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# REA FINANCING



## HEARING

BEFORE THE

SUBCOMMITTEE ON CONSERVATION AND CREDIT

OF THE

COMMITTEE ON AGRICULTURE

HOUSE OF REPRESENTATIVES

EIGHTY-EIGHTH CONGRESS

SECOND SESSION

MARCH 5, 1964

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HEARING

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## CONTENTS

---

Campbell, Joseph, Comptroller General of the United States, letter of November 22, 1963-----	Page 28
Guthmann, Harry G., professor of finance, Northwestern University School of Business, statement of-----	2

2

# CONTENTS

1	Introduction
2	Chapter I
3	Chapter II
4	Chapter III
5	Chapter IV
6	Chapter V
7	Chapter VI
8	Chapter VII
9	Chapter VIII
10	Chapter IX
11	Chapter X
12	Chapter XI
13	Chapter XII
14	Chapter XIII
15	Chapter XIV
16	Chapter XV
17	Chapter XVI
18	Chapter XVII
19	Chapter XVIII
20	Chapter XIX
21	Chapter XX
22	Chapter XXI
23	Chapter XXII
24	Chapter XXIII
25	Chapter XXIV
26	Chapter XXV
27	Chapter XXVI
28	Chapter XXVII
29	Chapter XXVIII
30	Chapter XXIX
31	Chapter XXX
32	Chapter XXXI
33	Chapter XXXII
34	Chapter XXXIII
35	Chapter XXXIV
36	Chapter XXXV
37	Chapter XXXVI
38	Chapter XXXVII
39	Chapter XXXVIII
40	Chapter XXXIX
41	Chapter XL
42	Chapter XLI
43	Chapter XLII
44	Chapter XLIII
45	Chapter XLIV
46	Chapter XLV
47	Chapter XLVI
48	Chapter XLVII
49	Chapter XLVIII
50	Chapter XLIX
51	Chapter L

## REA FINANCING

THURSDAY, MARCH 5, 1964

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON CONSERVATION AND CREDIT  
OF THE COMMITTEE ON AGRICULTURE,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10 a.m., in room 1310, Longworth House Office Building, Washington, D.C., Hon. W. R. Poage (chairman of the subcommittee) presiding.

Present: Representatives Poage, Gathings, Jones of Missouri, Johnson of Wisconsin, Stubblefield, Hagan, Purcell, McIntire, Short, Harvey, and Dole.

Also present: Representative Teague of California; Hyde H. Murray, assistant clerk; Robert Bruce, assistant counsel and Martha Hannah, staff.

Mr. POAGE. The committee will please come to order.

The committee is met this morning at the request of our colleague, Mr. Teague from California, who has invited Dr. Harry G. Guthmann, Morrison professor of finance, Northwestern University School of Business, to speak to the subcommittee on REA financing.

Mr. Teague would like to make a statement.

We are delighted to have you do that, Mr. Teague.

Mr. TEAGUE. Thank you, Mr. Chairman. I shall be very brief. As I explained to you, I had to go to California due to a death in the family and I did not get back until late last night.

First, let me thank the chairman very much for his courtesy and cooperation in arranging this hearing this morning so that Dr. Guthmann can present his views on the subject of REA financing. It was particularly kind of you to do so, because Dr. Guthmann is going to be out of the country for several months. Therefore, the fact that you were willing to accommodate your time to his is much appreciated.

Secondly, let me say for the record I have two bills in on the subject of REA financing. I want to make it entirely clear that it is not my intention to abolish the Rural Electrification Administration nor to do away with REA cooperatives.

The purpose of my legislation is twofold. One is to equalize interest payments in the utilities field; in other words, to do away with interest subsidy now enjoyed by REA co-ops; secondly, to be sure that the REA Administration, in making loans to REA co-ops, is not encouraging going beyond the original intention of Congress as to the proper functions of REA cooperatives.

Thank you, Mr. Chairman.

Mr. POAGE. Thank you, Mr. Teague.

Now, I suppose the chairman ought to make a statement for the record. We are glad to have Dr. Guthmann here today and glad

to have him present any views that he wants to. The chairman wants to make it perfectly plain that as far as I know, I do not share any of Dr. Guthmann's views and I do not share Congressman Teague's views on this REA matter. That is not offered by way of criticism at all, but I do not want any implication that the fact that we are holding the meeting means that I am giving any personal approval to the viewpoints expressed.

Mr. TEAGUE. If the chairman will yield, I am very well aware of that, Mr. Chairman.

Mr. POAGE. We simply feel that everybody should have an opportunity to present their views to this committee, whether we agree with them or not. We do not agree among ourselves and we do not think the public does and we do not think it would be a good thing for the country if we did.

So I just want to make it quite clear that I do not see the need of the proposed legislation, but we are always glad to have those who feel there is need for legislation to suggest why they feel as they do. We shall be happy to hear from Dr. Guthmann.

**STATEMENT OF HARRY G. GUTHMANN, PROFESSOR OF FINANCE,  
NORTHWESTERN UNIVERSITY SCHOOL OF BUSINESS**

Mr. GUTHMANN. Mr. Chairman and members of the committee, my name is Harry Guthmann and I live at 718 Noyes Street in Evanston, Ill. I am a professor of finance, Northwestern University, in Evanston, in their school of business, where I have taught since 1927. I have taught in other places, such as the University of Texas, the University of California at Berkeley, and Syracuse.

I appreciate very much the opportunity of appearing before your subcommittee today. I may say that this testimony represents material that I have gathered myself. These are my own views and are not necessarily those of the university with which I am affiliated, or any one else.

My testimony will be on the subject of proposed legislation to raise the borrowing rate of Rural Electrification Administration from 2 percent to going cost of U.S. Treasury. The last time I noticed, there were something like 14 different bills with various provisions other than this one having to do with the interest rate.

Turning to the prepared testimony, you will notice I set out the two chief issues as follows:

First, whether such an increase would handicap REA operations; I felt that the REA has performed a very useful function and I would certainly hesitate to offer anything that would handicap greatly a job that has been necessary and essential, particularly in the setting in which it began during the 1930's. As an older person, why, I lived during that difficult period and I know some of the circumstances that made it extremely desirable at that time.

Second, the other question, as I see it, is whether such a change would be more equitable as between REA electricity consumers on the one hand, and the consumers who use electricity supplied by investor-owned utilities. In reading the material about this, I have noticed the implication of some protests against this change have been that it would handicap the REA intolerably, and even force the farmer

to go back to the use of candles, as one person put it. The fact of the matter is that earnings of the REA system have grown to the point that they now exceed a 4-percent rate on the amounts which have been borrowed from the U.S. Treasury. The figures which indicate that are as follows:

*Earnings of REA electric borrowers*

[In millions of dollars]

	1957	1958	1959	1960	1961
Utility operating margins.....	106	113	124	125	132
Nonoperating margins net.....	8	9	11	13	14
<b>Total earnings.....</b>	<b>114</b>	<b>122</b>	<b>135</b>	<b>138</b>	<b>146</b>
Interest on long-term debt.....	45	47	49	51	53
Times interest earned.....	2.5	2.6	2.8	2.7	2.8

Source: 1961 Annual Statistical Report, Rural Electrification Borrowers, p. XVI. Excludes figures for jointly-financed systems and those for which figures were not available.

Here we have the net operating margins of the utilities, with total earnings before interest on their long-term debt, which is their debt to the REA, which in turn is the debt to the Treasury.

The interest on the long-term debt is stated below that. Then the number of times the interest has been earned by those charges, or by those earnings is shown in the following line. You will notice they run from 2.5 times earned in 1957 to a figure of 2.8 times in the year 1961.

Now, let me emphasize what that means. When the 2 percent now charged REA borrowers is earned twice over, that means that they have earnings equal to 4 percent on total borrowing.

When it is earned 2.8 times as in 1961, it means their earnings equal 5.6 percent on the total borrowing.

These net margins, or earnings in excess of the amount needed to pay interest, are largely retained in the business. These amounts, insofar as they are not refunded to the members but are accumulated and held in the business, show up in the balance sheets under the headings of operating margins, nonoperating margins, and patronage capital. As shown in the table below, these amounts grew from \$382 million to \$680 million, or 78 percent, in the 4 years from the end of 1957 to the end of 1961, which was the last report available at the time I put this together.

(The figures referred to above are as follows:)

*Increases in retained earnings by REA electric borrowers*

[In millions of dollars]

	1957	1961	Increases
Patronage capital.....	184	404	220
Operating margins.....	176	226	50
Nonoperating margins.....	22	50	28
<b>Total.....</b>	<b>382</b>	<b>680</b>	<b>298</b>

Source: Ibid., p. XIV.

In short, the REA borrowers have built up a nest egg of owners' capital from amounts charged in excess of operating costs and interest totaling \$680 million by the end of 1961. If the net margins of \$93 million were duplicated in 1962 and 1963, and \$66 million were retained in each year as it evidently was in 1961, this accumulated capital should now exceed \$800 million. These accumulated earnings from the use of Government funds at 2 percent by ERA borrowers are now in the business, either in the form of utility property or investments and earning a return. But no interest or dividends have to be paid on such capital.

In the table above I set up the amounts of those three items of retained earnings by the REA borrowers under those three headings, "Patronage Capital," "Operating Margins," and "Nonoperating Margins."

These retained earnings were the chief source of funds that enabled REA borrowers to increase their net utility plant more rapidly than their borrowing during this period by some \$130 million. Long-term debt totaled \$70 million more than net utility plant in 1957 but was \$60 million less than in 1961. They also were able to increase their other—that is, nonutility—investments and property from \$192 million to \$403 million, or by some \$211 million.

