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RURAL TELEPHONE BANK

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HEARING

BEFORE THE

SUBCOMMITTEE ON AGRICULTURAL
CREDIT AND RURAL ELECTRIFICATION

OF THE

COMMITTEE ON
AGRICULTURE AND FORESTRY
UNITED STATES SENATE

NINETY-FIRST CONGRESS

FIRST SESSION

ON

S. 1684 and S. 2202

BILLS TO AMEND THE RURAL ELECTRIFICATION ACT OF 1936,
AS AMENDED, TO PROVIDE AN ADDITIONAL SOURCE OF
FINANCING FOR THE RURAL TELEPHONE PROGRAM, AND FOR
OTHER PURPOSES

NOVEMBER 6, 1969

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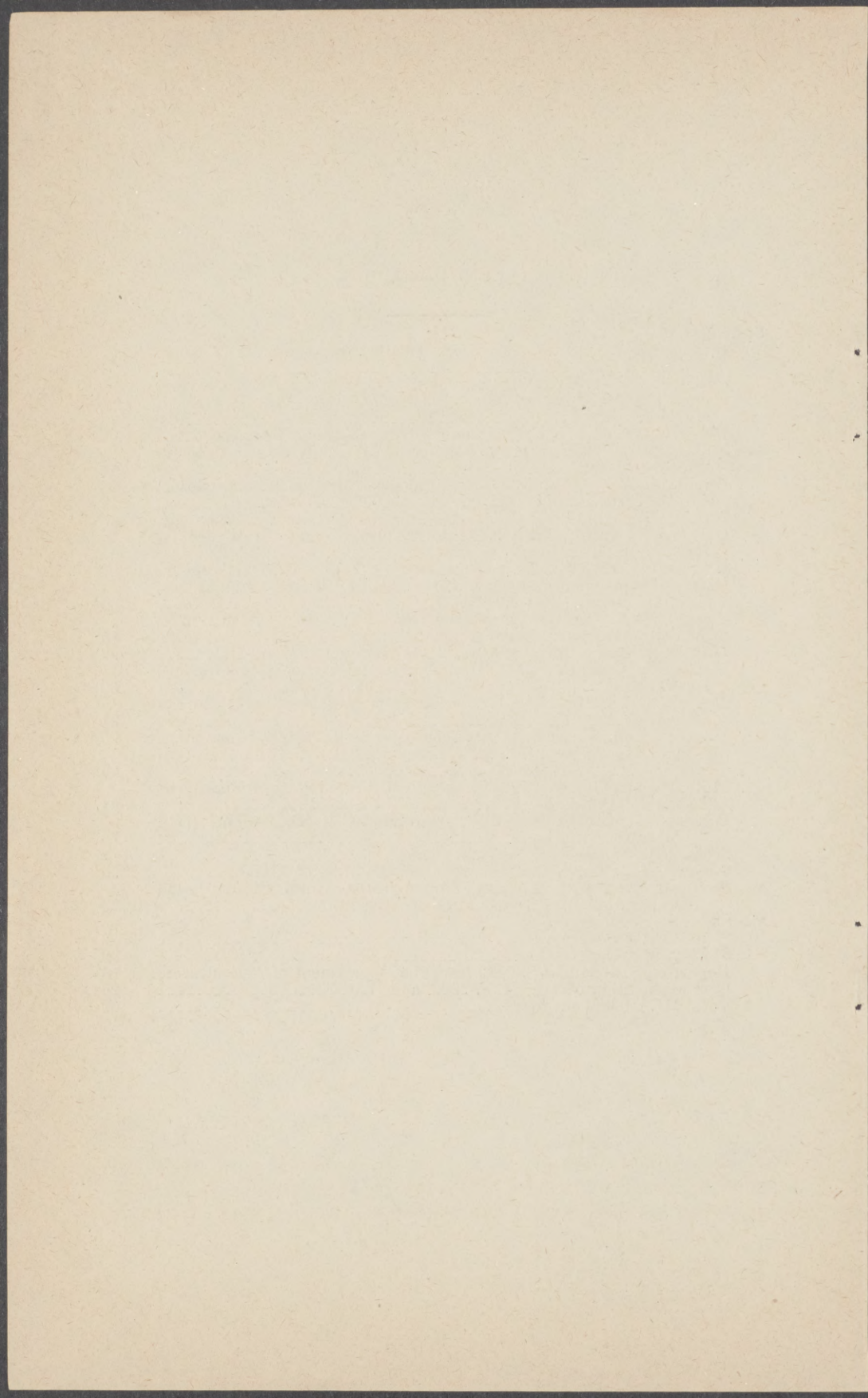
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RURAL TELEPHONE BANK

THURSDAY, NOVEMBER 6, 1969

U.S. SENATE,
SUBCOMMITTEE ON AGRICULTURAL CREDIT
AND RURAL ELECTRIFICATION OF THE
COMMITTEE ON AGRICULTURE AND FORESTRY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 324, Old Senate Office Building, Senator Herman E. Talmadge (chairman of the subcommittee) presiding.

Present: Senators Talmadge, Holland, McGovern, Allen, Miller, and Dole.

Also present: Senator Bellmon.

Senator TALMADGE. The subcommittee will come to order.

The subcommittee is holding hearings today on S. 1684, introduced by Senator McGovern, and S. 2202, introduced by Senator Dole. These bills would create an REA telephone bank revolving fund and a rural telephone bank.

I believe the members of this subcommittee are quite familiar with the REA telephone loan program. In 1949, the year the REA loan program was amended to include rural telephone loans, only about 38 percent of our farmers had telephones. Today, about 80 percent of our farmers have telephone service. Over 2 million rural subscribers, or some 6 million people, enjoy the benefits of modern telephones.

However, the telephone service available to our rural citizens is far from adequate. It is, in fact, plagued by poor service and overloaded party lines. Eight telephone subscribers per rural line was the standard set by the REA when the rural telephone loan program was started. Although this standard represented a substantial improvement over the service then available. I don't believe that any modern family—urban or rural—would consider telephone service adequate when it must be shared with seven other families. To the modern farmer the telephone is as important as it is to any other businessman.

In my view, good telephone service is a vital part of efforts to make rural areas attractive places which will slow the trend of outmigration from our farms. Effective telephone service is essential if we are to make these areas attractive and prosperous places for new industries and businesses to locate.

No longer should rural residents be required to settle for less than quality telephone service.

Of course, it is difficult for any telephone company to provide the same quality service to rural residents that is available to city dwellers. On the average, REA telephone borrowers have only 33.8 subscribers

per mile of line as compared to a subscriber density of 16 for the totally independent telephone company and over 40 per mile for the Bell System companies. If rural telephone companies are to provide the additional lines that are needed to give adequate telephone service to all rural subscribers, they will need a great deal of capital. This capital is not available through normal channels and the needs of REA telephone loan borrowers exceed the amounts which can be obtained through appropriations for the 2 percent REA loan program.

The telephone bank of the bills we are here to discuss this morning would provide supplemental financing at higher rates of interest.

The bills before the subcommittee today are quite similar, and I believe that they have a great deal of merit. Both would go a long way toward meeting the pressing capital needs of rural telephone systems.

The bank would be financed through the purchase by the United States of a total of \$300 million of class A stock over a period of 10 or more years, and by sale of debentures and class B and C stock.

The bank would make "intermediate" loans at a subsidized interest rate of 4 percent or less, and "other" loans at a rate reflecting the cost of money.

Loans would be made by the bank to existing on approved REA borrowers for the same purposes as under the 2-percent loan program, or to finance system improvement or the purchase of class B stock.

The bills look to eventual retirement of the Government investment and conversion to private ownership. The bank would, however, continue as an instrumentality of the United States exempt from taxation.

The bills are identical, except for the inclusion in S. 2202 of a section 412, which prohibits 2-percent loans to borrowers with subscriber density of more than three per mile, having net worth in excess of 20 percent of assets, and able to obtain loans elsewhere on reasonable terms.

Copies of the bills, the report of the Department of Agriculture, and a committee staff explanation will be inserted in the record at this point.

(The documents are as follows:)

[S. 1684, 91st Cong., first sess.]

A BILL To amend the Rural Electrification Act of 1936, as amended, to provide an additional source of financing for the rural telephone program, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That it is hereby declared to be the policy of the Congress that the growing capital needs of the rural telephone systems require the establishment of a rural telephone bank which will furnish assured and viable sources of supplementary financing with the objective that said bank will become an entirely privately owned, operated, and financed corporation. The Congress further finds that many rural telephone systems require financing under the terms and conditions provided in title II of the Rural Electrification Act of 1936, as amended. In order to effectuate this policy, the Rural Electrification Act of 1936, as amended (7 U.S.C. 921-924), is amended as hereinafter provided.

SEC. 2. The Rural Electrification Act of 1936, as amended, is amended by adding the following two new titles:

"TITLE III

"SEC. 301. RURAL TELEPHONE ACCOUNT.—(a) There is hereby established in the Treasury of the United States an account, to be known as the rural telephone account, consisting of:

"(1) all notes, bonds, obligations, and property delivered or assigned to the Administrator pursuant to loans heretofore or hereafter made under section 201 of this Act, including notes, bonds, obligations, and property held in trust by him on behalf of the Secretary of the Treasury, as of the effective date of this title, which shall be transferred to and be assets of the rural telephone account;

"(2) undisbursed balances of telephone loans made under section 201, which, as of the effective date of this title, shall be transferred to and be assets of the rural telephone account;

"(3) all collections of principal and interest received on and after July 1, 1968, on notes, bonds, judgments, or other obligations made or held under title II of this Act, which shall be paid into and be assets of the rural telephone account;

"(4) all appropriations for telephone loans made under the authority of section 3 of this Act and funds obtained in accordance therewith and the unexpended balances of any funds available on the effective date of this title for telephone loans under section 201 of this Act, including any funds made available for telephone loans under the item 'Rural Electrification Administration,' in the Department of Agriculture Appropriation Acts current on the date of enactment of this title, and said appropriations, balances, and funds shall be assets of the rural telephone accounts; and

"(5) shares of the capital stock of the Rural Telephone Bank acquired by investment of the rural telephone account pursuant to section 302(b) (3) of this title, and moneys received from said bank upon retirement of said shares of stock in accordance with the provisions of title IV of this Act, which said shares and moneys shall be assets of the rural telephone account.

"SEC. 302. LIABILITIES AND USES OF ACCOUNT.—(a) The notes of the Administrator issued to the Secretary of the Treasury to obtain funds for loans under section 201 of this Act, and all other liabilities against the appropriations or assets in the rural telephone account in connection with telephone loan operations shall be liabilities of the rural telephone account, and all other obligations against such appropriations or assets arising out of telephone loan operations shall be obligations of the rural telephone account.

"(b) The assets of the rural telephone account shall be available for the following purposes:

"(1) loans under section 201 of this Act and for advances in connection therewith, except that no such loans shall be made in any year in excess of the amounts previously authorized therefor in appropriation Acts for such year or available pursuant to section 3 of this Act; the amounts so authorized for loans and advances shall remain available until expended;

"(2) payment of interest as it accrues on loans to the Administrator from the Secretary of the Treasury for telephone purposes pursuant to section 3(a) of this Act;

"(3) investment in the capital stock of the Rural Telephone Bank in accordance with section 406(a) of this Act: *Provided*, That such investment shall be deemed paid in capital of the said bank notwithstanding that funds representing the proceeds from the purchase of such stock shall remain in the rural telephone account until required for actual disbursement in cash by the said bank; and

"(4) payment of principal when due on loans to the Administrator from the Secretary of the Treasury for telephone purposes pursuant to section 3(a) of this Act.

"SEC. 303. DEPOSIT OF ACCOUNT MONEYS.—Moneys in the rural telephone account shall remain on deposit in the Treasury of the United States until disbursed.

"TITLE IV

"SEC. 401. ESTABLISHMENT, GENERAL PURPOSES, AND STATUS OF THE TELEPHONE BANK.—(a) There is hereby established a body corporate to be known as the Rural Telephone Bank (hereinafter called the telephone bank).

"(b) The general purposes of the telephone bank shall be to obtain an adequate supply of supplemental funds to the extent feasible from non-Federal sources, to utilize said funds in the making of loans under section 408 of this title, and to conduct its operations to the extent practicable on a self-sustaining basis.

"(c) The telephone bank shall be deemed to be an instrumentality of the United States, and shall, for the purposes of jurisdiction and venue, be deemed

a citizen and resident of the District of Columbia. The telephone bank is authorized to make payments to State, territorial, and local governments in lieu of property taxes upon real property and tangible personal property which was subject to State, territorial, and local taxation before acquisition by the telephone bank. Such payment may be in the amounts, at the times, and upon such terms as the telephone bank deems appropriate but the telephone bank shall be guided by the policy of making payments not in excess of the taxes which would have been payable upon such property in the condition in which it was acquired.

"SEC. 402. GENERAL POWERS.—To carry out the specific powers herein authorized, the telephone bank shall have power to (a) adopt, alter, and use a corporate seal; (b) sue and be sued in its corporate name; (c) make contracts, leases, and cooperative agreements, or enter into other transactions as may be necessary in the conduct of its business, and on such terms as it may deem appropriate; (d) acquire, in any lawful manner, hold, maintain, use, and dispose of property: *Provided*, That the telephone bank may only acquire property needed in the conduct of its banking operations or pledged or mortgaged to secure loans made hereunder or in temporary operation or maintenance thereof: *Provided further*, That any such pledged or mortgaged property so acquired shall be disposed of as promptly as is consistent with prudent liquidation practices, but in no event later than five years after such acquisition; (e) accept gifts or donations of services, or of property in aid of any of the purposes herein authorized; (f) appoint such officers, attorneys, agents, and employees, vest them with such powers and duties, fix and pay such compensation to them for their services as the telephone bank may determine; (g) determine the character of and the necessity for its obligations and expenditures, and the manner in which they shall be incurred, allowed, and paid; (h) execute, in accordance with its by-laws, all instruments necessary or appropriate in the exercise of any of its powers; (i) collect or compromise all obligations assigned to or held by it and all legal or equitable rights accruing to it in connection with the payment of such obligations until such time as such obligation may be referred to the Attorney General for suit or collection; and (j) exercise all such other powers as shall be necessary or incidental to carrying out its functions under this title.

"SEC. 403. SPECIAL PROVISIONS GOVERNING TELEPHONE BANK AS AN AGENCY OF THE UNITED STATES UNTIL CONVERSION OF OWNERSHIP, CONTROL, AND OPERATION.—Until the ownership, control, and operation of the telephone bank is converted as provided in section 410 (a) of this title and not thereafter—

"(a) the telephone bank shall be an agency of the United States and shall be subject to the supervision and direction of the Secretary of Agriculture (hereinafter called the Secretary): *Provided, however*, That the telephone bank shall at no time be entitled to transmission of its mail free of postage, nor shall it have the priority of the United States in the payment of debts out of bankrupt, insolvent, and decedents' estates;

"(b) in order to preform its responsibilities under this title, the telephone bank may partially or jointly utilize the facilities and the services of employees of the Rural Electrification Administration or of any other agency of the Department of Agriculture, without cost to the telephone bank and without charge to administrative expenses recoverable by the telephone bank under section 408 (b) (3) of this title, but the compensation and expenses of members of the Telephone Bank Board who are not Federal officers or employees, and of officers and employees engaged solely on telephone bank activities, and procurement for the telephone bank, shall be administrative expenses recoverable under said subsection;

"(c) notwithstanding the provisions of the second sentence of subsection (d) of section 303 of the Government Corporation Control Act, as amended (31 U.S.C. 868), all telephone debentures issued by the telephone bank shall be issued at such times, bear interest at such rates, and contain such other terms and conditions as have been or may be approved by the Secretary of the Treasury;

"(d) the telephone bank may without regard to the civil service classification laws appoint and fix the compensation of such officers and employees of the telephone bank as it may deem necessary;

"(e) the telephone bank shall be subject to the provisions of sections 517, 519, and 2679 of title 28, United States Code.

"SEC. 404. GOVERNOR.—Subject to the provisions of section 410, the Administrator of the Rural Electrification Administration shall serve as the chief executive officer of the telephone bank (herein called the Governor of the telephone bank). Except as to matters specifically reserved to the Telephone Bank Board in this

title, the Governor of the telephone bank shall exercise and perform all functions, powers, and duties of the telephone bank.

"SEC. 405. BOARD OF DIRECTORS.—(a) The management of the telephone bank, within the limitations prescribed by law, shall be vested in a board of directors (herein called the Telephone Bank Board) consisting of thirteen members.

"(b) The Administrator of the Rural Electrification Administration and the Governor of the Farm Credit Administration shall be members of the Telephone Bank Board. Five other members of the Telephone Bank Board shall be designated by the President to serve at his pleasure, three of whom shall be officers or employees of the Department of Agriculture but not officers or employees of the Rural Electrification Administration, and two of whom shall be from the general public and not officers or employees of the Federal Government. The Administrator and other officers and employees of the Department of Agriculture and the Governor of the Farm Credit Administration shall serve as members without additional compensation.

"(c) As soon as practicable after enactment of this title, the President of the United States shall appoint six additional members of the initial Telephone Bank Board to be selected from the directors, managers, and employees of any entities eligible to borrow from the telephone bank and of organizations controlled by such entities, with due regard to fair representation of the rural telephone systems of the Nation. The six members thus appointed shall serve until their successors shall have been duly elected in accordance with subsection (d).

"(d) Within twelve months following the appointment of the six members of the initial Board as provided in subsection (c), the Governor of the telephone bank shall call a meeting of all entities then eligible to borrow from the telephone bank and organizations controlled by such entities for the purpose of electing members of the Telephone Bank Board. Each such entity and organization shall be entitled to notice of and shall have one noncumulative vote at said meeting. Six members of the Telephone Bank Board shall be elected for a two-year term, three from among the directors, managers, and employees of cooperative-type entities eligible to vote and organizations controlled by such entities, and three from among the managers, directors, and employees of commercial-type entities eligible to vote and organizations controlled by such entities. These six members shall be elected by majority vote of the entities and organizations eligible to vote and such entities and organizations may vote by proxy.

"(e) Thereafter, in accordance with the bylaws of the telephone bank, the six members of the Telephone Bank Board shall be elected by holders of class B and Class C stock, three from among the directors, managers, and employees of cooperative-type entities and organizations controlled by such entities holding class B or class C stock, and three from among the directors, managers, and employees of commercial-type entities and organizations controlled by such entities holding class B or class C stock. These six members shall be elected by majority vote of the entities and organizations eligible to vote and such entities and organizations may vote by proxy.

"(f) Any Telephone Bank Board member may continue to serve after the expiration of the term for which he is elected until his successor has been elected and has qualified. Telephone Bank Board members designated from the general public, pursuant to subsection (b), or appointed or elected pursuant to subsections (c), (d), and (e), shall receive \$100 for each day or part thereof, not to exceed one hundred days per year for the first three years after enactment of this title and not to exceed fifty days per year thereafter, spent in the performance of official duties, and shall be reimbursed for travel and other expenses in such manner and subject to such limitations as the Telephone Bank Board may prescribe.

"(g) The Telephone Bank Board shall prescribe by bylaws, not inconsistent with law, regulating the manner in which the telephone bank's business shall be conducted, its directors and officers elected, its stock issued, held, and disposed of, its property transferred, its bylaws amended, and the powers and privileges granted to it by law exercised and enjoyed.

"(h) The Telephone Bank Board shall meet at such times and places as it may fix and determine, but shall hold at least four regularly scheduled meetings a year, and special meetings may be held on call in the manner specified in the bylaws of the telephone bank.

"(i) The Telephone Bank Board shall make an annual report to the Secretary for transmittal to the Congress on the administration of this title IV and any other matters relating to the effectuation of the policies of title IV, including recommendations for legislation.

"SEC. 406. CAPITALIZATION.—(a) The telephone bank's capital shall consist of capital subscribed by the United States, by borrowers from the telephone bank, by corporations and public bodies eligible to become borrowers from the telephone bank, and by organizations controlled by such borrowers, corporations, and public bodies. Beginning with the fiscal year 1970 and for each fiscal year thereafter, the United States shall furnish capital for the purchase of class A stock and there are hereby authorized to be appropriated from net collection proceeds in the rural telephone account created under title III of this Act such amounts, not to exceed \$30,000,000 annually, for such purchases until such class A stock shall equal \$300,000,000: *Provided*, That on or before July 1, 1974, the Secretary shall make a report to the President for transmittal to the Congress on the status of capitalization of the telephone bank by the United States with appropriate recommendations. As used in this section, the term 'net collection proceeds' shall be deemed to mean payments from and after July 1, 1968, of principal and interest on loans heretofore or hereafter made under section 201 of this Act, less an amount representing interest payable to the Secretary of the Treasury on loans to the Administrator for telephone purposes pursuant to section 3(a) of this Act.

"(b) The capital stock of the telephone bank shall consist of three classes, class A, class B, and class C, the rights, powers, privileges, and preferences of the separate classes to be as specified, not inconsistent with law, in the bylaws of the telephone bank. Class B and class C stock shall be voting stock, but no holder of said stock shall be entitled to more than one vote, nor shall class B and class C stockholders, regardless of their number, which are owned or controlled by the same person, group of persons, firm, association, or corporation, be entitled in any event to more than one vote.

"(c) Class A stock shall be issued only to the Administrator of the Rural Electrification Administration on behalf of the United States in exchange for capital furnished to the telephone bank pursuant to subsection (a), and such class A stock shall be redeemed and retired by the telephone bank as soon as practicable after June 30, 1984, but not to the extent that the telephone Bank Board determines that such retirement will impair the operations of the telephone bank: *Provided*, That the minimum amount of class A stock that shall be retired each year after said date and after the amount of class A and class B stock issued totals \$400,000,000, shall equal the amount of class B stock sold by the telephone bank during such year. Class A stock shall be entitled to a return, payable from income, at the rate of 2 per centum per annum on the amounts of said class A stock actually paid into the telephone bank. Such return shall be cumulative and shall be payable annually into miscellaneous receipts of the Treasury.

"(d) Class B stock shall be held only by recipients of loans under section 408 of this Act. Borrowers, receiving loan funds pursuant to section 408(a) (1) or (2) shall be required to invest in class B stock 5 per centum of the amount of loan funds so provided. No dividends shall be payable on class B stock. All holders of class B stock shall be entitled to patronage refunds in class B stock under terms and conditions to be specified in the bylaws of the telephone bank.

"(e) Class C stock shall be available for purchase and shall be held only by borrowers, or by corporations eligible to borrow under section 408 of this Act, or by organizations controlled by such borrowers and corporations, and shall be entitled to dividends in the manner specified in the bylaws of the telephone bank. Such dividends shall be payable only from income and, until all class A stock is retired, shall not exceed the current average rate payable on its telephone debentures.

"(f) If a firm, association, corporation, or public body is not authorized under the laws of the jurisdiction in which it is organized to acquire stock of the telephone bank, the telephone bank shall, in lieu thereof, permit such organization to pay into a special fund of the telephone bank a sum equivalent to the amount of stock to be purchased. Each reference in this title to capital stock, or to class B, or class C stock, shall include also the special fund equivalents of such stock, and to the extent permitted under the laws of the jurisdiction in which such organization is organized, a holder of special fund equivalents of class B, or class C stock, shall have the same rights and status as a holder of class B or class C stock, respectively. The rights and obligations of the telephone bank in respect of such special fund equivalent shall be identical to its rights and obligations in respect of class B or class C stock, respectively.

“(g) After payment of all operating expenses of the telephone bank, including interest on its telephone debentures, setting aside appropriate funds for reserves for losses, and making payments in lieu of taxes, and returns on class A stock as provided in section 406(c), and on class C stock, the Telephone Bank Board shall annually set aside the remaining earnings of the telephone bank for patronage refunds in accordance with the bylaws of the telephone bank.

“SEC. 407. BORROWING POWER.—The telephone bank is authorized to obtain funds through the public or private sale of its bonds, debentures, notes, and other evidences of indebtedness (herein collectively called ‘telephone debentures’). Telephone debentures shall be issued at such times, bear interest at such rates, and contain such other terms and conditions as the Telephone Bank Board shall determine: *Provided, however,* That the amount of the telephone debentures which may be outstanding at any one time pursuant to this section shall not exceed eight times the paid-in capital and retained earnings of the telephone bank. The telephone bank shall insert in all its telephone debentures appropriate language indicating that such telephone debentures, together with interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the telephone bank. Telephone debentures shall not be exempt, either as to principal or interest, from any taxation now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any State or local taxing authority. Telephone debentures shall be lawful investments and may be accepted as security for all fiduciary, trust, and public funds, the investment or deposit of which shall be under the authority and control of the United States or any officer or officers thereof.

“SEC. 408. LENDING POWER.—(a) The Governor of the telephone bank is authorized on behalf of the telephone bank to make loans, in conformance with policies approved by the Telephone Bank Board, to corporations and public bodies which have received a loan or loan commitment pursuant to section 201 of this Act, (1) for the same purposes and under the same limitations for which loans may be made under section 201 of this Act, (2) for the purposes of financing, or refinancing, the construction, improvement, expansion, acquisition, and operation of telephone lines, facilities, or systems, in order to improve the efficiency, effectiveness, or financial stability of borrowers financed under sections 201 and 408 of this Act, and (3) for the purchase of class B stock required to be purchased under section 406(d) of this Act but not for the purpose of class C stock, subject, as to the purposes set forth in (2) hereof, to the following provisos: That in the case of any such loan for the acquisition of telephone lines, facilities, or systems, the acquisition shall be approved by the Secretary, the location and character thereof shall be such as to improve the efficiency, effectiveness, or financial stability of the telephone system of the borrower, and in respect of exchange facilities for local services, the size of each acquisition shall be not greater than the borrower’s existing system at the time it receives its first loan from the telephone bank, taking into account the number of subscribers served, miles of line, and plant investment.

“(b) Loans under this section shall be on such terms and conditions as the Governor of the telephone bank shall determine, subject, however, to the following restrictions:

“(1) All loans made hereunder shall be fully amortized over a period not to exceed fifty years.

“(2) Notwithstanding any other provision of law, all loans made pursuant to this Act for facilities for telephone systems with an average subscriber density of three or fewer per mile shall be made under section 201 of this Act; but this provision shall not preclude the making of such loans from the telephone bank at the election of the borrower.

“(3) Intermediate loans shall bear interest at a rate equal to (i) a rate determined by the Secretary of the Treasury, taking into consideration the current average market yield, during the month of May preceding the fiscal year in which the loans are made, on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities of such loans, or (ii) 4 per centum per annum, whichever is lower. All other loans made hereunder shall bear interest at a rate which shall reflect the average cost of moneys to the telephone bank, including (a) interest on its debentures, and (b) the return on funds provided by the United States for the purchase of class A stock pursuant to

section 406(a) of this Act, and (c) administrative expenses, and (d) reserves, and (e) estimated losses of the telephone bank. Intermediate loans shall not be made to a borrower which is determined by the Governor of the telephone bank, under standards to be established by the Secretary, to be capable of both paying the interest rate applicable hereunder to loans other than intermediate loans and achieving the objectives of the Federal rural telephone loan program. The authority to make intermediate loans hereunder shall terminate on June 30, 1984, or such earlier date as conversion take place under section 410(a): *Provided*, That on or before July 1, 1974, the Secretary shall make a report to the President for transmittal to the Congress on the status of the intermediate loan program with recommendations concerning its continuation thereafter.

"(4) Loans shall not be made unless the Governor of the telephone bank finds and certifies that in his judgment the security therefor is reasonably adequate and such loan will be repaid within the time agreed.

"(5) No loan shall be made in any State which now has or may hereafter have a State regulatory body having authority to regulate telephone service and to require certificates of convenience and necessity to the applicant unless such certificate from such agency is first obtained. In a State in which there is no such agency or regulatory body legally authorized to issue such certificates to the applicant, no loan shall be made under this section unless the Governor of the telephone bank shall determine (and set forth his reasons therefore in writing) that no duplication of lines, facilities, or systems, providing reasonably adequate services will result therefrom.

"(6) As used in this section, the term 'telephone service' shall have the meaning prescribed for this term in section 203(a) of this Act, and the term 'telephone lines, facilities, or systems' shall mean lines, facilities, or systems used in the rendition of such telephone service.

"(7) No portion of any loan made under this Act shall be used to finance any political activities prohibited under sections 600, 601, 610, 611, and 612 of title 18, United States Code, and prior to the making of any loan the borrowing entity shall agree in writing not to engage in any such prohibited political activities during the term of such loan. If the Telephone Bank Board finds a violation of this provision to have occurred, it shall so notify such borrower in writing and thirty days thereafter such loan shall become due and payable in full.

"(8) Notwithstanding any other provision of law, (i) no borrower of funds under section 201 of this Act shall, without approval of the Administrator, sell or dispose of its property, rights, controlling interest, or franchise until all indebtedness, including all interest and charges, to the Rural Electrification Administration shall have been repaid, and (ii) no borrower of funds under section 408 of this Act shall, without approval of the Telephone Bank Board, sell or dispose of its property, rights, controlling interest, or franchise until all indebtedness, including all interest and charges, to the telephone bank shall have been repaid.

"(c) The Governor of the telephone bank is authorized under rules established by the Telephone Bank Board to adjust, on an amortized basis, the schedule of payments of interest or principal of loans made under this section upon his determination that with such readjustment there is reasonable assurance of repayment: *Provided, however*, That no adjustment shall extend the period of such loans beyond fifty years.

"SEC. 409. TELEPHONE BANK RECEIPTS.—Any receipts from the activities of the telephone bank shall be available for all obligations and expenditures of the telephone bank.

