet the capital requirements of farmers and their cooperatives, we recommend that USDA's Business and Industry (B&I) guaranteed loan program be modernized and strengthened as it applies specifically to farmer cooperatives.

Specifically, we recommend the following:

1. Eliminate the current \$25 million maximum loan guarantee for farmer cooperatives.
 - ◆ This would make the program for farmer cooperatives consistent with other USDA lending programs for other types of cooperative borrowers, and provide greater flexibility to meet the capital requirements of farmer cooperatives in today's global economy. In most cases, the current limitation is actually even lower since USDA has generally limited the size of such loan guarantees to a maximum of \$10 million. Such a restriction limits the effective use of the program by farmer cooperatives for the benefit of their farmer members.
 - ◆ The current limitation also fails to recognize the increased costs and capital requirements involving commercially viable projects since it was established. For example, in the 1970's, B&I loan guarantees helped Texas cotton producers finance a cotton denim mill, allowing them to capture the additional value created by further processing and marketing their cotton in the form of denim, while also helping create additional jobs. Today, such a facility would cost an estimated \$100 million or more and would not be possible with the current limitation on the B&I loan program.
2. Eliminate requirement that farmer cooperative borrowers or their related plants, equipment and facilities be located in areas of 50,000 or less in population.
 - ◆ Such a limitation adversely affects sound business decisions by the farmer owners, directors and management of a farmer cooperative in terms of the strategic location of plants and facilities necessary to be competitive and commercially viable, and thereby able to generate desired returns to the cooperative's farmer owners for the purpose of improving their income.
 - ◆ Increasing expansion of urban and suburban areas, along with population growth, has resulted in many farmer cooperatives no longer being eligible under the current program since they are now located in areas that exceed the 50,000 population threshold.

- ◆ Regardless of business location, earnings of farmer cooperatives are returned to their farmer owners on a patronage basis, thereby improving their income, and contributing to the economic and tax base of rural communities where they reside.
3. Require consideration of both tangible and intangible assets, and unsecured subordinated debt, in the case of farmer cooperative borrowers, consistent with recognized commercial lending practices and in accordance with generally accepted accounting principles.
 - ◆ Currently, in the case of farmer cooperatives, USDA allows consideration of only tangible assets. Commercial lenders, however, generally recognize there is considerable value associated with brands, licenses, patents and trademarks, and will take into account such intangible assets subject to appraisal when evaluating the eligibility of a potential borrower. This also applies to unsecured subordinated debt, which can be viewed as equivalent to equity. The effect of USDA's current guidelines is to reduce the ability of farmer cooperatives to access needed capital on an affordable basis under the program.
 4. Provide minimum loan guarantees of 90% in the case of farmer cooperatives to make the program more consistent with other USDA programs for other types of cooperative borrowers.
 - ◆ Under the current program, USDA has authority to provide up to 90% loan guarantees. However, actual guarantees are generally limited to 80% up to \$5 million; 70% for loans from \$5-10 million; and 60% for loans from \$10-25 million. Such limited guarantees have the effect of increasing the cost of capital for farmer cooperatives relative to other types of cooperative borrowers which, in turn, impacts the cooperative's farmer owners.
 - ◆ Requiring USDA to fully utilize existing loan guarantee authority in the case of farmer cooperatives would help improve access to need capital and credit on a more affordable and cost effective basis, improve cash flow, enhance returns and the commercial viability of related projects.
 5. Eliminate 2 percent loan origination fee to make the program more consistent with similar programs for other types of cooperative borrowers.
 - ◆ The current fee structure imposes a significant cost on the farmer members of a cooperative. The result is to reduce available capital, or reduce cash flow due to higher effective interest rate. Eliminating the fee would make capital available on a more affordable and competitive basis, and enhance the commercial viability of a project, especially new, start-up ventures for value-added purposes.

6. Provide authority for USDA to allow repayment terms up to 35 years on guaranteed loans for farmer cooperatives to make the program more consistent with similar programs for other types of cooperative borrowers.
 - ◆ USDA B&I loan guarantees generally include terms of up to 7 years for working capital, up to 15 years (or useful life) for equipment and up to 30 years for real estate. Increased flexibility would better enable the program to meet the needs of farmers and their cooperatives especially during start-up and initial phases of operation.
 - ◆ Longer repayment terms would also help farmer cooperatives meet costly environmental and other regulatory requirements. For example: EPA's sulfur-diesel and gasoline regulation is projected to require as much as \$400 million or more to re-engineer existing farmer owned cooperative refining facilities. USDA should have required flexibility in their programs to help meet such needs. Another consideration: farmer cooperatives are a critical component of rural energy infrastructure, accounting for 40 percent of on-farm fuel needs. Being farmer-owned, they have a unique accountability to their farmer owners, making them a dependable and competitive source of energy-related products.
7. Modify current authority established under the 1996 Farm Bill providing guaranteed loans to farmers for the purchase of stock in a farmer-owned cooperative for value-added purposes to include existing as well as new, start-up, farmer-owned cooperatives.
 - ◆ The current program, which applies only to new, start-up ventures, in effect discriminates against farmers who are members of existing cooperatives who are looking to modernize and expand into more value-added business activities for the benefit of their farmer owners. Clarifying existing authority would address this issue and ensure that farmer members of existing cooperatives have equal opportunity to participate in value-added activities.