Far from being a poverty-stricken system barely able to earn the 2 percent charged by the U.S. Treasury, the REA system has been able to earn more than twice that figure in recent years. Moreover, these surplus earnings have been largely retained so that the debt has been protected by an increasing margin of utility and nonutility assets.

In 1957, this supporting cushion of ownership equity amounted to 17 percent of the long-term debt. By the end of 1961, 4 years later, it had grown to 26 percent of that debt. This accumulation was predominantly retained earnings, although it included minor amounts of membership fees, and other equities. (These lesser items were less than 9 percent of the total \$744 million ownership equity in 1961. The total long-term debt at that time amounted to \$2,830 million.)

The majority of REA electric borrowers, then, should be able to pay 4 percent on money borrowed in the future without increasing their rates. They are already charging enough to yield that return and will continue to have surplus earnings on funds borrowed in the past. Even borrowers not earning 4 percent at present should do better with future money borrowed for expansion purposes. Growth and increased volume of business typically improve profitability in the utility business. Borrowed capital used for expansion should earn more than present capital rather than less.

With all but about 2 percent of our farm families served with central station power, REA expansion must consist chiefly of selling more families from existing lines and more electricity per customer rather than developing new territory. Only about 80,000 farms in the United States were without central station power at June 30, 1962. Yet REA-financed borrowers are providing electric service to about 120,000 new consumers annually. About five out of six new consumers are nonfarm. The number and importance of commercial and individual consumers is growing.<sup>1</sup>

<sup>1</sup> Report by the Comptroller General to the Congress of the United States, "Possibilities for Reducing Federal Expenditures Under the Electric Loan Program and Other Matters Pertaining to the Rural Electrification Administration" (November 1963) pp. 70-72.

But even if expansion yielded no economies and that minority of REA borrowers who barely earn the present 2 percent rate were being considered, it should be noted that the present 2 percent interest constitutes only 7½ percent of the amount charged their customers for power in 1961. Were this interest cost to double for future loans, and I would underline that "future loans," it should not constitute a prohibitive burden. Expansion should reduce other costs. Any amount not absorbed by the economies of growth would be spread over total business and not merely the new business.

As the years have passed, operations have shaken down and business expanded. In consequence, the number of REA borrowers who have failed to earn enough revenue to show a net margin over expenses and interest has steadily declined. The number that has a deficit operation reached a peak of 277 in 1950 but fell to a modest 31 in 1961. Over the whole life of the REA only two of its borrowers have had to be foreclosed (*ibid.*, p. 227). In contrast, 97 borrowers have repaid their loans in full (p. XXI), leaving 922 active borrowers at the end of 1961.

The increased ability of the REA borrowers to pay a reasonable rate for their capital is also reflected in their figures for residential rates and average consumption of electricity. The average number of kilowatt-hours taken by residential consumers and the average revenue per kilowatt-hour from these consumers are shown for REA distribution borrowers and for investor-owned utilities, respectively, in the accompanying table.

Year	Average monthly consumption (kilowatt-hour)		Average revenue per kilowatt-hour (cents)	
	REA	Investor-owned	REA	Investor-owned
1948.....	121	127	3.92	3.06
1957.....	283	245	2.77	2.68
1961.....	375	305	2.44	2.60

Source: REA figures, *ibid.*, p. xiii; "Investor-Owned Utilities From Federal Power Commission," *Statistics of Electric Utilities in the U.S.: Privately Owned*, 1961, p. xxi, and 1957, p. xxiii.

The table shows that the average monthly consumption in kilowatt-hours for these residential consumers grew for the REA consumers from 121 kilowatt-hours in 1948 to 375 in 1961. In 1948, the investor-owned utilities had a slightly higher consumption per consumer, 127, but it grew at a slower rate and was only some 305 kilowatt-hours in 1961. The average revenue per kilowatt-hour for these residential consumers shows that the REA felt it necessary to charge 3.92 cents in 1948, but this declined to 2.44 cents in 1961.

On the other hand, the investor-owned price per kilowatt-hour was lower in 1948, amounting to only 3.06 cents, but it did not decline as rapidly during this period, so they were charging more per kilowatt-hour, about 2.60, on the average, in 1961.

Even should REA borrowers pay the Federal Government some 4 percent in the future rather than the present 2 percent, they would be paying substantially less than the most highly rated investor-owned electric utilities are obliged to pay on their funds. These latter utilities find it necessary to earn and are typically allowed under

regulation to earn an average rate of about 6 percent on their total investment, which is drawn not only from bondholders but also from stockholders.

If REA paid the Treasury 4 percent for money, the consumer of electricity buying from an investor-owned utility would have still to pay 50 percent more at a 6-percent rate. At present he has to pay 3 times as much, or 200 percent more, when we compare the 6 percent paid to the 2 percent paid by the REA borrower.

Where REA borrowers needed only 7½ percent of their revenue to cover the interest on their borrowed funds in 1961; investor-owned electric utilities needed 20 percent of their revenues to provide their combined return to bond and stockholders.

An even greater advantage REA borrowers have over investor-owned utilities is their lighter tax burden. In 1961, REA borrowers showed tax expenses of 3.3 percent of the \$707 million of revenues. Investor-owned electric utilities showed a total of 21.5 percent tax expenses on revenues of \$12,604 million. Of the 21.5 percent total, 11.7 percent represented Federal income taxes and 9.8 percent other taxes. This tax advantage enjoyed by REA borrowers and those whom it furnishes with electricity far exceeds the interest rate advantage represented by the difference between 2 and 4 percent.

The present low rate for REA money has the further disadvantage that it induces cooperatives to go into the generating business because the cost of capital is a more important part of the cost of power than it is for nonutility goods and services. An examination of the annual reports of REA power-type borrowers shows most of the generating plants completed and in operation at the end of 1961 had a low capacity. The 62 plants in-being had a combined capacity of 1,155,695 kilowatts, or an average capacity of 18,640 kilowatts.

Attracted by the cheap rates for borrowing, more substantial projects comparable to the large-scale generating plants now favored by investor-owned utilities are now planned. The controversial loan of \$60,225,000 approved for Hoosier Cooperative Energy, Inc., contemplates three 66,000-kilowatt steam units costing \$31,864,000 and 285 miles of 154-kilovolt line and 1,267 miles of 69-kilovolt line costing \$28,361,000.

One argument has been that these facilities would "save" the customers \$5.5 million in 10 years. An additional 2 percent paid for this loan for 10 years would amount to \$6 million. These figures show that the "savings" are at the expense of the taxpayers and are, therefore, fictitious. They come out of the difference between what the REA pays and what the Treasury has to pay for the money. Since the investor-owned utilities now supplying these cooperatives with power are paying even more than 4 percent for their capital and bearing a much heavier tax burden as well, it would indicate that in spite of its size the projected Hoosier generating plant is much less efficient.

Such figures raise the question as to the wisdom of a policy of REA financing for generating facilities, which not only burdens the Treasury with a large part of the interest cost but also shrinks the contribution of electricity consumers to local taxes and eliminates their contribution to Federal taxes. The question is especially pertinent when, as in Indiana, the proposed REA generating facilities would deprive investor-owned utilities of business for which they have already

incurred the burden of capital costs, depreciation, and local property taxes. Any losses will, of course, be borne about equally by the Treasury through reduced corporate income tax receipts and the investor-owned utility.

Electricity is produced most efficiently by large generating units that are linked together to insure maximum use of capacity. The encouragement of splintering of generating facilities through unwise REA lending would run counter to the trend of recent years of building larger and larger units and increasing unification among the investor-owned companies and between them and REA borrowers. Some areas have recognized this principle by linking both investor-owned and cooperative electric companies into an integrated power system.<sup>1</sup>

In the footnote there, I call attention to a plan of that sort that the Mid-Continent Power Planners have in such States as Minnesota, the Dakotas, Iowa, and goes down as far as Nebraska and as far north as Manitoba, Canada.

They have a power grid which links together both the generating co-ops in that area and the investor-owned utilities that are in that area.

It means that they can interchange power and utilize the capacity to the best advantage. And with a minimum of investment.

In 1956 the proportion of REA loans for generating and transmission loans was a little less than a third of the total amount approved; in 1962, the proportion had risen to 58.7 percent of the total.

This development marks a departure from the original policy of the REA. As the late Senator Norris said in discussing the bill in 1936:

\* \* \* It would not be practicable to construct a farm line somewhere and build a generating plant for it; that would cost too much.<sup>2</sup>

He clearly saw the economics of the rural power problem. The problem was not to generate power more economically but to get the power from existing systems to a widely scattered farm population. The investor-owned utilities with their own depression-created financial problems felt unable to undertake the large capital investment required per customer to build the transmission facilities to reach the farmers. They were also uncertain as to the amounts of power which farmers, who were suffering even more from the depression than the utilities, could afford to buy.

On the subject of generating loans, Senator Norris said:

REA can make loans for generating plants but we must be shown conclusively—

- (1) that energy is not available from any existing source.
- (2) that the proposed generating plant can produce energy at a lower cost than it could be obtained from any other source.
- (3) that the output of such plant will be used mainly for supplying energy for use in rural areas.<sup>3</sup>

These are three points I am sure the members of this committee have heard many times.

Since that time farm population has shrunk from about a fourth of the total population to about a tenth. The economic position of

<sup>1</sup> The Mid-Continent Power Planners, for example, includes 14 investor-owned companies, 6 large rural electric generating cooperatives representing 72 distribution cooperatives, and 2 public power districts (Omaha and Manitoba).