"SEC. 410. CONVERSION OF OWNERSHIP, CONTROL AND OPERATION OF TELEPHONE BANK.—(a) Whenever after retirement of class A stock issued to the United States has begun pursuant to section 406(c) of this title, the total amount in stated value of class B and class C stock outstanding equals two-thirds of the total amount in stated value of class A, class B, and class C stock outstanding, as determined by the Secretary—

"(1) the powers and authority of the Governor of the telephone bank granted to the Administrator of the Rural Electrification Administration by this title IV shall vest in the Telephone Bank Board, and may be exercised and performed through the Governor of the telephone bank, to be selected by the Telephone Bank Board, and through such other employees as the Telephone Bank Board shall designate;

"(2) the five members of the Telephone Bank Board designated by the President pursuant to section 405(b) shall cease to be members, and the number of Board members shall be accordingly reduced to eight unless other provision is thereafter made in the bylaws of the telephone bank;

"(3) the telephone bank shall cease to be an agency of the United States, but shall continue in existence in perpetuity as an instrumentality of the United States and as a banking corporation with all of the powers and limitations conferred or imposed by this title IV except such as shall have lapsed pursuant to the provisions of this title.

"(b) When all class A stock has been fully redeemed and retired, loans made by the telephone bank shall not continue to be subject to the restrictions prescribed in the provisos to section 408(a) (2).

"(c) Congress reserves the right to review the continued operations of the telephone bank after all class A stock has been fully redeemed and retired.

"SEC. 411. LIQUIDATION OR DISSOLUTION OF THE TELEPHONE BANK.—In the case of liquidation or dissolution of the telephone bank, after the payment or retirement, as the case may be, first, of all liabilities; second, of all class A stock at par; third, of all class B stock at par; fourth, of all class C stock at par; then any surpluses and contingency reserves existing on the effective date of liquidation or dissolution of the telephone bank shall be paid to the holders of class A and class B stock issued and outstanding before the effective date of such liquidation or dissolution, pro rata, and any remaining surplus and contingency reserves shall be distributed to those entities to which they are allocated on the books of the bank at the time of the liquidation or dissolution."

SEC. 2. (a) Subsection (f) of section 3 of the Rural Electrification Act of 1936, as amended, is amended by inserting "rural electrification" immediately following the words "interest on" in both places where it appears in said subsection and by inserting the words "for rural electrification purposes" after the words "Secretary of the Treasury" the second time they appear in said subsection.

(b) Section 201 of the Rural Electrification Act of 1936, as amended, is amended by inserting ", to public bodies now providing telephone service in rural areas", immediately after the word "areas" in the first sentence and also immediately after the word "areas" in the first proviso of the second sentence.

SEC. 3. Section 201 of the Government Corporation Control Act, as amended (31 U.S.C. 856), is amended by striking "and" immediately before "(5)" and by inserting ", and (6) the Rural Telephone Bank" immediately before the period at the end.

SEC. 4. The second sentence of subsection (d) of section 303 of the Government Corporation Control Act, as amended (31 U.S.C. 868), is amended by inserting "the Rural Telephone Bank," immediately following the words "shall not be applicable to".

SEC. 5. The right to repeal, alter, or amend this Act is expressly reserved.

SEC. 6. This Act shall take effect upon enactment.

[S. 2202, 91st Cong., first sess.]

A BILL To amend the Rural Electrification Act of 1936, as amended, to provide an additional source of financing for the rural telephone program, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That it is hereby declared to be the policy of the Congress that the growing capital needs of the rural telephone systems require the establishment of a rural telephone bank which will furnish assured and viable sources of supplementary financing with the objective that said bank will become an entirely privately owned, operated, and financed corporation. The Congress further finds that many rural telephone systems require financing under the terms and conditions provided in title II of the Rural Electrification Act of 1936, as amended. In order to effectuate this policy, the Rural Electrification Act of 1936, as amended (7 U.S.C. 921-924), is amended as hereinafter provided.

SEC. 2. The Rural Electrification Act of 1936, as amended, is amended by adding the following two new titles:

"TITLE III

"SEC. 301. RURAL TELEPHONE ACCOUNT.—(a) There is hereby established in the Treasury of the United States an account, to be known as the rural telephone account, consisting of:

"(1) all notes, bonds, obligations, and property delivered or assigned to the Administrator pursuant to loans heretofore or hereafter made under section 201 of this Act, including notes, bonds, obligations, and property held in trust by him on behalf of the Secretary of the Treasury, as of the effective date of this title, which shall be transferred to and be assets of the rural telephone account;

"(2) undisbursed balances of telephone loans made under section 201, which, as of the effective date of this title, shall be transferred to and be assets of the rural telephone account;

"(3) all collections of principal and interest received on and after July 1, 1968, on notes, bonds, judgments, or other obligations made or held under title II of this Act, which shall be paid into and be assets of the rural telephone account;

"(4) all appropriations for telephone loans made under the authority of section 3 of this Act and funds obtained in accordance therewith and the unexpended balances of any funds available on the effective date of this title for telephone loans under section 201 of this Act, including any funds made available for telephone loans under the item 'Rural Electrification Administration,' in the Department of Agriculture Appropriation Acts current on the date of enactment of this title, and said appropriations, balances, and funds shall be assets of the rural telephone account; and

"(5) shares of the capital stock of the Rural Telephone Bank acquired by investment of the rural telephone account pursuant to section 302(b) (3) of this title, and moneys received from said bank upon retirement of said shares of stock in accordance with the provisions of title IV of this Act, which said shares and moneys shall be assets of the rural telephone account.

"SEC. 302. LIABILITIES AND USES OF ACCOUNT.—(a) The notes of the Administrator issued to the Secretary of the Treasury to obtain funds for loans under section 201 of this Act, and all other liabilities against the appropriations or assets in the rural telephone account in connection with telephone loan operations shall be liabilities of the rural telephone account, and all other obligations against such appropriations or assets arising out of telephone loan operations shall be obligations of the rural telephone account.

"(b) The assets of the rural telephone account shall be available for the following purposes:

"(1) loans under section 201 of this Act and for advances in connection therewith, except that no such loans shall be made in any year in excess of the amounts previously authorized therefor in appropriation Acts for such year or available pursuant to section 3 of this Act; the amounts so authorized for loans and advances shall remain available until expended;

"(2) payment of interest as it accrues on loans to the Administrator from the Secretary of the Treasury for telephone purposes pursuant to section 3(a) of this Act;

"(3) investment in the capital stock of the Rural Telephone Bank in accordance with section 406(a) of this Act: *Provided*, That such investment shall be deemed paid in capital of the said bank notwithstanding that funds representing the proceeds from the purchase of such stock shall remain in the rural telephone account until required for actual disbursement in cash by the said bank; and

"(4) payment of principal when due on loans to the Administrator from the Secretary of the Treasury for telephone purposes pursuant to section 3(a) of this Act.

"SEC. 303. DEPOSIT OF ACCOUNT MONEYS.—Money in the rural telephone account shall remain on deposit in the Treasury of the United States until disbursed.

"TITLE IV

"SEC. 401. ESTABLISHMENT, GENERAL PURPOSES, AND STATUS OF THE TELEPHONE BANK.—(a) There is hereby established a body corporate to be known as the Rural Telephone Bank (hereinafter called the telephone bank).

"(b) The general purposes of the telephone bank shall be to obtain an adequate supply of supplemental funds to the extent feasible from non-Federal sources,

to utilize said funds in the making of loans under section 408 of this title, and to conduct its operations to the extent practicable on a self-sustaining basis.

"(c) The telephone bank shall be deemed to be an instrumentality of the United States, and shall, for the purposes of jurisdiction and venue, be deemed a citizen and resident of the District of Columbia. The telephone bank is authorized to make payments to State, territorial, and local governments in lieu of property taxes upon real property and tangible personal property which was subject to State, territorial, and local taxation before acquisition by the telephone bank. Such payment may be in the amounts, at the times, and upon such terms as the telephone bank deems appropriate but the telephone bank shall be guided by the policy of making payments not in excess of the taxes which would have been payable upon such property in the condition in which it was acquired.

"SEC. 402. GENERAL POWERS.—To carry out the specific powers herein authorized, the telephone bank shall have power to (a) adopt, alter, and use a corporate seal; (b) sue and be sued in its corporate name; (c) make contracts, leases, and cooperative agreements, or enter into other transactions as may be necessary in the conduct of its business and on such terms as it may deem appropriate; (d) acquire, in any lawful manner, hold, maintain, use, and dispose of property: *Provided*, That the telephone bank may only acquire property needed in the conduct of its banking operations or pledged or mortgaged to secure loans made hereunder or in temporary operation or maintenance thereof: *Provided further*, That any such pledged or mortgaged property so acquired shall be disposed of as promptly as is consistent with prudent liquidation practices, but in no event later than five years after such acquisition; (e) accept gifts or donations of services, or of property and in aid of any of the purposes herein authorized; (f) appoint such officers, attorneys, agents, and employees, vest them with such powers and duties, fix and pay such compensation to them for their services as the telephone bank may determine; (g) determine the character of and the necessity for its obligations and expenditures, and the manner in which they shall be incurred, allowed, and paid; (h) execute, in accordance with its bylaws, all instruments necessary or appropriate in the exercise of any of its powers; (i) collect or compromise all obligations assigned to or held by it and all legal or equitable rights accruing to it in connection with the payment of such obligations until such time as such obligation may be referred to the Attorney General for suit or collection; and (j) exercise all such other powers as shall be necessary or incidental to carrying out its functions under this title.

"SEC. 403. SPECIAL PROVISIONS GOVERNING TELEPHONE BANK AS AN AGENCY OF THE UNITED STATES UNTIL CONVERSION OF OWNERSHIP, CONTROL, AND OPERATION.—Until the ownership, control, and operation of the telephone bank is converted as provided in section 410(a) of this title and not thereafter—

"(a) the telephone bank shall be an agency of the United States and shall be subject to the supervision and direction of the Secretary of Agriculture (hereinafter called the Secretary): *Provided, however*, That the telephone bank shall at no time be entitled to transmission of its mail free of postage, nor shall it have the priority of the United States in the payment of debts out of bankrupt, insolvent, and decedents' estates;

"(b) in order to perform its responsibilities under this title, the telephone bank may partially or jointly utilize the facilities and the services of employees of the Rural Electrification Administration or of any other agency of the Department of Agriculture, without cost to the telephone bank and without charge to administrative expenses recoverable by the telephone bank under section 408(b)(3) of this title, but the compensation and expenses of members of the Telephone Bank Board who are not Federal officers or employees and of officers and employees engaged solely on telephone bank activities, and procurement for the telephone bank, shall be administrative expenses recoverable under said subsection;

"(c) notwithstanding the provisions of the second sentence of subsection (d) of section 303 of the Government Corporation Control Act, as amended (31 U.S.C. 868), all telephone debentures issued by the telephone bank shall be issued at such times, bear interest at such rates, and contain such other terms and conditions as have been or may be approved by the Secretary of the Treasury;

"(d) the telephone bank may without regard to the civil service classification laws appoint and fix the compensation of such officers and employees of the telephone bank as it may deem necessary;

"(e) the telephone bank shall be subject to the provisions of sections 517, 519, and 2679 of title 28, United States Code.

"SEC. 404. GOVERNOR.—Subject to the provisions of section 410, the Administrator of the Rural Electrification Administration shall serve as the chief executive officer of the telephone bank (herein called the Governor of the telephone bank). Except as to matters specifically reserved to the Telephone Bank Board in this title, the Governor of the telephone bank shall exercise and perform all functions, powers, and duties of the telephone bank.

"SEC. 405. BOARD OF DIRECTORS.—(a) The management of the telephone bank, within the limitations prescribed by law, shall be vested in a board of directors (herein called the Telephone Bank Board) consisting of thirteen members.

"(b) The Administrator of the Rural Electrification Administration and the Governor of the Farm Credit Administration shall be members of the Telephone Bank Board. Five other members of the Telephone Bank Board shall be designated by the President to serve at his pleasure, three of whom shall be officers or employees of the Department of Agriculture but not officers or employees of the Rural Electrification Administration, and two of whom shall be from the general public and not officers or employees of the Federal Government. The Administrator and other officers and employees of the Department of Agriculture and the Governor of the Farm Credit Administration shall serve as members without additional compensation.

"(c) As soon as practicable after enactment of this title, the President of the United States shall appoint six additional members of the initial Telephone Bank Board to be selected from the directors, managers, and employees of any entities eligible to borrow from the telephone bank and of organizations controlled by such entities, with due regard to fair representation of the rural telephone systems of the Nation. The six members thus appointed shall serve until their successors shall have been duly elected in accordance with subsection (d).

"(d) Within twelve months following the appointment of the six members of the initial Board as provided in subsection (c), the Governor of the telephone bank shall call a meeting of all entities then eligible to borrow from the telephone bank and organizations controlled by such entities for the purpose of electing members of the Telephone Bank Board. Each such entity and organization shall be entitled to notice of and shall have one noncumulative vote at said meeting. Six members of the Telephone Bank Board shall be elected for a two-year term, three from among the directors, managers, and employees of cooperative-type entities eligible to vote and organizations controlled by such entities, and three from among the managers, directors, and employees of commercial-type entities eligible to vote and organizations controlled by such entities. These six members shall be elected by majority vote of the entities and organizations eligible to vote and such entities and organizations may vote by proxy.

"(e) Thereafter, in accordance with the bylaws of the telephone bank, the six members of the Telephone Bank Board shall be elected by holders of class B and class C stock, three from among the directors, managers, and employees of cooperative-type entities and organizations controlled by such entities holding class B or class C stock, and three from among the directors, managers, and employees of commercial-type entities and organizations controlled by such entities holding class B or class C stock. These six members shall be elected by majority vote of the entities and organizations eligible to vote and such entities and organizations may vote by proxy.

"(f) Any Telephone Bank Board member may continue to serve after the expiration of the term for which he is elected until his successor has been elected and has qualified. Telephone Bank Board members designated from the general public, pursuant to subsection (b), or appointed or elected pursuant to subsections (c), (d), and (e), shall receive \$100 for each day or part thereof, not to exceed one hundred days per year for the first three years after enactment of this title and not to exceed fifty days per year thereafter, spent in the performance of official duties, and shall be reimbursed for travel and other expenses in such manner and subject to such limitations as the Telephone Bank Board may prescribe.

"(g) The Telephone Bank Board shall prescribe bylaws, not inconsistent with law, regulating the manner in which the telephone bank's business shall be conducted, its directors and officers elected, its stock issued, held, and disposed of, its property transferred, its bylaws amended, and the powers and privileges granted to it by law exercised and enjoyed.

"(h) The Telephone Bank Board shall meet at such times and places as it may fix and determine, but shall hold at least four regularly scheduled meetings a

year, and special meetings may be held on call in the manner specified in the bylaws of the telephone bank.

“(i) The Telephone Bank Board shall make an annual report to the Secretary for transmittal to the Congress on the administration of this title IV and any other matters relating to the effectuation of the policies of title IV, including recommendations for legislation.

“SEC. 406. CAPITALIZATION.—(a) The telephone bank’s capital shall consist of capital subscribed by the United States, by borrowers from the telephone bank, by corporations and public bodies eligible to become borrowers from the telephone bank, and by organizations controlled by such borrowers, corporations, and public bodies. Beginning with the fiscal year 1970 and for each fiscal year thereafter, the United States shall furnish capital for the purchase of class A stock and there are hereby authorized to be appropriated from net collection proceeds in the rural telephone account created under title III of this Act such amounts, not to exceed \$30,000,000 annually, for such purchases until such class A stock shall equal \$300,000,000: *Provided*, That on or before July 1, 1974, the Secretary shall make a report to the President for transmittal to the Congress on the status of capitalization of the telephone bank by the United States with appropriate recommendations. As used in this section, the term ‘net collection proceeds’ shall be deemed to mean payments from and after July 1, 1968, of principal and interest on loans heretofore or hereafter made under section 201 of this Act, less an amount representing interest payable to the Secretary of the Treasury on loans to the Administrator for telephone purposes pursuant to section 3(a) of this Act.

“(b) The capital stock of the telephone bank shall consist of three classes, class A, class B, and class C, the rights, powers, privileges, and preferences of the separate classes to be as specified, not inconsistent with law, in the bylaws of the telephone bank. Class B and class C stock shall be voting stock, but no holder of said stock shall be entitled to more than one vote, nor shall class B and class C stockholders, regardless of their number, which are owned or controlled by the same person, group of persons, firm, association, or corporation, be entitled in any event to more than one vote.

“(c) Class A stock shall be issued only to the Administrator of the Rural Electrification Administration on behalf of the United States in exchange for capital furnished to the telephone bank pursuant to subsection (a), and such class A stock shall be redeemed and retired by the telephone bank as soon as practicable after June 30, 1984, but not to the extent that the Telephone Bank Board determines that such retirement will impair the operations of the telephone bank: *Provided*, That the minimum amount of class A stock that shall be retired each year after said date and after the amount of class A and class B stock issued totals \$400,000,000, shall equal the amount of class B stock sold by the telephone bank during such year. Class A stock shall be entitled to a return, payable from income, at the rate of 2 per centum per annum on the amounts of said class A stock actually paid into the telephone bank. Such return shall be cumulative and shall be payable annually into miscellaneous receipts of the Treasury.

“(d) Class B stock shall be held only by recipients of loans under section 408 of this Act. Borrowers, receiving loan funds pursuant to section 408(a) (1) or (2) shall be required to invest in class B stock 5 per centum of the amount of loan funds so provided. No dividends shall be payable on class B stock. All holders of class B stock shall be entitled to patronage refunds in class B stock under terms and conditions to be specified in the bylaws of the telephone bank.

“(e) Class C stock shall be available for purchase and shall be held only by borrowers, or by corporations eligible to borrow under section 408 of this Act, or by organizations controlled by such borrowers and corporations, and shall be entitled to dividends in the manner specified in the bylaws of the telephone bank. Such dividends shall be payable only from income and, until all class A stock is retired, shall not exceed the current average rate payable on its telephone debentures.

“(f) If a firm, association, corporation, or public body is not authorized under the laws of the jurisdiction in which it is organized to acquire stock of the telephone bank, the telephone bank shall, in lieu thereof, permit such organization to pay into a special fund of the telephone bank a sum equivalent to the amount of stock to be purchased. Each reference in this title to capital stock, or to class B, or class C stock, shall include also the special fund equivalents of such stock, and to the extent permitted under the laws of the jurisdiction in which such organization is organized, a holder of special fund equivalents of

class B, or class C stock, shall have the same rights and status as a holder of class B or Class C stock, respectively. The rights and obligations of the telephone bank in respect of such special fund equivalent shall be identical to its rights and obligations in respect of class B or class C stock, respectively.

"(g) After payment of all operating expenses of the telephone bank, including interest on its telephone debentures, setting aside appropriate funds for reserves for losses, and making payments in lieu of taxes, and returns on class A stock as provided in section 406(c), and on class C stock, the Telephone Bank Board shall annually set aside the remaining earnings of the telephone bank for patronage refunds in accordance with the bylaws of the telephone bank.

"SEC. 407. BORROWING POWER.—The telephone bank is authorized to obtain funds through the public or private sale of its bonds, debentures, notes, and other evidences of indebtedness (herein collectively called 'telephone debentures'). Telephone debentures shall be issued at such times, bear interest at such rates, and contain such other terms and conditions as the Telephone Bank Board shall determine: *Provided, however*, That the amount of the telephone debentures which may be outstanding at any one time pursuant to this section shall not exceed eight times the paid-in capital and retained earnings of the telephone bank. The telephone bank shall insert in all its telephone debentures appropriate language indicating that such telephone debentures, together with interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the telephone bank. Telephone debentures shall not be exempt, either as to principal or interest, from any taxation now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any State or local taxing authority. Telephone debentures shall be lawful investments and may be accepted as security for all fiduciary, trust, and public funds, the investment or deposit of which shall be under the authority and control of the United States or any officer or officers thereof.

"SEC. 408. LENDING POWER.—(a) The Governor of the telephone bank is authorized on behalf of the telephone bank to make loans, in conformance with policies approved by the Telephone Bank Board, to corporations and public bodies which have received a loan or loan commitment pursuant to section 201 of this Act, (1) for the same purposes and under the same limitations for which loans may be made under section 201 of this Act, (2) for the purposes of financing, or refinancing, the construction, improvement, expansion, acquisition, and operation of telephone lines, facilities, or systems, in order to improve the efficiency, effectiveness, or financial stability of borrowers financed under sections 201 and 408 of this Act, and (3) for the purchase of class B stock required to be purchased under section 406(d) of this Act but not for the purchase of class C stock, subject, as to the purposes set forth in (2) hereof, to the following provisos: That in the case of any such loan for the acquisition of telephone lines, facilities, or systems, the acquisition shall be approved by the Secretary, the location and character thereof shall be such as to improve the efficiency, effectiveness, or financial stability of the telephone system of the borrower, and in respect to exchange facilities for local services, the size of each acquisition shall be not greater than the borrower's existing systems at the time it receives its first loan from the telephone bank, taking into account the number of subscribers served, miles of line, and plant investment.

"(b) Loans under this section shall be on such terms and conditions as the Governor of the telephone bank shall determine, subject, however, to the following restrictions:

"(1) All loans made hereunder shall be fully amortized over a period not to exceed fifty years.

"(2) Notwithstanding any other provision of law, all loans made pursuant to this Act for facilities for telephone systems with an average subscriber density of three or fewer per mile shall be made under section 201 of this Act; but this provision shall not preclude the making of such loans from the telephone bank at the election of the borrower.

"(3) Intermediate loans shall bear interest at a rate equal to (i) a rate determined by the Secretary of the Treasury, taking into consideration the current average market yield, during the month of May preceding the fiscal year in making the loans are made, on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities of such loans, or (ii) 4 per centum per annum, whichever is lower. All other loans made hereunder shall bear interest at a rate

which shall reflect the average cost of moneys to the telephone bank, including (a) interest on its debentures, and (b) the return on funds provided by the United States for the purchase of class A stock pursuant to section 406(a) of this Act, and (c) administrative expenses, and (d) reserves, and (e) estimated losses of the telephone bank. Intermediate loans shall not be made to a borrower which is determined by the Governor of the telephone bank, under standards to be established by the Secretary, to be capable of both paying the interest rate applicable hereunder to loans other than intermediate loans and achieving the objectives of the Federal rural telephone loan program. The authority to make intermediate loans hereunder shall terminate on June 30, 1984, or such earlier date as conversion takes place under section 410(a) : *Provided*, That on or before July 1, 1974, the Secretary shall make a report to the President for transmittal to the Congress on the status of the intermediate loan program with recommendations concerning its continuation thereafter.

"(4) Loans shall not be made unless the Governor of the telephone bank finds and certifies that in his judgment the security therefor is reasonably adequate and such loan will be repaid within the time agreed.

"(5) No loan shall be made in any State which now has or may hereafter have a State regulatory body having authority to regulate telephone service and to require certificates of convenience and necessity to the applicant unless such certificate from such agency is first obtained. In a State in which there is no such agency or regulatory body legally authorized to issue such certificates to the applicant, no loan shall be made under this section unless the Governor of the telephone bank shall determine (and set forth his reasons therefor in writing) that no duplication of lines, facilities, or systems, providing reasonably adequate services will result therefrom.

"(6) As used in this section, the term 'telephone service' shall have the meaning prescribed for this term in section 203(a) of this Act, and the term 'telephone lines, facilities, or systems' shall mean lines, facilities, or systems used in the rendition of such telephone service.

"(7) No portion of any loan made under this Act shall be used to finance any political activities prohibited under sections 600, 601, 610, 611, and 612 of title 18, United States Code, and prior to the making of any loan the borrowing entity shall agree in writing not to engage in any such prohibited political activities during the term of such loan. If the Telephone Bank Board finds a violation of this provision to have occurred, it shall so notify such borrower in writing and thirty days thereafter such loan shall become due and payable in full.

"(8) Notwithstanding any other provision of law, (i) no borrower of funds under section 201 of this Act shall, without approval of the Administrator, sell or dispose of its property, rights, controlling interest, or franchise until all indebtedness, including all interest and charges, to the Rural Electrification Administration shall have been repaid, and (ii) no borrower of funds under section 408 of this Act shall, without approval of the Telephone Bank Board, sell or dispose of its property, rights, controlling interest, or franchise until all indebtedness, including all interest and charges, to the telephone bank shall have been repaid.

"(c) The Governor of the telephone bank is authorized under rules established by the Telephone Bank Board to adjust, on an amortized basis, the schedule of payments of interest or principal of loans made under this section upon his determination that with such readjustment there is reasonable assurance of repayment : *Provided, however*, That no adjustment shall extend the period of such loans beyond fifty years.

"SEC. 409. TELEPHONE BANK RECEIPTS.—Any receipts from the activities of the telephone bank shall be available for all obligations and expenditures of the telephone bank.

"SEC. 410. CONVERSION OF OWNERSHIP, CONTROL AND OPERATION OF TELEPHONE BANK.—(a) Whenever after retirement of class A stock issued to the United States has begun pursuant to section 406(c) of this title, the total amount in stated value of class B and class C stock outstanding equals two-thirds of the total amount in stated value of class A, class B, and class C stock outstanding, as determined by the Secretary—

"(1) the powers and authority of the Governor of the telephone bank granted to the Administrator of the Rural Electrification Administration by

this title IV shall vest in the Telephone Bank Board, and may be exercised and performed through the Governor of the telephone bank, to be selected by the Telephone Bank Board, and through such other employees as the Telephone Bank Board, shall designate;

"(2) the five members of the Telephone Bank Board designated by the President pursuant to section 405(b) shall cease to be members, and the number of Board members shall be accordingly reduced to eight unless other provision is hereafter made in the bylaws of the telephone bank;

"(3) the telephone bank shall cease to be an agency of the United States, but shall continue in existence in perpetuity as an instrumentality of the United States and as a banking corporation with all of the powers and limitations conferred or imposed by this title IV except such as shall have lapsed pursuant to the provisions of this title.

"(b) When all class A stock has been fully redeemed and retired, loans made by the telephone bank shall not continue to be subject to the restrictions prescribed in the provisos to section 408(a) (2).

"(c) Congress reserves the right to review the continued operations of the telephone bank after all class A stock has been fully redeemed and retired.

"SEC. 411. LIQUIDATION OR DISSOLUTION OF THE TELEPHONE BANK.—In the case of liquidation or dissolution of the telephone bank, after the payment or retirement, as the case may be, first, of all liabilities; second, of all classes A stock at par; third, of all class B stock at par; fourth, of all class C stock at par; then any surpluses and contingency reserves existing on the effective date of liquidation or dissolution of the telephone bank shall be paid to the holders of class A and class B stock issued and outstanding before the effective date of such liquidation or dissolution, pro rata, and any remaining surplus and contingency reserves shall be distributed to those entities to which they are allocated on the books of the bank at the time of the liquidation or dissolution."

"SEC. 412. BORROWER NET WORTH.—Except as provided in subsection (b) (2) of section 408, notwithstanding any other provision of law, a loan shall not be made under section 201 of this Act to any borrower which during the immediately preceding year had a net worth in excess of 20 per centum of its assets unless the Administrator finds that the borrower cannot obtain such a loan from the telephone bank or from other reliable sources at reasonable rates of interest and terms and conditions."

SEC. 3. (a) Subsection (f) of section 3 of the Rural Electrification Act of 1936, as amended, is amended by inserting "rural electrification" immediately following the words "interest on" in both places where it appears in said subsection and by inserting the words "for rural electrification purposes" after the words "Secretary of the Treasury" the second time they appear in said subsection.

(b) Section 201 of the Rural Electrification Act of 1936, as amended, is amended by inserting ", to public bodies now providing telephone service in rural areas", immediately after the word "areas" in the first sentence and also immediately after the word "areas" in the first proviso of the second sentence.

SEC. 4. Section 201 of the Government Corporation Control Act, as amended (31 U.S.C. 856), is amended by striking "and" immediately before "(5)" and by inserting ", and (6) the Rural Telephone Bank" immediately before the period at the end.

SEC. 5. The second sentence of subsection (d) of section 303 of the Government Corporation Control Act, as amended (31 U.S.C. 868), is amended by inserting "the Rural Telephone Bank," immediately following the words "shall not be applicable to".

SEC. 6. The right to repeal, alter, or amend this Act is expressly reserved.

SEC. 7. This Act shall take effect upon enactment.

DEPARTMENT OF AGRICULTURE,
OFFICE OF THE SECRETARY,
Washington, D.C., October 29, 1969.

HON. ALLEN J. ELLENDER,
Chairman, Committee on Agriculture and Forestry,
U.S. Senate.

DEAR MR. CHAIRMAN: This is in reply to your requests of March 27, 1969, for a report on S. 1684 and of May 22, 1969, for a report on S. 2202. The purposes of these bills are "to amend the Rural Electrification Act of 1936, as amended, to

provide an additional source of financing for the rural telephone program, and for other purposes."

In recent years, the Rural Electrification Administration has not been able to satisfy all the requests for capital from its telephone borrowers. The level of loan applications carried over from year to year has been mounting steadily. The backlog of pending applications increased from \$302 million on June 30, 1968, to \$346 million on June 30, 1969, and to \$364 million on September 30, 1969. The direct loan program is budgeted for fiscal year 1970 at a level of \$125 million dollars. Consequently, in the face of competing budgetary demands, other sources of financing must be sought to aid in meeting the credit needs of rural telephone companies and cooperatives.

S. 1684 and S. 2202 are almost identical with H.R. 7 which was reported by the House Committee on Agriculture, March 18, 1969. S. 1684, however, does not include a new Section 412 added to H.R. 7 by the Committee. S. 2202 includes the new Section 412 and also corrects a typographic error appearing in both H.R. 7 and S. 1684. In those two bills, there are two Sec. 2's, so that the last section is numbered Sec. 6 instead of Sec. 7 as in S. 2202.

This Department supports the objective of these bills and believes that their provisions, as set forth in the enclosed summary, are generally appropriate thereto.

These bills would establish a Rural Telephone Bank for the purpose of supplying additional capital for the rural telephone program as a supplement to the present direct REA loan program. The bank would be capitalized initially by Government subscription with provision for retirement of the Government investment. The financing plan is an adaptation of the Federal land bank system which has demonstrated its capability as a means of completely freeing a lending program from reliance on Treasury financing over a period of years.