B. Establishment of an Equity Capital Fund

We also recommend the Committee consider authorizing the establishment of an Equity Capital Fund as has been proposed to further help attract capital to rural America for the benefit of farmers and their cooperatives, as well as other types of rural businesses.

II. Revitalize USDA Programs in Support of Farmer Cooperatives

The other major area where federal agriculture policy needs to be focused is on revitalizing USDA programs, including research, education and technical assistance, whose objectives are to enhance the ability of farmers to join together successfully in cooperative self-help efforts. If farmers and their cooperatives are to be successful in moving into more value-added business activities, they must have the right tools and assistance.

- A. Farmer Business Cooperative Service - We recommend that a separate agency be established with USDA to be called the Farmer Business Cooperative Service that is totally dedicated and focused in support of farmer cooperatives. In addition, the Under Secretary for Rural Development should be designated the Under Secretary for Rural Development and Cooperatives.
- B. Research, Education and Technical Assistance Programs - We also recommend that not less than \$6 million annually should be specifically authorized for the new agency for the purpose of administering and carrying out research, education and technical assistance programs within its mission area in support of farmers and their cooperatives. Further, we recommend that not less than \$6 million annually should be authorized for cooperative grants relating to such programs to be administered by the Farmer Cooperative Business Service.

Since the elimination of what was the Agricultural Cooperative Service in 1994, there has been no agency within USDA that has been totally dedicated and focused on helping farmers join together in cooperative self-help efforts. We believe there needs to be a separate agency with that mission and it deserves a high priority.

In addition, there is currently no separate authority for funding for such activities. Instead, funding for such activities currently comes out of the salary and expense budget for USDA as part of the appropriations process. This makes long term planning very difficult and adversely affects program continuity, especially with regard to programs relating to farmer cooperatives.

- C. Value-Added Technical Assistance Grants - We also recommend that the Value-Added Technical Assistance Grants Program be continued at not less than \$50 million annually to assist farmers and their cooperatives in capitalizing on value-added business opportunities.

Conclusion

Mr. Chairman, we believe including these recommendations in the Farm Bill is essential as part of a long-term strategy to help farmers improve their economic well being and profitability. Farmers need to gain a greater stake in value-added activities beyond the farm gate to improve their income from the marketplace, better manage

their risk, capitalize on new market opportunities, and compete more effectively in a rapidly changing global economy. We believe this can best be achieved through public policies and programs that encourage and enhance the ability of farmers to join together in cooperative self-help efforts. Accordingly, we look forward to working with you and the members of this Committee to help achieve these important goals.

Thank you again, Mr. Chairman, for the opportunity to share our views and recommendations.

Regional Report: 'Angels' Unite to Invest Locally --- Networks of Angel Investors Are Forming to Keep Capital in Rural Areas

By Robert Gavin
Staff Reporter of The Wall Street Journal

08/29/2001

The Wall Street Journal

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LONG OVERLOOKED by traditional venture funds, out-of-the-way communities are creating networks of so-called angel investors to provide the capital needed to fuel start-ups and boost local economies.

Angel investors are wealthy individuals who make early-stage investments in new companies. Typically, these angels have acted alone or in loosely formed groups. But now capital-starved communities are creating formal structures both to build investment pools and make it easier for entrepreneurs and angels to find each other. The goal: keeping local capital local.

In many ways, these angel networks represent a return to earlier days in small-town America, when, before mergers ended local control of financial institutions, local bankers would pull together Main Street business leaders to invest in promising ventures.

Even the poorest places have wealth that could be tapped for business investment, says Don Macke, director of the Rural Enterprise Initiative, a national economic-development effort based in Lincoln, Neb. For example, a recent study by the Nebraska Community Foundation, a nonprofit development agency, estimates that \$94 billion in land and assets will be transferred from one generation to another over the next 50 years in rural Nebraska. The problem, says Mr. Macke, is this wealth "is being invested outside these local communities."

Last week, new angel investment networks were announced in Bozeman, Mont., and Grand Forks, N.D. In Minnesota, the Minnesota Investment Network Corp., a St. Paul-based nonprofit economic-development agency known as MIN-Corp., is trying to organize at least 10 angel networks, each with funds of \$500,000 to \$1 million, in rural areas of the state. Already, two are up and investing -- Lakes Venture Group in Alexandria (population 8,820) and Prairie Capital in Worthington (population 11,283) -- while a third, in Albert Lea (population 18,356), is raising capital.

In Idaho, the Department of Commerce is encouraging the formation of an angel network in Idaho Falls while trying to build connections between existing networks in Boise and Coeur d'Alene. The result, officials hope, will be a statewide system to connect entrepreneurs and investors.

And the Rural Enterprise Initiative is working with agencies in at least seven states to develop similar capital-raising structures to aid economic development.

"Over the last 50 years," Mr. Macke says, "we've developed a culture that we go to USDA [U.S. Department of Agriculture] for subsidies and low-interest loans, and try to bring in branch plants that pay \$8 an hour. We've gotten away from investing in local companies."