<sup>2</sup> Congressional Record, 74th Cong. 2d sess., p. 2823 (vol. 80, pt. 3).

<sup>3</sup> Ibid.

farmers has been vastly improved. The farmer has gradually developed his potential as a user of electric power. These factors plus the growing urbanization of areas previously devoted to farming has led to an increasing portion of the business of REA borrowers being with nonfarm, residential, commercial, and industrial customers. The growing profits of the REA, their increased consumption per customer, and their low rates all point to a greatly diminished need for Federal support in their financing. The transition to more equal treatment versus the investor-owned utilities would be aided by the proposed legislation. They would still enjoy large advantages over the investor-owned utilities in a lower cost of capital, in taxation, and in a fund of retained earnings upon which they do earn a return but are obliged to pay nothing.

In view of the large and increasing Federal debt and the problem of curtailing Federal deficits, Federal lending should be confined to areas where there is no other solution. Those using Federal credit should be encouraged to graduate to financial independence and to raise their capital directly from the private financial markets.

The possibilities of such independence are illustrated in the recent announcement that the 30 co-ops selling electricity in Ohio were forming a super co-op to finance their share of a new generating plant with a capacity of 1,230,000 kilowatts to be jointly constructed and owned with the investor-owned Ohio Power Co., a part of the American Electric Power System.

This new Buckeye power co-op is reported to be planning to finance its share of the \$125 million cost of the plant in the private capital market. It seems likely that the cost of this financing will exceed but little the rate that the Federal Government is paying currently for new long-term borrowing.

Some estimates I have seen suggest that the rate they ought to be able to command will come very close to that of high-grade corporate borrowing, which at the present time is between  $4\frac{1}{4}$  and  $4\frac{1}{2}$  percent.

While some capital contributions may be made by member co-ops, the bulk of the money will be borrowed. This borrowing of the new generating company will depend primarily for its strength upon the record of the distribution co-ops and the Ohio Power Co.

Such cooperation, if encouraged and extended, should discourage isolated and relatively inefficient generating plants. REA policy should be shaped to increase such cooperation and reduce conflict. The credit standing and ability to borrow at minimum rates in the private capital market will be enhanced for both co-ops and investor-owned utilities by such a policy.

Perhaps I ought to interject here that the reason I feel that way is that during the 1930's, while I became interested in this subject of finance, I found the disagreement between the public power advocates and the investor-owned utilities was undoubtedly one of the factors, as well as poor earnings, that contributed to the lower credit standing of power companies, despite the fact that investor-owned utilities had fared relatively better than other businesses during those difficult depression years.

So increased cooperation between investor-owned utilities and REA's is one of the things we would like to see. They each have their place.

Because capital costs are so important to the cost of electricity, amounting to about a fifth of what the consumer pays to both the electric co-op (if you include net margins) and the investor-owned utility, the users of electricity will benefit from any lowering of the cost of the capital.

In summary, the proposed legislation to increase the rate charged REA electric borrowers in the future an amount that equals the cost of such funds to the Federal Treasury should be no handicap to REA operations, be more equitable to the taxpayers who otherwise must bear the loss of interest to the Treasury, and be fairer to the electric customers of investor-owned utilities who bear the full burden of taxation. The present 2 percent rate was initiated at a time when the Federal Government paid about that rate for its borrowed funds. As a matter of fact, the average rate for all Government borrowing during the thirties was somewhat in excess of 2 percent if you put it all together, because they still had some debt that hung over them from the 1920's, on which they were paying something like 4 percent. Then there was a period of something like 4 years, as I recall it, in which the average rate the Government was paying on its total debt was actually slightly under 2 percent.

In today's capital market, a rate of 4 percent, or thereabouts, is still a bargain for a private borrower. Electric customers of investor-owned utilities pay more for borrowed funds and about 6 percent for their total invested capital.

The record of REA co-op borrowers shows that with rising earnings the majority are now actually earning 4 percent or more on the capital borrowed from the Government. This result has been achieved while rates have been reduced and residential consumption increased to levels similar to those of investor-owned utilities.

Because the farm population is now almost fully served either by existing electric co-ops or investor-owned utilities, new customers must come almost wholly from nonfarm families and commercial and industrial establishments. Such business should be readily and profitably served at the relatively low rate paid by the Federal Government.

The electric cooperatives will continue to enjoy three substantial advantages over the investor-owned utilities: (1) the margin they can earn over the 2 percent they now pay and will continue to pay on existing borrowing, (2) their nest egg of at least \$680 million—probably more now—which was accumulated up to the end of 1961 upon which they pay no return, and (3) their differential tax treatment, which takes only about 3 percent of the cooperative customer's dollar as compared with the 21 percent from the investor-owned customer's dollar (1961).

I thank you, gentlemen.

Mr. POAGE. Thank you very much, Dr. Guthmann.

As the Chair said before, many of our members came in. Dr. Guthmann's appearance here is not to be taken as endorsement by the chairman, at least, of his views, but rather as an effort to be fair to everybody who wants to be heard. I do not know whom he represents.

I do not know why you wanted to come before us, Doctor.

Mr. GUTHMANN. Thank you—

Mr. POAGE. If you want to suggest why, we shall be glad to hear from you. I do not know your purpose in coming.

Mr. TEAGUE. Mr. Chairman, may I be heard?

Mr. POAGE. Certainly.

Mr. TEAGUE. As the chairman knows, and as I also stated before some of these other gentlemen came in. I want the record to be quite clear that the purpose of the legislation I had in the field of REA financing is not to abolish the Rural Electrification Administration, nor to abolish REA co-ops. It is primarily to do away with the interest subsidy which, for reasons Dr. Guthmann has well stated, I believe, seems to me to have outlived its justification.

Dr. Guthmann is here partly at my request, or at the suggestion of some others who agree with me in my stated purpose and to start at least making a record in support of the legislation which I have proposed.

Mr. POAGE. I have wondered about this and I do not want to go into something that you do not want to go into, Doctor. But it seemed a little strange to me. Northwestern University would hardly be able to finance your trip down here just to present views. I did not understand that the university was in the position of either advocating REA or against REA. Certainly members of the faculty have a perfect right to have their own views, but I felt it was a little unusual if the university had sent you down here. Of course, I know we are not paying your way down here. So I just wondered if you represent anybody else or if you would like to have your statement indicate that you represent Northwestern University.

Certainly Northwestern University did not send you, did they?

Mr. GUTHMANN. I beg your pardon?

Mr. POAGE. I merely was asking—I do not want to embarrass you if you do not want to suggest it. But your statement does indicate that Northwestern University sent you down here. I am quite certain that Northwestern University did not pay your way down here, nor did this committee. I want that made perfectly clear, of course. I just wondered if you were here representing anyone other than Northwestern University.

Mr. GUTHMANN. As I stated at the outset, Mr. Chairman, I represent nobody except myself, sir. I asked that I be allowed to speak on this legislation because I have been interested in this subject for a long time. I was introduced to Mr. Teague through some people whom I have known from the National Tax Equality Association. I am not here at their instance, nor am I accepting any fee of any sort for this particular engagement.

Mr. TEAGUE. And, Mr. Chairman, if you will yield—I am sorry to keep interrupting.

Mr. POAGE. Certainly.

Mr. TEAGUE. I think perhaps you did not understand. Maybe I misunderstood. I distinctly recollect that at the start of Dr. Guthmann's testimony, he stated that he was here representing himself and not Northwestern University.

Mr. POAGE. I did not get that. I do not see it in the statement.

Mr. TEAGUE. Before he started reading the statement, he said that.

Mr. POAGE. His statement does start by saying he is a professor at Northwestern University. It seems strange that the university would send him down.

Mr. TEAGUE. I think you will find that his statement says at the start that he is here representing himself and not Northwestern University.

Mr. POAGE. That is all right. He has a perfect right to come here representing nobody but himself, but very naturally the committee would like, when somebody comes here representing somebody else, we very naturally would like to know it, of course.

Mr. GUTHMANN. That is correct. Today I only represent myself, sir.

Mr. POAGE. Now, I want to congratulate you, Doctor, on the views you expressed about the desirability of interchanging power between power companies and the REA cooperatives. It has seemed to me to be a highly desirable objective. I have been pleased to note the development of this Ohio supercooperative and their relationship with the Ohio Power Co. I think that it probably offers us a very fine pattern. But I have not observed many areas in which you could expect that sort of thing to work out. Do you know of any other area in the United States where we could at the present time expect anything along the line of the Ohio Power Co. contract?

Mr. GUTHMANN. I am very hopeful that that Ohio pattern may become more common. I wrote to both the co-op and the company to get enough information to know that it was really operating, as the newspaper accounts said. I was very interested that while the newspapers reported they were cooperating, they made quite a point of the fact that the Buckeye co-op was going to own its half, itself, which I think is rather significant. It suggests a real desire for independence. I think that is rather characteristic of farm people generally. I think that if we can determine that it is possible for REA to carry its own weight in the matter of interest, that will be in keeping with this spirit of independence.

Mr. POAGE. Could you suggest any other power company that might be willing to enter into any such contract as that contract?

Mr. GUTHMANN. I have not studied that phase enough to really know. I think that the fact that in this Midwest Planners Group they are cooperating is very suggestive, because when you plan interconnecting lines, as they are in those various States, you have to determine who is going to put the money up and what sort of rates you will have for interchange. If you have groups that are at each other's throats, you cannot get the kind of cooperation necessary on a thing that requires a certain amount of give and take. That is why I thought those two cases were very significant for this particular legislation. It is pointing the direction in which we are moving.