The bills would provide supplemental financing. They would not supplant immediately and completely the existing REA direct loan program, on the premise that there is likely to be a continuing need for low interest rate, long-term financing of rural telephone systems. These systems have subscriber density and revenues which are relatively low and their operating and maintenance costs are relatively high due to their rural character.

Under these bills, those systems which continue to require minimum interest rates would be eligible for loans under Section 201 of the Rural Electrification Act. Those which are capable of paying higher interest rates would use the bank as their source of credit. Sec. 412 which appears in H.R. 7 and S. 2202 but not in S. 1684 would prohibit a loan under Section 201 for a borrower with an average density of more than three per mile if it had a net worth in excess of 20 per centum of its assets during the immediately preceding year unless the Administrator finds that the borrower cannot obtain a loan from the telephone bank or from other reliable sources at reasonable rates of interest and terms and conditions.

In view of the substantial Government investment in the Bank, we recommend that the following revisions be made in the proposed bills:

1. The activities of the telephone bank should be made subject to the provisions of the Government Corporation Control Act including annual budget review by the President and the Congress and audit by GAO so long as any Federal investment remains in the Bank. The bank should not be converted to private control until all Federal capital is repaid.

2. Debenture issuances by the bank after it is converted to private control should not be made without prior consultation with the Treasury. We believe this to be essential in order to assist Treasury with its complex problem of timing and management of the public debt.

3. The interest rate ceiling of not to exceed 4 percent on intermediate loans of the bank should be stricken as unnecessary, in view of the fact that borrowers unable to pay interest rates in excess of 4 percent will have available an appropriate mix of intermediate rate bank loans and direct REA financing.

4. The interest rate for the direct telephone loan program, now set by statute at 2 percent, should be made flexible so that it will cover the Government's interest and administrative costs and probable losses, except in those cases where the Administrator determines that a lower rate, not less than two percent, is necessary to enable the borrower to provide service without an excessive increase in the rates charged by the borrower to its subscribers.

To effectuate these changes, there is enclosed a list of amendment which we propose for your consideration.

The Bureau of the Budget advises that enactment of legislation as recommended in this report would be consistent with the Administration's objectives.

Sincerely,

CLIFFORD M. HARDIN, *Secretary of Agriculture.*

Enclosures.

U.S. DEPARTMENT OF AGRICULTURE

Short summary of H.R. 7, S. 1684, and S. 2202 (91st Cong., 1st sess.) bills to amend the Rural Electrification Act of 1936, as amended, to provide an additional source of financing for the rural telephone program, and for other purposes

These proposals create a Rural Telephone Bank, initially under the supervision of the Secretary of Agriculture, to provide non-Federal sources of financing to supplement the existing telephone loan program now administered by the Rural Electrification Administration.

The bank will initially be managed by a board of 13 directors, consisting of the REA Administrator, the Governor of the Farm Credit Administration and five Presidential appointees, three from the Department of Agriculture, and two from the general public; and six members, representing the rural telephone systems, initially appointed by the President, and thereafter elected for two-year terms by telephone system stockholders of the bank. After conversion of the bank to non-Federal ownership, operation and control, the board is reduced to eight members, the REA Administrator, the Governor of the Farm Credit Administration, and the remaining six elected by the non-Federal stockholders.

Until conversion to borrower control, the REA Administrator will serve as the chief executive officer ("Governor") of the bank, and until then, in addition to using its full-time employees, the bank may partially or jointly use the personnel and facilities of REA or other agencies of the Department of Agriculture, without cost to the bank.

Equity capital will be furnished the bank by the United States and by borrowers and eligible borrowers from the bank. The capital investment of the United States in the bank would be in amounts annually appropriated, beginning in fiscal 1970 and not exceeding \$30,000,000 each year, until the Government investment totals \$300,000,000. Government investments would be furnished from "net collection proceeds" of the 2 percent REA telephone loan program. Stock held by the United States (Class A) will be retired by the bank as soon as practicable after June 30, 1984, with provision for mandatory minimum retirements after Class A and B stock of the bank reach \$400 million. Class A stock will be entitled to a 2 percent annual return, payable from income, and cumulative. Borrowers from the bank will be required to invest 5 percent of their loan funds in nondividend bearing bank stock (Class B). Dividend-bearing bank stock (Class C) will be available for investment by borrowers, potential borrowers, and their organizations.

The bank is authorized to obtain borrowed funds through the sale of its debentures, up to 8 times the amount of paid-in capital and retained earnings of the bank. Debentures will not be guaranteed by the United States. Until conversion to borrow control, Treasury approval of debenture issues is required.

Bank loans, to be fully amortized over a period not exceeding 50 years, may be made to eligible borrowers: (1) until June 30, 1984 or until bank conversion, if earlier, at an "intermediate loan" rate, reflecting the current average market yield on marketable securities of the United States having comparable maturities, but with a 4 percent interest ceiling; or (2) at an interest rate reflecting the average cost of moneys to the bank, including interest on the bank's debentures, return on Class A stock, administrative expenses, reserves and estimated losses. Intermediate loan rates will not be available to borrowers which are capable of both paying the higher bank rate and achieving Federal program objectives. The purposes for which bank loans may be made include the same purposes governing REA 2 percent telephone loans, as well as improving the efficiency, effectiveness or financial stability of borrowers systems; special limitations are specified in respect of bank loans for acquisitions. Provision is made for loans under section 201 to borrowers with average density of three or fewer subscribers per mile, unless the borrower elects a telephone bank loan. Certain political activities by borrowers are prohibited, and sales of a borrower's property prior to full repayment of indebtedness are not permitted without approval of the Administrator or bank board.

After the Government's investment has been retired by the bank to the extent that stock held by others than the Government equals two-thirds in stated value

of all capital stock, provision is made for conversion of the banks to private ownership, control and operation. The bank is deemed a "mixed ownership Government corporation," and as such is subject to GAO auditing and report procedures.

The proposals also establish a Rural Telephone Account into which will be transferred appropriations, assets and collections of the REA telephone loan program and from which will come funds for the direct telephone loan program and for Federal investments in the telephone bank.

Section 201 of the Rural Electrification Act is amended to authorize direct telephone loans to public bodies now providing rural telephone service.

Sec. 412 which appears in H.R. 7 and S. 2202 but not in S. 1684 would prohibit a loan under section 201 for a borrower with an average density of more than three per mile if it had a net worth in excess of 20 per centum if its assets during the immediately preceding year unless the Administrator finds that the borrower cannot obtain a loan from the telephone bank or from other reliable sources at reasonable rates of interest and terms and conditions.

CHANGES IN S. 2202¹ RECOMMENDED BY THE DEPARTMENT OF AGRICULTURE

1. Page 8, lines 22-25, and page 9, lines 1-4, section 403, strike subsection (c) and insert in lieu thereof—

"(c) the telephone bank shall be subject to the provisions of the Government Corporation Control Act, as amended (31 U.S.C. 841, et seq.), in the same manner and to the same extent as if it were included in the definition of 'wholly owned Government corporation' as set forth in section 101 of said Act (31 U.S.C. 846)."

2. Page 17, line 10, section 407, insert before the colon—

"after consultation with the Secretary of the Treasury".

3. Page 19, line 19, section 408, strike the figure "(i)" in subsection (b) (3), and on page 20, lines 1-2 of said subsection, change the first comma to a period, and strike the words "or (ii) 4 per centum per annum, whichever is lower."

4. Page 23, section 410, strike lines 5-11 in subsection (a) and insert in lieu thereof—

"(a) Whenever class A stock issued to the United States has been fully redeemed and retired pursuant to section 406 (c) of this title—"

5. Page 25, following line 25, insert a new subsection (c) to section 3, reading as follows:

"(c) Section 201 of the Rural Electrification Act of 1936, as amended, is further amended by striking the period at the end of the first sentence and the words 'Except as otherwise provided by this title, such loans shall be made under the same terms and conditions as are provided in section 4 of this Act,' by inserting a period in lieu of the colon preceding the first 'Provided, however,' clause, and inserting the following after such period:

"Such loans shall be on such terms and conditions relating to the expenditures of the moneys loaned and the security therefor as the Administrator shall determine and may be made payable in whole or in part out of the income: *Provided however*, That all such loans shall be self-liquidating within a period not to exceed thirty-five years, and shall bear interest at a rate equal to (1) a rate determined by the Secretary of the Treasury, taking into consideration the current average market yield, during the month of May preceding the fiscal year in which the loans are made, on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities of such loans, adjusted to the nearest one-eighth of one percent, plus an allowance adequate in the judgment of the Administrator to cover administrative costs and probable losses, or (2) a rate, determined by the Administrator, not to exceed the rate determined under (1) but not less than two per centum per annum, in any case where the Administrator determines that a rate lower than the interest rate determined under (1) is necessary to enable the borrower to provide service without an excessive increase in the rates charged by the borrower to its customers."

Page 26, strike out sections 4 and 5, and renumber sections 6 and 7 to read "Sec. 4." and "Sec. 5", respectively.

¹ Similar changes should be made in H.R. 7 and S. 1684.

SENATE COMMITTEE ON AGRICULTURE AND FORESTRY

Staff Explanation of S. 1684, S. 2202, and H.R. 7 (as reported by the House Committee on Agriculture)

Short explanation

These bills create an REA telephone loan revolving fund (rural telephone account) and a Rural Telephone Bank which would provide supplemental financing for telephone borrowers. They would add two new titles to the Rural Electrification Act of 1936 to provide for—

1. A rural telephone account (title III), and
2. A Rural Telephone Bank (title IV).

New Title III—Rural Telephone Account

The rural telephone account would consist of appropriations and assets received under the 2 percent telephone loan program, and could be used (1) for such program to the extent authorized by annual appropriation act and (2) without appropriation for repayment of Treasury loans to REA for telephone program purposes, and investment in the bank.

New Title IV—Rural Telephone Bank

A. *Bank Directors and Governor.* The REA Administrator would be the chief executive officer (Governor). There would be thirteen directors as follows:

The REA Administrator

The Governor of the Farm Credit Administration

Three USDA (but not REA) employees appointed by the President

Two public members (not Federal employees) appointed by the President

Six members elected by holders of Class B and Class C stock (to follow 6 temporary Presidential appointees and their 6 elected two-year successors). 3 would be elected from among personnel of cooperative-type entities and 3 would be elected from among personnel of commercial-type entities.

B. *Financing of the bank* would be through the sale of stock and debentures and U.S. Financing as follows:

(1) U.S. stock purchases of \$300 million (\$30 million annually to be appropriated from net collection proceeds of the rural telephone account).

(2) Use of USDA facilities and personnel without cost.

(3) Exemption from U.S., State, and local taxes (with authority, but no obligation, to make payments in lieu of taxes on real and tangible personal property previously subject to such taxes).

Bank debentures may not exceed 8 times paid-in capital and retained earnings, and are not tax-exempt.

C. *Loans by the bank* would be made to existing or approved borrowers under the 2 percent loan program, would be for up to 50 years, and would be either "intermediate", with a subsidized interest rate, or "other". The "intermediate" rate would be the lower of (i) a rate determined by the Secretary of the Treasury, after consideration of the average yield of Treasury obligations of comparable maturity, or (ii) 4 percent. (Intermediate loans would be restricted to borrowers unable to pay the rate applicable to other loans, and to loans made prior to June 30, 1984.) The interest rate on "other" loans would be a rate reflecting the cost of money, interest paid on the bank's debentures, administrative expenses, reserves, and estimated losses.

D. *Loan Purposes:* Loans could be made for the same purposes as section 201 loans, or to finance or refinance system improvement, or for the purchase of Class B stock. System improvement loans would not be subject to the "rural area" or 40 percent refinancing limitations of 2 percent telephone loans.

E. *Acquisition Limits:* The bill limits loans for any single telephone acquisition, with respect to exchange facilities for local service, to the size of the borrower's system at the time of its first loan from the bank.

F. Classes of Stock:

Class A: Issued only to U.S. Government, bearing an annual return of 2 percent, to be redeemed as soon as practicable after June 30, 1984 and in any event, after Class A and Class B stock totaling \$400 million has been issued, in at least the amount of annual sales of Class B stock.

Class B: Issued to borrowers, who are required to invest an amount equal to 5 percent of the loan (not including that part of the loan made for the purchase of the stock). No dividends, but patronage refunds in Class B stock would be paid in accordance with the by-laws.

Class C: Sold to borrowers or persons eligible to borrow or their subsidiaries. Dividends in accordance with by-laws, payable only from income.

Dividends may not exceed the average rate on debentures until all Class A stock is retired.

G. *Conversion to Private Ownership:* Upon retirement of Class A stock down to an amount equal to one-half the total Class B and C stock outstanding—

(1) the powers of "Governor" would be vested in the board, to be performed by a Governor selected by the board and such other employees as the board designated;

(2) the Presidential appointed board members would cease to be board members and the board would be reduced to 8 (including the REA administrator and the Governor of the Farm Credit Administration);

(3) the bank would cease to be an agency of the United States subject to the supervision of the Secretary, but would continue as an instrumentality of the U.S. exempt from taxation;

(4) the bank's authority to use USDA facilities would terminate; and

(5) various additional provisions of section 403 dealing with Treasury approval of debentures, suits by and against agencies of the United States, and other matters would become inapplicable.

Upon retirement of all Class A stock, the limits on the bank's loans for acquisitions contained in the proviso to section 408(a)(2) would become inapplicable.

H. *Borrowers Eligible for 2 Percent Loan Program.* Loans for facilities for telephone systems with an average subscriber density of three or fewer per mile would be made under the existing 2 percent program unless the borrower elected to take a telephone bank loan. A system with greater density would not be eligible for a 2 percent loan under H.R. 7 or S. 2202 unless (1) its net worth was not in excess of 20 percent of its assets, or it could not obtain a loan from the telephone bank or from other reliable sources at reasonable rates and terms.

Additional Provisions

The sections beginning on page 25 of the bills, following new title IV—

(1) amend section 3(f) of the Rural Electrification Act so that telephone loan payments under the 2 percent program can go to the rural telephone account instead of being covered into the Treasury as miscellaneous receipts;

(2) extend the telephone loan program to public bodies "now" providing telephone service in rural areas;

(3) amend the Government Corporation Control Act to include the telephone bank as a mixed-ownership Government corporation, subject to GAO audits and reports, but not required to submit annual budget programs; and

(4) exempt the telephone bank from the requirements of sections 303 (a) and 303 (b) of the Government Corporation Control Act for Treasury approval of its obligations and of its sales and purchases in excess of \$100,000 of U.S. obligations; and provide only for consultation on such matters with Treasury as provided by section 303 (d) of that Act.

Comparison of S. 1684, S. 2202, and H.R. 515

These three bills are identical, except as indicated in the last sentence of paragraph H above (which refers to quoted section 412 appearing on page 25 of H.R. 7 and S. 2202, but not in S. 1684), and except for typographical errors indicated below.

Typographical Errors in S. 1684

On page 4, line 23, "suck" should be "such".

On page 20, line 16, "take" should be "takes".

On page 25, line 4, "Sec. 2." should be "Sec. 3."

All succeeding section designations should be changed accordingly.

Typographical Errors in S. 2022

On page 9, line 10, the word "section" should be "sections".

On page 19, line 1, the word "to" appears in place of "of" in H.R. 7 and S. 2202. Either version is correct.

Typographical Errors in H.R. 7

On page 4, line 23, "suck" should be "such".

On page 20, line 16, "take" should be "takes".

On page 21, line 15 should be brought flush with line 14.

On page 25, line 12, "Sec. 2." should be "Sec. 3."

All succeeding section designations should be changed accordingly.

Senator TALMADGE. The first witness this morning was scheduled to be Senator McGovern but I have just received word that he has just arrived at the airport so he will be a little late.

The second witness is Senator Dole, who is the author of S. 2202 and we will be happy to hear from you now, Senator.

Senator DOLE. Thank you, Mr. Chairman.

Senator HOLLAND. Mr. Chairman, before Senator Dole starts, may I say that at 10:30 I have got to leave, we are having a markup by the full Appropriations Committee of the independent office bill and I must be there, and I am sorry I won't be able to be here for the full hearing.

Senator TALMADGE. I understand. Unfortunately we are required to be in about three different places at the same time. You may proceed, Senator Dole.

STATEMENT OF HON. ROBERT DOLE, A U.S. SENATOR FROM THE STATE OF KANSAS

Senator DOLE. Mr. Chairman, I will only take a minute or two because I know we have other witnesses and I am on the subcommittee.

Let me state very briefly there are 36 sponsors of either S. 1684 or S. 2202 which indicates to me widespread support from both sides of the political aisle for the telephone bank concept.

As a member of the House Committee on Agriculture, I worked very closely with our chairman, Congressman Poage, and the ranking Republican, Congressman Belcher, on the telephone bank bill last year and the year before. The telephone bank portion of the bill, I might add, was never very controversial but it was coupled with a bank for rural electric cooperatives which was highly controversial. The result was that no action was ever taken on the telephone bank portion because of the great controversy over the other portion of the bill.

I believe Congressman Poage has made it clear, and I am certain we will make it clear, at least I will, there will be no effort to do anything but pass a telephone bank bill. There is no effort to try to resurrect an electric bank bill as an amendment.

Senator TALMADGE. Will you yield for a question at that point?

Senator DOLE. Yes.

Senator TALMADGE. It is my understanding that the Agriculture Committee of the House has already reported a bill identical to the one you offered, S. 2202; is that correct?

Senator DOLE. Yes.

Senator TALMADGE. That bill is now pending in the Rules Committee.

Senator DOLE. Right.

It is rather deeply pending there. [Laughter.]

Senator TALMADGE. Do you have any idea why they are holding it up?

Senator DOLE. Not for the record, I am not certain. [Laughter.]

Senator TALMADGE. Excuse me, go ahead.

Senator DOLE. I have my own idea. But it is a very fine committee, the Rules Committee, and we have great faith in what they may do.

Let me say, first of all, I understand I have a fellow Kansan in the

audience, I just arrived, but I am pleased that Mr. Junior Clark is here today to represent Kansans who are interested in a telephone bank bill. Mr. Clark is the manager of the Wamego Telephone Co. and president of the Kansas Telephone Association and he is among the witnesses today.

On May 20, I introduced S. 2202 with 11 cosponsors and as the chairman has already pointed out, and I will not repeat what he already has said, this bill would create a rural telephone bank initially under the supervision of the Secretary of Agriculture and ultimately converted to non-Federal ownership with operation and control by its borrowers.

H.R. 7, as the chairman just indicated, is an identical bill passed by the House committee and now is pending in the Rules Committee. It was introduced by Chairman Poage. I am gratified that the Department of Agriculture has given a favorable report and we will be hearing from some of their witnesses this morning. As a matter of brevity, plus the fact I have a very bad cold, I will ask permission to insert the balance of my statement in the record at this point.

Senator TALMADGE. Without objection it will be inserted in full and you may proceed in any manner you desire, Senator.

(The statement is as follows:)

STATEMENT OF HON. ROBERT DOLE, A U.S. SENATOR FROM THE STATE OF KANSAS

Mr. Chairman, I am pleased Junior L. Clark, President of the Kansas Telephone Association and Manager of Wamego Telephone Company, Wamego, Kansas is among the witnesses today.

On May 20, 1969, I introduced S. 2202, with eleven cosponsors. The legislation would create a rural telephone bank, initially under the supervision of the Secretary of Agriculture and ultimately converted to non-federal ownership with operation and control by its borrowers.

H.R. 7, a similar bill introduced by the Chairman of the House Agriculture Committee, Mr. Poage, passed the Agriculture Committee and is now pending in the House Rules Committee.

Mr. Chairman, I am gratified the Department of Agriculture has given a favorable report on this legislation and am hopeful a rural telephone bank bill will be reported by the Committee. The original REA loan program has meant much to rural America. The Nation's farms receiving telephone service have risen from 38% in 1949 to approximately 82% today. REA loans have helped build and improve more than 500,000 route miles of telephone service to approximately 2,400,000 subscribers in rural areas.

REA originally established a standard of 8 subscribers per rural line but with the increased use resulting from dial service, these systems must now be upgraded. While REA telephone borrowers have received loans for over \$1.6 billion since the beginning of the program, they will need more than twice this amount in the next 15 years.

The number of loan applications to the REA has steadily increased to meet this need. However, budget demands make it impossible to approve the pending applications. As a result, the Secretary of Agriculture reported the backlog of applications has increased from \$302 million on June 30, 1968 to \$364 million by September 30, 1969. Other sources of financing must be found to meet the credit needs of rural telephone companies and cooperatives.

S. 2202 would create a rural telephone bank for the purpose of supplying additional capital for the development and improvement of rural telephone systems. Such a bank is necessary because the REA telephone systems have not been able to go directly into the private money market because of their low subscriber density handicap. REA telephone borrowers have an average subscriber density of 3.8 subscribers per route mile of line as compared to a subscriber density of 16 per mile for total independent telephone companies and even 40 per mile for the Bell System.

The independent telephone companies and the telephone cooperatives are to be commended for devising this approach to the difficulties of financing their expansion. The rural telephone bank is adapted from the successful example of the federal land bank system which has demonstrated its capability as a means of freeing a lending program from reliance on Treasury financing over a period of years.

I urge my colleagues to seriously consider the testimony presented today. The rural telephone bank proposal is an example of how an industry itself can solve problems without continued reliance on public funds. This is important to rural America and will assist in bringing the benefits of our economy to all America.

Senator DOLE. I would like to develop questions for some of the witnesses but I am finished with my formal statement.

Senator TALMADGE. I think we need to get into the record fully the various factors in the bill. Would you want to do that or let Mr. Hamil, perhaps, explain the method of financing?

Senator DOLE. I would prefer if Mr. Hamil did that; yes.

Senator TALMADGE. Any questions?

Senator HOLLAND. May I ask a question? I think someone should very fully explain for the hearing record the standard which is set up by the bill.

Senator TALMADGE. I agree.

Senator HOLLAND. As to inability of some operators to have advantage of the small interest rate loans.

Senator TALMADGE. I share that view and I thought we would go into detail in those aspects with Mr. Hamil.

Senator HOLLAND. Somewhere there should be a careful workout on that because this is going to be one of the critical points.

Senator DOLE. I feel this is the critical point, if I might interpose.

Senator TALMADGE. As to who pays what, and why.

Senator DOLE. This was a critical point in the legislation in the House. It is going to be the critical point here, and resolution of this area is going to be the difference between passage or failure of the bill. As I understand it there are some differences of opinion, so perhaps when Mr. Hamil appears we can explore that question.

Senator TALMADGE. Senator Allen?

Senator ALLEN. Does your bill set up any criterion, Bob, as to how the interest rate is arrived at?

Senator DOLE. Yes, my bill has certain criteria but there is a suggested amendment to be discussed by Mr. Hamil with reference to 2-percent loans, and I thought when we got to this point with the Agriculture Department witnesses we could explain the whole thing.

Senator ALLEN. As I understand it, even though your bill, 2202, does have a formula for possibly the abolition of the 2-percent money, that if that is not agreed upon then you would, of course, support S. 1684 that would leave the 2-percent money intact? In other words, you are interested in the bill and not just a bill with the elimination of the 2 percent?

Senator DOLE. Right.

But I have a general feeling that while in 1949, 2 percent was the going rate of interest for the Government, there is some opposition, and some justified opposition because we now have to pay—I don't know what the Government has to pay now.

Senator TALMADGE. Eight percent right now. That is on Government guarantee.

Senator DOLE. We are hoping we can work out an intermediate rate and still make available a lower rate, maybe it will be 2 percent, for those telephone co-ops who are going to provide service to the public. I am not wedded to any one bill if that is the question.

Senator ALLEN. Well now, actually these loans that are made at the low interest rate they are paid back as to principal 100 percent. No portion of it is a grant, isn't that correct?

Senator DOLE. Right.

Senator ALLEN. And all of these loans, perhaps without exception, are being repaid on schedule?

Senator DOLE. In fact, the record will show they are ahead of schedule.

Senator ALLEN. So if there is any subsidy involved it will be the low interest rate.

Senator DOLE. It will be the difference between the going rate to the Government and the 2 percent paid by the borrower, whether it be a co-operator or an independent.

Senator ALLEN. Well, the Senate, in its wisdom, recently passed a bill authorizing, I believe, \$480 million in no interest rate loans to emerging nations, I believe, isn't that right? Of course, I don't believe you or I, either one, voted for it.

Senator DOLE. No, I don't believe I did. If I did it was a mistake. [Laughter.]

Senator ALLEN. A little of this subsidy ought to remain at home, should it not?

Senator DOLE. Right.

I don't have any quarrel with that. In fact, I know all the witnesses here quite well, and I really don't know of any basic disagreement unless we start tampering, and Mr. Hamil is here tampering, with the original 2-percent loan provision. Then we are going to have some difficulty. I mean speaking very practically, not politically but knowing the witnesses and knowing their feelings about this provision, it is a very tender spot. There are borrowers, whether they be independent or co-ops, who just are barely getting along in low-density areas, in some of the very rural areas we have not only in the Midwest but also in the South and other parts of the country. This is the one area we need to explore in great detail when we have the witnesses before us but I again state that I am not wedded to any one concept.

Senator ALLEN. Thank you.

Senator TALMADGE. Any further questions?

Senator HOLLAND. One thing I wanted to go into, I was a little disturbed a moment ago when you seemed to differentiate the co-ops and independents, and my own feeling is that the density of the operation, whether it is to be served by one or the other, is the criterion that should govern.

Senator DOLE. Right.

Senator HOLLAND. I handled the original rural telephone legislation, as I was then chairman of the subcommittee. I also handled the bill on the floor and its conferences, and we were very careful to make it clear there wasn't any difference between the co-ops and the independents; that the facts already obtaining as to who is in there serving and also the density of the service required would be the

salient facts that should be considered in the deliberation of making the loan. Is that your feeling now?

Senator DOLE. Right.

I didn't mean to make any distinction. The word I should have used was "borrower" which includes everyone who can qualify.

Senator HOLLAND. That thoroughly meets my view.

Senator DOLE. Right.

Senator HOLLAND. I don't think there is any difference.

Senator DOLE. No, no.

Senator HOLLAND. If there is an independent that is very weak and that can meet the need by having a loan for the extension of service where it is not now rendered it is much more reasonable to use that independent than to require a duplicate organization of a co-op. That has been the method of approach used by Congress, and I hope it will continue to be.

Senator DOLE. Right.

In fact there was, the last I knew, with the different borrowers, whether they be independents or cooperatives.

Now, I raised some question last year that was later resolved to my satisfaction about the larger companies who were borrowing money and buying up smaller companies, and I had some difficulty resolving this in my mind, but I think that may be discussed later, too.

Senator HOLLAND. I think that might be a reasonable cause for some trouble arising for all of us. But the point I am making is that the facts in the particular case as to the density of area to be served should be the criterion which should govern.

Senator DOLE. Right, unquestionably.

Senator TALMADGE. Thank you, Senator Dole.

We have statements here from Senator Burdick, from Senator Hansen and from Senator Stevens and without objection they will be made a part of the record at this point.

(The statements are as follows:)

STATEMENT OF HON. QUENTIN N. BURDICK, A U.S. SENATOR FROM THE STATE OF NORTH DAKOTA

Mr. Chairman, it is my pleasure to appear before this Committee to testify in support of S. 1684, the Telephone Supplemental Financing Bill introduced by my colleague Senator George McGovern of South Dakota and co-sponsored by 23 additional members including myself.

I know that all of you on the Committee are aware of the splendid record of achievement made by the REA Telephone Loan program during the 20 years since its inception in 1949. I'm sure that the exact figures concerning numbers of rural homes served and miles of line are a part of the official record and I won't take the time to reiterate them here today. I will say that certainly, no state is more aware of the benefits of this program than my own state of North Dakota where the citizenry has received enormous benefit from the rural electrification administration programs, both telephone and electric.

As we are all aware, for the past several years, the annual appropriations for the REA 2%—35 year loan program have not been adequate to meet the growing needs of the telephone borrowers. There are two basic reasons behind this drastic increase in demand for funds. First, the telephone business is capital intensive, equipment costs are the greatest part of the operating expenses of any telephone system. Inflation and the introduction of new and more sophisticated equipment have dramatically increased the needs of the small rural telephone systems for debt capital. Secondly, the rural subscribers who have been served by the REA financed telephone systems have experienced a "revolution in rising expectations". Those who prophesied 20 years ago that rural people didn't need telephone service have been proven dramatically wrong.

Rural citizens not only want telephone service, they are coming more and more to want exactly the same modern up-to-date service as their urban counterparts. That means rural telephone cooperatives and companies are receiving increasing subscriber pressure to offer additional services, single-party lines, extended area service, direct distance dialing and push-button phones. Our rural telephone systems have a pressing need to upgrade their service to remain competitive. I might add that current trends in the regulatory area indicate that commissions, both state and national may soon be requiring all telephone systems, large and small to offer equivalent services.

This escalation in requirements for capital has raised the backlog of 20% loan applications on hand from \$122 million in 1965 to over \$350 million today and no relief is in sight. To remedy this shortage, the telephone borrowers have gathered in support of the supplemental financing bank. Following the proven example of the Farm Land Banks, this new instrumentality would provide an additional source of debt capital for rural telephone systems, ending their historic complete dependence on the 2% loan program.

I support this bill. It represents the end result of several years of discussion and debate. The bill, as written, has gained the support of the entire telephone industry—from AT&T on down to the smallest cooperative. Additionally, a total of 38 Senators have joined as co-sponsors to S. 1684 and Senator Dole's essentially identical bill, S. 2202. There are several particularly important points of the legislation I would like to stress. I have noted with interest Secretary of Agriculture Hardin's delineation of the "Administration" position. I do appreciate the Administration's support for the concept of a telephone bank, however, I feel that position contains several points which would have a serious and detrimental effect on the objectives of this legislation.