Access to capital has long been a problem in many states, particularly in rural areas, as nearly three-fourths of the nation's venture investments have been concentrated in a handful of states, with California alone sucking up nearly half the money. Last year's technology crash hasn't made it any easier. Equity investments in the first half of this year plunged to less than \$20 billion nationwide from more than \$50 billion in the first half of 2000, according to PriceWaterhouseCoopers's Money Tree Survey.

Angel investors, especially, are pulling back. Angels, corporations and other nontraditional venture capitalists accounted for about 10% of equity investments in the second quarter of 2001, compared with a peak of 24% in the first quarter of 2000, according to the Money Tree Survey.

But, say investors, entrepreneurs and economic-development officials, angels are still looking for promising new ventures -- plus an opportunity to boost their communities.

The Lakes Venture Group in Alexandria, Minn., provides an example. The group of 17 angels, who capitalized a \$580,000 fund, invested about \$100,000 in AbbeyMoor Medical Inc., a two-year-old, medical-device maker in nearby Milltona, population 181. John Reid, the company chairman, says that investment, along with \$500,000 investment from MIN-Corp., anchored a recently completed \$2.5 million round of financing needed to conduct clinical trials to win U.S. regulatory approval.

"There is capital in a lot of rural areas, and there are deals, but there is just not a good capital system to bring them together," says Keith Anderson, one of the Lakes angels. So, "instead of putting money in a mutual fund that ends up in New York City or Silicon Valley, let's put in a system so local investors can invest in local entrepreneurs."

Rural angel networks are following one of two general models. One follows the tradition of the small-town banker, in which a facilitator, like MIN-Corp., organizes local angels to pool money in a fund, and provides legal and technical support. The recently announced network in Grand Forks, N.D., is using this model, and is capitalizing a \$1 million fund known as the Center of North America Capital Fund.

In Bozeman, Mont., TechRanch, a nonprofit business incubator, is taking a different approach, acting more as a matchmaker. Its Montana Private Capital Network uses an Internet-based system that allows entrepreneurs to submit business plans online and matches them with the interests of angels. John O'Donnell, Tech Ranch's executive director, expects to have at least 200 Montana angels, with a total of some \$10 million in capital, participating by year's end. Already, 50 angels have joined the network and eight start-ups have submitted business plans.

To be sure, angel networks won't end capital shortages in these off-the-beaten-track places, in large part because of their limited resources. Robert Heard, president of the National Association of Seed and Venture Funds, an Oklahoma City-based organization of government and nonprofit agencies that promote capital formation, warns that angel networks can have short lives. Not only can risky investments evaporate quickly -- drying up angel funds -- but they also demand constant attention and effort that nonprofessional investors have difficulty maintaining.

In addition, angels typically can raise capital to invest in only the earliest stages of a company; ultimately a successful start-up still may need to turn to the deeper pockets of traditional venture-capital funds.

Nonetheless, a well-timed early investment can provide big dividends: a \$1 million angel investment in 1978 by agribusiness tycoon J.R. Simplot, for example, propelled Micon Technology Inc. of Boise from struggling start-up to fast-growing company that employs more than 5,000 in Idaho. Ron Ryan, CEO of Money Suite Co., a two-year-old software start-up in Missoula, Mont., that recently launched a second round of fund raising, says any initiative that helps expand the pool of available capital can only help.

Says Mr. Ryan, "What these guys are doing is bringing water to the desert."

QUESTIONS AND ANSWERS

AUGUST 2, 2001

Questions for the Panel

1. The relationships between local, regional, and state organizations with federal agencies whose primary responsibility is the implementation of rural programs and policies is critical for the programs' success. As we have seen in some rural areas, the lack of resources at the local level presents a major problem for rural communities who would like to participate in the federal programs. Most rural communities lack the professional expertise and financial resources to solely fund and generate comprehensive economic development strategies. Many rural leaders are not cognizant of the federal programs intended to assist their communities, and if so, they are not trained at completing the application process.

When looking for assistance with environmental infrastructure projects, communities can find themselves in a maze of programs. The Indiana Rural Development Council established the Environmental Infrastructure Working Group. The Working Group has been successful in helping communities identify potential funding sources for water and wastewater projects. The purpose of the Working Group is to bring together representatives of various state and federal agencies to meet with communities one-on-one to discuss all funding and technical assistance options at one time.

This program is not available in every state. What are the obstacles to instituting similar interagency working groups to this in every state? And do you feel that these programs are worthwhile?

2. USDA has done much to assist in the development of infrastructure in rural areas. This covers electricity and telecommunications systems and water and sewer systems. What continuing role do you see for USDA in these areas? Are there needs that USDA still has to address? What do you see as the top priority for USDA in these areas?
3. The Rural Utilities Service telecommunications program has an outstanding record of service in bringing telephone service to rural America without a single loan default. That program is now being called upon to perform the same task in bringing broadband access to rural America which may involve not only traditional phone systems, but also satellite, cable, microwave, fiber optic, and other technologies. In the first wave of applications for the new broadband loan program this year, RUS has been confronted by many new companies seeking to provide this service with little equipment against which to place liens required to secure loans. We all know the current economic upheaval going on in the information technology and related telecommunications marketplaces. As we examine proposals for increased loans to support rural broadband access that are likely to be part of the farm bill, what recommendations do you have to ensure that the government's investment is protected?