Mr. POAGE. Do you not have to have something that has not been discussed here at all before you can have a practical interchange of power, and that is standby power at a reasonable price? That is essential, is it not? No cooperative, no matter how large it may be, can go into one of these cooperative ventures unless they have standby power at a reasonable price, can they?

Mr. GUTHMANN. Well, they can get this standby power cheaper if it is a part of a large—

Mr. POAGE. When you build your own plant, yes; you do; and I think that is fine. But all too often the power company tells us they will be glad to furnish the co-op standby, but they fail to point out

what they charge for the standby—not for the power that is used, but merely for the existence of the standby.

Is that not the general situation?

Mr. GUTHMANN. That I do not know. I do know this, that the question of the price, a fair price for standby power, is one of the most difficult ones to settle, simply because it is a question of allocating fixed costs, you see. When you get two parties bargaining with each other on a thing of this sort, you are bound to have differences of opinion.

The fact that in these two instances I have mentioned, they have succeeded in resolving these differences just as satisfactorily as investor-owned utilities are now taking care of it is indicative to me that we can hope for more in that direction. The reason I think it is important in terms of Federal economy is that if the Government starts lending money for general rating capacity, it is a very expensive proposition. We can waste a lot of money on general rating plants that are just not efficient.

Mr. POAGE. You are suggesting that we should not have so many of these small plants. Again I must agree with you that I think the larger generating plants are obviously far more efficient; at least with today's technology, they are.

Mr. GUTHMANN. That is right.

Mr. POAGE. I think in the days of Senator Norris, a little 10,000 plant was probably a proper operation in a good many places. Senator Norris spoke of conditions as they existed a third of a century ago, did he not?

Mr. GUTHMANN. I think Senator Norris had the idea, because even back in the twenties, people were working at this problem of how to get standby power or enough to carry peak loads without paying too much for it. If you have a group of purely residential consumers and they are scattered about, it is very, very difficult to handle that problem. So you really need cooperation between these utilities in a given area in order to get power for peak loads at a reasonable figure. Otherwise, this standby power problem becomes extremely expensive.

Mr. POAGE. Now, you phrased another question that I think goes to the crux of much of the misunderstanding about cooperative and private service to these rural areas. You have pointed out how expensive it is to serve residential customers scattered around in rural areas. Can you tell the committee roughly what is the average number of connections per mile of line owned by the private utility company?

Mr. GUTHMANN. I have seen the figures but I do not recall them. I know the point you are driving at and I recognize that as true.

Mr. POAGE. Well, it is actually about 32 connections per mile, isn't it?

Mr. GUTHMANN. Now, remember that the big urban utility has its problems, too, because it is much less expensive to build a mile of transmission out in the country compared to the plowing into the ground that you have to do to put concealed cables in the city. That difficulty—

Mr. POAGE. Before you go too far there, will you tell us what the average density or number of connections per mile is for the average REA-financed co-op line?

Mr. GUTHMANN. I do not know what the actual figure is. I know it is lower.

Mr. POAGE. It is actually almost exactly one-tenth or just over three connections per mile, isn't it?

Mr. GUTHMANN. I would not be surprised. I know it is sparse. But the interesting thing is in spite of that scarcity, the——

Mr. POAGE. I do not believe you understood me, Doctor. I asked you what the density of the utilities was per mile, and it is actually 32 per mile, the last figures I have seen. It is not sparse. It is just over 10 times what it is on the lines of these REA-financed cooperatives. Certainly it costs more to build a mile of line that is going to serve 32 people than it costs to build a line that is going to serve 3. There is no question about that, but it does not cost anything like 10 times as much.

Mr. GUTHMANN. I agree. Nevertheless, what they have been able to earn due to their rates show that that has not been an intolerable handicap.

Mr. POAGE. That what has not?

Mr. GUTHMANN. The fact of few consumers per mile of line——

Mr. POAGE. I was making no point that it is an intolerable handicap. I am simply trying to get it right clear here and I think you must know substantially—you may not have an exact figure, but you must know that I am substantially correct when I say that the private power companies have on the average approximately 10 times as many connections per mile of line that they own as the REA-financed cooperatives? That is substantially right, is it not?

Would you answer for the stenographer, because we are making a record of this, Doctor? That is substantially correct as far as you know, is it not?

Mr. GUTHMANN. I just do not know what the figures are.

Mr. POAGE. You have no idea—it is all right. Doctor, if you don't know, we will accept it any time you tell us you don't know.

Mr. GUTHMANN. It sounds reasonable.

Mr. POAGE. So you said you don't know. But you do know that the REA cooperatives have to run many more miles of line for each subscriber than the utility companies do. And the utility companies find that it is costly to put these lines into the rural areas. As late as 1937, Mr. Neff, then president of the Electric Utilities Association, stated that for practical purposes, all of the rural service that was needed in this Nation had already been achieved and there were about 10 percent of the rural homes then electrified.

The utility companies didn't feel that they could afford to electrify the rural areas, did they? They charged anywhere from \$1,000 to \$2,000 a mile to put in the line. They required the subscriber to pay that and the line still was their property.

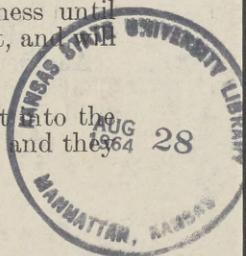
Mr. GUTHMANN. That was not unusual back in the 1930's.

Mr. POAGE. No, sir; it was not until the REA-financed cooperatives began building those lines for \$500 a mile and it became very evident that the utilities were pocketing a good deal of money on those charges they were making.

Now, the utilities did not find this an attractive business until somebody else went into it, did they? That is clear, is it not, and do you not agree with that?

Mr. GUTHMANN. Right.

Mr. POAGE. So after the REA-financed cooperatives went into the field, the utilities then immediately went into the same field and they



now supply about one-third of the rural homes of America, I believe. That is roughly correct? It may not be exact.

Mr. JOHNSON. Mr. Chairman, I was just going to mention, the farms they serviced were the richest farms in the area.

Mr. POAGE. Of course they were. But the utilities did not feel that it was economically desirable to go into this area until there was somebody else offering to go into it. Then they felt that they did not want to give the area up to somebody else and they do not want to today, do they? They want the rural areas the same as the city areas, do they not?

Do you know of a single utility that has come along and said to a co-op "Take over this rural area and give the needed rural service and we will give the urban service"? Do you know of any utility that has moved out of rural territory and said to the cooperative, "You take and serve this territory and we will confine our operations to the towns"?

Mr. GUTHMANN. Do I know of any utilities that what?

Mr. POAGE. That have voluntarily said, "We will move out of this rural territory and you cooperatives take the territory and we will serve only the towns."

Mr. GUTHMANN. I do not see why they should, sir.

Mr. POAGE. You do not know of any who have done it, do you?

Mr. GUTHMANN. I do know that in some States where they have had cooperation, the co-ops and the investor-owned utilities have given up or in some parts they have exchanged territory in order to have more efficient operations.

Mr. POAGE. They have done that. But what I am saying is that the utilities have not shown that they felt that rural service was unprofitable. They have wanted all the rural service they can get since 1937—not before. They did not want any then. They now want all they can get.

Mr. GUTHMANN. But, sir, I think that grows out of the times at that time. Remember that back in the 1930's, the private utilities could not afford to take on additional business which would not carry its own weight. Furthermore, at that period, public utility commissions were much more inclined to make small local areas bear their own burden.

Since that time, I notice two things have happened. One is that the public utility commissions have changed their point of view and you will find a gradual extension of common rates, even though some of the communities may not be carrying their weight. They say let's have common rates over wider and wider areas.

The other thing is that the utilities are now in a position where they can absorb new business that may be unprofitable at the time it is absorbed. This is true because in the future they may have more business there and because their earnings are in better shape and they are growing.

Consequently, I point out that the investor-owned utilities, while they are now serving, as I understand it, pretty close to half of this rural population, did not feel able to back before 1937.

And remember that the farmer himself is now a better customer. That is suggested by the kilowatt-hour consumption for the average residential consumer. Notice, you have a larger figure in the year 1961 for the REA co-ops than you do for the investor-owned utility.

In other words, you may have fewer farmers on the line, but if he is one of the modern, present-day farmers that uses a lot of electricity, power tools and things of that sort, he actually is a better customer than the city dweller, who uses a relatively smaller amount. The farmer has become a different kind of customer now. That is good for both the REA and the investor-owned utility.

(Discussion off the record.)

Mr. POAGE. I would like to now analyze that statement, Doctor. If I understand you, you, in effect, said that the utilities now could afford to go into the rural areas because they could spread their charges over the more profitable areas and absorb losses in these rural areas and that they were doing a better business and therefore could better afford to absorb losses. That was substantially the reasoning behind this, if I understand it.

Now, does that not inevitably lead to a recognition of the fact that city customers are presently subsidizing the rural service of the private power companies?

Mr. GUTHMANN. I have no way of knowing and I have never seen any data that would prove that sort of thing.

Mr. POAGE. You must know it. If the total service is a profitable service and if this particular service is not profitable, and you have just said that they were now able to give it because they could spread their charges, if they do spread their charges and charge a uniform rate, which is high enough to make a profit on all the business they are doing, is it not inevitable that the urban customers must be paying something more because of the service given by the private utilities to the rural areas?

Mr. GUTHMANN. Not necessarily.

Mr. POAGE. All right. How do you explain it?

Mr. GUTHMANN. I would explain it in various ways. One thing is that the addition of these rural customers may improve the load factor.