The bills, as written, provide for two types of bank loans, loans at the full bank rate and loans at an intermediate rate. Admiral Mott, representing USITA, has testified before the other body that many of his member telephone companies require only the availability of additional capital, and that the rate of interest on bank loans, whatever it may be, is not of paramount concern to them. I don't know who he is referring to but I doubt very seriously if it is true of any of the REA financed telephone cooperatives in my state of North Dakota. For that reason the intermediate program has been designed to allow "a stepping-stone" for systems strong enough to break away from total dependence on 2% money but not able to pay the full bank rate. All of the legislation being considered by the Congress further assumes the continued availability of the 2% loan program.

I regard this point as vitally important, I regret to note that the Administration program would appear to terminate the two percent program, as well as eliminate the proposed intermediate loan program of the bank. As I understand the Administration-proposed amendments the REA would have an annual appropriation which the Administrator would blend with bank loans at an interest rate of his choosing but not less than 2%, to achieve a total loan interest rate which he deems appropriate. In his earlier testimony before the House Agriculture Committee and in various public statements, the Administrator has stated that he regarded the intermediate program as unnecessary. He proposed to mix bank rate loans with 2% money in a proportion to achieve his decided upon interest rate, be it 2.2% or 5.9%.

I oppose this logic for two basic reasons. Firstly, when monies from the annual 2% loan appropriation are used for "blending" loans with higher rate bank monies, the total available for 2% loans is reduced. In my state of North Dakota we have 13 REA financed telephone systems with an overall average of 1.7 subscribers per mile. Under the terms of both of the bills before the Senate, these companies will continue to be eligible for 2% loans. If a great portion of the annual 2% appropriation is used by the Administrator to "blend" loans, the systems will find themselves relatively worse off after enactment of the bank than they are today. We don't want legislation which will primarily benefit only the largest and most prosperous independent companies.

My second objection is more theoretical. The 2% interest rate is established by act of the Congress. This legislation S. 1684 and S. 2202 carefully delineate the interest rates to be charged by the bank and is predicated on the continuance of the 2% program. I would regard it as an improper delegation of legislative authority to replace this approach with an open-ended grant of administrative authority to the REA Administrator. The status and operation of the rural tele-

phone loan program is a matter of national policy which should be determined by the Congress.

Gentlemen: the need for this bank is established. The legislation proposed has been carefully considered, it has the unanimous support of the telephone industry, the House Agriculture Committee approved a similar bill by the overwhelming vote of 18-3, 38 Senators are "officially" on record in support of this approach. I urge this Committee and the Senate to act promptly to enact a telephone supplemental bank bill into law, before a drought of debt capital begins choking off rural telephone systems as happened a generation ago.

STATEMENT OF HON. CLIFFORD P. HANSEN, A U.S. SENATOR FROM THE STATE OF WYOMING

Mr. Chairman, I am testifying before this distinguished Committee today to indicate my continued strong support for the establishment of a Rural Telephone Bank as proposed in S. 2202, a bill which I am cosponsoring.

The REA program has done an outstanding job of financing telephone systems which provide service to a large part of rural America. Although much has been accomplished, there is still much to be done. The bill before you today establishes a procedure to provide modern, dependable, quality service in the sparsely populated areas of our country.

REA in past years has not been able to meet all the requests for capital from rural telephone systems and the backlog of pending applications has shown a marked increase over the last 18 months. New sources of capital must be found.

It is difficult for REA telephone systems to compete with other parties in the commercial money market because of the very low subscriber-density ratio of these companies. REA telephone borrowers have an average subscriber-density of less than one-fourth that of total independent telephone companies and less than one-tenth that of the Bell System Companies. At the same time, the REA telephone borrowers fill a very real need of the citizens of the United States, and a method of providing adequate financing for these companies must be developed.

S. 2202 establishes a rural telephone bank which will act as a supplemental credit mechanism to the existing REA direct loan program. This bill has the desirable feature of making capital available from the commercial money markets. This legislation will relieve the \$364 million backlog of pending applications with producing a heavy drain on the U.S. Treasury.

Mr. Chairman, I know the members of this Committee are well acquainted with the fine job that has been done by the REA Telephone program and wish to provide a firm financial base for this program in the future. I think this can be accomplished by S. 2202 and strongly urge the Committee to favorably report this legislation at the earliest opportunity.

STATEMENT OF HON. TED STEVENS, A U.S. SENATOR FROM THE STATE OF ALASKA

Thank you for giving me this opportunity to testify before this committee on behalf of this important Rural Telephone Bank legislation.

Since 1949, 869 borrowers have made use of the REA telephone loan program. These loans—amounting to over \$1.6 billion—funded by Congressional appropriations and loaned at the statutory rate of 2 percent, have not fulfilled the loan application demands. Loan needs for 1969 are more than \$500 million while appropriations for the same year amount to only \$125 million.

The Rural Telephone Bank bill provides that the telephone bank will be a corporate body with the purpose of obtaining "an adequate supply of supplemental funds to the extent feasible from non-Federal sources, to utilize said funds in the making of loans" in order to meet the needs of potential rural telephone customers. The money for financing the bank would derive from the use of repayments on loans already outstanding at the rate of \$30 million per year until total capitalization of \$300 million were reached. No new Treasury funds would be necessary, and it would not be long before the United States Government would be completely out of the rural telephone loan business. According to

the bill, the control and the administration of the bank would be eventually turned over to the borrowers themselves.

My State of Alaska has entered a period of unparalleled economic development and expansion due to the recent oil developments on the Arctic North Slope and in Cook Inlet. The need for expanding the two rural telephone systems which provide service to approximately 4,000 Alaskan users is pressing. At the present time, this need cannot be met as evidenced by the \$173,000 loan application which the Matanuska Valley telephone cooperative has submitted to REA. This application, so important to rural Alaskans, is just one of the many applications that make up the \$309 million backlog of REA applications as of April 30, 1969. It has no chance of becoming a reality unless additional funds are made available to REA.

I urge this committee to support the Rural Telephone Bank System. It is a realistic plan for supplying the additional funding necessary to provide rural Americans with the telephone service that urban Americans already enjoy. The Rural Telephone Bank will furnish this funding at the same time reducing both the amount of money loaned at 2 percent and further heavy reliance on the Federal Treasury for funds.

Thank you for this opportunity to present my views to this committee on this important piece of legislation.

Senator TALMADGE. Senator McGovern hasn't arrived yet, has he? Then we will proceed with you, Mr. Hamil, if you don't mind.

STATEMENT OF DAVID A HAMIL, ADMINISTRATOR, EVERETT C. WEITZELL, DEPUTY ADMINISTRATOR, RURAL ELECTRIFICATION ADMINISTRATION; AND HOWARD V. CAMPBELL, ASSISTANT GENERAL COUNSEL FOR RURAL DEVELOPMENT AND CONSERVATION, OFFICE OF GENERAL COUNSEL, U.S. DEPARTMENT OF AGRICULTURE

Mr. HAMIL. Mr. Chairman, and members of the committee, I have with me Mr. Everett C. Weitzell, the Deputy Administrator of REA.

Senator TALMADGE. Mr. Hamil, you can proceed as you see fit. You can read your statement in its entirety or you can summarize it. It will all be inserted in the record. I think the members of the subcommittee will want to go into considerable detail on what these bills provide and why.

Mr. HAMIL. All right.

It is a privilege to appear before this committee in support of S. 2202 and S. 1684, two bills similar to H.R. 7 which was reported by the House Committee on Agriculture on March 13. I am pleased to state that the Department of Agriculture and the Rural Electrification Administration endorses the objectives of the proposed legislation. May I suggest that the department's report on S. 2202 and S. 1684 be inserted in the record at this point?

Senator TALMADGE. It has already been inserted.

Mr. HAMIL. I am now serving my second tenure as the Administrator of REA. The need for legislation of this type became apparent to me during the first year of my first tenure back in 1956. Even then, the demand for rural telephone loans gave good indication that future needs would probably exceed amounts which the Congress might feel it could make available at 2 percent for loans under section 201 of the Rural Electrification Act. As early as 1958, I suggested that the borrowers consider asking the Congress to authorize the creation of a financial institution similar to the Federal Land Bank to meet some of their loan needs in the future.

The Farm Credit System has demonstrated that a Treasury-financed program can, in a reasonable period of time, be converted into a completely borrower-owned institution. I believe the proposed Rural Telephone Bank can be just as successful in this respect. The Rural telephone program came into existence on October 28, 1949. From that date to September 30, 1969, loans totaling \$1,697,575,432 have been made to 869 systems in 46 States. In that time, service has been furnished or improved for more than 6 million people in over 2 million rural establishments. The percentage of farms without telephone service in the country has decreased from 61 percent in 1949 to 18 percent today.

The percentage of farms without telephone service, however, is a poor measure of the present financial needs of these rural telephone systems. In 1949, when many rural subscribers had to share their telephone lines with up to 25 other families; reducing the number of parties on a line to a maximum of eight appeared to be a substantial improvement in the quality of service. At that time, providing a better grade than eight-party service for rural people in high-cost, low-density areas did not appear feasible. Reducing the number of parties on a line as well as the improved quality of service encouraged greater utilization of the telephone facilities. As a result, it has now become increasingly difficult for a party line subscriber to make or receive a call. The resulting frustration has led to a growing demand for upgrading of service. Fortunately, in the intervening years, the ability to pay for higher grade telephone service has also improved. Upgrading of service is therefore both necessary and economically feasible, provided adequate funds can be found to do the job.

The level of loan applications carried over from year to year has been mounting steadily. On June 30, 1968, REA had 312 telephone loan applications on hand totaling \$320 million. The backlog of pending applications increased to 345 in number and \$346 million on June 30, 1969, and to 358 in number and \$364 million on September 30, 1969. About 60 percent of the funds required in these applications will be used for the upgrading of telephone service. The backlog of applications on hand is almost three times the annual level of loans now being authorized by the Congress in the appropriations acts.

Estimates indicate that these rural telephone systems will need in the next 15 years more than twice the \$1.7 billion they have received in loans during the first 20 years of the telephone loan program. It is obvious that other sources of financing must be sought to supplement the present direct loan program if the rural telephone systems are to meet their service responsibilities.

This legislation would establish a rural telephone bank to provide rural telephone systems with some of the additional funds required. To help the bank get started, the Government would use net collection proceeds from the present 2 percent REA telephone loan program in amounts not exceeding \$30 million annually as appropriated by the Congress to purchase the bank's 2-percent class A stock until the Government's investment totals \$300 million. Each borrower from the bank would be required to invest 5 percent of its loans in nondividend-bearing class B stock. In addition, dividend-bearing class B stock. In addition, dividend-bearing class C stock would be available to borrowers and potential borrowers. This financing plan is an adapta-

tion of the Federal land bank system which has demonstrated its capability as a means of completely freeing a lending program from reliance on Treasury financing over a period of years.

With this equity capital as a base, the bank would be able to raise additional funds from the private money market through the sale of debentures. The bills limit such borrowings to eight times the amount of paid-in capital and retained earnings, and requires Treasury approval of debenture issues until the bank has been converted to borrower control. Retirement of the Government's class A stock would be started in 1984. Debentures would not be guaranteed by the United States.

The bank may make loans to eligible borrowers either at an intermediate loan rate or at an interest rate reflecting the average cost of moneys to the bank, including interest on the bank's debentures, return on class A stock, administrative expenses, and provision for reserves and estimated losses. The intermediate loan rate, available only until the bank is converted to borrower control or June 30, 1984, whichever comes first, would be set at the current average yield of marketable securities of the United States having comparable remaining maturities, or at 4 percent, whichever is lower. The intermediate loan rate would not be available to borrowers capable of paying the higher bank rate and still achieving program objectives.

The bills also provide for a rural telephone account into which will be transferred appropriations, assets, and collections of the present 2-percent telephone loan program. Funds for both the present direct telephone loan program and for the annual Federal investment in the telephone bank would come from this account.

As indicated previously, the bills under consideration are almost identical. Section 412, however, which was added to H.R. 7 by the House Committee on Agriculture before it reported the bill on March 18, 1969, appears in S. 2202 but not in S. 1684. This added provision would prohibit a loan under section 201 for a borrower with an average density of more than three per mile if the borrower had a net worth in excess of 20 percent of its assets during the immediately preceding year. An exception would be permitted, however, if the Administrator finds that the borrower cannot obtain a loan from the telephone bank or some other reliable source at reasonable rates of interest and terms and conditions.

At the hearings on H.R. 7 there was some testimony to the effect that a number of telephone borrowers were able to pay higher interest rates than they are now paying. One major purpose of this bill is to enable borrowers which can pay higher interest rates to obtain appropriate financing. For many telephone borrowers, the level of the interest rate is a secondary consideration in comparison to the lack of availability of loan funds.

Allegations were also made at the House committee hearings that several telephone companies enjoyed inordinate returns on capitalization. The high rates of return on equity capital cited are misleading in that they fail to take into consideration the capital structures of these borrowers.

Companies reporting to the U.S. Independent Telephone Association had long-term debt equal to 53.53 percent and equity equal to 46.47 percent of their total capitalization at the end of 1967. By contrast, the 585 commercial telephone companies financed by REA had

long-term debt equal to 80.34 percent and equity equal to only 19.66 percent of their total capitalization. The 224 cooperative borrowers had composite long-term debt equal to 92.04 percent and equity equal to only 7.96 percent of their total capitalization.

The companies included in the USITA report had a composite return of 6.43 percent in 1967 on their total capitalization as of December 31, 1967, while the commercial borrowers financed by REA had a composite return of only 3.95 percent on their total capitalization. With the composite return for the commercial borrowers being less than 62 percent of the composite return for the independent telephone industry as a whole, it would appear that the benefits of REA financing are being passed on to the subscribers of the systems financed. This is as it should be.

Senator HOLLAND. May I ask a question, I have to leave. The figures you use are, of course, average figures. The criticisms of the House may have been addressed, although I am not familiar with them, to certain specific cases and specific companies. Would you care to address yourself to that point?

Mr. HAMIL. Senator, in all but two States the telephone borrowers from REA are subject to public utilities commission or public service commissions, whatever they may be called, and they have a pretty thorough review of the return that is being permitted, and we at REA have a pretty thorough review also, and I can say to the members of this committee that we strive diligently to see that there is not undue personal gain of resources made available through the REA loan program.

Now, it is absolutely necessary that they do make a profit because these are all, Senator Allen asked, repayable loans, and they are repaid on an amortized basis. So we strive, Senator Holland, to see that the benefits of the REA loan money are passed on to the users and subscribers of the telephone service.

Senator HOLLAND. One more question: Do you show anywhere in your statement, and I haven't had any chance to read it through, the division of the total volume of credit you have extended as between independent companies and cooperatives?

Mr. HAMIL. Yes, Senator Holland, that is not a part of this statement but we have that and I will provide it for the committee.

Senator TALMADGE. Without objection, it will be inserted in the record.

Mr. HAMIL. Yes.

(The information is as follows:)

REA TELEPHONE LOANS FROM BEGINNING OF PROGRAM THROUGH NOV. 7, 1969

	Number	Amount
Cooperatives.....	235	\$623, 145, 157
Companies.....	632	1, 041, 262, 417
Total.....	867	1, 664, 407, 574

Senator HOLLAND. I thank you, Mr. Chairman. I will leave my proxy with you and I hope this question of standards which we spoke of a while ago by which the sheep are divided from the goats or the

borrowers at higher rates are divided from the lower rates will be thoroughly explored. I can't stay with you, I am sorry.

Senator TALMADGE. I understand fully. And we will explore that. Proceed, Mr. Hamil.

Mr. HAMIL. In contrast with the rate of return on total capital, calculating rates of return on equity capital is frequently a meaningless exercise, particularly with respect to the many cases where borrowers have negligible or negative equity positions. The need to retire obsolete or inadequate plant, before it was fully depreciated on the books, in order to make way for modern telephone service caused many of these negative equity positions. It is not uncommon for a completely rehabilitated and greatly expanded plant to accrue operating deficits for a few years after cutover until the number of subscribers for which the basic backbone plant has been completed have been connected.

In 1967, 48, or 8.2 percent, of the 585 commercial REA borrowers reported net losses for the year on an accrual basis. Proprietors of systems with small amounts of equity capital run significant risks that they may lose all of their original investments should their companies be unable to meet debt service requirements. To prevent this and to assure the buildup of net worth, REA has inserted provisions in its mortgages placing restrictions on the payment of dividends and similar payouts until specified net worth and other requirements have been met.

A borrower which has just changed its equity position from negative to positive can have a computed rate of return on the small amount of reported equity capital as high as 100 percent or even more. This is no assurance that the particular borrower is qualified to obtain financing from commercial sources. In fact, the inability of small telephone companies and cooperatives throughout the United States to raise the equity capital needed to make them eligible for commercial debt financing was the basic reason for the enactment of the legislation implementing the rural telephone program in 1949. An excellent mathematical return on equity capital, because of the lack of equity capital, will not enable a rural telephone system to obtain financing from commercial sources which still insist on relatively low debt-equity ratios.

Returning to the proposed legislation, we would like to point out that the Department's report recommends the following changes:

"1. The activities of the telephone bank should be made subject to the provisions of the Government Corporation Control Act including annual budget review by the President and the Congress and audit by GAO so long as any Federal investment remains in the Bank. The bank should not be converted to private control until all Federal capital is repaid.

"2. Debenture issuances by the bank after it is converted to private control should not be made without prior consultation with the Treasury. We believe this to be essential in order to assist Treasury with its complex problem of timing and management of the public debt.

"3. The interest rate ceiling of not to exceed 4 percent on intermediate loans of the bank should be stricken as unnecessary, in view of the fact that borrowers unable to pay interest rates in excess of 4 percent will have available an appropriate mix of intermediate rate bank loans and direct REA financing.

"4. The interest rate for the direct telephone loan program, now set by statute at 2 percent, should be made flexible so that it will cover the Government's interest and administrative costs and probable losses, except in those cases where the Administrator determines that a lower rate, not less than 2 percent, is necessary to enable the borrower to provide service without an excessive increase in the rates charged by the borrower to its subscribers."

Senator TALMADGE. Will you yield at that point now, Mr. Hamil? I believe the present law requires that all of these loans have to be made at the 2-percent rate regardless of the debt-equity ratio of the borrower, is this correct?

Mr. HAMIL. That is correct. The rate is 2 percent.

Senator TALMADGE. In other words, you feel the law should be amended to make the rate flexible. If they are able to pay the going interest rate they should and if they require subsidy the rate would still remain at 2 percent. Is that your objective?

Mr. HAMIL. That would be the objective. Under this term, Mr. Chairman, under (4) here, the Administrator, having reviewed all circumstances pertaining to the loan application, could make the loan at 2 percent if it appeared that that were the maximum figure that the borrower could pay for money and provide the service of the type that we want to see provided, and I am sure that you want to see provided in the area involved.

Senator TALMADGE. Proceed, sir.

Mr. HAMIL. The proposed amendments are described in an attachment to the Department's report.

It will be noted that with the proposed amendments the bills would provide two interest rates for loans from the bank as well as a flexible interest rate for direct loans by REA. The standard rate for direct REA loans would take into consideration the current average market yield on outstanding marketable obligations with remaining periods to maturity comparable to the average maturities of such loans plus an allowance adequate to cover administrative costs and probable losses. This rate could be reduced down to the present 2 percent statutory rate when necessary to enable the borrower to provide service without an excessive increase in the rates charged by the borrower to its subscribers. We are in the process of developing objective standards which can be used to determine the relative amounts of REA and bank funds which should be made available to particular borrowers. We believe that mixed financing can be utilized to effect a resulting composite interest rate which will enable the borrower to meet its utility responsibilities. These standards can be revised from time to time to utilize larger amounts of rural telephone bank funds as the bank's assets grow, with a corresponding reduction in the proportion of financing which must be accomplished by direct Government loans.

The proposed legislation will make it possible for REA telephone borrowers to utilize other sources of funds to supplement section 201 appropriated funds. It will, for the first time, enable REA borrowers who can pay more than 2 percent for their borrowings to do so. I have no doubt that the Government's investment in the bank's class A stock will be the pump primer needed to start the flow of non-Federal funds into the rural telephone program. The committee is to be congratulated for its work on a bill which, I believe, will lead to a completely borrower-owned institution in the image of the farm credit system. I wish to thank the committee for this opportunity to voice my support for such forward-looking legislation.

Senator TALMADGE. Thank you, Mr. Hamil.

Let me see if I understand how the capitalization of the bank will work.

I believe both bills will provide ultimately \$30 million of class A stock that will be wholly owned by the Government.

Mr. HAMIL. The class A stock will be wholly owned by the Government.

Senator TALMADGE. And would the Government get any return?

Mr. HAMIL. Two percent.

Senator TALMADGE. Three percent?

Mr. HAMIL. Two.

Senator TALMADGE. Two percent on its stock ownership and that would be paid at the rate of \$30 million a year.

Mr. HAMIL. Not to exceed \$30 million.

Senator TALMADGE. In loans that will be collected.

Mr. HAMIL. Yes, sir.

Senator TALMADGE. As principal and interest accrues. In other words, that will require no additional outlays from the Treasury, is that correct, except the transfer of the incoming flow of money to this new corporation.

Mr. HAMIL. Your statement is correct, Senator.

Senator TALMADGE. You will also have class B stock. Who will own the class B stock?

Mr. HAMIL. Class B stock will be owned by the borrowers.

Senator TALMADGE. In other words, when for example, a rural telephone company borrows \$100,000 in money they will have to put up 5 percent of that or \$5,000 to buy stock.

Mr. HAMIL. That is right.

Senator TALMADGE. And will that stock pay any dividend or any interest?

Mr. HAMIL. It is not interest bearing.

Senator TALMADGE. Noninterest bearing.

Mr. WEITZELL. That is right.

Senator TALMADGE. And then you have your class C stock. This will flow into them to buy your class B stock only at a 5-percent rate of what the Government puts in class A, is that correct?

Mr. HAMIL. I don't follow you exactly.

Senator TALMADGE. I am trying to get the inflow of money on class B stock.

Mr. HAMIL. You could——

Senator TALMADGE. You first have to make a loan——

Mr. HAMIL (continuing). Yes.

Senator TALMADGE (continuing). Before you could have any flow of money into your class B stock, and then whoever borrowed the money would have to put 5 percent of what they had borrowed in class B stock.

Mr. HAMIL. This is correct.

Senator TALMADGE. So your inflow of money into your class B stock would be only 5 percent of what the outflow of your corporation will be then, is that correct?

Senator ALLEN. Wouldn't they also put up 5 percent on direct loans? Would that go in or would that——

Mr. HAMIL. It would be 5 percent, Senator, on bank loans.

Senator TALMADGE. Five percent of that which flowed from the RE and also 5 percent of that which flowed from the corporation.

Mr. HAMIL. I don't think we are looking at that right. Let's assume you authorize \$30 million be appropriated that year to go in——

Senator TALMADGE. We will assume the full amount is loaned out that year.

Mr. HAMIL. Yes; you will loan it out. You will get 5-percent increase there but according to the terms of the banking provisions that you are going to authorize this could be expanded up to 8 times. In other words, if there were \$30 million in there, and it was permitted to go the maximum, that could be expanded 8 times.

Senator TALMADGE. In other words, if you issued debentures and loaned money, that also would flow into class B stock?

Mr. HAMIL. Yes.

Senator TALMADGE. I notice your assistant shaking his head a while ago at something you and Senator Allen said. Could you clarify that a little?

Mr. WEITZELL. Senator——

Senator ALLEN. I was asking if also the 5 percent that the borrowers had to pay of their loans also applied to the direct loans.

Senator DOLE. Not 201 loans. It does not apply to that provision.

Mr. WEITZELL. That is what I was referring to.

Mr. HAMIL. I did not understand you, I was thinking strictly of the bank loan.

Senator TALMADGE. Your answer is the outflow of the direct 2-percent loan from the REA would not require 5-percent investment in the class B stock.

Mr. HAMIL. They are not even in the same category. They would proceed in exactly the same manner as they do now. That money would be loaned, and it would be repaid in toto at the interest rate that was determined. If it be 2 percent or at some figure higher than that.

Senator TALMADGE. It is your idea that the REA and the corporation would both be making loans simultaneously.

Mr. HAMIL. It could be.

Senator TALMADGE. In other words, you would continue your Federal program and only phase that out when the bank became strong enough to carry the entire load—is that your objective?

Mr. HAMIL. That would be the objective.

Senator TALMADGE. All right, let's get to your class C stock now. What does that provide?

Mr. HAMIL. Class C stock would provide——

Senator TALMADGE. Who buys it?

Mr. HAMIL. Borrowers and potential, and persons eligible to borrow.

Senator TALMADGE. In other words, anyone. Would they be required to buy any class C stock when they borrowed some money?

Mr. HAMIL. No.

Senator TALMADGE. In other words, it is wholly optional for any individual to purchase your class C stock?

Mr. HAMIL. That is right.

Senator TALMADGE. All right.

What do you contemplate your class C stock would represent—what interest rate and dividends?

Mr. HAMIL. I think it is open. I think you can pay whatever you wanted to.

Senator ALLEN. It says, shall not exceed the current average rate payable on its current telephone debentures, that might be 6 or 7 percent.

Mr. HAMIL. In other words, if Senator Bellmon's telephone company had some extra money they wanted to invest they could invest it in this bank and could obtain an interest rate which would not exceed that which we were paying for the debentures that we were selling.

Senator TALMADGE. The staff have just handed me an analysis of the bill that corresponds exactly to your answer. Dividends, in accordance with the bylaws are payable only from income. Dividends may not exceed the average rate on debentures until all class A stock is retired.

So, the sale of your class C stock then would be a slow business until it got into private hands, I assume.

What about the voting rights of the various classes of stock?

Mr. HAMIL. I am going to let Senator Dole—he started to answer that and if it is all right he can answer it because it is written out pretty well in the bill.

Senator TALMADGE. All right.

Senator DOLE. As I recall, the B and C classes are voting stock.

Mr. HAMIL. Until the Government's capital is retired.

Senator DOLE. It is section 406. It is on page 15, line 12, page 14 of my bill. I am not certain where it would be in the McGovern bill, but in S. 2202, class B and class C stock shall be voting stock, but no holder of said stock shall be entitled to more than one vote, nor shall class B and class C stockholders, regardless of their number, which are owned or controlled by the same person, group of persons, firm, association or corporation shall be entitled in any event to more than one vote.

Senator TALMADGE. All of the holders of class A, B, and C stock have the same rights as to voting?

Mr. HAMIL. The Government stock—

Senator TALMADGE. I believe your assistant—

Mr. HAMIL. This is our counsel, Mr. Howard Campbell.

Senator TALMADGE. All right.

If you will answer the question, Mr. Campbell.

Mr. CAMPBELL. Class A stock would be held exclusively by the United States to represent its investment in the capital of the corporation. It does not, under the terms of this bill, pose a problem of voting because the Government's interest in the management of the corporation is under the control of a board which is heavily represented by the Government's interest, and during the time until borrower control is transferred, the interest of the United States is represented by the control of the board rather than by the voting of the class A stock.

Senator TALMADGE. What you are saying is the stockholders cannot vote the board out of office regardless of the stockholders the board will run the corporation?

Mr. CAMPBELL. Yes, sir.

Senator TALMADGE. Is that the answer?

Mr. HAMIL. Until the Government stock has been retired.

Senator TALMADGE. And it becomes a privately owned stock company.

Senator ALLEN. May I ask a question, Mr. Chairman?

Mr. Hamil, assume the hypothetical situation that the bank is established, the Government pays in its \$30 million, no loans have been made, therefore, there is no class B stock sold, no borrower or potential borrower has purchased any C stock, and you have only \$30 million. You go into the market to theoretically borrow \$240 million, I assume. At today's market what would you anticipate, and I note either from your statement or the bill itself that the debentures are not to be guaranteed by the Government, at what rate do you think you could borrow that money?

Mr. HAMIL. I would imagine it would be at about a rate that would be similar to that which the Farm Credit Administration is borrowing money which, at this time, happens to be about 8 percent.

Senator TALMADGE. A little over 8 for the last issues of debentures.

Mr. HAMIL. A little over eight.

What we would have to do, Senator, when the bank started we would need to make some loans with the original \$30 million upon which potential investors could review the activities of the bank in order that they would know whether or not—and at what rate they would want to invest their money. Now, it would be my opinion, Senator, that the security of good telephone systems in the rural part of this country would be in the order of the securities issued by the Farm Credit Administration for the Federal Land Bank, for the intermediate credit banks and for the bank for cooperatives and those securities have sold at quite reasonable rates, considering the cost of money. I would anticipate that this bank, as soon as it had an opportunity to develop some experience, could have a similar history for the sale of its securities.

Senator ALLEN. You have got then, the Government participation of \$30 million at 2 percent, and then \$20 million at 8 percent, which would certainly make the average 7 percent plus, and if you are going to make a profit in the bank wouldn't you have to pass that interest rate on to your borrowers?

Mr. HAMIL. Well, it is anticipated that in the volume of loans that the Rural Electrification Administration would be making that approximately a quarter of 1 percent would cover the overhead.

Senator ALLEN. But say there is no overhead, just take your rates, how are you going to lend money at 7 percent or are you going to make any loans now or are you going to have to just have this Government money at 2 percent that you can possibly lend at two, I would hope, or are you still going to have to rely in the main on the direct loans of the REA?

Mr. HAMIL. Well, I think that there are among the borrowers from REA, Senator, some whose territory would at this time support some additional money at a rate, say, 6 or 7 percent.

Senator ALLEN. In other words, we are going really in the final analysis from a practical standpoint, the telephone bank is going to be available really only for the affluent associations and the direct money is going to be available to the smaller low population systems? Isn't that the practical effect of it?

Mr. HAMIL. I think from a practical standpoint you probably hit it just about as logically as it could be.

Senator TALMADGE. Let's get into your directors now. How many directors do you appoint?

Mr. HAMIL. Well, let's see, we will read that from the bill here, do you have that spot, Mr. Campbell?