CENTER *for*
RURAL AFFAIRS



August 23, 2001

Ver' Shawn Perkins
Senate Agriculture Committee
(202) 224-2035 9287

Follows my response to the questions mailed to witnesses at the August 2 hearing on rural development.

1. I do not have the experience or expertise to provide an informed response to this question.
2. There are continuing needs for USDA to address in telecommunications and water and sewer. Many small, low-moderate income communities are struggling with deteriorating water and sewer systems and/or systems that do not meet EPA standards. They simply cannot afford the cost of coming into compliance in many cases without federal assistance. In telecommunications, there are profound needs. If small communities are to survive, we must close the digital divide to ensure they have high quality Internet access. Those communities that do not gain such access will have little future. The problem for small, remote communities is that the high cost of serving them relative to the potential business volume. The distance between users and the absence of high volume business users in most rural communities make the returns low in relation to the high fixed costs. If we believe that all communities should have quality access to the Internet, because of its essential nature in the future, then government must play a role. Just as just as government acted to provide all communities access to postal services, electricity and telephone, it should act to provide universal access to the Internet.
3. I do not have a specific suggestion on how to secure loans, but I would like to offer a bit of perspective on what I see in rural Nebraska. In many cases, smaller telephone companies – in some cases privately held and in other cases cooperatives – have been most aggressive in providing quality Internet access in rural areas. Some of the large providers whose service areas include both metropolitan and rural areas have been less aggressive in provide quality rural access. One could surmise the reasons for that. The large regional providers have the opportunity to earn higher returns in investments in metropolitan areas. By contrast, smaller providers know their future is tied to the future of the rural areas they serve and thus they have moved more aggressively to serve them. Whatever steps are taken to secure telecommunications loans should not have the effect of disproportionately denying assistance to the smaller providers who have often shown the greatest commitment to upgrading service.

Sincerely,

Chuck Hassebrook



INDIANA 15 REGIONAL PLANNING COMMISSION

610 MAIN STREET
P.O. BOX 786
JASPER, IN 47547-0786

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August 31, 2001

United States Senate
Committee on Agriculture, Nutrition, and Forestry
Attn: Mr. Robert Sturm, Chief Clerk
Washington, DC 20510-6000

Originally Faxed: 1-202-224-2587 Page(s): 3

Dear Mr. Sturm:

For review and reference for the members of the Senate Agriculture, Nutrition and Forestry Committee as requested, please find these remarks as my response to their questions.

Question 1. Obstacles to instituting similar interagency working groups such as the Indiana Rural Development Council's EIWG, and do I find these programs to be worthwhile?

Response: Several states have formed Rural Development Councils to varying degrees of success or failure. Any such council is only as good as its board members and its director, with successes frequently built on strong connections to regional development commissions or other similar regional economic development districts -- built from this long-standing point of strength and capacity at the local level that has hands-on experience in making federal programs work.

For the most part, in my genuine opinion, Rural Development Councils are beneficial and meaningful *only* when they provide for federal and state intergovernmental coordination: single application processes, single environmental review processes, and coordinated funding policies (consider researching Arkansas's program as a model). If or when state USDA directors or EDA economic development representatives refuse to think beyond what is standard operating procedure, any such efforts in intergovernmental coordination will fail. Only with key personal commitments from USDA, EDA, as well as the state's CDBG director, will any such effort succeed. And further, in my opinion, it isn't necessary for states to form a Rural Development Council to have this kind of coordination; it could be led by the state USDA director. To my knowledge, the Indiana Rural Development Council's board of directors voted to phase out their administrative role in EIWG at their board meeting in 2000.

In addition, to quote one of my town council presidents regarding EIWG, "It just repeated what you had already told us for funding of our (wastewater) project, but we'll do what we have to do." When regional planning commissions or similar regional economic development districts exist and are staffed properly, they are the professional and administrative capacity to assist communities find their way through the "maze of programs".

Rural Development Councils and groups such as EIWG cannot replace local capacity afforded by regional commissions such as Indiana 15 RPC. The Rural IMPAC

program as proposed by the National Association of Development Organizations would further this necessary local capacity and would directly link USDA with regional efforts to further rural development, to not only guide communities through the “maze of programs”, but would also further enable the actual development and administration of such programs to their fruition.

Questions 2 and 3. What is the future role of USDA in rural utility infrastructure, rural development needs to be addressed, and what should be top priority for USDA within these areas? Recommendations regarding ensuring the governments investments in rural broadband capacity and minimizing associated risks.

Response: USDA will continue to be an important source for funding of water and wastewater, electricity, and telecommunications well into the future for rural communities. Many rural communities, both municipal and non-profit organizations, must utilize USDA loan and grant funds to provide for infrastructure for water and wastewater in particular as these can be multi-million dollar projects. Over the past several years, however, state-operated revolving loan funds for wastewater projects are cutting into the lending area traditionally held by USDA in that these state RLFs have lower/better terms on debt financing than USDA and have a significantly quicker process time. The backlog for funding of these conventional projects by USDA is tragic, pointing to the great deficiency of funding for rural infrastructure.