Mr. POAGE. That is not what you said, Doctor. I am talking about what you testified to and I repeated it to be sure that I correctly understood you. You said that there are now two reasons why the utilities could go into the rural areas when they could not do it in the thirties and that one of them was that the utilities were in better shape and they could afford to take losses that they could not take in 1930.

Mr. GUTHMANN. Right.

Mr. POAGE. And the other one was that they could now spread their charges on a uniform rate in the city and in the rural areas and, therefore, that they could have a uniform rate high enough to suffer no loss.

Now, if they are not going to suffer a loss, is it not inevitable that it be made up out of the charge made to the city customer?

Mr. GUTHMANN. I say that they have greater freedom of that sort. But whether it actually results in their losing on this rural area business and it may not always be farm customers; it may be any rural area business—I do not know because I have not seen any data on it. But I think it is quite possible that the greater freedom they have been given to have uniform charges may not have been as expensive as suggested by your question. It may be that they are not losing.

Mr. POAGE. I did not suggest it. You suggested it, Doctor. You are the man who laid out these two reasons why they could now go into the rural areas. You are the one who suggested it and I am just

asking you if it does not follow from your suggestions that city customers are inevitably paying more right now because of this rural service?

Mr. GUTHMANN. No; it does not follow.

Mr. POAGE. It does not. All right; that is fine.

Then the only ones who need a subsidy in the rural area are the REA-financed cooperatives. Is that right? The private utilities can make money in the rural areas. That is your statement now, is it?

Mr. GUTHMANN. The weight of my testimony has been that they may have needed it at the beginning, but it certainly does not appear that they need it now.

Mr. POAGE. Let's get it plain: Are the private utilities making money on their rural service?

Mr. GUTHMANN. I have no way of knowing.

Mr. POAGE. They have a way of knowing, don't they?

Mr. GUTHMANN. In fact I do not know of any source of exact data that would show that. They may have analyses for themselves in connection with their rate cases, but I just do not happen to be familiar with that data.

Mr. POAGE. You suggested on page 5 that expansion should reduce other costs and I agree with you on that, that the larger these REA cooperatives can become, the cheaper they can operate per unit. I think that is true of private utilities, too.

Mr. GUTHMANN. I think that is the idea.

Mr. POAGE. But I think it is an interesting question as to how far we want either the cooperatives or the utilities to go in the way of effecting these economies, you would not suggest, would you, that you would like to see in the utility field what we have seen in the telephone field, where one company serves 82 percent of the customers of the United States. Would you want to see any one utility company serve 82 percent?

Mr. GUTHMANN. I think the telephone company does a pretty good job. But I do not think that is the issue here. I do not think we will ever have such concentration in the electric industry.

Mr. POAGE. Do you think it would be desirable?

Mr. GUTHMANN. No.

Mr. POAGE. Why?

Mr. GUTHMANN. I think it is desirable to have different management in different areas so we can have——

Mr. POAGE. So we can have what?

Mr. GUTHMANN. So you can have comparison.

Mr. POAGE. Not competition; only comparison; is that right?

Mr. GUTHMANN. You have a kind of competition in that you are able to see what different managements can do under different conditions. If, for example, American Electric Power does an outstanding job, the result is that commissions are inclined to say, "Why don't you do as well in your area?"

So while we do not have direct competition in the power field itself, although you do have a competition of substitutes, nevertheless we do have independent managements whose record in the way of producing efficient low-cost power at reasonable rates can be compared.

Mr. POAGE. Doctor, you suggested that there have only been two REA-financed cooperatives that have gone bankrupt during its life period and I think that is a real good record. Do you know how

many utility companies have gone bankrupt in the same period of time?

Mr. GUTHMANN. Since 1935?

Mr. POAGE. Yes.

Mr. GUTHMANN. I do not know of any electric utility companies that have gone bankrupt in that period.

Mr. POAGE. Well, I do not, either. But I did not know whether they had or whether they had not. I suppose that we can now forget the talk about "the REA co-ops destroying the private power industry" because not one company has been destroyed.

Now, we were speaking of the telephone company; and that leads me to a question that has always been of interest to me. Why do not the power companies borrow this REA money? They can get it at 2 percent, too. The law lets them get it on exactly the same terms that it lets any cooperative get it. Why do they not borrow it?

Mr. GUTHMANN. The private companies?

Mr. POAGE. Yes, the private companies. They can get it at 2 percent. Of course, they cannot borrow it through their holding company at that, but they can borrow it through the REA at that.

Mr. GUTHMANN. I believe a few of them did it, did they not?

Mr. POAGE. Yes; there are a very few. Why does not the industry, as an industry, take advantage of this 2-percent money?

Mr. GUTHMANN. I do not know the answer. I can speculate, but I do not think that that would be helpful to you or to this committee. I just do not know the answer to that.

Mr. POAGE. Do you think that the holding companies have anything to do with it?

Mr. GUTHMANN. No. You see, almost all of our companies now are big operating companies. We have practically done away with the holding company in the electric field.

Mr. POAGE. We still have a good deal of common ownership in bond houses, do we not?

Mr. GUTHMANN. You see, most of the big holding companies were split up a few years ago and so the result is that you have a rather limited number of major holding companies, nothing like what we had back when I began studying this sort of thing.

Mr. POAGE. But do you think this opportunity to make a profit off this private financing has anything to do with the fact that they prefer the private financing at 4 and 5 percent to the Government financing or would they just rather avoid the obligation to serve everyone in the area?

Mr. GUTHMANN. I would have to speculate just as in the case of this Buckeye Co-Op. Why did they go to private financing? I think there is a time when a person just kind of cherishes private financing. He feels, Why should I ask the taxpayer to bear this burden?

Mr. POAGE. It isn't just the co-ops that did that, because all telephone companies that I know of with the exception of Bell, all take this 2-percent money.

Mr. GUTHMANN. I have heard that. I have not checked it.

Mr. POAGE. REA loans \$3 to private telephone companies for every dollar that they lend to a cooperative for telephone purposes. There is no such reluctance on the part of the telephone companies. So I have wondered why there was such a reluctance on the part of

the electric companies. I think it would be most interesting if some expert would tell us, but they clam up every time they come up here.

Mr. SHORT. Well, Mr. Chairman, if I could interpose an observation here, I think one of the obvious reasons is the difference in the tax treatment extended to the cooperatives as compared to the private utilities in many States. Certainly, it is a vast difference, and there is an obvious reason in North Dakota.

Mr. POAGE. Reason for what?

Mr. SHORT. For the utility not being able to utilize the REA funds.

Mr. POAGE. You will have to explain a little, Mr. Short. I am talking about why would a utility in Texas prefer to pay 5 percent to some bond house rather than to pay 2 percent to the Government?

Mr. SHORT. No. 1, the area coverage principle applies.

Mr. POAGE. That has nothing to do with taxation.

Mr. SHORT. Yes, it does.

Mr. POAGE. How does it have anything to do with it?

Mr. SHORT. Because the utility has to pay taxes on their facilities, their lines, their transformers. The co-op does not.

Mr. POAGE. The co-op does have to and does pay them.

Mr. SHORT. No, sir.

Mr. POAGE. I do not know what you do in North Dakota, but I know the co-ops in Texas do pay a tax on their property.

Mr. SHORT. They do not in North Dakota, Mr. Chairman. Please do not make that statement, because it is not true.

Mr. POAGE. I would certainly disclaim any familiarity with North Dakota. Maybe they don't pay property taxes there and maybe the other fellow doesn't, too. I don't know.

Mr. SHORT. Let me say this in clarification, because I am sure the chairman does not mean to make a misstatement. North Dakota has a gross income tax of 2 percent that applies to REA co-ops on their income from sales in North Dakota in place of property taxes.

Mr. POAGE. It applies to the co-op and applies to the utility, does it not?

Mr. SHORT. No; it does not apply to the private utility. This is the big difference. The REA in North Dakota that would sell its power outside North Dakota, and we have an instance right there in an REA loan just granted, where all of the power would be sold outside of the State, and this \$20 million plant would not pay 1 single cent of taxes in the State of North Dakota. A corresponding plant owned by the Montana-Dakota Utilities Co. paid \$242,450.25 annual property tax on their plant in 1963. Now, this is a big difference.

Mr. POAGE. If they sold all of their power outside the State?

Mr. SHORT. That is right. Either one. It would not make any difference. The property is there and it is assessed as property in North Dakota for the private utility. The co-op pays taxes only on the basis of 2 percent of its gross sales in North Dakota, but this one does not sell anything in North Dakota.

Mr. POAGE. And the utility does not pay that 2 percent; is that right?

Mr. SHORT. No; the utility pays on the basis of a property evaluation.

Mr. POAGE. I asked you about the 2 percent. I did not ask about the property. Does the utility in North Dakota pay the 2 percent?

Mr. SHORT. No; this is a special tax treatment that is extended to the co-op.

Mr. POAGE. And that is a special tax treatment extended to the utility; isn't it?

The utility does not pay the 2 percent, does it?

Mr. SHORT. But it pays a property tax in lieu of it.

Mr. POAGE. I understand, and the cooperative pays the 2 percent in lieu of the property tax.

Mr. SHORT. It does not pay the 2 percent if it does not sell in North Dakota. This is the point I am making.

Mr. POAGE. If the State of North Dakota wants to exempt utility companies, they can. If they want to exempt cooperatives, undoubtedly they can and have.

Mr. SHORT. I am just saying, Mr. Chairman, this is one of the reasons the utilities in North Dakota have not been able to avail themselves of the REA financing that we were talking about.