On page 10 it says as soon as practical after the enactment of this title the President of the United States shall appoint six additional members of the initial telephone bank board to be selected from directors, managers, and employees of any entities eligible to borrow from the telephone bank and organizations controlled by such entities, with due regard for a fair representation of rural telephone systems of the Nation. The six members thus appointed shall serve until their successors have been duly elected in accordance with section (d).

Senator TALMADGE. Six of how many now? I believe there are 13 directors.

Mr. HAMIL. At the bottom of page 9:

"The Administrator of the Rural Electrification Administration and the Governor of the Farm Credit Administration shall be members of the Telephone Bank Board. Five other members of the Telephone Bank Board shall be designated by the President to serve at his pleasure, three of whom shall be officers or employees of the Department of Agriculture but not officers or employees of the Rural Electrification Administration, and two of whom shall be from the general public and not officers or employees of the Federal Government."

That makes 13.

Senator TALMADGE. In other words, the Government would have seven of the directors and the borrowers would have six—is that correct?

Mr. HAMIL. I think your addition is correct on that, Senator.

Senator TALMADGE. Now, let's get into the business of the loans. Senator Allen covered it partially a moment ago in his questions, and I think they were very well taken. You don't propose that this new corporation we are creating could under present circumstances, lend any money cheaper than the cost of the money, do you?

Mr. HAMIL. It could with the blend of the \$30 million, Senator. It could lend some money lower than that.

Senator TALMADGE. You would presume that these REA's or private companies which had a very low ratio of equity to debt then would continue to borrow direct REA money at 2 percent.

Mr. HAMIL. We would hope that there would be a supply of money that could be loaned at 2 percent, and according to the amendments that have been suggested here by the Department, the Administrator could make loans at 2 percent when it was necessary for the carrying out of the objectives and the evidence indicated that no higher interest rate could be borne by the borrower and provide the service.

Senator TALMADGE. If some borrower was getting along well and making some money and in pretty good circumstances he would be expected to perhaps use the bank and pay a higher rate; is that your thinking?

Mr. HAMIL. Yes.

Senator TALMADGE. Now, I believe the bill offered by Senator Dole and the one that the House committee reported purport to fix some rate. What do they provide?

Mr. HAMIL. That provides for an intermediate rate which would be in effect up until 1984, and it can be at the cost of money to the Federal Government plus cost of administration but not more than 4 percent. If the cost of money were below the 4 percent it could be loaned there but it couldn't be above 4 percent.

Senator TALMADGE. What does Senator McGovern's bill provide?

Mr. HAMIL. The same thing.

Senator TALMADGE. The same thing?

Mr. HAMIL. All three bills, Senator, have that provision.

Senator TALMADGE. What are you going to do if someone comes up here from some remote rural area with a little telephone company or a co-op and says, "We are going to borrow money." How are you going to determine what rate is going to prevail?

Mr. HAMIL. Well, the first thing that we have to do under any circumstances and what we have been doing in the telephone program since 1949, is make a thorough review of the potential borrowers area.

Senator TALMADGE. In other words, he has got to come up here with an auditor's report for how many years of business in the past?

Mr. HAMIL. That is a specific I cannot answer but we have reviewed since 1949 every borrower that has come in and we have reviewed his territory, his potential service, the potential number of subscribers that he may have, and have reviewed also the ability of that area to pay for telephone service, and when we have come up with a feasible loan—and we have had the money available we have granted the loan, Senator.

In other words, every loan which has been made since 1949 has been thoroughly reviewed and has been tailored to the situation at hand. The only thing that would be different under the bill here is that there may be a different interest rate.

Senator TALMADGE. All right.

Suppose I own some little moderately successful local telephone company and my family owns all the stock. I am getting a pretty high salary out of the thing and we are paying some dividends to my family. If I wanted to borrow some money, I wouldn't want to go to my banker today. He would probably want 10 or 12 percent, so I would probably be looking to you. How would you determine that interest rate?

Mr. HAMIL. We would probably have trouble loaning the money.

Senator TALMADGE. Do you look at the salary, dividends, profits, and losses?

Mr. HAMIL. Yes, we do.

Senator TALMADGE. In other words, if he is able to borrow money other than the Governments, do you send him elsewhere? Is that what you do?

Mr. HAMIL. Under the terms of this bill that has been proposed here, and under the terms in which we have been operating the Rural Electrification Administration, we have demanded that the equities be up to a certain percentage. Will you answer that, Mr. Weitzell?

Mr. WEITZELL. Actually, Senator, we have no preference or no requirement that a borrower first go to a private bank and be turned down. A borrower, an eligible borrower, may come directly to REA and if he meets the requirements of this program we are free to proceed to make him a loan.

Senator TALMADGE. All of those that are doing business in rural areas are then going to come to you, aren't they?

Mr. WEITZELL. Well, a great many of them have come to us, especially the smaller ones.

Senator TALMADGE. He would certainly want to get the cheapest money he could.

Mr. WEITZELL. That is generally the case. However, there have been a number of telephone companies that have felt they could be and should be financed in the private money market and they have stayed there for that purpose and they have not come to REA.

Senator TALMADGE. This new bank then would give you some latitude about the interest rates that you don't now have; is that correct?

Mr. WEITZELL. That is correct.

Senator TALMADGE. In other words, you have got two options now. One, you can lend him the money at 2 percent, and the other, you can turn him down?

Mr. WEITZELL. That is correct.

Mr. HAMIL. That is true.

Senator TALMADGE. Under this new bank you propose to create, you can fix the rate at the lowest rate or as low as 2 percent?

Mr. WEITZELL. That is correct. However, the important thing here, Senator, is that this would provide a supplemental source of financing in addition to the variation in the rates which you indicated.

Senator TALMADGE. What do you recommend we put in the law now. We ought to have some guidelines as to who can borrow cheap money and at what rate, and who can borrow money at some intermediate rate, and who can pay the going rate that it costs the Government. What do you suggest in that regard?

Mr. WEITZELL. Well, Senator—

Senator TALMADGE. I don't think that ought to be left wholly to the Administrator. It will be too much of a burden on you, for you to wave a magic wand and say to one "You get 2-percent money," and say to the other, "You get 8-percent money."

What guidelines would you suggest?

Mr. WEITZELL. Senator, the Administrator indicated in his testimony, as you may recall, that we were now in the process of making an examination which would result in the establishment of certain criteria that would be used in determining this kind of a problem. We believe that this should be variable year to year as the bank is able to increase its resources, and let's say the first year or two the bank would probably not have more than that amount of money which was put in to capitalize it by the Government until it had a portfolio of loans as a basis for going to the private money market.

Now, the criteria that we would use with only that money available would very likely, I would say, be different than the criteria that might be used as we were able to obtain a substantial amount of money from the market.

Senator TALMADGE. I think every member of this subcommittee and full committee wants to do something to help you, but the sticky question is going to be the interest rate that an individual borrower pays and under what circumstances. And we would appreciate the Department sending detailed recommendations in that regard because I think the committee would want to study them seriously before it passed on that provision.

I want to apologize to the subcommittee for taking so much time on this but I thought the record ought to be concise as to the organization and structure of this bank and the interest rate.

Senator Dole asked for recognition first and then Senator Allen.

Senator DOLE. Do I understand, that the third suggestion you make

on page 8, would have the effect of eliminating the intermediate loan provision in 2202 and 1684?

Mr. WEITZELL. Senator Dole, that has the effect of eliminating the limitations at 4 percent. It would not eliminate entirely, the provision for an intermediate rate.

Senator DOLE. As a practical matter, how do you envision, if the change were made, how would it operate? In my proposal and in Senator McGovern's, we provide three different type loans, we continue the 201 loans at 2 percent, and then under section 408 we have the intermediate loan which is the cost of money plus certain expenses or 4 percent whichever is lower, and then finally the cost of the loan at the cost to the Government, which are three different levels.

If we do what you suggest on page 8, number 3, what is the practical effect of that?

Mr. WEITZELL. The practical effect would be that the intermediate rate would have to be the cost of money less any allowance for losses or administration, as would be provided in the regular rate.

Senator DOLE. What does that mean percentagewise, do you have any idea?

Mr. WEITZELL. It would probably mean a difference, well, let's say $6\frac{1}{2}$ versus maybe 8 or $8\frac{1}{2}$ or one-fourth.

Senator MILLER. Would the Senator yield at that point?

Senator DOLE. Yes.

Senator MILLER. Really the question then is what would be the difference between that intermediate rate you just referred to and the going rate?

Senator DOLE. The going rate.

Senator MILLER. Or are you going to end up with this being one and the same?

Senator DOLE. If you consider only the cost of money to the United States then it would be identical.

Mr. HAMIL. Senator Miller, in order to make a blend that would be operable, you probably have to go back to the system that was used by the Federal Land Bank several years back, I don't know whether they still use it but they had what they call a commissioner loan which was at a different figure, and what the Administrator and what the bank could do would be make some of that money 20 percent of the 201 money and 60 percent of the other or take a blend of those two to where he could get an interest rate that the borrower would be able to pay and to do the job that he needed to do and have reasonable rates for his people.

Senator DOLE. I believe Mr. Campbell is going to comment on that, too.

Mr. CAMPBELL. I would like to supplement your answer to the Senator with a little more thorough examination of page 19 of the Senator's bill. The intermediate rate base is a rate determined by the Secretary of the Treasury talking into account the current average market yield.

Senator BELLMON. What line are you reading from?

Mr. CAMPBELL. I am reading from line 19, 20, and 21. Taking into consideration the current average market yield during the month of May on the outstanding marketable obligations of the United States. That is not the current cost of money. That is a computed figure

which takes into account obligations of the United States of a long-term nature, and when the Treasury computes that figure it may come out to be 5, 5½, 6 percent depending on the whole block of outstanding marketable obligations of the United States. It is entirely different from—

Senator MILLER. What you are proposing to do for example, is just take item 3 in our bill but delete the 4-percent maximum; is that what you are proposing?

Mr. CAMPBELL. That is correct, on the intermediate loans.

Senator MILLER. Yes.

Mr. CAMPBELL. And then let it ride up to 5 or 5½ if that is the determined figure for the formula.

Senator MILLER. Or 6 or 6½?

Mr. CAMPBELL. You see, the rest of the loans above the intermediate are based on a different formula which is the cost of money to the bank for its current obligations. That is a blend of the capital cost on the Class A stock and the debenture costs, and that may be an entirely different figure from your computed figure based on the current yield on outstanding obligations of the Treasury.

Senator MILLER. All you are doing then is you are suggesting we take out our 4-percent ceiling in this intermediate loan?

Mr. CAMPBELL. That is the effect, that is the only thing that this particular suggestion of the administrator's does.

Senator DOLE. You are not suggesting we change that to 5 or 6 but just to eliminate—

Mr. CAMPBELL. Eliminate the ceiling on it so it will ride up and down with whatever the average yield on Treasury obligations of long-term maturities—

Senator DOLE. You don't think it will ride down?

Mr. CAMPBELL. We are hopeful that it might some day.

Senator DOLE. With reference to the fourth suggestion, as I understand it, you are asking us to amend section 201 of the basic act, the 1949 act?

Mr. WEITZELL. That is the recommendation.

Senator DOLE. What are we talking about there, as to a specific rate of interest. The reason I asked the question, I can see some opposition immediately to tampering with the original act. I know the cost of money is higher to the Government than it was in 1949 and perhaps they should pay the same rate as the Government. But, on the other hand, there are some struggling REA or independent telephone borrowers who receive a subsidy, in effect the cost of money to you and the cost to them, but they still provide a service to the people. I am wondering what the real impact of suggestion No. 4 would be.

Mr. HAMIL. It would be a little hard to answer immediately. Under this provision, Senator, the administrator would have the authority to make 2-percent loans to those borrowers who could pay no more than 2 percent and still carry out the objectives which would be to provide reasonable service at a reasonable—I should say good service at a cost which would be reasonable in the area.

Senator DOLE. But if we accepted your suggestion would we have in effect another interest rate. In other words would there still be some entitled to 2 percent, some entitled to the rate provided in suggestion 4, the intermediate loan, and the cost of money to the bank. Would there be 4 categories of loans?

Mr. WEITZELL. Senator, under section 201 the rate could vary from 2 percent to the cost of money.

Mr. HAMIL. That is correct.

Senator DOLE. If we accept your suggestion?

Mr. WEITZELL. If we accept this provision, the bank would have two additional rates, the intermediate rate and the regular rate or the cost of money rate.

Mr. TALMADGE. Senator Allen.

Senator ALLEN. Mr. Chairman, it seems to me the issue is simply that the REA's, the local REA's, want the bank—the administrator wants the bank. Unless this would be subsidized it has got to lend money at somewhat more than it borrows money for. So there is no need of one rate there. That is the going rate.

Now, over on the 2 percent that ought to remain 2 percent, and that should be available to the REA's that cannot pay the higher rate.

The administrator would have some discretion here because he wears two hats. He is head of the bank and he is the administrator as well, so he would have his discretion, and the bank has got to make money, it has got to lend at more than it pays. It is very simple. You need but the two rates. Leave the 2 percent alone and let the bank rate seek its own level.

Senator MCGOVERN. Mr. Chairman.

Senator ALLEN. It is real simple.

Senator MCGOVERN. I agree strongly with what Senator Allen has said.

Isn't it a fact, Mr. Hamil, what you are asking for is really a blank check from the Congress to determine what these interest rates ought to be on an arbitrary basis. If we strike that 2-percent requirement that has been in the law for the last 20 years it seems to me you are removing the legislative guidelines; that in essence is what you are asking for is endorsement from the Congress in advance for anything you want to do with reference to who qualifies for the 2-percent loan or at any level between that and the going rate provided in other section of the bill.

I just say that in a State like mine, where you have an average of less than two subscribers per mile, if we lost that 2-percent provision we would be out of business. I don't know why, with as much leeway as you have in the rest of the bill and two different levels, you need to tamper with that historic 2-percent rate. It is still needed as much as it ever was by these areas where there is a sparseness of population. It doesn't seem to me the needs of those people have changed any since 1949. Our population is the same today as it was then and the cost of living has gone up.

Mr. HAMIL. Senator McGovern, under the terms of 4, the Administrator could and should take full cognizance of what you have said, and there are areas in the United States, quite a number of them, I want to tell you, Senator McGovern, and they are not all in South Dakota either.

Senator MCGOVERN. No; I understand that.

Mr. HAMIL. And he could make these determinations, and I think he would have to be reasonable about it in order that telephone service could be provided in those areas as well as in some of the others, some of the other areas that have had improved service and have started to move up in population, and we have had that happen, Mr. Chair-

man; hopefully, this would also provide an avenue for them to obtain additional credit more than has been made available under the regular section 201 program.

As I indicated in my testimony, we have got about 3 years of applications down in our office, if we were to make all of the loans and using the amount of money that has been regularly allocated under REA Act.

Senator McGOVERN. I am not sure I understood your reply to Senator Talmadge's question here about how you would make the determination of who gets the 2-percent loans if, you know, you did that on an arbitrary basis. Would you contemplate making economic studies on an exchange by exchange basis to determine what the conditions are, that is the economic capacity of these various telephone exchanges to pay given interest rates?

Mr. HAMIL. Well, we have to make pretty thorough studies to make the loans we are making now, Senator, and as I think we indicated to you, we have not developed the detailed criteria the chairman has asked us to present to this committee, which we have agreed to do, some guidelines that we hope might be applicable here and would be satisfactory to the Congress for making these loans.

Senator DOLE. Mr. Chairman—

Senator MILLER. I am concerned about preserving this 2-percent money, and I think the reason we put this intermediate rate in the bill was to recognize, and I say this with all deference to my colleague from Alabama, that it could be extremely difficult to manage this thing if you had 2-percent interest money, on the one hand, and maybe 8 or 9 percent, on the other, and we wanted to give you some flexibility so that you could meet some of those needs in the intermediate area. But if you come along and say: "Well, we will use the intermediate area but it may reach 6½ percent because we are going to take your 4-percent maximum out of there," I can see some merit to that, but to couple with that the potential destruction of 2-percent interest money, I think is going too far and I can see where you and your people would get all bogged down in administrative studies to try to implement this.

The virtue of Senator Allen's approach is that it is very simple. We want to keep it simple but we think that the intermediate area is needed to provide flexibility, and I just don't think we should go too far.

Senator ALLEN. Would you yield there?

How are you going to have flexibility when money costs so much? How are you going to have flexibility unless somebody is going to pick up the tab?

Now, the bank is supposed to be self-sustaining. Now the 2 percent is not self-sustaining. That, of course, is understood, but how are you going to have flexibility when money costs so much?

Senator MILLER. Well, I think if you take a view of the overall picture you have got to recognize that you may be confined on the amount of these intermediate loans. They may be very few in number, but they certainly would be available to the Administrator to use in certain areas where they can't go up to 8 but they can go over 2. I am not thinking in terms of a lot of these loans in the intermediate area but it seems to me that some flexibility is indicated.

Anyhow, that was the intention behind putting this intermediate rate in and I think you can accommodate—

Senator ALLEN. What would be wrong with the mix of the two, some 2 percent and some from the bank?

Senator MILLER. That is correct.

Senator DOLE. If somebody makes an application for a 201 loan and he is eligible for a loan under the bank at the intermediate or the higher rate you don't have to approve the 2-percent application, do you? Can't you accomplish the same objective by rejecting his application for a 2-percent loan and suggesting he go to the bank for his money?

Mr. HAMIL. Yes; it could be, Senator Dole. As the circumstances prevail right now we have \$340 million worth of applications and approximately \$125 million to loan.

Senator DOLE. Because you have enough bona fide applications that deserve 2-percent money there is probably no problem right now. You have got more applications that you have money. But we discussed this in the House last year that you really accomplish your objective by suggesting the applicant go to the bank. Second, if we tamper with this bill on the Senate side, I believe we would be backing into a buzz saw with reference to any action in the House. I know they feel very strongly about not tampering with section 201.

If you want to introduce a separate bill to accomplish what you suggest in number 4 then perhaps we should consider that, but I think to make it a part of the telephone bank bill would end up defeating the entire program.

Senator ALLEN. Responding again to what you suggest, Senator Miller, I don't believe we are far apart at all on the thing, on the flexibility because, as you say, there is a certain amount of 2-percent money available and then over here is the intermediate money that would be available at the going rate. I agree with Senator Dole that if we tamper with the 2 percent we are going to get into trouble.

Senator MILLER. I agree with him, too.

Senator ALLEN. I am opposed to that.

Senator MILLER. I can't disagree with you from the standpoint of quantity because I think you are eminently sound on that. My own point is that there might—there will be a relatively small amount in this intermediate area which will enable the borrowings to be sustained which will enable the Administrator to have flexibility to that extent, which he should have, I think, to accommodate those that can't go up to 8 or 9 and those that are not eligible for 2.

Senator ALLEN. Yes, and as was suggested a moment ago, possibly to start with the bank is just going to lend this 2 percent money of the Government's \$30 million at 4 percent or 3 percent on that.

Senator MILLER. They can do that but I detected from the Administrator's testimony if we keep the 2 percent, the regular 2 percent, that is one thing. On this other 2 percent they would use that not for 2 percent but would use it for a blend in this intermediate arrangement and if they do that—

Senator ALLEN. No, Senator. The blend was on the 2 percent with the 201 with the other, not the blend inside the bank. That would be the way I understood it.

Senator MILLER. I didn't understand it that way.

Mr. HAMIL. It could be that we would have to take some of the 201 money, Senator Allen, to blend with some of the other bank money to get the rate necessary.

Senator ALLEN. That is what I was talking about.

Mr. HAMIL. And to bring the rate down to a point that the borrower would be able to pay and still provide the service.

Senator ALLEN. Another point, you are going to blend in the entire bank.

Senator MILLER. That is what I thought you were going to do. Because to the extent you do what you just suggested you are going to greatly diminish, in fact you could completely throw out, the 2-percent interest money under 201, and I don't think we would want that to happen.

Mr. HAMIL. I don't think, Senator Miller, that you would throw it out. There are some borrowers who will, who could not go beyond that.

Senator MILLER. Well, suppose, for example, your studies indicate that \$300 million worth of applications were sustainable at 2 percent, that you had a number of other applications that could go beyond 2 percent but they couldn't go up to 8, they could maybe hit 4 or 5, and you had \$300 million that you could lend at 2 percent. Would it be your thought that you would take maybe \$150 million of that to satisfy half of those \$300 million loans that are sustainable at 2 percent and then take the other \$150 million and throw it in to make a blend in the intermediate system?

Mr. HAMIL. Well, if this were the case, that would be a way to do it, Senator Miller.

Senator MILLER. It would be a way to do it but I personally would think it would be unfortunate if it turned out that way because if you have sustainable applications at 2 percent I wouldn't personally want to see you drain that out of the 2-percent interest money and put some of it over to make it a blend and that is why I thought in my colloquy with Senator Allen we were talking about the 2-percent money within the bank.

Mr. HAMIL. Well, if I may offer a comment, and this is just strictly a comment, there are \$340-\$350 million worth of loan applications in the office of REA at this moment. There are many of those applicants, I am sure, that would be very happy to be able to obtain loan funds from REA at a rate higher than 2 percent if we had the money. We don't have the money. We have, apparently are going to have, \$125 million dollars, so we are going to have to do the best job we can of sorting the \$350 million of applications; as a matter of fact we don't have \$125 million today, Senator, we have already loaned some of it.

Senator TALMADGE. If I may interrupt at this point, Mr. Hamil, that is a sticky issue that several Senators have commented on this morning. We have requested of you and you have agreed to submit to us some recommendations for appropriate guidelines in this area. We could continue discussion on this question all day, but we have a great number of witnesses and the Senate is already in session. At least one witness has to leave for California at 1 p.m., and I don't know how long we are going to be able to continue here. If you will submit your recommendations in that regard this subcommittee will consider them carefully.

Senator Bellmon hasn't had a chance to ask a question.

Senator BELLMON. I don't want to ask any questions at this time but I do have some questions to ask him later. Will he come back to testify?

Senator TALMADGE. I think he should come back with his recommendations as to what the interest rate is going to be and under what circumstances, because, as I see it, that is the only sticky issue in the bill. I think everybody is in favor of trying to do something to help these rural people get adequate telephone service, but I doubt that this committee is going to want to leave it to you to fix any interest rate for any borrower under any circumstances as you see fit.

Senator DOLE. Would they include in that study this so-called application within the bank? I am not certain I understand that and I thought I understood the bill fairly well.

Senator ALLEN. What I meant by that, you have got \$30 million that the Government puts in at 2 percent. Well, obviously there could be a mix on the next \$30 million in loans, \$60 million, but when you try to blend \$30 million in with \$240 million you have a blend about like a chicken with a horse, you see, to end up with a blend so you can't blend much of \$30 million into \$240 million.

Mr. WEITZELL. Mr. Chairman, on this point, I would like to point out that the possibility of getting \$240 million is some ways down the road, Senator. There would have to be quite a bit of experience accumulated in the REA program before we could hope to attract that kind of money from the private market in order to give us that amount of loan funds.

There is another point that I think we might clear up just a bit here, and I think Senator Dole was referring to it just a few minutes ago. It would be possible, as we understand it, to make an intermediate loan, as the bill is now written, at 4 percent and also a cost of money loan or a regular loan at a higher rate to the same borrower in order to get a blend of a rate—intermediate rate.

Senator TALMADGE. And 2-percent money from the Government so you would have three different rates to the same borrower.

Mr. WEITZELL. Well, that would be possible, but very likely it would be impractical to go to that extent.

Senator MILLER. Mr. Chairman, could that study include a little discussion about the use of 2-percent money under 201 in connection with this intermediate rate.

Senator TALMADGE. Mr. Hamil is coming back at a later date for further comments.

Senator BELLMON. Mr. Chairman, I would like some additional information on this study. Can you give me some indication of what percent of my phone bill as a telephone user represents the use of money, in other words if the interest rate doubles what will be my phone bill?

Mr. HAMIL. Yes, sir.

Senator ALLEN. I was just going to suggest that the point I was making we were talking about giving the Administrator discretion, I feel he should have full discretion over in the management of the bank but leave the 2-percent money under 201 intact. There is no need of putting a limitation on him on the operation of a business operation there on borrowing money. It will seek its own level. Leave the 2-percent limit intact and give all the discretion he wants over there in the operation of the bank and we would have a sound system that way.

Senator MILLER. I had a question on another subject, Mr. Hamil. Under our bill—and, by the way, I want to thank you very much for your friendly testimony in support of this bill of which I am a cosponsor—class B stock would be a required investment for borrowers, but I am worried about class C stock.

Suppose you have a number of these rural electrical phone cooperatives who have some substantial reserves. There may not be very many, but suppose you do. Why shouldn't there be a requirement that some portion of those reserves be put into this class C stock. After all this legislation is designed for the whole rural telephone system's benefit. Would it be untoward do you think to have a requirement that 5 percent of reserves over a certain amount or 10 percent be invested in this bank?

Mr. HAMIL. I can tell you one thing if you put it in there, Senator Miller, and we were administering it, we would sure carry it out.

Senator MILLER. I am sure you would carry it out but you have had a great amount of experience in this field which I have not but, as you well know, there have been suggestions made for required participation on the part of cooperatives in this bank, and I would like to have your views on that.

Mr. HAMIL. Well, you are requiring here that 5 percent of the loan—

Senator MILLER. I am not talking about the B stock, I am talking about the C stock because you are going to have a lot of these people who are not borrowing today but they may be borrowing tomorrow. So why shouldn't they participate today, if they have the reserve capability?

Senator TALMADGE. Some of them won't borrow if it is compulsory unless it is refunded in full because the rate is limited to interest rates on class A stock, which is 2 percent.

Senator MILLER. That is true, but why shouldn't every member of this system participate if they have certain reserves. Some day they are going to benefit from it. It is for the good of the whole system. This has been a suggestion which has been kicked around during consideration of a number of bills not only this one but the rural electric bills also.

Mr. HAMIL. Well, the Association is now setting up a finance organization called CFC, Cooperative Finance Corporation, and they are capitalizing it from reserves which have been accumulated from margins earned over the years by the member associations who have borrowed from REA. Now that is a private, not a Government entity like this one is. This is a checkoff arrangement here, Senator Miller, in which they are going to be required to put up 5 percent of their loan into the stock of the bank under the same provisions as have been used by the Farm Credit System which has worked remarkably well.

Senator MILLER. I understand all of that but I would like to have your response to my question.

Mr. HAMIL. If you put it in the act we will administer it.

Senator MILLER. Well, yes, sir; but what is your observation on something like this?

Mr. HAMIL. What I do, Senator Miller, is this. I am encouraging the borrowers from REA, whether they be electric or telephone, to

reinvest in their own system every dollar that they can accumulate over and above that which is absolutely necessary to run the business and have a reasonable little nest egg in case of a daily emergency on hand; I am encouraging them to invest in their own business. Therefore, it would not be hard for me to stretch my statement and to say then, If you can't invest it or you don't want to invest it in poles or wires or switchboards, then you ought to invest it in your financial institutions. It is a matter of persuasion. If the Senate puts it in the bill, I would administer it. What I am doing now as your administrator is to encourage them to do just exactly what you are saying.

Senator MILLER. Would you give us a comment in connection with that study of what kind of a workable approach this would be?

Mr. HAMIL. All right.

Senator MILLER. For example, whether it should be a certain percent, 5 percent of reserves over a certain amount so that we might consider that when your study comes up.

Mr. HAMIL. We will prepare something. This takes just a few days on this one because I think we would need to review this with several of the entities borrowing money.

Senator TALMADGE. You can take some time because it will take some time to print the record of these hearings. Any further questions?

Senator McGOVERN. Mr. Chairman, I have a statement which I would like to file in the record.

Senator TALMADGE. Wait a minute, do you have any questions of Mr. Hamil? Thank you very much, Mr. Hamil, we appreciate your testimony and at a later date, when the record is prepared, we will call an executive session of the subcommittee. At that time please come back with some recommendations regarding the interest rates, and the other information that Senators have requested of you, specifically what Senator Miller requested about the class C stock. At the appropriate time, we hope we can get a quorum to mark up the bill.

Thank you very much.

Mr. HAMIL. Thank you very much, Mr. Chairman.

Senator TALMADGE. Senator McGOVERN, I am sorry to keep you waiting. You were the first witness on the list this morning but unfortunately your plane was delayed and we proceeded with Mr. Hamil and Senator Dole. You may file your statement in full and you may make any other statement you wish to make at this time.

STATEMENT OF HON. GEORGE McGOVERN, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

Senator McGOVERN. I just want to say very quickly, Mr. Chairman, this bill S. 1684 has been cosponsored by 23 Members of the Senate. It is similar to the legislation which cleared the House committee and I am very hopeful that this legislation or something similar to it can be passed. I think the rural telephone users are in a real crisis in terms of financing but I am very much concerned about the removal of the 2-percent interest provision which has been in the legislation from the very beginning. I recognize that to be a subsidy but I think it is a subsidy that is clearly in the public interest and that is the one point about Mr. Hamil's testimony that I feel strongly about.

I hope the committee will stay with the provisions that are outlined in S. 1684 or in Senator Dole's bill which would provide for the continuance of the 2-percent funds for those systems which have less than three subscribers per mile. That is a principle, I think, which is sound and one I would hope the committee would approve.

I would like to have the entire statement made a part of the record.

Senator TALMADGE. Without objection the entire statement will be made a part of the record at this time.

(The statement is as follows:)

STATEMENT OF HON. GEORGE MCGOVERN, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

Mr. Chairman, it is a pleasure today to recommend, as its sponsor and on behalf of 23 cosponsors, that the Committee act favorably on S. 1684, to create a system of supplemental financing for rural telephone borrowers.

Those of us in the Senate who represent states with large rural areas know of the job the REA telephone loan program has done in the 20 years since its inception. Under the REA Telephone Act of 1949 we have helped to build or improve more than one-half million miles of line, serving 2.3 million rural subscribers. Service is now supplied to more than 80 percent of the nation's farms, compared to less than 40 percent only two decades ago.