USDA, as is noted in the remarks previously made by RUPRI, is an instrument of the federal government that primarily operates by lending funds, *not granting funds*, for rural development needs. In the early years of electrification and telephone utility development, private citizens serving on cooperatives would sign personal notes as collateral for USDA loans – this is not an option for rural areas anymore, and the differences and difficulties in developing critical telecommunications capacities for rural areas is becoming evermore evident. The point is that telecommunications beyond telephone services is still an *optional utility* especially for rural areas, and therefore particularly risky for local providers and local cooperatives. **There is a priority need for developing and funding additional grant programs for rural telecommunications capacity.** This day and age will not see local citizens putting their homes and properties at risk as they did to develop rural telephone and rural electric utility systems.

Currently, Indiana 15 RPC is facilitating/negotiating a three-party regional telecommunications initiative that involves a municipal electric department, regional telephone cooperative, and private utility in a \$10+ million regional project to provide broadband telecommunications capacity. There is approximately a \$3 million gap in financing that cannot be collateralized against existing infrastructure due to state and/or federal regulations, let alone by basic good business practices. How is this gap to be filled? Additional debt is not the answer. Therefore Indiana 15 RPC is leading this initiative to approach EDA with this project as a possible Public Works Grant project in that RUS programs again are only *debt financing*, and NTIA grant programs are once a year and totally overwhelmed by the number and amount of applicants that primarily are more urban in nature.

More debt is not the answer to the needs of rural communities, and yet USDA is viewed as the primary agency for rural development, which mostly operates

programs that are *debt* programs. We have done more with CDBG grant funds from HUD, and Public Works grant funds from EDA for critical rural development projects than we have ever brought to fruition with USDA other than for basic projects in water and wastewater infrastructure. More debt is not the answer.

If there is one additional critical need for USDA to address beyond its program and funding needs, it is inefficient, cumbersome and lengthy processing of applications and disbursements, and ineffective staffing. Whether it is in housing or infrastructure programs, USDA has much to improve in staff competency and productivity. There are ineffective staff and bottlenecks within the USDA bureaucracy nationwide detrimentally effecting rural communities daily. Further efforts must be made to totally re-think USDA as an agency, let alone their programs.

In that I have accepted a position in Alaska and will be leaving this post as of September 27th, my remarks are perhaps more candid and more pressing that I otherwise would have prepared. Once I vacate this post, I will have no financial interest in the success of funding for the Rural IMPAC program or in reorganizing/re-thinking USDA programs. I am, however, very concerned that the Senate Ag Committee know what is and is not working for rural America, and what truly is needed to change matters for the better. I also would like to point out the fact that not a single elected official from a rural county or rural community was present to testify before the Senators on August 2nd. These citizens that benevolently serve our rural areas as local elected officials are key to and critical for the success of much of the Congress's efforts to address rural development needs. Please ask for their input and further seek their counsel; they must be a part of helping re-think rural development programs for this great nation.

My best regards to you and my great appreciation for the opportunity to testify and submit these further remarks,

Yours in public service,
INDIANA 15 REGIONAL PLANNING COMMISSION



Karen S. Dearlove
Executive Director

Questions for Dr. Deborah Markley:

1. In your recently published study on nontraditional sources of venture capital for rural America, you note that successful rural equity funds share certain characteristics. Some of these characteristics include having and maintaining skilled and experienced venture capital management, providing financial incentives for management based on the fund's success and limiting political influence on the fund's investment decisions. However, you are careful to note that a "one-size-fits-all" model does not exist. How can Congress develop legislation that incorporates these characteristics but provides enough flexibility to allow us to meet the unique venture capital needs of rural America? Is there already a federal model out there that we should use as our basis?
2. We've heard a great deal about the need to get venture capital into rural America. Our Committee Chairman in the last Congress introduced legislation to create a national public-private equity fund to provide venture capital to rural businesses. For urban businesses, the past Congress enacted the New Markets Venture Capital Program which guarantees debentures and provides grants for private venture capital funds. These examples represent two different approaches for Federal venture capital initiatives: a national fund to provide venture capital directly to businesses and a national fund to guarantee private venture capital funds. Dr. Markley, you've examined these types of approaches in an article in the May 2001 issue of "Rural America." Based on your experience, which approach is likely to be more successful in ensuring the proper venture capital management expertise needed to get the greatest return in business creation in rural America for the Federal investment?
3. Why have the federal government's past efforts to encourage venture capital investments in rural America failed?
4. The National Rural Leadership Forum's Fall Conference recommended that the New Farm Bill include provisions that grant rural development flexibility to the states in order to optimize the potential benefit for rural America. Examples include, state rural development block grants and giving more discretion to State Rural Development Directors. As chair of the National Rural Leadership Forum, could you elaborate on the benefits of the Forum's recommendations?

**Response to Questions from Members of the
Senate Agriculture, Nutrition, and Forestry Committee**

**Dr. Deborah M. Markley, Chair
Rural Policy Research Institute's Rural Equity Capital Initiative**

1. The RUPRI research team developed a set of shared characteristics of successful nontraditional venture capital funds from case studies of 23 institutions across the U.S. These characteristics include:
 - A skilled management team was rewarded through an appropriate incentive structure recognizing sound investment behavior that achieved institutional goals.
 - Adequate resources were devoted to deal flow development and/or creation.
 - Capitalization of the fund was optimal to provide for a diverse portfolio and follow-on investments.
 - Managers gave significant, but not always primary, attention to fund rate of return to maintain the long-run sustainability of the program.
 - Fund managers conducted rigorous due diligence prior to investments and adequate technical and management assistance post-investment.
 - Fund was structured to minimize political interference in investment decisions, even when public capital was used.