Mr. JOHNSON. This is one particular instance, though, is it not?

Mr. SHORT. This applies to all of the utilities in North Dakota.

Mr. POAGE. It may apply to North Dakota. North Dakota can pass any tax laws she wants, just as the State of Texas can pass any tax laws she wants to, locally. We do and we assess the same taxes against the cooperatives that we do against the utilities.

Mr. SHORT. They do in many States. They do in Minnesota, I believe.

Mr. POAGE. Any State that wants to do it can do it and they cannot blame the REA Act if they do not. If the State of North Dakota wants to collect taxes, it is their business.

Mr. SHORT. They have no bonded indebtedness. North Dakota has no bonded indebtedness and we are proud of it.

That is a little off the subject.

Mr. POAGE. Yes; we cannot, of course, discuss every local law, I am sure, because the States still do have some taxing power.

But there is no REA provision that exempts anybody from payment of local taxes. There is nothing in the REA Act that exempts anybody from local taxes.

Mr. SHORT. It does not require them, either.

Mr. POAGE. No; it leaves it up to the State.

Mr. GUTHMANN. I would assume that, because my data shows they were paying a little over 3 percent gross for taxes and that would have to be local taxes of some sort.

Mr. POAGE. So over the Nation as a whole, these cooperators are paying local taxes.

Mr. GUTHMANN. Right.

Mr. POAGE. And in most States, they pay them on exactly the same basis as anybody else. In most States, the utilities pay them on the same basis as the REA. But apparently in North Dakota, they give the utilities certain exemptions and the REA certain exemptions.

Mr. SHORT. That was property tax. Now let's talk about income tax.

Mr. GUTHMANN. However, the burden of local tax is about three times as heavy on the investor-owned utility. In other words, it came to around 9 percent as against 3 percent for the REA. Whether that is due to rural location of the property or what not, I have no idea. We know in our State, there are different assessments according to the county—

Mr. POAGE. Of course, the city tax rate may be higher than rural tax rate. It is with us. So that would seem to be logical.

But what I am getting at is why is it not profitable for these companies to avail themselves of the Rural Electrification Act and take advantage of this low-interest rate? If it is the advantage that you point it out to be and I am not questioning that, why do not utilities take advantage of it? I think you have said you did not know.

Mr. GUTHMANN. I do not know. I can only say with certainty that only a very few such loans have been made. I believe the bulk of those have all been paid off.

Mr. POAGE. I think that is true. I know there have not been many, but they are eligible. If they want to give the service that these co-ops give, they can do it and get exactly the same interest rates and that is all that REA fixes. The REA does not fix the tax rates.

Mr. GUTHMANN. That is right.

Mr. POAGE. So that all the REA law, and that is all we can tamper with is the Federal law all that the Federal law has to do with, the only thing it fixes is the interest rate and not the tax rates. So it seems to me right clear that this committee cannot do anything about Mr. Short's complaint. The Legislature of North Dakota can.

Mr. SHORT. I was just trying to get the record straight, Mr. Chairman. I was not complaining.

Mr. JOHNSON. This happens to be a particular plant they have put up that is right next to the State line that sells their power to another State?

Mr. SHORT. No; it is right in the middle of the State.

Mr. JOHNSON. Why don't they sell their power in the State?

Mr. SHORT. Because they built it to sell in Minnesota and Wisconsin.

Mr. JOHNSON. But they have other plants to take care of power in North Dakota on which they are paying the 2-percent rate?

Mr. SHORT. No.

Mr. JOHNSON. Where do they get the power for North Dakota?

Mr. SHORT. They buy it from the utilities company.

Mr. POAGE. That is where they get most of their power.

Mr. SHORT. And the Bureau of Reclamation.

Mr. POAGE. Do you know what percentage of the REA cooperatives buy power from the utilities?

Mr. GUTHMANN. No; the way the REA reports, it is a little difficult to get any figure on that. But a number, by looking them over, a very substantial number, buy their power from utilities. I did notice in the figures for the generating co-ops a figure for purchase power suggesting that some at least did exchange power or bought power from companies in addition to what they generated themselves.

Mr. POAGE. In other words the REA cooperatives are a very large market. Taken as a whole, they are a very large market for the private utilities, are they not?

Mr. GUTHMANN. Yes; they would be. They would be important. But the importance varies greatly. In some States it is very, very minor. That is why in some States like this Indiana case, you have great bitterness of feeling.

Might I point out in support of your position that they pay taxes, that so long as the Hoosier co-ops were buying from Public Service of Indiana, they were in a sense contributing taxes that did not show

up in their own statement which appeared in the tax bill of Public Service of Indiana.

Now, when you move them out, they do not pay any income tax and they pay reduced local taxes as part of their revenue. The result is that you can erect a generating plant and make it appear efficient when a large part of the difference is that they have simply ceased to contribute, you see, to these various local tax bills.

Mr. HARVEY. Mr. Chairman, since the gentleman has mentioned my State as one of the areas which he has used as an example, I want to say, first of all, to make the record eminently clear, that my own Henry County REMC was the first in the United States to pay off its indebtedness from earnings. It is not a part of this Hoosier cooperative energy group of which you speak. So I want to make it clear so that it will be understandable that the co-op to which I belong is not a part of this controversy.

Now, I am not going in, Mr. Chairman, to all of the details, but I can say I have been very acutely aware of this controversy and there are a great many factors on both sides that have been offered in the argument.

I just want to say this, that without in any sense disputing your position I would say that your explanation is a vast oversimplification of the problem.

That is all.

Mr. POAGE. Thank you, Mr. Harvey.

Mr. Gathings?

Mr. GATHINGS. I just wanted to ask the witness, Dr. Guthmann, to follow through with respect to Senator Norris' views, as you expressed them on page 9. It was brought out by the chairman that Senator Norris lived in a different era from what we have today. Of course, it was many years ago. You quoted him as follows:

REA can make loans for generating plants, but we must be shown conclusively (1) that energy is not available from any existing source; (2) that the proposed generating plant can produce energy at a lower cost than it could be obtained from any other source; and that is important to everyone who uses power; and (3) that the output of such plant will be used mainly for supplying energy for use in rural areas.

I want to say to you, Doctor, that you have brought us quite an enlightening statement and you are one of few witnesses who has cheerfully stood up under the most grilling cross-examination of the best in the business, the chairman of this subcommittee. You have done a splendid job, sir.

Mr. GUTHMANN. I have not lived in Texas for a long time. I think it an honor to cross swords with anybody from that State. I like their spirit.

Mr. POAGE. Thank you, Mr. Guthmann.

Mr. Short?

Mr. SHORT. Well, Mr. Chairman, I think the question under consideration here is a real important one. I think, sir, you have made a contribution, although I would be inclined to agree with my friend from Indiana that you have perhaps oversimplified. Certainly I think any of us that live in rural areas have no desire to do anything to harm the stability of the REA program. I think REA has developed into a situation that was inevitable and something that I do not think we have any particular quarrel with. But it is the simple premise of REA serving nonfarm customers.

Now, before somebody says that the REA Act does not say farm customers, it says rural areas, I think we have to have in mind that the primary purpose, the primary justification of the REA program was to serve farmers, people living in rural areas. Now we have the situation in many rural areas of the country where small industrial plants, and in some instances quite large industrial plants, have located themselves in rural areas. And this is area that in most parts of the United States, under State laws or whatever it may be, is area that REA has a prior right to serve. And I think this is as it should be. You should not have two utility companies trying to serve people in the same area.

Mr. GUTHMANN. I agree.

Mr. SHORT. Now, the \$64 question arises as to whether or not REA, and particularly a generating and transmission co-op, should be extended through the U.S. Treasury an interest rate below the cost of funds to the Government to build a generating facility that is largely needed to serve certainly a nonfarm load, an industrial plant. You get to the point of analyzing the merits and demerits, the moral principle involved in subsidizing—if this is not a dirty word to use—the cost of the generation of power that is going to be furnished to one business enterprise as compared to another business enterprise that is not so favored, if this does result in a favorable electricity rate.

I do not think anybody wants to tamper with the interest rate—certainly they do not in my State—on extending loans to the REA distribution co-ops to continue to serve their rural load, which is primarily a farm load, and some rather substantial additional loans are required as they need to heavy up their lines. You mentioned the increase in the size of the use, in the amount of the use of the average farm, and this is very substantial. It has grown much more than the average urban user. They are having to put in heavier transformers. They are having to spend quite a lot of money in the simple job of serving their rural customers. Even though this number of customers unfortunately continues to decline, the load keeps growing. You do not think anybody, any fairminded individual that understands REA, has any desire to change the interest rate on this premise. And in passing, may I say I have yet to find anybody who thinks that the 2-percent interest rate should be tampered with for the RIA, the telephone program in its responsibility of serving rural areas.

When it comes to making 2 percent section 5 loans to distribution co-ops that they in turn make loans to users or potential users it is another question. The much-publicized loan was to a winter resort for a ski lift in Illinois. I do not say that this was an inappropriate thing at all. The question arose there as to why this 2 percent interest rate should apply to funds that were extended to be passed on to this kind of customer. The section 5 loans were visualized originally, I think, as a loan to a farmer to enable him to put in an electrified milking parlor, some electrical use expansion on the farm. I do not think anybody quite visualized a ski lift.