Because customers are widely separated—averaging only 3.7 per mile of line, compared to over 40 for the Bell System—this service can only be improved and expanded if low interest capital is made available. And the need for improvement is indeed extensive.

The preponderance of telephone service is still offered in rural areas on an outdated eight-party basis. This was a significant advance fifteen or twenty years ago when having a telephone at all was a rarity. Since the enactment of the Telephone Act of 1949 then, however, telephone usage has tripled, leaving today's eight-party service as the actual equivalent of 24-party service in 1949. The need for improvement is now nearly as critical as were the original needs for service itself two decades ago.

This legislation is offered in recognition of these rising needs and of the fact that appropriations of REA 2 percent funds have not been adequate to meet them. At the end of fiscal 1969 rural telephone systems had loan applications totaling \$347 million for which there were no funds on file with REA. This represents a backlog of fully two and three-quarters years at the present loan authorization level. Moreover, the most conservative estimate of future capital needs of these systems is close to \$4 billion over the next fifteen years.

The supplemental financing plan we have under consideration was developed by REA telephone borrowers themselves as a means of meeting the excess of their capital needs over and above what they expect Congress will be willing to supply through the existing loan program. Representatives of the borrowers are here to describe the operation of the new system in some detail, although its concept should be quite familiar. The bank which would be created is similar in design to the Federal Land Bank system. The bill is enabling legislation, aimed at assisting REA telephone borrowers to enter the private money market and, eventually, to own and control their own source of supplemental financing. The House Agriculture Committee has voted 18 to 3 in support of a similar proposal.

Beyond the provision of a supplemental source of loan capital, S. 1684 seeks to reduce and eventually eliminate the dependence of telephone borrowers on the Federal government. In this connection I want to emphasize the importance of its "stepping stone" approach. The bank will make new loans available at two rates—a full bank rate of interest, based on the cost of money to the telephone bank, and an intermediate rate determined by the current average market yield of marketable securities of the United States having maturities comparable to those of the loans, but with a ceiling of four percent. Both of these types of loans would be used to supplement the existing two percent program.

S. 1684 provides that all borrowers with a ratio of fewer than three subscribers per mile of line will still be eligible for 2 percent—35 year REA loans. Speaking as a South Dakotan I feel I can testify strongly to the need for this

provision. In my state we have 14 REA telephone borrowers with an overall average of only 1.8 subscribers per mile of line. They are, for the present, totally unable to move to a higher rate. For them, an end of 2 percent loans would in most cases mean the destruction of their future financial vitality.

The telephone business is capital intensive. To continue to offer efficient service, to prosper, or even to survive, these rural systems must have an expanding supply of money at rates they can afford to pay. Action on this legislation will aid greatly in assuring that REA telephone borrower systems will have the ability to continue and complete the work they have so ably done to date.

Mr. Chairman, I would like at this point to take note of the report on this legislation supplied by the Department of Agriculture, and to express my special concern about the fourth recommended amendment contained in that report. It asks, as you know, that the present two-percent REA telephone loan interest rate be made "flexible."

The Administration asks that the rate be set so that it will cover the Government's interest and administrative costs and probable losses—except in those cases where the Administrator of REA determines that a lower rate, not less than two percent, is necessary to provide service without "an excessive increase in the rates charged by the borrower to its subscribers."

This recommendation should be rejected by the Committee.

In the first place, it presents an obvious contradiction to the Congressional policy of the 1949 telephone amendment to the Rural Electrification Act. The declared Congressional policy is "to assure the availability of adequate telephone service to the widest practicable number of rural users."

An already hard-pressed and undercapitalized rural telephone industry could not accomplish this objective in the face of an REA interest rate at least double—and probably triple—the present rate.

There can be no doubt that rate increases to rural subscribers would be the result of the so-called "flexible" rate. The question would then become whether or not this increase would be "excessive." This determination appears to be the sole criterion upon which would be based the determination of which system has to pay a rate reflecting the government's cost of interest and administration, or which one might receive a lower rate.

I submit that a good case could be made for the contention that rural people already pay "excessive" telephone rates in terms of what their neighbors in the city pay. Whether or not this is true—and I believe it is—the criterion of "excessive" rates is certainly not a sturdy one upon which to build a so-called "flexible" interest rate. It would inevitably result not only in higher rural telephone rates, but in making the long-accepted principle of area coverage a slogan rather than a practice. Further, quality of service to existing subscribers would also be adversely affected.

Beyond the determination of what rate is "excessive" are more fundamental questions. This Committee is well aware of the problems facing rural America, but I would like to briefly review them with you.

Rural Housing.—Over half of the nation's substandard homes—more than four-million—are in rural America. Many who live in these homes are old. Many are poor.

Community Facilities.—Nearly 30,000 rural communities are without adequate water systems. About 45,000 are without sewer systems. Thousands lack medical centers, public libraries, good schools and recreation programs.

Jobs and Training.—Few of the nearly 14-million new jobs created in the last 15 years were in rural America. Rural unemployment figures in many areas run as high as 18 percent.

The lack of opportunity, the lack of community facilities and adequate housing are combining to drive more and more of our rural citizens to the city, where they rarely find conditions much better. Former Kentucky Governor Edward T. Breathitt, Chairman of the President's National Advisory Committee on Rural Poverty, summed up the problem this way:

"Poverty and misery are highly transportable items. Both apparently love company and so their movement is almost invariably from the isolation of rural areas to the congestion of our cities.

"There—quite often—they explode and the damage of their explosions is one of the prices we pay for our neglect of rural education, rural health, rural transportation, rural housing and the rural economy."

Our efforts today should be directed toward strengthening rather than weakening programs which benefit rural America. The rural electrification program and

its offspring, the rural telephone program, have demonstrated that there is a way that we can improve conditions in out-of-the-way areas. And they are the foundation upon which we can build these improvements.

The Administration recommendation to in effect eliminate the two-percent REA telephone loan program represents a weakening of the concern we all have about improving rural conditions so that the effects of these conditions do not spill over into our cities with disastrous consequences.

Programs and funds for the basic facilities required in rural areas—power, communications, housing, water, sewage disposal, transportation—need to be increased rather than decreased to achieve the rural-urban balance that political leaders of all parties have embraced.

I do not have to remind the members of this Committee of the success of either the rural telephone or rural electric program. Both have been widely commended as the type of program that should be used in other types of government-incentive programs.

Almost exactly 20 years ago the Congress passed the telephone amendment to the Rural Electrification Act. The comments of the House Agriculture Committee in its report accompanying the bill are still pertinent today:

"The 2-percent-interest rate provided in this bill is clearly a form of subsidy from the standpoint of the borrower, even though it may not cost the Government anything and may, therefore, not be a subsidy from the Government's standpoint. However it is a subsidy of the most desirable type, since its benefits will accrue only to those who have the initiative to undertake the expansion and development of the Nation's physical assets. It will be a stimulus to activity, development, and production instead of—as in the case with some subsidies—a reward for maintaining the status quo.

"In any event, it is a subsidy which will cost the Nation very little—merely the difference between the interest paid by the Federal Government on the money it borrows and the 2-percent interest at which it is loaned to telephone companies. Actually, the increased taxation and other direct benefits to the Federal Government from the augmented business activity which will result from the manufacture and installation of millions of dollars' worth of new telephone equipment, will probably more than offset the cost of the loans to the Federal Treasury, even during times when Federal borrowings are at a rate in excess of 2 percent."

All of us know—and regret—that Federal borrowings are at a rate well above 2 percent. We hope that this will not always be the case. In any event, I believe the Congress was right in saying in 1949 that the two-percent rate was a "desirable type" of subsidy and that, in fact, the cost of the subsidy would be more than offset by benefits accruing the Government.

And, in spite of today's high interest rate, I believe these observations are still true.

Mr. Chairman, I do not believe that time has—or will—come when we should set out deliberately to destroy a program that has meant so much to rural America.

Senator TALMADGE. Any questions of Senator McGovern?

Senator ALLEN. Senator McGovern, I am happy to be one of the cosponsors along with you on this bill. I was wondering, some of the questioning of Mr. Hamil, some of the limitations, brings to mind some of the limitations on the lending power of the bank, here on page 190, the intermediate loans item (3) of (b) there that intermediate loans shall bear interest at a rate equal to that determined by the Secretary of the Treasury, and so forth, or (ii), 4 percent per annum, whichever is lower.

Senator MCGOVERN. Yes.

Senator ALLEN. So I was just wondering if that is a practical limitation when we are going out in the market and raising money through debentures?

Senator MCGOVERN. Senator Allen, when you said a while ago that I agreed strongly with your analysis, I was referring to your defense of the 2-percent system.

Senator ALLEN. Yes.

Senator MCGOVERN. I do think that the point Senator Miller has made in defense of this intermediate range at not more than 4 percent is a good one. It does seem to me that there need to be some kind of guidelines, some legislative guidelines which, in effect, will make the administrator's job easier, less cumbersome. I think there is something to be said for not having it an either/or theory or situation where you either give a prospective buyer a 2-percent loan or you take him all the way up to $6\frac{1}{2}$ or 7 or 8 percent. That is really the reason for that 4-percent limitation.

Senator ALLEN. How much money do you think we would be able to go out in the market and borrow where the collateral we are putting up are 4-percent loans?

Senator MCGOVERN. I don't think you could get any. I think what this is another subsidy, but it is on a somewhat higher level.

Senator ALLEN. Where is the subsidy coming from? There is not a subsidy provided in the bill. Where is the subsidy coming from?

Senator MCGOVERN. Well, it is coming from the same place, the 2-percent money is.

Senator ALLEN. No, sir; this doesn't provide for any subsidy. It provides for investment by the Government in stock. It doesn't provide for any subsidy. It says it is going to pay its way, not even giving any guarantee of the security or the interest exemption or anything.

Senator MCGOVERN. Senator Allen, I don't know how much money we are talking about on that provision but my guess is that the amount the Government would have to make up is probably rather small. I can't answer that question though with any certainty. It may be that there is a funding gap there in the bill that the committee will have to take a look at.

Senator TALMADGE. That is the reason I asked Mr. Hamil to come back with some proposed recommendation on this interest rate.

Senator MCGOVERN. Yes.

Senator TALMADGE. I think the point that Senator Allen makes is very valid. You can't take notes to loan from the REA at 2 percent and offer them to the public while the only security is the assets that you expect them to subscribe for with a going interest rate at 8, 10 percent.

Senator MCGOVERN. I think this is an unanswered question.

Senator TALMADGE. If there are no further questions, thank you very much.

We will call next Mr. David C. Fullarton, executive manager of the National Telephone Cooperative Association.

Mr. Fullarton, you may file your statement in full in the record, and you can summarize it as briefly as possible. We have some other witnesses.

**STATEMENT OF DAVID C. FULLARTON, EXECUTIVE MANAGER,
NATIONAL TELEPHONE COOPERATIVE ASSOCIATION**

Mr. FULLARTON. Sir, I would be happy to file my statement and summarize it most briefly.

With me, Senator, to assist in any questions on my left Mr. James L. Bass from Carthage, Tenn., general counsel of the National Tele-

phone Cooperative Association. On the right of Senator McGovern is Robert E. Jamison of Conway, S.C. Mr. Jamison is president. If I may begin—

Senator TALMADGE. Your organization is cooperatives now, not independents?

Mr. FULLARTON. That is right, sir. We represent the Nation's 231 telephone cooperatives. In response to comments made earlier however by Senator Holland and Senator Dole, I would like to point out that we feel that our interests in this legislation in the REA program are identical with those of the REA commercial borrowers, particularly small ones, and we make no effort to make the corporate structure distinction and I don't think it should be made.

Second, the question that Senator Allen and Senator McGovern are just discussing, I think, is quite easily answered by the way the bill is written.

The bank is set up to operate on a concept of mixing funds. Within the bank you have four different kinds of stock. You have class A stock by the Federal Government at 2 percent return, you have class B stock with an estimated zero return. Class C with some other interest rate and debentures at some further—

Senator TALMADGE. Class C stock now is limited during the Government ownership to 2 percent.

Mr. FULLARTON. I don't believe so, sir.

Senator TALMADGE. You are not going to get investors at 2 percent.

Senator ALLEN. Yes.

Mr. FULLARTON. Class C stock is limited to the market yield, I believe, not 2 percent.

Senator ALLEN. It is in—

Senator TALMADGE. I have been corrected by the staff it is limited to the amount paid on the debentures.

Mr. FULLARTON. It is set up so that you put in money at four different rates, debenture rate being high, and class B zero, and the Government low and you can get a various mix depending on market conditions. This is what generates funds for the intermediate program and it is subsidized by the class B stock and the 2-percent dividend on the Government stock. I believe that is the question the Senator was trying to get answered before.

I will be very brief, and again I appreciate your consideration in allowing me to appear this morning in support of the Nation's telephone cooperatives for this legislation was predicated on two basic concepts. One of them has been discussed in detail here this morning and that is the continuation of the present 2-percent program as specified by the Congress, and such has been a matter of public policy for 20 years, in fact 20 years last October 28.

Second, we believe that this legislation, if it should be placed in effect, should be sufficient to satisfy these supplemental needs of the borrowers.

Now, there are a great many difficulties here, particularly with the present economic conditions in this country. The thing that determines whether it can meet those needs is primarily the debenture rate, the private money market debenture rate. The House Agriculture Committee, in fact, increased the flow of money into the bank, not in volume, not in total dollars but at the rate it went in. They changed it

from a 15-year rate to a 10-year rate at \$300 million in order to partially offset the increased interest rate in the private money market. We think that, first, the 2-percent program should be maintained at least at present levels and that the bank is structured on that premise and, second, that the bank conditions should be such that it meets the supplemental needs for funds of the borrowers.

I would frame the rest of my remarks in reference to the recently published position of the administration. There are four points as they summarize their position. With all due respect to Administrator Hamil, I find some issue with all of them. The first two points deal primarily with the Government Corporation Control Act and we agree with the administration that we see no reason for Government involvement in the bank after the Federal capital has been retired.

However, the bill presently provides for a mixed ownership Government corporation. As I understand the administration amendments they would make the bank a wholly owned Government corporation until full retirement of Government capital. I don't think this is congruous with the intent of the legislation. I think it is unwarranted—particularly due to the fact from the very beginning there will be private capital involved. Since the private capital is there, legislation passed by the House Agricultural Committee and introduced in the Senate provides for a mixed ownership corporation.

As to points 3 and 4 which deal with interest rates, the 2-percent loan program and the intermediate program. Point No. 4 is most startling and least palatable, at least as it recommends to us the virtual elimination of the 2-percent program. If that program were not longer needed it would be one thing. But it is desperately needed by the telephone borrowers. I represent the telephone cooperatives, particularly the telephone borrowers serving the most sparsely populated areas of the United States. We think the 2-percent program should be allowed to continue and be used for the original purposes. It is on the way to achieving them and it has done a good job. We think that job can be completed so far as the 2-percent program goes within a reasonable number of years.

As to the intermediate lending program, the intermediate program was designed as a stepping stone to interest rates more in line with market conditions. That is why it is in there. It is temporary and it will cease after 15 years of bank operations and we feel to remove the 4-percent limitation on it, as the administration suggests, will only make it that much longer before these borrowers can graduate from 2-percent loans—it is easier to go from 2 percent to 4 percent than it is from 2 to 6, and for this reason we support the intermediate program. We think the 4-percent limitation ought to be in there. The combination of the administration amendment results in a completely variable interest rate from 2 percent up to some unknown rate. With all due respect to administrator Hamil his position is not a permanent one. Administrations change and administrators change and the administration's recommendations imply that the interest rates should be set by administration discretion rather than by rule of Congress. We believe the choice is clear. We believe Congress should set the interest rates. We believe the stepping stone approach to eventual market financing is a sound one, and we believe criteria which are included in the bills like the three subscribers per mile criteria which

allow them to stay with 2-percent money, this reflects economic conditions in density. The net worth requirement that is in Senator Dole's bill reflects their financial maturity and stability. These things are important, they are criteria set by the Congress as to who could get what interest rate and, by the way, we do support both bills. We have no objection to the net worth requirement. That requirement was put in there in executive session in the House and we were not privy to any of the considerations that went into this. We think perhaps some study of just what level should be set as the dividing line is necessary and I think Senator Dole has indicated he agrees with this and we would be happy to submit any such of our recommendations that deal with this.

Senator TALMADGE. We would be happy to have your recommendations.

Mr. FULLARTON. I would be delighted to present them, Senator.

We have been round and round on this legislation in the House, as Senator Dole knows, and many, many of the points of issue have been resolved.

We were talking about voting by Class C borrowers; the one man-one vote provision was resolved after some argument in the House.

Basically I think what you have to remember about this program, is that the REA telephone program—and we hope it is going to eventually involve the 2-percent money and a separate entity of the bank—is itself not a program for companies nor is it a program for cooperatives. The program is designed to benefit the people of the United States and particularly the people of rural America, and when you talk about returns on invested capital, et cetera, we are talking about companies and I think administrator Hamil stated quite accurately that the benefits of this program have over the years gone to the people of rural America and that is where they belong.

If people are going to live in rural America, and we want them to, I think, this has to be the kind of place they want to live, it has got to have telephone and schools and hospitals and all other things. Basic to this are opportunities in rural America and opportunities mean business and business means communications as well as individuals who reside there. So we think that modern reliable telephone service is essential to rural America and we think this bank bill is essential to getting the telephone service out there. Thank you very much. I would be very happy to answer any questions.

Senator TALMADGE. Any questions?

Senator Allen?

Senator ALLEN. Mr. Fullarton, I believe wholeheartedly with your thought that we must leave the 2-percent money provided by section 201 intact, and we want to, or I want to, arm you with a bill that will be meaningful and will allow you to go out in the money market and borrow money on debentures and that will not limit you merely to the \$30 million that the governments put in each year, plus the 5 percent on loans which would be then a million and a half dollars, so you would have \$31½ million to lend if you are going to insist on a 4-percent maximum on some of your loans without any limit there.

Now, you go out in the money market with a security that is not tax exempt, it is not guaranteed by the Government, it is guaranteed only by the assets of the telephone bank and you say "Gee, I want to

borrow \$200 million and we are going to put these mortgages that we take from the REA's, local REA's," and we may lend that whole amount out at 4 percent. There is no limitation on the amount you can lend at 4 percent, "and we want to borrow this money on these debentures, we will pay the 7 or 8½ percent, and we will go back and have the authority to lend every dime of it at 4 percent." You are going to limit yourself under a bill of that sort to lending the \$30 million that the Government puts in.

Now, you want flexibility. It would seem to me that you would have flexibility by your mix of the 2 percent in the direct loans plus the loans that are at a realistic figure and not trying to borrow money because the average investor, he is a little bit harder to deal with than the Government contribution, and you are not going to be able to borrow that money if you don't put some kind of limitation on how much money they can lend at 4 percent. Would you feel that that is logical, that analysis?

Mr. FULLARTON. Well, sir, if I understand your question properly you are discussing about the ability to sell debentures—

Senator ALLEN. That is right.

Mr. FULLARTON (continuing). At whatever the market rate is versus the specific lending operations of the bank and how they would work.

As I understand the legislation, a certain amount of bank loans would be going at cost of money to the bank which would be the debenture rate minus their administrative expenses.

Senator ALLEN. What is the rate?

Mr. FULLARTON. There is no rate, that is the eight times limitation.

Senator ALLEN. You are putting a 4-percent limit on some of that?

Mr. FULLARTON. Yes; I am going to say that is part 1 of the bank lending program. On the other hand, the legislation says that the bank can go out and borrow debentures in the same group or separate group that they would inject into an intermediate program which is a subsidized rate of interest. How much can they get? I will give you an example, one of the examples we worked out 2 years ago, which was a different market condition. We were estimating that 5½ percent debenture rather than 8 which it is now with the Government interjection of capital, we figured we could get just over \$100 million a year at 5½ percent. If it is less we will get less, maybe \$60 million but the bank lending program continues. But the limitation they put on it was 15 years, and felt this was a sufficient time to get these borrowers on the steppingstones to the market rate of interest.

Senator ALLEN. The question I am asking, Should there not be some kind of a limitation on the amount you can lend at 4 percent?

Mr. FULLARTON. I have no particular objection to a sufficient statutory limitation, but a manager of the amount you can lend at 4 percent is limited by the debenture rate, it is absolutely limited.

Senator ALLEN. How is it limited?

Mr. FULLARTON. Because to lend money at 4 percent you have to mix funds and if you only have \$30 million at 2 percent you can only get so much at 8 percent.

Senator ALLEN. The point I am making you go to the lenders or purchasers of the debentures and say "I am going to take this money and I have got authority to lend it out at 4 percent. There is no limit on how much I can lend at 4 percent," how are you going to—

Mr. FULLARTON. The balance sheet of the bank dictates how much you can lend. If you only have \$30 million at 2 percent, in order to lend 4 percent you can only use debentures, say, in the amount of additional \$25 million otherwise you can't lend it at 4 percent. The bank would be broke.

Senator ALLEN. Why not put that in instead of giving carte blanche authority for lending all of your funds at 4 percent.

Mr. FULLARTON. I would not have any knowledge as to what percentage you would use but the fiscal situation limits it.

Senator ALLEN. I would say it does limit it. It would limit it to where you wouldn't be able to borrow the money, you would limit it to \$30 million.

Senator DOLE. Just a comment because I know Mr. Fullarton has to leave. As he pointed out we have been over this precise question a number of times on the House side but since Senator Allen has raised the question, I know Dave Fullarton well enough to know that he will come up with some suggestion that we can rely on. I certainly commend you for a good statement.

Mr. FULLARTON. Thank you, Senator.

Senator TALMADGE. Thank you very much, Mr. Fullarton.
(The prepared statement of Mr. Fullarton is as follows:)

STATEMENT OF DAVID C. FULLARTON, EXECUTIVE MANAGER, NATIONAL
TELEPHONE COOPERATIVE ASSOCIATION

My name is David C. Fullarton, I am Executive Manager of the National Telephone Cooperative Association. NTCA is the national service organization for the nation's 230 telephone cooperatives. These telephone cooperatives provides service to more than 600,000 rural establishments in 31 states.

The member systems of NTCA obtain long-term capital financing through the present REA direct loan program and thus have an immediate and vital interest in legislation affecting this program. It is through REA that more than 50% of the present subscribers of telephone cooperatives first could obtain telephone service.

The REA direct loan telephone program has been one of the most successful undertakings of the Congress. Telephone cooperatives and other REA borrowers have made remarkable progress over the past 20 years in bringing telephone service to the rural areas of the nation. As recently as 1960 only 54% of the farms in the United States had service available. This figure is now over 80%. Telephone cooperatives and other borrowers have in many areas not only kept pace with the industry but have taken the lead in extending the best in communication services to rural areas.

RURAL TELEPHONE STATISTICS

Statistics as to the nation's telephone cooperatives are probably the best means of illustrating the reason and necessity for the REA telephone loan program. As a group, telephone cooperatives have the lowest subscriber density in the entire telephone industry; just 2.4 subscribers per mile of line as compared to 16 subscribers per mile for the other independents and something in excess of 40 subscribers per mile for the Bell System. In terms of operating revenues per mile of telephone line, cooperatives realize \$264 per mile; REA commercial borrowers \$580 per mile; the other independents \$2,774 per mile and the Bell System something over \$12,000 per mile. In terms of investment per subscriber, telephone cooperatives average \$812 per subscriber; REA commercial borrowers \$672 per subscriber; independents \$705 per subscriber and the Bell System somewhere around \$700 per subscriber. The rural member subscribers of the nation's telephone cooperatives appreciate the telephone service that they have as well as the understanding and sympathy of the Congress in making REA telephone loans available to provide this service. Although not many people

realize it, the nation's telephone cooperatives have the lowest amount of uncollectable accounts per subscriber in the nation. This figure for telephone cooperatives is only 46 cents per subscriber as compared to 96 cents for the independent telephone industry and somewhere between 90 cents and a dollar for the Bell System. Of course, in the cooperative way of doing business, the users of the service not only control the business but have and feel responsibility for its success.

Telephone cooperatives and the REA telephone program have performed magnificently, not only for rural areas, but also for the nation as a whole since the inception of the program. However, we believe that an even bigger job lies ahead; a job which points up the need for a basic 2%, 35 year loan program and a supplemental financing program, such as embodied in S. 1684 and S. 2202. This can best be illustrated in the following table which shows the type of telephone service available in rural areas during the years 1963, 1966 and projected for the year 1980.

[Percent of subscribers by grade of service]
REA TELEPHONE BORROWER

Grade of service	1963	1966	1980
1-party.....	22	27	67
2-party.....	10	11	20
4-party.....	18	23	11
8-party.....	50	40	2
Total.....	100	100	100

If one-party service and service to all who desire it in rural areas is to someday become a reality in this country, this Association believes that the 2% loan program must serve as the foundation upon which supplemental financing legislation is based.

REA telephone borrowers are faced with a critical shortage of long term debt capital. As of 6-30-69, there were telephone loan applications at REA for \$347 million for which no funds were available. The stimulation and impetus given the rural telephone industry by the 1949 amendment to the Rural Electrification Act has resulted in a continually increasing demand for growth capital to build the facilities necessary to provide modern telephone communications in rural areas.

Since 1949, REA has loaned a total of \$1.6 billion to 74 rural telephone systems. The borrowers have used these funds to build and improve 523,000 miles of outside plant to serve 2.3 million subscribers.

The future capital requirements of the telephone borrowers over the next 15 years are almost double the total loans made by REA during the past 15 years for the low estimate of about \$3 billion and almost four times as great for the high estimate of \$6 billion.

Enactment of this legislation will assure rural telephone systems access to reasonable cost growth capital through private sources by establishing a supplemental credit mechanism to which the borrower systems may turn for all or a part of their future capital requirements, thereby reducing the drain on the Treasury both for loan funds as well as subsidies. The proposed bank is patterned after the Federal Land Banks, which have successfully operated for more than 50 years and have long since reimbursed the Treasury for all government investments, and become totally borrower owned and controlled.

Legislation of this type is not uncomplicated. Many people who are not intimately acquainted with the legislation have difficulty in understanding exactly how the telephone bank will work. For this reason I have attempted in the following paragraphs to summarize the essentials of the bill.

ADEQUATE FUNDS AND USABLE RATES

The National Telephone Cooperative Association supports S. 1684 and S. 2202 as a suitable means of supplying those supplemental and additional funds which REA telephone borrowers will require to complete the task assigned to them. There are, however, two aspects of supplemental financing legislation which must be kept firmly in mind. Whatever mechanics are set up to provide the needed supplementary, additional long-term debt capital, must provide adequate funds to meet the needs of REA telephone borrowers and must provide these

funds under terms and conditions which are usable by the REA telephone borrowers.

CAPITAL NEEDS OF THE TELEPHONE BORROWERS

Estimates of the future capital requirements of the REA telephone borrowers indicate that they will need between \$3 billion and \$6 billion to carry out their full utility responsibility over the next 15 years. These capital estimates are based on studies prepared by REA and the New York investment firm of Kuhn, Loeb and Company. The estimates of capital needs are shown in the following table.

Capital needs of the rural telephone program

	<i>Billions</i>
REA estimates-----	¹ \$3.1
Kuhn, Loeb & Co. (estimate)-----	² 4.8
REA estimate (adjusted)-----	³ 3.8
Kuhn, Loeb & Co. (estimate, adjusted)-----	⁴ 6.1

¹ Based on annual rate of growth of 5.7 percent.

² Based on annual rate of growth of 11.8 percent.

³ Based on annual rate of growth of 5.7 percent plus 5 percent of plant in 1971 required for special services increasing to 50 percent by 1980.

⁴ Based on annual rate of growth of 11.8 percent, plus 5 percent of plant in 1971 required for special services increasing to 50 percent by 1980.

TELEPHONE SUPPLEMENTAL FINANCING LEGISLATION

The Rural Electrification Act of 1936, as amended, presently has two titles. Title I established the Rural Electrification Administration and provided for the present 2% rural electrification loan program. Title II provided for the present 2% rural telephone loan program. The proposed supplemental financing bill is drafted as an amendment to the original Act and includes Titles III and IV which deal with financing for rural telephone systems. The essential features of the telephone bank bills introduced in the Senate this year are summarized for your information:

Rural telephone account.—Title III establishes in the Treasury of the United States a "rural telephone account". Into this account would go all REA assets, undisbursed loan balances, principal and interest payments from the present 2% REA telephone loan program, appropriations, and shares of capital stock of the Rural Telephone Bank.

The funds in the account would be used for advances on REA telephone loans, payment of interest and principal on borrowings from the Secretary of the Treasury, and investments in the Rural Telephone Bank.

Rural telephone bank.—Title IV establishes a Rural Telephone Bank with the general purpose of obtaining an adequate supply of supplemental funds from non-Federal sources to be used in making loans to organizations which are telephone borrowers of REA. The telephone bank would be an instrumentality of the United States and would have a general corporate power. As long as the telephone bank is an agency of the United States it would be authorized to use the REA services, facilities and employees, be subject to the supervision of the Secretary of Agriculture, and to specified provisions of various Federal laws.

Governor.—The Administrator of REA serves as chief executive officer-Governor of the telephone bank.

Board of directors.—Management of the telephone bank is vested in a 13-member board of directors which includes the REA Administrator, the Governor of the Farm Credit Administration, and five members to be designated by the President, three of whom shall be from the Department of Agriculture, and two from the general public. The six other members of the board will be selected from the directors, managers, and employees of rural telephone systems. Initially these six will be appointed by the President but later will be elected, three from among the cooperative rural telephone borrower systems and three from among the commercial rural telephone borrower systems. The Board will prescribe by-laws, regulate the manner in which the bank shall conduct its business, and will be required to meet at least four times each year and make an annual report to the Congress.