While successful funds share these characteristics, each case study fund chose a unique institutional structure that made sense given the conditions and constraints in the local, regional, or state environment. For example, a small community bank chose to use its own capital to create a bank SBIC because the bank operated in a small region and had limited potential to attract outside investors to a venture capital fund. Another regional venture fund chose a corporate structure that satisfied the interests of foundation investors seeking a permanent venture capital presence in the region.

How can the federal government use this information in crafting a federal policy to enhance rural venture capital availability? The answer is twofold. One, any federal policy can use the characteristics of successful funds in allocating federal investment among existing or newly created rural venture capital funds. Through a competitive process, rural venture funds could be selected to receive federal investments by showing that the fund has:

- Devoted the time and resources to identifying and developing deals in their rural regions.
- Strong, experienced managers capable of investing in and providing support to rural businesses and entrepreneurs.
- A presence within the rural environment, permitting close contact and interaction with portfolio companies.
- Given significant attention to fund sustainability while targeting resources to rural businesses.

Two, federal policy can provide flexibility by recognizing that rural areas and the institutions that serve them are unique and that there is no one venture capital model that will work in all places. Federal investments can be made in a range of venture capital funds: new and existing; SBICs and private corporations; stand-alone funds and subsidiaries of existing organizations. The litmus test should not be the structure of the fund but whether the fund has the characteristics to successfully invest in rural America.

Some existing federal programs can provide guidance in this area. The SBA's SBIC program uses a very thorough review before an SBIC license is granted to ensure that the management team has the experience to effectively manage a venture fund. The New Markets Venture Capital Program requires applicants to provide a business plan for making developmental venture capital investments, a description of how the fund will work with other community organizations, and a proposal for how any technical assistance grant monies will be used.

2. Venture capital investing is a hands-on activity. Venture fund managers sit on the boards of their portfolio companies and, when necessary, are actively involved in company management. These managers rely on local intelligence to build a successful venture capital investment portfolio—understanding both the business and the people that are part of the investment. Innovation in venture capital markets occurs at the local level—this is where the need is identified, this is where the local intelligence is generated, and this is where the investment decisions need to occur.

The importance of local decision-making and local innovation is even greater in a rural venture capital market. One of the most significant constraints faced by a rural venture fund is identifying good investment opportunities from the relatively limited deal flow in many rural areas. In some cases, the businesses are present but the need for venture investment is not yet recognized. In other cases, the entrepreneurs are present but their ideas need to be developed into viable businesses. In still other cases, businesses have a defined need for venture capital that has been unavailable previously in the rural market. In all these cases, successful venture investing can occur only when a skilled manager is on the ground in a rural area, working with entrepreneurs and businesses to identify venture capital needs.

The local, hands-on nature of venture capital investing suggests that any federal policy to encourage rural venture capital investments should be focused on supporting the existing and potential innovation at the local level. The RUPRI research project found examples of innovation at the community, regional, and state levels. There are lessons to be learned from these innovators that can support the expansion of these efforts to other rural regions in the country.

While the focus is on encouraging local decision-making and innovation, achieving scale is important. We need to get more venture capital into rural

America, helping more entrepreneurs develop businesses and helping more businesses grow. However, it is important to distinguish between the need for scale in the rural venture capital industry and scale in the context of any single venture capital fund.

There is some correlation between fund size and size of investments made. For most rural business enterprises, equity capital needs likely fall below \$1 million in the first round of investment. (This compares to the overall U.S. average second quarter 2001 venture capital investment of \$15 million.) A venture fund capitalized at \$10 million (most of the funds in the RUPRI study were capitalized at \$10 million or less) would be able to make about 8 investments and a one or two-person management team could adequately oversee these investments.

As the size of the venture fund increases, the size of the venture capital investment generally increases as well. In terms of time and money, a \$10 million deal costs as much to manage as a \$1 million deal and, in fact, the smaller deals associated with rural funds likely require more technical assistance and, as a result, are higher cost. For example, a fund capitalized at \$200 million might support a management team of 5 professionals managing about 30 deals averaging \$6-10 million. It is difficult to see how this same fund could focus on rural deals of less than \$1 million. This hypothetical fund would have to manage about 180 deals, requiring a management team of about 30 professionals.

Any federal effort needs to be capitalized at a level to help the rural venture capital industry achieve scale and leverage private sector funds. This support can be provided by making investments in local, regional, or state funds, both existing and newly created, that have as their focus investment in rural businesses, both farm and nonfarm, rural cooperatives, and entrepreneurs.