This is one of the places where I think people have some legitimate question as to the merit of the 2 percent interest rate. The other one is when the additional generating capacity needs to be built by the G. & T. co-op to serve the industrial installation, should the 2 percent interest rate apply there to a G. & T. loan—not necessarily to an

REA loan per se, but to this particular kind of an REA loan. I just wanted to make this observation, I think I have given an analysis of the thinking of a great many people in regard to the 2 percent interest rate. I do not think that this is necessarily thinking that is contrary to the best interests of REA. I think in the long run, it is an objective consideration of the whole thing that people realize is in the real long time interest of REA. Because if this 2 percent interest rate, if it is a subsidized interest rate, is abused, there are a lot more people in the United States that are nonfarmers than there are that are farmers. There are going to be a lot more Members of Congress who represent nonfarm areas than farm areas. If it appears that this is a real abuse, the 2 percent interest rate is going to be removed eventually, it seems to me, if it is not objectively and fairly used.

Thank you very much, Mr. Chairman.

Mr. POAGE. You are welcome.

Mr. GUTHMANN. May I just say that I think you, Congressman Short, have made a very good point about the difference between the generating and the distribution systems. Frankly, I think the abuse is much more likely to be found in the generating area. I cannot see why we should build a generating plant that is so inefficient that it depends upon half of the interest being paid by the Treasury in order to make it competitive with an investor-owned utility that is paying 6 percent—50 percent more for its money than the 4 percent in this bill—and paying a substantially greater differential in terms of taxes.

Now, on the distribution, I would just like to raise a question. I will agree that the previous member of the committee speaking about oversimplification; we have had to deal with the thing in the aggregate. But taking the thing as a whole, do you not feel that the typical member of an REMC now is better able to pay 4 percent as a part of the cost than he was, too, back in 1935 or 1936, when this thing began?

Mr. SHORT. In 1935, if I had had to pay an electric bill on my ranch, I would have gone without it because I did not have the money to pay for it.

Mr. GUTHMANN. That is right. Today we see these distributors, REMCA's, taken as a whole are charging an amount that exceeds 4 percent on the average on their bill. That is why they have these substantial margins which are so much larger than the interest they are paying. It seems to me that this thing which is improving the operations of the REMCA's, the introduction of industry, which is to be welcomed, and the growth of small communities in these areas, mean that a continuance of a subsidy to the REMCA's of a 2-percent interest rate is in effect a subsidy to a growing number of nonfarm customers who do not need it any more than I need it. Why should I, if I move to a community where the REMC operates with 2 percent money, get a bargain in this 2 percent money when, if I live in one a little bit larger served by an investor-owned utility, I pay 6 percent. I think four is a bargain.

Mr. SHORT. I can just say you are getting a bargain any time you live in a small town.

Mr. GUTHMANN. I do not know. I like the country, and for a long time we used not candles but kerosene lamps.

Mr. POAGE. Mr. Johnson?

Mr. JOHNSON. Doctor, on page 4 of your statement, you say, in the second paragraph:

Yet REA-financed borrowers are providing electric service to about 120,000 new consumers annually. About five out of six new consumers are nonfarm.

Well, do not those new customers all arise in the area that is serviced by the REA?

Mr. GUTHMANN. That is true.

Mr. JOHNSON. What would you do in the case of those people who move in and want service? Would you turn around and give them to the power company?

Mr. GUTHMANN. No. I would not. The point I am making is the one we were discussing here, you see. Namely, because you are getting that particular type of customer, there is no reason why you should get a 2-percent rate. Four percent is very cheap money for that. I was suggesting if I were one of those nonfarm consumers and I moved to one of these small towns where I enjoy living in in the summer, I cannot see why I should have that subsidy. That is the reason I am making the point.

In other words, a type of business is developing that I am not striving to take away from the REA. On the contrary, it is quite clear that it is a thing that is making it possible for the REA not only to lower the rates, but to pay 4 percent because they are charging 4 percent in many of the cases.

Mr. JOHNSON. It seems most of this argument has arisen since the REA has started generating power and borrowing money from the Government to generate power. That seems to be the thing the power companies do not want.

Mr. GUTHMANN. I think that is true, for the reasons I suggested to Mr. Short. I think the abuses of this thing are clear in the case of the generating. In one case, for example, in Florida, where the sole customer that was to be served was an Air Force base, the Gulf Power Co. bid against the local co-op.

Mr. JOHNSON. If I understand the facts of that case, the Air Force was in the REA area.

Mr. GUTHMANN. It was in the REA territory. But the point was, it was near enough to the border of the two territories so there was a question, which way would you do it? It was quite clear that the Treasury was putting in enough to make up the interest that more than offset the difference. So in the long run, the Government was paying more than it would if it had taken the Gulf power.

Mr. JOHNSON. In that case, you would have taken the territory away from the REA.

Mr. GUTHMANN. I would not take the territory away, but in a case where it was bidding for a particular customer—

Mr. POAGE. As a matter of fact, if the Gulf Power had furnished this power, it would have required a 20-mile line as against a 3-mile line by the REA. I have never heard of a utility commission that would grant one company the right to move 20 miles over here when another company was within 3 miles.

Mr. GUTHMANN. I gathered there was a question as to whose territory it was because they asked them to bid. If it was in REA territory, the logical thing would have been to raise the question, why not let REA wheel the power from a private company that can generate it cheaper if you take in all the costs?

Mr. JOHNSON. As I have watched over the years, it seems the private company wants to come in when the area gets profitable.

Mr. GUTHMANN. I have never made such a statement.

Mr. JOHNSON. No. I am making it.

Mr. GUTHMANN. I think that having established such a territory, you are going to continue our general principle, that it is inefficient to have two companies.

Mr. JOHNSON. In case after case where cities have moved out into an REA territory the private utility would like to take over that part of the city which was formerly rural and was serviced by the REA.

Mr. GUTHMANN. I know that has been an argument, but I do not choose to get into that argument here.

Mr. POAGE. Thank you, Mr. Johnson.

Mr. Dole?

Mr. DOLE. I might just point out that in the State of Kansas, under the guidance and leadership of our senior Senator, Senator Carlson, while he was Governor, our private utilities and REA were very compatible. They have a very fine working relationship and do many of the things suggested this morning. In our State, we do not have some of these problems. I do think there are many leaders in REA who feel that since there are public moneys involved, we have an obligation and responsibility to see it is properly spent, as long as it is done on an objective basis, not a basis to cut up the REA. This is the way we view it in Kansas.

Mr. POAGE. Thank you, Mr. Dole.

Mr. Stubblefield?

Mr. STUBBLEFIELD. Doctor, on page 4, you casually refer to the growth and increase in volume of the business improving the profitability. In your opinion, have the private utilities been shortsighted on keeping a higher rate rather than seeking more consumption?

Mr. GUTHMANN. Who is this you are referring to?

Mr. STUBBLEFIELD. I assume you have given a lot of thought to the utility business. Is that right?

Mr. GUTHMANN. Yes, sir.

Mr. STUBBLEFIELD. On page 4, you say that growth and increased volume of business would lead to more profitability. I asked you if the private utility companies have not had a tendency to keep their rate high rather than to lower the rate and seek more volume. Have they been shortsighted in that respect?

Mr. GUTHMANN. I think there have been individual cases, but I think by and large that today at least, they are quite cognizant of this point. I think you see it in their rates. If you take not the average cost per kilowatt-hour, but take rates for a given amount of consumption, the way the FPC studies it, I think you will find that the rates have remained remarkably constant during a period of rise in costs, which is really a cut.

I think most of the public utilities that are investor-owned have recognized this point we are discussing and have attempted to use it.

A bothersome point is where to make the rate cut so it will be advantageous, industrial consumers or residential, residential that are smaller consumers or who are substantial consumers.

Mr. STUBBLEFIELD. Let me just cite you a figure here of a cooperative whose source of power is a private utility company and the average annual cost per kilowatt-hour is 8.3 mills.

Mr. GUTHMANN. Where is this 8.3 mills?

Mr. STUBBLEFIELD. This is a figure I am giving you. Two other cooperatives of comparable size whose source of power is the Tennessee Valley Authority, have an annual average kilowatt-hour cost of 4.8 mills. In the area served by—whose source of power is a private utility, the consumption is about 60 million kilowatt-hours annually. In the area served by a co-op for which the source of power is Tennessee Valley Authority, the consumption is 239 million kilowatts annually, or about four times that which carries a higher rate. Would that not be right conclusive that the consumption varies directly with the rate?

Mr. GUTHMANN. Yes. I hate to recognize a criticism here of making too sweeping statements, but nevertheless I would say, generally speaking, I think that is correct. I think that is one of the reasons why we have such a steady growth of electric power consumption.

Mr. STUBBLEFIELD. That as the rate goes down, the consumption goes up?

Mr. GUTHMANN. That is right.

Mr. STUBBLEFIELD. I just happened to be familiar with all three of these areas and you can go from one to the other. One area paying 4.8 mills will have air conditioners, the house will be heated by electric heat. You go across the road and they do not have any of those accommodations. So you just want to make the point—of course, you just casually mention it in your statement—that the growth factor was also an effect. I just wanted to make the point that the power companies, in my view, have been rather shortsighted in not adjusting their rates, which would be conducive to more consumption, which would inevitably lead to more profitability.

Mr. TEAGUE. Will the gentleman yield on that point if the chairman will permit it?

I am not a member of the subcommittee.

Mr. POAGE. Certainly we will permit it.

Mr. TEAGUE. I wonder if the doctor has any observations to make, even at the risk of oversimplifications, as to private power rates as compared with those charged by REA co-ops. It seems to me to have some bearing on this.