Capitalization.—Federal equity capital will be furnished the bank from the net collection proceeds of the rural telephone account (Title III). This capital, for which stock will be issued, is authorized to be appropriated over a ten-year period in amounts up to \$30 million annually and until the total capitalization of \$300

million is reached. The Federal capital contribution, evidenced by the issuance of Class A stock, will bear annual interest in the amount of 2% until repaid in accordance with the bank's charter. Borrowers from the bank will furnish equity capital through the purchase of stock in amounts equal to 5% of their borrowings.

Classes of stock.—The capital stock of the telephone bank will consist of three classes—A, B, and C. Class B and C stock will be voting stock.

Class A stock will be redeemed as soon as practicable after an initial 15-year period, or after the total of outstanding class A and B stock reached \$400 million. The minimum amount of Class A stock then to be retired would be an amount equal to 5% of the bank loans made each year. Class A stock shall be entitled to a return, payable from income, at the rate of 2% per annum on the amounts of Class A stock actually paid into the telephone bank. Such return shall be cumulative and shall be payable annually into miscellaneous receipts of the treasury.

Class B stock will be issued to recipients of bank loans. Each borrower will be required to invest in the bank a sum equivalent to 5% of the total amount of the loan. Holders of this stock would not receive dividends but would be entitled to patronage refunds.

Class C stock will be available for purchase by rural telephone systems eligible to borrow from the bank and organizations controlled by such borrowers. This stock will be entitled to dividends from the income of the bank, but such dividends shall not exceed the current average rate payable on telephone debentures issued by the bank.

Borrowing power.—The telephone bank is authorized to obtain funds through public or private sale of its debentures, provided that the amount of outstanding debentures does not exceed eight times the paid-in capital and retained earnings of the bank. Debentures would be issued at interest rates, and with terms and conditions determined by the bank's board of directors, and approved by the Secretary of Agriculture.

Lending power.—The bank Governor is authorized to make bank loans to corporations or public bodies which are REA telephone borrowers. Loans may be made for periods not exceeding 50 years for the same purposes for which loans are made under Section 201 of the original Act, and for financing, or refinancing, the construction, improvement, expansion, acquisition, and operation of telephone lines, facilities, or systems, in order to improve the efficiency, effectiveness, or financial stability of the borrowers. Two types of loans will be available to borrowers from the telephone bank—an intermediate type loan and a full bank rate loan. Bank borrowers unable to meet the terms of the bank rate lending program will receive loans carrying an intermediate interest rate, which rate shall be determined by the current average market yield on marketable securities of the United States having maturities comparable to those of the loans, but with an interest ceiling of 4%. Authority to make "intermediate" loans will terminate after an initial 15-year period. Full bank rate loans will be available to borrowers at interest rates reflecting the average rate payable on the bank's debentures, return on Class A stock, administrative expenses, reserves, and estimated losses. Telephone systems with an average subscriber density of three or fewer per mile would be entitled to loans under Section 201 of the Act.

Loan limitations.—Loans to finance acquisition of telephone facilities must be approved by the Secretary of Agriculture. Such acquisitions must improve the efficiency, effectiveness or financial stability of the borrower's system and the size of any acquisition shall not exceed the borrower's existing system at the time it receives its first bank loan. Certificates of convenience and necessity from states with regulatory bodies, or a determination that there will be no duplication of facilities, is required for all telephone loans. No portion of any loan may be utilized to finance political activities.

Conversion of bank ownership and control.—When, through retirement of the government's investment and the increase in borrower investment, the amount of stock held by the government represents less than one-third of the bank's capital, the process of converting the bank to borrower control and operation will begin: The REA Administrator will cease to be the Governor; the bank will cease to be a government agency; and the board of directors will consist of the REA Administrator and the FCA Governor plus six members elected by rural telephone voting stockholders of the bank. Special limitations on loan powers are eliminated after all government-held stock has been retired. Operations of the bank will continue to be subject to Congressional review.

The National Telephone Cooperative Association endorses and strongly supports the basic concept and detailed provisions as they are now embodied in S. 1684 and S. 2202.

THE NEED FOR CAPITAL FOR NEW AND SPECIAL SERVICES

The National Telephone Cooperative Association also believes very strongly that any legislation providing supplemental and additional funds for rural telephone systems should include such loan funds for construction of systems of the nature of a CATV system. To clarify this point, we don't know of very many borrowers who want to get into the CATV business; but the nature of a CATV transmission system is such that it is more adaptable to many of the new communication services coming into use, such as data transmission, than is the normal telephone network. CATV is here and will become more common in the years ahead. To allow other communications carriers to construct communications systems within the service territories of the REA telephone borrowers will make less feasible their already difficult operations.

Telephone cooperatives believe, as does every operating telephone company, that they should provide all communication services in their service territories. To exclude provisions for CATV-type loan funds in supplemental financing legislation will detract from the growth and development of the telephone borrowers. Supplemental financing legislation is intended to enhance growth and development. Also, we predict that a significant part of the capital usable at market terms and conditions over the next 15 years will be usable in this category. We suggest to the committee that without this provision supplemental financing will be usable by a considerably smaller portion of the telephone borrowers than if it were included.

The REA telephone program was necessary in the first place because of "cream skimming" on the part of large companies. To preclude REA telephone borrowers from providing these services will be simply to encourage further "cream skimming".

SUPPORT FOR S. 1684 AND S. 2202

Mr. Chairman and Members of the Committee, the rural telephone systems need supplemental financing. The National Telephone Cooperative Association support S. 1684 and S. 2202 and believes that favorable action on this bill will strengthen the REA telephone program and subsequently the rural areas of the nation. I thank the Committee very much for giving me the opportunity to present the views of the membership of the National Telephone Cooperative Association.

Senator TALMADGE. The next witness is Adm. William C. Mott, executive vice president, U.S. Independent Telephone Association, and appearing with Admiral Mott is Hugh L. Wilburn, president of the Allied Telephone Co., Little Rock, Ark., who is the chairman of the committee on legislation; Mr. Harold G. Payne, president, Telephone Utilities of Pennsylvania, Export, Pa.; and Mr. Eugene J. Harmon, Director, REA telephone program.

I understand attending the hearings also are Mr. Milton Stewart, president, Standard Telephone Co., Cornelia, Ga.; Mr. W. F. Corman, president, South Central Rural Telephone Cooperative Corp., Atmore, Ala.; Mr. Dana Haskin, Waitsfield-Fayston Telephone Co., Inc., Waitsfield, Vt. Senator Aiken wanted you to know, Mr. Haskin, he could not be present at this morning's hearing because of the death of a close friend for many years, Ernest B. Gibson, Federal district judge, former Governor of Vermont and also U.S. Senator. Mr. Leo Havercamp, North Central Telephone Co., Badger, Iowa; and Junior Clark, president, Kansas Telephone Association, are also present.

Admiral, if you will proceed to make it as brief as possible we will be grateful to you. You may insert your statement in full in the record, extemporize or summarize in any way you see fit.

**STATEMENT OF WILLIAM C. MOTT, EXECUTIVE VICE PRESIDENT,
AND EUGENE J. HARMON, DIRECTOR, REA TELEPHONE PROGRAM,
U.S. INDEPENDENT TELEPHONE ASSOCIATION**

Mr. MOTT. Thank you very much, Senator.

I should add there are a great many more people here attracted by this hearing who have come in from all over the United States. I won't attempt to name them but they are here.

Senator DOLE. I wonder if you would mind just furnishing their names for the record.

Mr. MOTT. I will be glad to.

Senator DOLE. At a later time.

Mr. MOTT. Yes, sir.

(The list is as follows:)

Harold L. Ericson, President, Northland Consolidated Telephones, Inc., Hector, Minn.

J. Lee Keiger, Jr., Manager-President, Old Town Telephone System, Inc., Winston-Salem, N.C.

R. S. McClelland, Manager, Lakeland Telephone Company, Bolivar, Mo.

Abe Miller, Manager, Mississippi Telephone Corp., Leakesville, Miss.

Craig D. Vail, Manager-President, West Jersey Telephone Company, Belvidere, N.J.

Herman H. Wagner, Manager-President, Empire Telephone Corporation, Prattsburg, N.Y.

Mr. MOTT. I think I should tell you who we are. We represent 95 percent of the independent telephones in this country, which amount to about 19 million telephones as of today, which is small by Bell standards but big by any other measuring rods that you want to use.

There are about 1,100 operating companies, independent telephone operating companies who are members of ours. There are close to 200,000 altogether, there are about 900 REA borrowers in the country of which 470 are commercial borrowers that belong to our association, and 70 of them are co-ops so we represent both types in the Independent Telephone Association.

The first point I want to make, Mr. Chairman, I am very happy to be able to make this because I have been through testifying before Mr. Dole on the House Agriculture Committee many times, but this is the first time that I can say, Mr. Dole, that the entire telephone industry, including the Bell System, is united behind the objectives of this bill. We are very happy to have Mr. Wilbur Mills, who is the chairman of the House Ways and Means Committee, behind us in this legislation, and Mr. Mills wrote to the Bell System and asked them if they would please take a position on this bill, and the Bell System has now come out in favor of the bill, and I will just read two paragraphs from their letter to Mr. Wilbur Mills, and they stated:

The objectives of the bill, in my opinion—

This is the vice president and comptroller of the A.T. & T.—

appear to be good and desirable ones. It is in the best interests of the general public and of the customers of all telephone companies, Bell as well as non-Bell, commercial and cooperative, that telephone service be made universally available and that existing multiparty or inferior service be upgraded. In view of the problems of small telephone companies in obtaining capital to meet the need for improving service in sparsely populated but developing rural areas, some form of financial assistance may be needed, and the proposed rural telephone bank would provide such a need.

We feel that a desirable feature of H.R. 7 is that it is designed to provide capital for such a purpose that will come primarily from the commercial money market rather than from the U.S. Treasury. The long-run result, if the bank achieves its purpose, will be to reduce or eliminate Government subsidies in this viable area of the economy and to put telephone systems largely on a privately owned, operated and financed basis.

I quote from this letter to demonstrate that the telephone industry is entirely behind this bill with complete unanimity.

I want to say that there are about two and a half million subscribers who are not represented here but who also have a vital interest in what this committee does with this particular bill.

We won't go into the details of the bill because Mr. Hamil has already done that and Mr. Fullarton has added to it.

We in the United States Independent Telephone Association have only one amendment which we would like to have the committee consider. We have a friendly disagreement with Mr. Fullarton on this amendment, at least I hope it is friendly, about 75 percent of the telephones financed by the REA are commercial telephones, about 25 percent are co-ops. There are, of course, a great many more commercial companies than there are co-ops and we, therefore, believe that there should be no artificial makeup of the telephone representatives of the board which this bill now provides, 50 percent from the cooperative and 50 percent from the commercial borrowers.

If we were going to make a case for rigidity our case would be that they should be 75 percent commercial and 25 percent co-ops but we are not asking for that. We think the bill ought to have no set number from any kind of borrower but simply the best people that the industry has and, therefore, we recommend that that provision be eliminated, Mr. Chairman, and we have suggested language in this statement to eliminate it.

Now, we are prepared, because we recognize that getting legislation through must be done in the spirit of compromise, we are prepared to accept the first three of the administration's proposals; namely, that the telephone bank be a wholly-owned Government corporation, that it should consult with the Secretary of the Treasury prior to issuing debentures and even when all Government money has been returned, and we agree to strike the 4-percent alternative in the intermediate fund.

In addition, I have no choice in this matter because my board of directors has directed me to support that before the administration ever took that position anyway.

Senator TALMADGE. Would you comment on Senator Allen's statement that you are not going to be able to market debentures when your securities are pledged with assets that earn 4-percent income?

Mr. MOTT. Well, this is, of course, one of the reasons that we think this should be eliminated. We think you should just have the intermediate funds and, as I understand it, there wouldn't be very much money in that either, but we feel that the intermediate fund, and that the full bank rate and the 2 percent, would give you sufficient to choose from.

Senator TALMADGE. In other words, that would give you flexibility by mixing the 2 percent, plus whatever the going rate was?

Mr. MOTT. I believe it would, yes, sir.

The way I described this to the House committee would be in your example, Senator, if this borrower came up here and went to the bank

and said, "Look, I want to borrow money," that he would be given an order to show cause in legal terms why he shouldn't go to the bank and then when he got to the bank he would be given another order to show cause why he shouldn't pay the full interest rate, and eventually he might get some of the intermediate money. But he would not be able to go into the REA, as I understand the operations of the REA, and borrow 2-percent money if he could qualify for either the full bank rate or the intermediate rate.

Mr. Hamil has added another formula here being that he might lend him some money at 2 percent and let him get the rest from the bank so he would create his own mix, as I understand it. I wouldn't have any objection to that if it didn't turn out to be an administrative monstrosity. This I judge Mr. Hamil is going to report on to you when he comes up.

But we would find one change—we would find it impossible to accept, and I consider there is considerable sentiment on the committee of the same nature, this amendment of section 201 to substitute for the present 2-percent direct loan rate a flexible interest rate from cost of money to the Government down to 2 percent as the judgment of the Administrator acting as Solomon dictates.

We feel that such an amendment is extraneous to the purposes of the establishment of a supplemental financing bank and, indeed, and this is our real concern, Senator, if left in the bill would seriously jeopardize its chances of passing.

We are interested in the passage of the bank bill. We are anxious to see that the Congress create a tried and effective instrument to give relief to companies able and willing to pay the full bank rate or pay the cost of money to the Government but when such a bill is saddled with a nongermane, controversial amendment which relates back to the original bill we cannot help but fear for the survival of what we need and want most.

Senator TALMADGE. Let me see if I understand you now, Admiral.

You are in favor of two rates. One is the 2 percent that the Government will provide with appropriated tax funds.

Mr. MOTT. Yes, sir.

Senator TALMADGE. The other rate is whatever is necessary to market these debentures to the public to get money in the bank and available to the borrower.

Mr. MOTT. That is a full bank rate.

Senator TALMADGE. And these are the two and only two rates.

Mr. MOTT. No, sir, it wouldn't.

The bill provides for two rates in the bank. The bill provides for a full bank rate and it provides for an intermediate fund which would be at a rate—

Senator TALMADGE. That gets to the question Senator Allen raised. You have got authority to take whatever money you have got in the bank and multiply it by 8 and you start off with nothing except \$30 million that the Government is going to put in.

Mr. MOTT. Yes, sir.

Senator TALMADGE. In addition to that, prospective borrowers whoever they may be, in such sum as there are, must put up 5 percent of such sums they borrow in class B stock. You take that now and theoretically you take it now to the marketplace and say, "We want to borrow some

money, here is what we have got, this is our source credit." And the man wants to know what are you going to do with the money.

"Well, we are going to lend it to Joe Jones at 4 percent." And the man who says he is going to lend you the money says he wants 9. How do you think you are going to market a security that pays a 4-percent rate when you are going to have to pay him 9 percent for the money you get?

Mr. MOTT. Well, I don't remember that, sir. We are recommending that the 4-percent rate be eliminated from the intermediate fund.

Senator TALMADGE. Then what rates—

Mr. MOTT. But the intermediate funds then would be the closer to the full bank rate.

Senator TALMADGE. But you have got two different sources of income. One is from the REA, that is 2-percent money. The other is from the bank. You are going to have two different interest rates within the bank.

Mr. MOTT. Yes, sir.

Senator TALMADGE. How are you going to get money if you are going to have two different interest rates, one of them lower than in the marketplace?

Mr. MOTT. Well, there would be very little of the intermediate money available, as I understand it, but this is the way you would get it. You would take your 2-percent money, your \$30 million, and you would mix some of this with what it costs you to get those debentures on the outside, and a certain amount of that money you could lend out at this intermediate rate which would probably be somewhere close to 6 percent, but the vast amount of money that you lend out of the bank would have to be lent out at the full bank rate.

What we are saying is you shouldn't further complicate this by allowing a 4-percent rate which we think is too low. There just wouldn't be enough of this mix to give you enough 4-percent money to put in your back tooth, in our opinion.

Do you want to add to that?

Mr. HARMON. The fact is we have mixes and mixes, and we have to sort of keep them separate. The one mix is the mixing of the 2-percent money which is in the 2-percent program with some rate coming from the bank; in other words, have the loan from the 2-percent program and the other half from the bank. That is one mix.

Senator DOLE. Could you do that now under the law?

Mr. HARMON. It could be done under the law.

Senator DOLE. Without an amendment?

Mr. HARMON. Without an amendment.

Now, the second mix has nothing to do with that whatsoever. It is related to the mix within the bank itself.

Now, maybe I could give you an example. Supposing you took the \$30 million, which the Government would put in and, let us say, the first year. Now, assume that they didn't pay the 2 percent because the result is about the same, let us say it was given to them. Now, they take that \$30 million and loan it out at 4 percent; in other words, do nothing but loan it out at 4 percent and you have a \$120 million profit. So you take that \$120 million profit—

Senator ALLEN. Wait a minute; you multiplied that too fast.

Senator DOLE. \$1,200,000.

Mr. HARMON. \$1,200,000.

Senator ALLEN. \$120,000.

Mr. HARMON. \$120,000, what did I say, which would be profit.

Senator TALMADGE. He is accustomed to Government budgets.

[Laughter.]

Mr. HARMON. You loan it out at 4 and you get \$300,000.

Senator DOLE. A million, two.

Mr. HARMON. A million, two. OK, this is profit. Now, supposing you did the same thing except that you went out and you borrowed in the commercial money market at 8 to 1 and you paid, let us say, 8 percent, you could balance this \$1.2 million against that and get a certain amount of money that you could loan out from the bank without losing money.

Now, you asked about the limitation, the limitation is here in the act. It says in substance that the bank must operate on a self-sustaining basis, so if you get to a point where the \$1.2 million profit has been blended down and you have no more to blend that is all the money that you can loan out at the intermediate rate.

Now, how much is going to be in that intermediate depends upon the spread between the interest rates, what you are paying for it and what you are getting it for, and the greater the spread the less money, so I would guess today there is darned little available in the intermediate funds and it has nothing to do with the security for the loan. That is a new subject. This is just the interest rate at which the loan will be granted to individual companies.

Senator ALLEN. Yes, but the bill does not put any limit on the amount that you lend at 4 percent.

Mr. HARMON. It does. It is automatic because it can't lend any more at 4 percent than it can afford to loan without costing itself money.

Senator ALLEN. That is a matter of judgment, though. You can't sell that to a bondholder. In other words, you are going to go back, going to borrow money from the market and then say, "Well, gee, we are going to go back and exercise good business judgment," that still is not enough to assure this fellow's parting with the money.

Senator TALMADGE. Hardly make a profit because of the volume.

Mr. HARMON. The security for the loan is the telephone bank security, not the individual security on a 4-percent loan that it might have loaned out some place else, you see.

Senator ALLEN. The security is what, all of the assets?

Mr. HARMON. All of the assets of the bank, that is right.

Senator ALLEN. That is right.

Mr. HARMON. So there is a limitation built in in the sense they can't create a Ponzi scheme and keep lending out more at a cost to the bank that is—

Senator ALLEN. No; but there is nothing to prevent them—take the \$240 million theoretically they could get, there would be nothing to prevent them, until it already had been done, going back and lending that, paying 9 on it, going back and lending it at 6, say, or lending it at the 4. They could lend it all at 4. There is no limitation on what they can lend.

Mr. HARMON. Here we run into an entirely different subject, I think, Senator, and this is where we are getting to the policing of it and one of the reasons for going along a hundred percent with this first pro-

posed amendment to make it a wholly owned Government corporation would be to have GAO supervise that. I don't see how else you could do with the varying interest rates and what have you.

Senator ALLEN. I don't know whether GAO is going to satisfy the investor, though, I don't know that that will satisfy him.

Mr. HARMON. Then again we have recommended the elimination of that 4 percent so that takes that part of the problem out.

Mr. MOTT. We are not suggesting another figure. The other figure is already in the bill. We have the intermediate loan.

Senator ALLEN. Another thing that occurs to me though instead of 4-percent loans this bonus that you are getting from the Government, 2-percent money on \$30 million in stock, that could be used to lower the rate for everybody.

Mr. HARMON. That is right.

Senator ALLEN. In other words, the market is 8 percent, and you could possibly lend then for 7½, something of that sort?

Mr. HARMON. That is correct.

Senator ALLEN. That could be passed on to everybody and not some the administrator might decide to make the 4-percent loans to?

Mr. HARMON. Except, Senator, if you go on the philosophy of a weaning process, what you are saying you wind up forgetting the 2-percent mix, you wind up with companies at 2 percent, others at the commercial rate and that is a big jump.

So the original idea of the intermediate fund was to provide a sum that wouldn't cost the bank any more money because of the mix that could get them out of the 2-percent program and into the bank. Now, the same thing can be accomplished if you add Mr. Hamil's mix so that in fact there is no need for an intermediate fund if you use that particular type mix. You can normally work out an interest rate that is acceptable if there is enough 2-percent money in the program.

Senator ALLEN. Just because you are willing to pay a certain interest rate does not necessarily mean you will get the money at any rate.

Mr. HARMON. That is right.

Senator ALLEN. If you tried to borrow money originally.

Mr. MOTT. We are very much interested in weaning people away from the 2-percent money as quickly as they are able to be weaned away and we look upon this as a device of stepping stones to get them away and I think it is in the interest of the country they should because it is economically unconscionable, as has been pointed out here, to borrow money at 2 percent if you can afford to pay more.

Well, I have just one further point to emphasize, Mr. Chairman.

You Senators, you gentlemen of this committee are practical politicians, and you are well acquainted with the art of politics in getting needed legislation enacted into law. We are aware of some 40 bills that have been introduced into the Congress since 1949 to alter this 2-percent interest rate, and in 20 years not a single one of those bills has ever advanced to the hearing stage and, therefore, we don't want to saddle this bill with something which applies only to telephone companies, by the way, which represent about one-third of all the REA borrowings, and we feel that if this is to be taken up it should be taken up as a separate issue on its merits and in a separate bill which would apply across the board and not just to these poor little old telephone companies.

So if I can put this in nautical language since I spent so much time in the Navy, we are concerned that an amendment of this sort would sink the very ship which we are urging this committee to bring into the port of law.

Senator DOLE. Or if I might add I think if we adopted this amendment the House committee might say, "Don't call us. We will call you." [Laughter.]

Mr. MOTT. I have received very strong indications that what you say is true, Senator Dole. I will be glad to try to answer any questions. (Mr. Mott's prepared statement follows:)

STATEMENT OF WILLIAM C. MOTT, EXECUTIVE VICE PRESIDENT, UNITED STATES
INDEPENDENT TELEPHONE ASSOCIATION

My name is William C. Mott and I am Executive Vice President of the United States Independent Telephone Association, a trade association representing some 95% of the 19,000,000 Independent (non-Bell) telephones in this country. Amongst our eleven hundred operating company members there are 470 telephone borrowers financed in large part by the Rural Electric Administration—70 of these are telephone borrowers operating as cooperatives.

You can understand, Mr. Chairman, why the telephone industry has a vital interest in the provisions of S. 2202, the subject of this hearing. I think I should make it crystal clear at the very onset that the entire telephone industry, including the Bell System, is united in favoring the principles set forth in S. 2202 and its companion bill in the House H.R. 7. As Mr. Alexander Stott, Vice President and Comptroller of the American Telephone and Telegraph Company put the case for the bill (H.R. 7) in a letter to Mr. Wilbur Mills:

"The objectives of the bill, in my opinion, appear to be good and desirable ones. It is in the best interests of the general public and of the customers of all telephone companies, Bell as well as non-Bell, commercial and cooperative, that telephone service be made universally available and that existing multiparty or inferior service be upgraded. In view of the problems of small telephone companies in obtaining capital to meet the need for improving service in sparsely populated but developing rural areas, some form of financial assistance may be needed, and the proposed rural telephone bank would provide such a need.

We feel that a desirable feature of H.R. 7 is that it is designed to provide capital for such a purpose that will come primarily from the commercial money market rather than from the U.S. Treasury. The long run result, if the bank achieves its purpose, will be to reduce or eliminate government subsidies in this viable area of the economy and to put telephone systems largely on a privately owned, operated and financed basis."

I quote from this letter to demonstrate the complete unanimity of the telephone industry behind the objectives of this bill.

With me here today is Mr. Harold Payne, President of Telephone Utilities of Pennsylvania, who is the Chairman of our Association's REA Borrowers Committee. With me also is Mr. Hugh Wilbourn, President of the Allied Telephone Company of Little Rock, Arkansas and Chairman of the USITA Committee on Legislation. Each of these gentlemen is a member of our Board of Directors. Also present are REA borrowers from Georgia, Vermont, Iowa, Kansas and other states.

Not present in the hearing room but nevertheless having a vital interest in what happens here are the two and a half million subscribers in Rural America served by the half million miles of line installed by our REA borrower telephone companies.

This program has helped those two and a half million families make vast improvements in their standard of living and they in turn have benefited the nation's consumers by increasing the efficiency of food and fiber production. In addition, the program has helped to create multi-million dollar markets for urban manufacturing industries. The REA Telephone Program has accomplished much at very little cost.

The only source of money available for lending to REA telephone borrowers is the annual appropriation from Congress which has been running at about the level of \$125 million a year.

The combination of record breaking budgets, war in Vietnam, pressures for domestic programs, etc., create a situation wherein Congress cannot appropriate enough money annually to make available the amount of capital necessary to keep up with the tremendous and continuing growth in rural telephony.

To demonstrate, the REA found itself at the beginning of this fiscal year with a backlog of loans well over \$345 million. We estimate that new loans for the year added to this backlog will create a loan need for about \$500 million. To meet this need the appropriation for this fiscal year is \$125 million.

Simple arithmetic demonstrates that something must be done or the REA borrowers will be faced with capital starvation and the attendant result will be their inability to get telephone service to new subscribers and the dry nursing of systems bursting at the seams with overload and obsolescence.

At present 38.8% of rural telephone service is provided to some 700,000 subscribers in the form of eight-party service. Telephone companies need capital to improve telephone service. Although many rural telephone customers presently are served by multi-party lines, some state commissions (such as the Illinois commission) have asked all companies in the state to show cause why they should not offer four-party service as the lowest grade of service. Rural customers also are becoming more sophisticated and are demanding better grades of service. It takes more than additional wire to upgrade service, it also takes switching equipment—and capital.

Sixty-six percent of the REA borrowers operate with less than 2,500 stations. By nature they are small and rural. The average equity for REA borrowers is approximately 15%. This coupled with a first mortgage held by the Government on all the property they own and will acquire precludes the obtaining of capital in the commercial money market in competition with the average borrower in the market, generally a large corporation.

Thus the commercial money market has proved to be not available for the type loans required by the rural telephone borrowers. They are, in effect, locked into REA financing, due to the lack of any other source of capital.

This committee has before it S. 1684 and S. 2202 both of which would create a rural telephone bank. This bank is the best vehicle available to solve the supplemental financing problems for the rural telephone program, converting from the use of Treasury money to commercial money and eventually relieving the Government of its responsibility for the telephone loan program.

The bank will be funded, not with new Treasury money, but by the use of repayments of existing loans not to exceed \$30 million a year until a total capitalization of \$300 million is achieved. It is interesting to note at this point that the total capitalization for the telephone bank is less than the loan backlog in the REA at the beginning of the fiscal year by almost a half million dollars.

The \$30 million a year "seed" money, together with other bank resources would be used to borrow money in the commercial money market at a rate of eight to one, multiplying its resources available for lending to REA telephone borrowers or those eligible to borrow. Eventually the control and operation of the bank will be turned over to a Board of Director dominated by the borrowers themselves.

Under the terms of this bill all of the Government seed money will be returned to the Treasury.

As I have stated, the United States Independent Telephone Association is delighted with the opportunity to give strong support to the bills before this Committee. We have only one minor amendment to suggest and that relates to the question of representation on the Bank Board by telephone company representatives. The present bill at page 11, lines 7 to 12, arbitrarily and artificially prescribes that the telephone representatives shall be split three and three between cooperative type entities and commercial type entities.

Such an artificial provision is wrong in principle and will not assure that the best experienced men in the industry will be available to serve on the Bank Board.

We in the United States Independent Telephone Association feel a respectable case could be made if we wanted to establish artificial limits for putting four or five commercial type entities on the Board as opposed to two or one cooperative type entity. The facts are simply that 75 percent of the REA telephone borrowers are commercial type entities and only 25 percent are co-ops. The arithmetic is inexorable.

We do not, however, propose such artificial provisions as exist in Section 405(d) at lines 7 through 12, because we think they would not yield the best men for the Board. Any Board for a Telephone Bank should be made up from the best

and most experienced men in the industry regardless of whether they happen to work for a commercial borrower or a co-op borrower.

USITA recommends that H.R. 7 be amended to provide that the members of the Board of Directors of the Telephone Bank be elected without reference to whether they be commercial or cooperative type operation. This can be accomplished by striking in H.R. 7 all of the words after "a two year term" on page 11, line 7 through line 12, ending with the words "by such entities" in line 12 and again on page 11, line 19, after the word "stock" and by striking lines 20, 21, 22, 23 and 24 in their entirety. Sections 405(d) and (e) will then read as follows:

"Section 405(d) :

Within twelve months following the appointment of the six members of the initial Board as provided in subsection (c), the Governor of the telephone bank shall call a meeting of all entities then eligible to borrow from the telephone bank and organizations controlled by such entities for the purpose of electing members of the Telephone Bank Board. Each such entity and organization shall be entitled to notice of and shall have one noncumulative vote at said meeting. Six members of the Telephone Bank Board shall be elected for a two-year term. These six members shall be elected by a majority vote of the entities and organizations eligible to vote and such entities and organizations may vote by proxy.

Section 405(e)

Thereafter, in accordance with the bylaws of the telephone bank, the six members of the Telephone Bank Board shall be elected by holders of class B and class C stock. These six members shall be elected by majority vote of the entities and organizations eligible to vote and such entities and organizations may vote by proxy."

We are delighted that the Nixon Administration speaking through the Secretary of Agriculture and Mr. David Hamil, the REA Administrator, supports the basic objectives of the bills before you. Mr. Hardin's letter and Mr. Hamil's testimony here give ample evidence that this Administration is keenly aware that our REA telephone borrowers are desperately in need of supplemental financing. Like the last Administration the present one believes that the relief needed to be found in the Farm Credit bank concept embodied in these bills.