3. There has been no focused federal effort to encourage venture capital investments in rural America. Existing federal programs, such as the SBIC program and the bank CDC program, have not been targeted to rural areas and, as a result, have been underutilized by existing rural institutions. To make an impact on rural America, federal programs need to be targeted to rural areas and recognize the obstacles to venture capital investing in rural places.
4. The one commonality in rural America is diversity. Rural places and rural people are diverse and face unique opportunities and constraints. In particular, venture capital needs vary across rural communities, as do the sources of capital. As a result, federal policies or programs to support the creation and/or expansion of venture capital infrastructure across rural America must be flexible enough to support local innovation wherever it occurs. At the same time, it is important to recognize that within each state, a unique set of institutions may be in the best position to craft and implement an effective rural development strategy. Federal policies and programs need to be flexible. Rather than allocating funds to one pre-selected set of state organizations, funds could be allocated using a

competitive process similar to that proposed above for venture capital investments. Within each state, organizations would apply for federal funds or investments by demonstrating a regional, collaborative approach to rural development. Federal policies could reward and encourage innovative, interjurisdictional collaboration through this process.

Steve Lane, President, Iowa Independent Bankers
 President and CEO of Security Savings Bank, Gowrie, Iowa.
 Response to Senate Agriculture Committee's Questions
 August 2nd Rural Development Hearing

Question – What are the obstacles to establishing Working Groups that could identify potential funding sources for water and wastewater projects? Are these programs worthwhile?

Answer – I believe that establishing such groups would be helpful for many rural areas and perhaps should be expanded to providing other types of assistance and resources. Many county governments lack personnel, funds and services to help rural communities apply for funding. Recently there was a comprehensive county government survey — undertaken by Ohio State University — that found 60 percent of metro-county governments have an economic development professional on staff, as compared with 34 percent of non-metro (i.e. rural) county governments. County governments have an economic development professional on staff in only 11% of rural counties and 39% of adjacent counties compared to 61% of metropolitan counties.

Furthermore, grant-seeking capacity is much lower in nonmetropolitan counties as compared to metropolitan counties. Only 28% of rural counties but 51% of metropolitan counties have a grant writer on staff. This means that counties without a grant writer will be unable or less able to obtain financial assistance from various government programs.

In the future, some of the need in this area could be partially provided by being able to offer rural communities assistance with identification of funding sources and grant writing over the internet. For example, "1stSource" is a service of the Federal Reserve Bank of Kansas City to help developers, community development practitioners, stakeholders, and resource providers quickly and easily access information about public programs to assist community and economic development projects. The one-page summaries are reviewed by each participating agency prior to becoming available on the public site. Any program changes or additions are the responsibility of the sponsoring agency. USDA could help coordinate and market these types of efforts in addition to providing more hands on assistance and funds to rural communities.

Question – USDA has done much to assist in developing infrastructure in rural areas. This covers electricity and telecommunications systems and water and sewer systems. What continuing role do you see for USDA in these areas? Are there needs that USDA still has to address? What do you see as the top priority for USDA in these areas?

Answer – I do believe that USDA should have a continuing role in enhancing rural infrastructure. The infrastructure in rural America needs to be a key focus of USDA because many communities are falling behind. As referenced in my testimony, in some communities the struggle to provide adequate services/infrastructure is a function of loss of population. That is why we need to ensure our rural programs have a population criteria with no exemptions allowed. This includes not allowing exemptions for farmer owned cooperatives headquartered in larger, non-rural cities, which the House Ag Committee's farm bill provides in the B&I program. The top priority for USDA programs should be to keep people in rural areas and ensure programs, wherever possible, have a rural job creation component.

Another reason some rural communities struggle to maintain services and infrastructure is lack of adequate financial resources which causes fiscal stress. For example, fiscal stress was reported as an important problem by more than two-thirds of all county governments. Governments in 38% of rural counties, 31% of adjacent counties, and 24% of metropolitan counties reported reduction in federal revenue as a very important problem. A declining local tax base is an important source of fiscal stress in 40% of rural counties, 31% of adjacent counties, but only 12% of metropolitan counties.

This fiscal stress reported by many rural counties underscores two important points in regards to the Farm Credit System (FCS). First, the FCS and its entities, including CoBank, should not be able to expand into non-farm lending areas. Because the FCS has tax exemptions, such expansion takes away money from the local tax base of many rural counties because lending that would normally be done by private sector, tax-paying, lenders will be shifted to the FCS due to their competitive advantages as a government sponsored enterprise. The second aspect relating to the FCS would be that the Senate Ag committee should not allow CoBank the authorities they requested before the Senate Ag Committee. For example, allowing CoBank to make loans to telecommunications companies who do not borrow from USDA's RUS is vague, undefined and unnecessary. CoBank appears to want to make loans to Sprint, AT&T, and other large corporate behemoths. The Committee should not allow CoBank to focus attention away from rural America by financing these large corporations, which the private sector already adequately serves.

Question – What recommendations do you have to ensure that the government's investment is protected in terms of providing loans to support rural broadband access when companies seeking to provide services have little collateral in terms of equipment that can be used as security?

Answer – USDA needs to do its due diligence to make sure that any RUS loans are sound. Greater use of guaranteed loans, where outside lenders share some of the risk, could be explored. Additional incentives for small companies could also be explored. This could include helping small telecommunications companies line up venture capital or help from USDA to establish angel capital networks (see attached article from the Wall Street Journal). Legislation introduced to establish a rural equity fund may also be of help in this area. Paperwork and regulatory burdens should be minimized for providing broadband services in rural areas.