Mr. GUTHMANN. It belongs with the sort of thing we were discussing. I have tried to find some material on this point and I may say the only thing I located that made a direct statement was the statement that was made in the Comptroller General's report in his discussion of REA last November. There is just one sentence and it is so short, if you do not mind, I will just read his statement. This was in the Comptroller General's report. Near the back, there is a letter from Mr. Richard Dell, the Acting Administrator of the REA, in which he gives his reaction to the Comptroller General's report. He made this statement about rates:

A recent study made by the REA shows that an average of the rates paid by residential consumers of REA-financed borrowers—

That would be your REMC's, you see—

at the 500 kilowatt-hour level is over 20 percent higher than the average of rates paid by urban residential consumers.

Then they put in parentheses, "communities of 2,500 population or over."

That is on page 89 of that report.

That bothered me considerably because I had had the impression that rates in a given area where they had an REMC and an investor-owned utility were closer than that. I pointed out that a 20-percent difference might be less important than you would think.

In other words in 1960 or 1961, the average bill in these larger communities, as published by the Federal Power Commission was about \$10.60. So if you bought that much, 20 percent would be a difference of about \$2 a month. That meant buying quite a lot of power because you remember, in our table, we showed that the REA's were only selling about 375 kilowatt-hours a month.

So I wondered. I studied to see if I could find out any reason. In looking over the Federal Power Commission figures, I found out that what they did was weight the rates they found in these various cities by the population. So what you really boost was something that was very heavily weighted with the amounts charged in the bigger cities, you see. There is no indication about the REA study and if I had had time, I would have liked to study them and see how they did it.

It is quite possible that if you just had just a simple average, you would get something that would be weighted equally by the very smallest REMC, rather than the largest. I suggest that might be the reason why you get what looks like a contradiction. My figures suggest that by 1961, the average bill or the average cost per kilowatt-hour was not too far apart when you got down to the typical bill of around 300-some kilowatt-hours a month.

It is very difficult to use figures where you may have one kind of distribution geographically for the farm co-ops and you may have another for cities. After all, taking a single State, Texas, for example, you will find a more than 20-percent difference between some of the major cities in that area. As I recall it, I took that up because that is a big State, so you get a lot of geographical difference. For example, in El Paso, the El Paso Electric, which is investor owned, has a bill of 9.25 for 500 kilowatt-hours. When you go to a town like Dallas, for example, it is up to 10.43. Oddly enough, Austin, where I used to live and where they have a municipal plant, it is 11.94. There you get more than a 20-percent spread. So you see how hard it is.

The thing that struck me most of all was that this was a discussion of rates and ignored the most important point of all, which is that the co-ops are not supposed to make any profit. If they have a margin, that belongs to the consumers. The figures we have in our reports show that they have had margins there that ran 130 percent of their revenues.

Mr. TEAGUE. Have they been returning those margins to the consumers?

Mr. GUTHMANN. They may or may not. If they return them, that would reduce this figure in the computation. If they did not, they are still in the business and making a good return.

The equity of the co-ops has been augmented by a return that is substantially as high, in fact a little higher than that of the investor-owned utilities.

Now, then, if you take that 15 percent in the way of net margins and say you are going to get it sooner or later, you will get some of it

now, some of it later. That would cut the rates, so instead of being 20 percent higher, they become something like 4 percent higher. So it seems to me that the co-ops, even on the face of the figures given by the REA, are extremely good.

Of course, if you raise some question of the validity of the 20 percent, they might still be some better.

Mr. STUBBLEFIELD. As to the point I was making, I was not going into the rate structure as much as making a point that a lower rate was conducive to greater volume. Where you have a 40-percent greater rate, you have 60 million against 239 million kilowatts difference. Where you had the lower rate, you had a greater volume of business which, according to you, is more profitable.

Mr. GUTHMANN. And of course, that is some of the explanation for the shrinking difference between REA and the investor-owned utilities, the more rapid growth in volume of the residential consumer of the REA's has helped make that showing. But that is all to the good. That is the way it should be.

Mr. STUBBLEFIELD. That is all.

Mr. POAGE. Mr. Teague?

Mr. TEAGUE. No questions, Mr. Chairman. I do once more want to express my appreciation.

I would respectfully request that a short letter here, a page and a half, from the Comptroller General of the United States to the President of the Senate and the Speaker, dated November 22, 1963, and dealing with the general subject of the possibility of reducing Federal expenditures under the rural electrification program and other matters pertaining to the Rural Electrification Administration, be made part of the record.

Mr. POAGE. Without objection, it will be made part of the record. (The document referred to follows:)

WASHINGTON, D.C., November 22, 1963.

*To the President of the Senate and the Speaker of the House of Representatives:*

Herewith is our report on possibilities for reducing Federal expenditures under the electric loan program and other matters pertaining to the Rural Electrification Administration, Department of Agriculture.

On the basis of our examination, we believe that in certain circumstances Federal expenditures under the electric loan program could be reduced without adversely affecting the accomplishment of program objectives. To avail itself of these possibilities, the Rural Electrification Administration should, in determining the need for granting loan and in establishing loan repayment periods, consider the availability of funds expected to be generated by borrowers' income-producing operations.

In arriving at its decision to approve or disapprove requests for loans, the Rural Electrification Administration does not consider the funds expected to be generated by the borrowers' income-producing operations except to determine whether the borrowers will be able to repay the proposed loans within the required period. Neither does it consider such funds from the standpoint of establishing the feasibility of a repayment period shorter than 35 years. Therefore, it is possible for borrowers to obtain loans at a rate of 2 percent a year for the maximum 35-year repayment period even though it appears that their financial needs could be satisfied from funds expected to be generated by their operations in ensuing years or that the borrowers have the financial ability to repay the loans in less than 35 years without endangering their financial position or their capacity to provide electricity at reasonable rates.

We noted, for example, a loan approved in May 1962 for \$6.7 million to a cooperative for the construction of generation facilities. On the basis of the borrower's own forecast of annual cash margins expected to be generated over

the years during which the generating plant financed by the Rural Electrification Administration is to be constructed, and after considering the estimated annual amounts required for plant additions during these years, it appeared that the borrower's financial needs could have been readily satisfied without the \$6.7 million loan at that time and without detriment to the rural electrification program objectives. On the basis of the difference between the interest cost incurred by the Treasury around the time of loan approval, for money obtained from outside sources for long-term marketable obligations, and the 2-percent interest paid to the Rural Electrification Administration by its borrowers, we estimate that the excess interest cost to the Federal Government on this 35-year loan will be about \$3.6 million.

In another case, we noted where a borrower received a 35-year loan in June 1962 for \$974,000. On the basis of the borrower's estimated cash margins from future operations, as shown by its financial forecast, and after allowing for the increase in debt service because of the \$974,000 loan and for a reduction in electric rates which became effective subsequent to the date of the REA loan, it does not seem that the increased amount of annual repayments that would have been required if the loan had been made for a shorter period of 30 or 25 years would cause a financial hardship to the borrower, require consumers to pay more for their electric power than they now pay, or prevent the borrower from further reducing its electric rates. A loan repayment period of 30 years would have reduced the excess interest cost to the Government on the \$974,000 loan by about \$83,000, and a loan repayment period of 25 years would have reduced the Government's excess interest cost by about \$162,000.

To place the Rural Electrification Administration in position to encourage and bring about the fullest use of a cooperative's own capital in lieu of Government loan funds, when warranted, and thereby effect savings in interest costs incurred by the Government, we are recommending that the Secretary of Agriculture institute appropriate action to provide that the agency impose a requirement upon borrowers to prepare and submit long-range financial plans and forecasts in support of loan applications. Our recommendation includes a provision for careful analysis by the agency of such plans and forecasts before approving loans or granting loans for the maximum authorized 35-year repayment period, giving particular attention to the availability of funds expected to be generated by borrowers' income-producing operations and to the financial policies governing the planned disposition of borrowers expected operating margins. We believe that such financial policies should be carefully weighed by the Rural Electrification Administration with due regard to the rightful interests of the borrowing cooperatives and the consumer public and also to the possibilities of effecting economies in the expenditure of Federal funds.

The comments of the Rural Electrification Administration on our proposals aimed at reducing Federal expenditures under the electric loan program without adversely affecting the attainment of program objectives are recognized and discussed in appropriate sections of the report and appear in detail in appendix II. The agency expressed complete agreement with the desirability of accomplishing rural electrification program objectives at the lowest cost to the Government and stated that it was considering certain action which it felt would be in line with the purpose of our recommendation. However, it did not agree to consider the availability of funds expected to be generated by borrowers' income-producing operations in determining the need for granting loans and in establishing loan repayment periods.

Other matters covered in the report include the need for full consideration by the Rural Electrification Administration of all offers by existing power suppliers to provide power requirements of its borrowers before making generation and transmission loans, the large increase in recent years in electric loan funds used to finance the construction of generating plants and transmission lines, the general funds of electric borrowers, and data concerning the composition of beneficiaries under the rural electrification loan program.

Copies of this report are being sent to the President of the United States, the Secretary of Agriculture, and the Administrator of the Rural Electrification Administration.

(Signed) JOSEPH CAMPBELL,  
*Comptroller General of the United States.*

Mr. POAGE. Thank you, Mr. Teague. We appreciate your visiting us this morning.

Mr. Purcell?

Mr. PURCELL. I have no questions, Mr. Chairman.

Mr. POAGE. If there are no further questions, we are very much obliged to you, Dr. Guthmann, and appreciate your attendance here.

Thank you very much.

The committee will stand in recess.

(Whereupon, at 11:50 a.m., the committee adjourned, subject to the call of the Chair.)