Again, demand from these companies for RUS funding, suggests that CoBank should not be able to divert their attention away from funding RUS participants and to funding non-RUS companies. Since the FCS has no CRA requirement, which commercial banks do have, the committee should consider mandating that FCS and CoBank provide some grant money for these types of companies to help them get started and to more clearly define FCS's social mission.



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August 30, 2001

Ms. Ver'Shawn Perkins
Documents Clerk
United States Senate
Committee on Agriculture, Nutrition, and Forestry
Washington, DC 20510-6000

VIA FEDERAL EXPRESS

Dear Ms. Perkins:

This is in response to the three questions the Senate Agriculture Committee asked members of the rural development panel (August 2, 2001, hearing).

Question #1: Relationship between local and federal agencies.

Response: CoBank is very involved with federal rural development programs, but much less involved with local and state development organizations. For that reason, other members of the panel can more adequately address the communication and coordination issues that exist between the federal and local agencies.

Question #2: Rural development infrastructure.

Response: USDA programs have historically done a good job in financing basic rural infrastructure. This is very important to CoBank and the agribusiness customers we serve. Marketing and processing companies cannot locate facilities in rural communities that lack adequate water, sewer, communications, or electric systems. In addition, employers cannot attract workers to communities that lack the community facilities that make for a good quality of life experience.

CoBank has also provided billions of dollars in rural infrastructure financing for telecommunications, water, and electric systems. We often work in partnership with USDA on these projects. There clearly continues to be a role for the federal government because many rural infrastructure projects simply cannot be financed exclusively with private sector funds.

However, we think there are many examples of companies that could attract more private sector financing (and would like to do so), but existing USDA rules and procedures discourage them from doing so. For example, we know of rural water systems that would like to refinance high interest federal loans (made years ago) with lower interest private sector debt. Unfortunately, these communities have received a formal or informal message from USDA that if they terminate their existing loan agreement they may not be welcome back at some future date. The USDA Inspector General's office has reported on this situation several times in the past, but we've seen no change in policy at USDA.

From a business standpoint, we find it remarkable that a rural community will feel obligated to forego an opportunity to refinance high-cost debt. By discouraging such refinancings for communities that could and want to reduce their immediate debt obligations, the government is effectively allocating resources to communities that have alternatives, while withholding resources from communities where the need is great. In addition, the rural community is paying an above-market rate for its debt, raising the costs to its consumers.

Question #3: Expanded financing for rural telecommunications.

Response: CoBank strongly agrees that large amounts of capital are and will be needed to upgrade telecommunications services that are far beyond the traditional POTS (plain old telephone service) that has been the hallmark of hundreds of small rural companies. In our financing of this industry, we have noted that it is increasingly difficult to identify companies, services, and technologies that have a sustainable formula for success.

To address the risk associated with financing this industry, CoBank employs a multi-lender strategy. This is a proven strategy used by banks that finance commercial enterprises of all kinds. The strategy is based on the philosophy that a lender should not make huge commitments to any single company, and that multiple lenders with expertise in the industry have an increased probability of making sound credit decisions. In addition, if there are losses associated with one company, they will not pose a threat to a single lender or the lender's commitment to serving the industry.

In this regard, we believe the Congress could take two specific actions that would help bring more capital to finance the expansion of rural telecommunications activities, which will be absolutely essential for rural economic growth.

First, RUS should be authorized and encouraged to develop programs that will involve multiple lenders. This will bring additional private sector expertise to the credit decision and reduce the government's exposure to individual customers. This approach to risk management is widely used by commercial lenders.

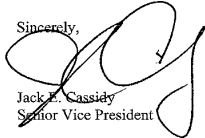
Second, CoBank's multi-lender authorities (authorized by Congress in 1992) should be updated. Specifically, current law includes limitations that effectively hinder our ability to work with commercial lenders that are originating loans to industries in which CoBank has expertise. Although we have sold \$4 billion in loans and purchased \$2.5 billion over the past 18 months, we have had turn down many opportunities to participate in loan syndications because of statutory limits that are not practical in today's business environment. The result has been less liquidity for commercial banks that are financing the industries important to rural America and limits on CoBank's capability to diversify our portfolio.

In addition to direct legislative action, current regulations limit our ability to participate in multi-lender transactions that are related to, but not directly involved in, the communications industry. Such companies provide products or services that are critical to the rural telecommunications companies. For example, commercial banks often ask us to participate in loans to equipment providers that are critical partners for the telecommunications companies that serve rural consumers. Our regulator could provide the flexibility to participate in such loan packages. This would help our current customers, diversify the bank's portfolio, provide additional liquidity to the originating commercial bank, and provide us with a better source of industry intelligence—strengthening our capability to serve the rural companies that are eligible to borrow directly from CoBank.

The loans referenced above would be originated by commercial lenders and would not be directly eligible to borrow from CoBank. CoBank would be one party to the "multi-lender" transaction. We believe current law would allow this, but some guidance from Congress to CoBank's regulator (the Farm Credit Administration) would be helpful in this area.

We look forward to working with the committee on specific proposals to address the above issues.

Sincerely,



Jack E. Cassidy
Senior Vice President