The United States Independent Telephone Association is prepared to accept every change proposed by the Administration with but one exception. We agree:

- (1) that the telephone bank be a wholly owned Government corporation;
- (2) that it should consult with the Secretary of the Treasury prior to issuing debentures even when all Government money has been returned;
- (3) to strike the 4% alternative in the intermediate fund; and
- (4) to postponing the turnover of the bank to its borrowers until the stock issued to the United States has been fully redeemed.

The one change we find it impossible to accept as a part of a supplemental financing bank bill would amend Section 201 of the original act to substitute for the present two percent direct loan rate a flexible interest rate from cost of money to the Government down to two percent as the judgment of the Administrator dictates. We feel that such an amendment is extraneous to the purposes of the establishment of a supplemental financing bank and indeed, if left in the bill, would seriously jeopardize its chances of passage.

The telephone industry is interested in the passage of the bank bill—is anxious to see the Congress create a tried and effective instrument to give relief to companies able and willing to pay the full bank rate or cost of money to the Government. When such a bill is saddled with a non-germane, controversial amendment which relates back to the original bill we cannot help but fear for the survival of what we need and want most.

You gentlemen of this Committee are practical politicians well acquainted with the art of the possible in getting needed legislation enacted into law. Some forty bills attempting to change the rate of interest of REA loans have been introduced into the Congress over the last twenty years. Not a single one of them has ever advanced even to the Committee hearing stage. To saddle this bill with such a provision, which applies only to telephone companies, representing less than a third of all REA borrowings outstanding, would in our opinion marshal enough opposition to the bill to defeat it—a result we pray does not come to pass.

It is our hope that this Committee will not accept the Administration proposal to monkey with the direct loan interest rate using the bills before this Commit-

fee as a vehicle. This matter is a separate issue and should be separately treated in proposed legislation which would apply across the board, not just to telephone companies. If I may put our fears in nautical language—we are concerned that an amendment of this sort would sink the very ship which we are urging this Committee to bring into the port of law.

Mr. Chairman, we appreciate very much the opportunity of making our views known on such important legislation. We shall be delighted to attempt to answer any question the Committee members may have.

Senator ALLEN. Mr. Peterson is the next witness.

STATEMENT OF A. HAROLD PETERSON, EXECUTIVE DIRECTOR AND COUNSEL, NATIONAL REA TELEPHONE ASSOCIATION

Mr. PETERSON. My name is A. Harold Peterson, attorney at law, and I appear today as executive director and counsel of the National REA Telephone Association, whose membership is comprised solely of REA financed telephone companies mainly of the commercial type.

Seated with me on my right is John F. O'Neal, who is associate counsel, and the record may show there are some other gentlemen from other telephone companies who are members of our executive committee and others who are here and I shall furnish their names.

Senator ALLEN (presiding). If you will hand the names to the reporter, please.

Mr. PETERSON. Thank you.

(The list of names follows:)

Herman H. Wagner, Prattsburg, N.Y.; J. Lee Keiger, Jr., Winston Salem, N.C.; Craig Vail, Belvidere, N.J.; Harold L. Ericson, Hector, Minn.; and Robert McClelland, Bolivar, Mo.

Mr. PETERSON. Mr. Chairman, at this time in deference to the time limitation of the committee I would ask that my entire statement be made a part of the record and I shall merely briefly comment on three or four items here that have come to the committee's attention.

Senator ALLEN. That will be incorporated in the record.

Mr. PETERSON. Mr. Chairman, our association shares the views which you have just heard enunciated here by the other two associations in support of S. 2202, Senator Dole's bill, and S. 1684, Senator McGovern's bill. I would like to point out that there is one difference in these two bills and that is that in Senator Dole's bill there is a 20-percent provision in connection with who must be required to go into the bank and this provision was put in this bill on the House side by a committee amendment.

I bring this up at this time to call to the attention of this committee the fact that perhaps they would want to examine this with a view of ascertaining whether or not that limitation ought to be raised.

We share the view of the House Agriculture Committee as to what their intent was in putting in this provision but we would like to point out that the average net worth of all of the telephone companies who borrow under the REA program today is about 16.5 percent. This is compared with 32.6 percent for the electric distribution co-ops. So what I am saying is that if this limitation were raised from 20 percent to 25 or 30 percent, I think it would be more in line with the bank's capability of loaning money. I think the lower you make that limitation the more people the bank is going to have to turn away because they are not going to have the money to lend. I merely make this

observation in connection with that one provision which does not appear in S. 1684.

Along that line, I would like to comment briefly on this intermediate interest rate which has been the subject of much discussion here this morning.

If a 4-percent intermediate rate is going to remain in the bill, it will necessarily limit the amount of money that the bank is going to be capable of lending. If the bank board determines that they want to lend money at 4 percent, as the bill provides with its intermediate interest rate, then we must analyze it from the point of view of how much money is a bank going to be able to borrow on the outside market to come up with this kind of borrowing at 4 percent. Based on today's market, I just throw this out as a ball park figure, if you take the \$30 million of Government input of the class A stock, and say, to yourself, that we want to borrow money at 4 percent as much as we can, it would seem to me that on today's market that the highest amount of money that you can lend at 4 percent would be about another \$30 million or \$60 million combined in getting the mix. So there is no question but what the committee is going to have a lot of discussion on the effectiveness of the intermediate rate at the present time.

Bear in mind when this bill was first introduced 3 years ago here in this body and 3 years ago in the House, that we were not confronted with the type of money market we are confronted with today and that events have changed quite markedly. As a result—

Senator MILLER. Would you yield at that point?

All of us have been talking about \$30 million but I do think we ought to maybe talk about \$300 million because \$30 million a year for 10 years will be put into the bank to get \$300 million so that might put it in a little better perspective. I am one who talks about \$30 million, too, but don't you think we might think in terms of \$300 million or maybe split it in half, \$150 million, which would help out in this connection much more than merely a \$30 million as time goes on.

Mr. PETERSON. Well, Mr. Hamil and his staff have the expertise over there to furnish the committee with a detailed analysis of just exactly what an input of \$30 million a year class A stock will do to get whatever amount of money you want to lend at 4 percent or whatever percent you want to lend it at, and this can be easily ascertained and, as I understand it, they are going to furnish that for the committee.

Senator DOLE. Mr. Chairman, I think you made a valid point, I am certain the interest picture has changed almost completely or radically over the last couple of years. Would you suggest we change the 4 to some other figure or do you suggest, as Mr. Hamil did, that we remove it in the intermediate loan provision?

Mr. PETERSON. I would agree with Mr. Fullarton's testimony in that regard, and keep the 4-percent intermediate rate in the bill, knowing full well that the bank's capability of loaning money at 4 percent under this money market is going to be extremely limited, but with the hope that as the years go by this might change. If it doesn't change obviously the bank is not going to be able to lend much money at 4 percent.

Senator DOLE. You wouldn't change it to five or —

Mr. PETERSON. No, sir.

Senator TALMADGE (presiding). Don't you think that it would cast a cloud on the marketability of debentures if you passed a law allowing them to be lent at 4 percent having borrowed for them at nine?

Mr. PETERSON. I don't think so, Senator, provided the bank uses astute financial judgment in governing the amount it is borrowing from the private money market.

Senator TALMADGE. You are dealing with something that is wholly new here. You are not like the Bank of the Cooperatives which has had experience in marketing debentures and paying them. You are starting out with something that is wholly new. The first thing any lender wants to know is what the assets are and what is the security.

Mr. PETERSON. Senator, we recognize this matter of the intermediate rate is a very sticky problem and I am sure all of the associations are willing to accede to the wisdom of the committee in trying to iron that one out. And we stand ready to help in any way, if you have any further questions about that.

Senator TALMADGE. If you have any suggestions, we would be glad to consider them.

Mr. PETERSON. Thank you.

I want to briefly go over the five recommendations that have just been alluded to in Mr. Hamil's testimony, and if I might have the permission to submit a more detailed analysis of this for the record at a later date, Mr. Chairman, I would appreciate it.

Senator TALMADGE. We would be delighted.

(The supplemental statement is as follows:)

SUPPLEMENTAL STATEMENT OF A. HAROLD PETERSON

Regarding changes in S. 2202 as recommended by the Department of Agriculture in Secretary Hardin's letter of October 29, 1969 to Honorable Allen J. Ellender, Chairman, Committee on Agriculture and Forestry, United States Senate.

RECOMMENDATION 1

While we have no hard and fast objection to this recommendation, we wonder why the Rural Telephone Bank should be subject to the controls now imposed on wholly owned Government corporations, when the Rural Telephone Bank will be, in fact, a mixed-ownership Government Corporation, patterned after the Federal Land Bank. The Federal Land Bank is defined by law as a mixed-ownership Government corporation.

RECOMMENDATION 2

We have no objection to this recommendation.

RECOMMENDATION 3

We would prefer to retain the intermediate rate, but it is recognized that the financial market today is quite different from that which existed over three years ago at the time the bank bill was first introduced. In today's market, the bank would not be capable of generating large amounts of four percent monies. We hope that money market conditions would improve so that an effective intermediate rate could be utilized. We recognize that this is a thorny problem at this time. We wish to point out that a net effective interest rate of four percent could be achieved in a loan combining part two percent direct loan monies under the present act, and part bank monies under the proposed bills.

RECOMMENDATION 4

When this legislation was first introduced over three years ago, conversion of the bank to borrower control was fixed at the point when the amount of Class B stock and Class C stock exceeded Class A stock (Government investment). This

was later compromised so that the control passes when the amount of Class B and C stock equals two-thirds of the total of Class A, B, and C stock. This is now the provision in both S. 1684 and S. 2202, and we feel it is not only fair and proper, but it will help encourage the borrowers to attain private control sooner.

RECOMMENDATION 5

The question of changing the present Section 201 (the telephone amendment to the Rural Electrification Act of 1936) has never been raised during three years of seeking a Rural Telephone Bank. Proponents of this legislation have always regarded the Rural Telephone Bank as a means of supplemental financing, above and beyond the present two percent program. We feel that it is imperative that this be maintained in order to continue to carry out the objectives outlined by the Congress twenty years ago when the telephone amendment to the R.E.A. Act as passed. We therefore oppose this recommended change. Flexibility of the interest rate can be achieved as outlined in 3. above for those borrowers who are able to pay more interest.

Mr. PETERSON. With respect to the first one which would make the telephone bank subject to the Government Corporations Control Act, I would like to merely point out that the committee may want to reexamine that recommendation with a view to determining whether or not this bank should be in any different light than for instance the Federal Land Bank. We think that we are patterned after that bank, and probably ought to be operating under the same kind of limitations.

Senator TALMADGE. There is not a dime of Federal money in that now. It is wholly privately owned.

Mr. PETERSON. That is true.

Senator TALMADGE. They bailed themselves out, just as we hope you are going to be able to do with this proposition.

Mr. PETERSON. Yes, sir; Senator, and we consider ourselves the same breed of cat, if I might use that term. But when you examine the Government Corporation Control Act, you will find that the Federal Land Bank was defined as being a mixed ownership type of corporation and never was brought into this kind of definition, and we would hope we could enjoy the same privilege. I just merely point that out to the committee.

With respect to item 2, which is talking about the sale of the debentures, we would have no objection to this because we realize that the managing of the fiscal affairs of this country on the part of the Treasury is a very important obligation and they would not want to be in conflict with any other marketing of bonds which would adversely affect the Treasury marketing and therefore, we would not object there.

Senator ALLEN. I want to ask a question. Getting back to the 4 percent, you know when you sell a municipal bond or tax or revenue bond it is supposed to have, say, two or two and a half times enough income from that tax to service the bonds. Well, now, here in trying to market these debentures from this bank you are going to have very little to cover that with except what the Government has put in, and on income you have only the income from the loans made of the \$30 million. Don't you think that you are going to need some kind of little overage to offer the lender as a hedge to make these debentures marketable? If we just have the low rate, isn't that going to reduce your hedge or your overage in going out into the market and selling these bonds?

Mr. PETERSON. Under normal financial arrangements with people seeking money and going to a money lender, this is certainly true.

However, the bill provides that the bank shall conduct its business in such a way as to provide for an orderly amortization of the loan money plus its administrative costs, plus an adequate reserve for possible losses and in this type of utility, I think we have a better chance of estimating what those would be because it is a very stable industry. It is not one that is here today and gone tomorrow.

Senator ALLEN. Would you anticipate that the loan to the REA would bear a higher or lower rate than you paid for securities, a bank paid for debentures? Would you think you would be able to lend to your borrowers at a less rate or a higher rate than the bank was paying for money?

Mr. PETERSON. Well, it depends on whether or not you are going to have a 4-percent intermediate interest rate. If you have that you can sell them for less. On today's market, I imagine, the borrowers would have to pay about 6½ percent for their debentures—

Senator TALMADGE. Did you say 6½?

Mr. PETERSON. Not what the bank will pay in the money market but the bank rate would probably be about 6½ percent plus the reserve for losses and plus administrative costs.

Senator ALLEN. The Government is paying 8 percent on bills right now, the U.S. Government.

Mr. PETERSON. That is right, and of course, this situation is very tough now, there is no question about it.

Senator ALLEN. I wonder if there is some little play there so that wouldn't it be better to divide that benefit among all the borrowers rather than to pick out, for an administrator to pick out, a select few for the lower rate, if there is a dividend there, so to speak?

Senator DOLE. You can make that same argument on the 2-percent money, why not divide that?

Senator ALLEN. No; that is available to everybody under the present law and I am in favor of keeping it, the present law. Under the other rate why should there be any different charge, why not have everybody on the same basis. If there is a dividend there why would it not be more nonpolitical and fairer for everybody to pay the same rate to the bank?

Mr. PETERSON. Well, I would be less than candid with you, Senator, if I did not say that the elimination of the 4-percent intermediate rate would be a simple solution; there is no question about that, if the bank used one lending rate.

Senator ALLEN. Must the law be complex, then?

Mr. PETERSON. If we assume you could eliminate the 4-percent rate and only have the debenture rate based on the cost of money on the market, then the administrator could make his loans by a blend of bank money, plus some 2-percent money. I think it is much more simple, if you want my honest opinion I think that is true. I think the administrator has that authority and I would certainly agree with you, Senator Allen, that would be a more simple way to solve it.

Senator DOLE. Would the Senator yield?

As I remember, last year I moved to strike out the intermediate rate provision in the House committee, and was finally convinced that it was necessary. Maybe your group was not opposing the striking but

certain members of the committee were. I am not suggesting we should do what the House did do last year, but we must cooperate. There was a strong feeling, maybe it is not as strong today, that there were those who could graduate from the 2 percent money but couldn't quite reach the other level. If there can be this mix on 201 money, plus bank money, maybe nothing is needed, but there was a feeling as far as the bank was concerned that there should be an intermediate loan rate. I am not wedded to anything except getting something passed because passage is long past due.

Mr. PETERSON. By a mixing of the bank rate plus the 2-percent direct loan you could end up with a net effective interest rate of anywhere from between two and the bank rate, and I would certainly agree with you gentlemen that this would be a more simple way of administering the program.

Senator DOLE. That will be in the study they are going to do for us, they have a lot of studies to do.

Senator MILLER. On that point may I ask you this, Mr. Peterson, assume we go the simple route as far as interest rate is concerned, might it be feasible to give some flexibility to this by differences in loan terms, that is years for them to repay it, so that everybody is treated the same after they get over that 2 percent as far as the interest rate is concerned but those that can pay more rapidly will have a shorter term loan and those who have a tougher time would have a longer term?

Mr. PETERSON. That is a possibility.

Senator MILLER. That might be sort of a compromise between what Senator Allen and I have been talking about. Have you given any thought to that?

Mr. PETERSON. I don't think that particular thought has come into consideration during the time that we have discussed the bill but it certainly is a valid one.

Senator MILLER. You see, the appealing thing about Senator Allen's approach is that it is simple to administer and simple to understand, and I would guess there would be less controversy over the differentials on the length of the loan than there would be over the interest rate.

Mr. PETERSON. Senator Miller, I would like to make this comment with respect to the length of the time. The 2-percent direct loans are for 35 years and these loans are amortized on a quarterly basis and must be paid off at the end of 35 years. This is not the usual practice for the utility industry. The private electric power industry, railroads, the airlines, these types of utilities provide their capital by equity and then whatever debt they have when it comes up for payment they merely roll it over. So I think that if you talk in terms of lessening the number of years in which to pay these loans off that you would impose an obligation on the company which would be automatically reflected in a higher rate to the subscriber just as certain as a higher rate is going to be reflected to the subscriber if the interest rate is increased, bearing in mind that 64 percent of these—

Senator MILLER. That is true. However, I wouldn't want you to get the impression I am talking about changing the 35 years on the regular 2-percent loans. I am not. I am talking about this problem within the bank as far as the blend amount of interest is concerned. Senator

Allen thinks we can blend this out to some kind of a figure so that it would be uniform throughout the loans. I am suggesting that we might do that as a matter of simplicity and then for the sake of differentiating between the affluent cooperatives and those that are not, perhaps you could use a different term of years to accommodate that problem. That is all I am suggesting.

Mr. PETERSON. I think a compromise could be worked out that would more nearly reflect the conditions we are facing today and be done in a sound manner. I would certainly agree with that.

Senator MILLER. Would you think there would be some of your members who would be able to get along on a 20-year loan, perhaps, and others who need 40 years, perhaps. Do you think you could find some differences.

Mr. PETERSON. It is quite possible. It depends on each individual circumstance.

Senator MILLER. Right.

Mr. PETERSON. In closing, gentlemen, I would just like to make this one comment, that when this program was instituted 20 years ago, the 2-percent interest rate was imposed upon it for a definite reason, and that was so that rural telephone service could be made available to the people who needed it, and really the interest rates of that day had nothing to do with the setting of the 2-percent interest rate. It was determined that in order to get this job done they must have low-interest money. This has been accomplished and, as has been previously testified to here today, now over 2 million telephones are being brought out to the rural areas of America and over 6 million people enjoy those benefits. This is real important, and when we talk about adjusting interest rates remember that we are talking about a group of companies whose average customers per mile are only about 3.8 compared to 16 for the total independent industry and over 40 per mile for the Bell System. Therein lies the reason why there must be a consideration of a low-interest rate. This program is not for companies. This is for people, and I think that those Senators of this committee who were in the Congress in 1949, and I believe there are four or them or five, they must look back upon this program with a great sense of pride because it has accomplished one of the great miracles of our day in providing modern telephone service so that people in rural America can dial, use that phone just as quickly as you who live in the urban areas.

I come from a small town myself, of less than a thousand people, and we are served by a REA company and this program is one that I don't think we have to hang our heads in shame on.

The subsidy involved, granted in today's money market there is a greater difference there, is small when compared to a great job being done in the public interest.

I might add, gentlemen, that these REA telephone companies last year paid over \$34 million in taxes. So here is one of the indirect benefits that has come back to our Nation. This is in the national interest.

I think unless there are any other questions I should close now and anything we can do to help the committee we would be more than happy to if you would only call upon us.

Senator ALLEN. Thank you for your presentation and we appreciate it.

Mr. PETERSON. I appreciate your time.
(Mr. Peterson's prepared statement is as follows:)

STATEMENT OF A. HAROLD PETERSON, EXECUTIVE DIRECTOR AND COUNSEL, NATIONAL
REA TELEPHONE ASSOCIATION

Mr. Chairman, Members of the Committee, my name is A. Harold Peterson, Attorney at Law, and my residence is at Chisago City, Minnesota. I appear here today as Executive Director and Counsel of the National REA Telephone Association, whose membership is comprised solely of REA financed telephone companies, mainly the commercial (privately owned) type. We are grateful for the opportunity you have afforded us to appear personally and testify in support of S. 1684 and S. 2202, the Rural Telephone Bank Bill, which is of such vital concern to the 869 REA telephone companies throughout 46 of our 50 states. This subject matter is not new. It received its first thorough airing in the second session of the 89th Congress in August 1966 in hearings before this Committee. We are, therefore, somewhat reluctant to impose on your time again. On the other hand, we feel that a record must be made. In addition, there are new members of this Committee who are entitled to know what these bills are all about and why it is so important for Rural America.

We would like, therefore, to briefly review the history of the REA telephone program so that it may be brought into proper perspective. This discussion will include: (1) the circumstances surrounding the original passage of the telephone amendment to the REA Act in 1949; (2) what the REA telephone program has accomplished for the people of rural America; and (3) what problems REA telephone borrowers have been facing in recent years as well as the problems that will be encountered in the foreseeable years ahead. It is our hope in so doing, that the very urgent need for a Rural Telephone Bank will be clearly demonstrated.

CONDITIONS OF RURAL TELEPHONE WHICH PRECIPITATED REA TELEPHONE
PROGRAM

Prior to the enactment of the REA telephone amendment in 1949, only 39% of America's farms had telephones. In the areas which were receiving telephone service, hundreds upon hundreds of small telephone companies were rendering poor service; in many instances the service was next to nothing. The underlying cause for this condition is simple to explain. Most of these companies had their beginnings at the turn of the century, and within the following twenty years. By 1949, most of them were still using the original plant, which was getting to be forty to fifty years old and wearing out. Meanwhile, telephony in the urban areas of America was making significant strides in terms of technological improvement. The time of physical and economic peril had arrived in the life of these rural telephone systems. They tried in vain to attract debt capital in the private money market. They found that broken down telephone plant, long outdated, did not provide the kind of equity that was attractive to either a banker or insurance company for loan purposes. It looked like a near hopeless situation for these companies, which, for the most part, were small, locally or family owned enterprises.

By the same year, 1949, much of rural America had received electric service under the REA program, which by that time had clearly proved its merit. Having witnessed the successful experience of the REA electric program, the Congress, in 1949, passed the telephone amendment to the Rural Electrification Act, stating, "it is declared to be the policy of the Congress that adequate telephone service be made generally available in rural areas through the improvement and expansion of existing telephone facilities and the construction and operation of such additional facilities as are required to assure the availability of adequate telephone service to the widest practical number of rural users of such services."

It is interesting to read the history of those early days. The program became effective on October 28, 1949. Within 30 days after the application forms and bulletins became available, REA had received 144 signed applications. In the first 90 days REA received 1,117 inquiries about the program from all over the United States.

When one considers the desperate conditions facing rural telephone companies in those days of 1949 and 1950, it is clear why there was this deluge of inquiries and applications for loans just described. After the program was instituted, a short period of uncertain but steady implementation followed.

Now, some 20 years later, it is of interest to note that from the date of inception of the REA telephone program to September 30, 1969, loans totaling \$1,649,832,294 had been made to 869 companies in 46 states. Whereas in 1949 only 39% of America's farms had telephone service, today 80% have modern dial telephone service, thanks to the financial and technical assistance furnished through the REA telephone program. Over two million rural subscribers or some six million people enjoy the benefits of modern telephony.

It is of further interest to note that as of June 30, 1969, REA telephone companies have paid on their loans, principal in the amount of \$186,685,024 and interest of \$163,313,069. They have made advance payments of \$23,234,636. To the question, are there any delinquent accounts, we are proud to say there are only 9 companies who are delinquent more than 30 days and the amount involved is only \$305,701 of principal and \$164,007 of interest. There has never been a foreclosure of any loan in the twenty year history of the program.

When the Congress passed the REA telephone amendment, the day of dark despair for rural telephony was ended. The financial vacuum that plagued hundreds of small telephone companies throughout America began to be filled. The program has proved to be unusually sound and is a credit to the entire telephone industry and to the Congress who made it possible.

REA RESPONSIBLE FOR FIRST GREAT TRANSFORMATION IN RURAL TELEPHONY

Eight telephone subscribers per rural line was the standard set by REA when the program started. Upgrading of service from twenty to twenty-five subscribers per line to a limit of eight subscribers per rural line represented the first great transformation in rural telephony and REA can proudly take the credit for it. Although this was a giant step forward in the industry, you will be interested to know that the second great transformation in rural telephony is now taking place; namely, upgrading of service from eight to four subscribers per rural line and, where economic feasibility can be shown, only one subscriber per rural line. The rural subscriber is using this modern telephone system so much more than the old system of twenty to twenty-five subscribers per rural line, that the eight party line is now more difficult to get to use than was the old system.

As a result of this desire on the part of rural people for more and better service, it is interesting to note that over 60% of all loan fund requirements for the REA telephone program for fiscal year 1970 will be used for upgrading of service. In this connection it ought to be stressed that the timetable for the Bell operating companies indicates that one party service will be furnished to 90% of their subscribers by 1975.

It is now estimated that 55% of all REA telephones will be one-party by 1975 compared to 33% today. REA estimates that in 1975 only 10% of the subscribers will be on eight-party service, compared to 30% today.

TOTAL TELEPHONE INDUSTRY COOPERATION BRINGS RESULTS

The rural REA telephone subscriber who could not even call his neighbor in 1949 can now call 97% of the world's telephones. The question may be asked, how was this accomplished in such a short span of time? The answer is very simple. The finest of relationships exist within the telephone industry to bring better communication to all of America. This includes the entire gamut of the industry from the giant Bell system to the smallest REA company. We know of no other industry where finer cooperation may be found.

Large and small telephone companies, working together, have wrought the finest telephone network in the world. We cite the following example to illustrate what we mean: All number calling (ANC) permits a telephone user to call another person faster and more efficiently. REA recognized the benefits of ANC early; it is now the standard in the industry. ANC is a key factor in the international dial program. This type of progress is impossible without total industry cooperation. REA telephone companies are proud to be a part of this dynamic industry and want to continue to give more and better service to meet public demands.

DEBT CAPITAL NEED TODAY IS GREATER THAN EVER DUE TO SECOND GREAT TRANSFORMATION

Having briefly reviewed the history of the REA telephone problem, let us now turn our attention to the greatest problem facing this program today. It can be

stated very simply. There is a very urgent need for adequate debt capital in order to accomplish program objectives.

Here are the facts. The second great transformation in rural telephony, namely, upgrading of service, has resulted in a huge backlog of unapproved loan applications on hand. On September 30, 1969, REA had 358 unapproved telephone loan applications on hand totaling \$363,553,000. The following is a breakdown of these applications by states:

UNAPPROVED REA TELEPHONE LOAN APPLICATIONS ON HAND SEPT. 30, 1969

[Dollars in thousands]

State	Number	Amount	State	Number	Amount
Alabama	11	\$16,373	Nevada	1	3655
Alaska	1	173	New Hampshire	2	3,567
Arizona	2	3,795	New Jersey	3	2,637
Arkansas	7	3,729	New Mexico	4	3,813
California	5	4,850	New York	16	30,140
Colorado	4	2,145	North Carolina	10	16,929
Connecticut			North Dakota	1	300
Delaware			Ohio	16	8,199
Florida	3	5,859	Oklahoma	6	4,746
Georgia	11	10,785	Oregon	14	17,245
Hawaii			Pennsylvania		
Idaho	2	1,156	Rhode Island		
Illinois	10	3,686	South Carolina	17	20,073
Indiana	7	7,136	South Dakota	8	10,364
Indiana	17	8,353	Tennessee	12	9,925
Iowa	14	9,041	Texas	27	19,746
Kansas	9	12,212	Utah	2	1,600
Kentucky	8	10,893	Vermont		
Louisiana	2	2,017	Virginia	4	6,180
Maine	1	848	Washington	4	2,060
Maryland			West Virginia	1	1,400
Massachusetts			Wisconsin	26	25,701
Michigan	9	9,447	Wyoming	2	350
Minnesota	29	36,188	Puerto Rico		
Mississippi	4	3,761			
Missouri	12	12,808	Total	358	363,553
Montana	4	2,970			
Nebraska	10	9,698			

The need for additional debt capital for the REA telephone program is extremely urgent. With the \$363.5 million of unapproved telephone loan applications on hand on September 30, 1969, added to the applications which can be expected for the remainder of this fiscal year, we are looking at a present debt capital requirement of over \$475 million dollars. If this need is not met in some manner, the problem will continue to be compounded. We cannot overemphasize the extremely serious position of the REA telephone borrowers in its need for more debt capital.

The financial plight of REA telephone companies has worsened over the past six years in spite of the fact that the amount of loan appropriations has increased. The following shows the level of appropriations for the years 1964 thru 1970:

Year:	REa telephone appropriations	Millions
1964		\$70.0
1965		70.0
1966		97.0
1967		117.0
1968		120.6
1969		125.0
1970 (recommended budget and passed by House and Senate)		125.0

CONTINUING NEED FOR 2 PERCENT LOANS

Before embarking on a discussion of S. 1684 and S. 2202, the Telephone Bank Bills, it should be clearly stated that there is and will be a continuing need for 2% direct loan financing for many REA telephone companies for some years to come. *This program is only twenty years old and the companies have not attained the degree of financial maturity found in the electric program.* The following will illustrate the point:

Net worth of telephone borrowers as percent of assets, Dec. 31, 1968

Net worth as a percent of assets :	Percent of borrowers
Negative net worth.....	5
Less than 5 percent.....	17
Less than 10 percent.....	33
Less than 15 percent.....	50
Less than 20 percent.....	64
Less than 25 percent.....	79
Less than 30 percent.....	88
Less than 35 percent.....	94
Less than 40 percent.....	96
Less than 45 percent.....	97
Less than 50 percent.....	99
Less than 95 percent.....	100

Net worth of electric borrowers as percent of assets, Dec. 31, 1968

Net worth as a percent of assets :	Percent of borrowers
Negative net worth.....	2
Less than 5 percent.....	4
Less than 10 percent.....	8
Less than 15 percent.....	14
Less than 20 percent.....	25
Less than 25 percent.....	35
Less than 30 percent.....	48
Less than 35 percent.....	58
Less than 40 percent.....	66
Less than 45 percent.....	72
Less than 50 percent.....	77
Less than 75 percent.....	94
Less than 95 percent.....	99
Less than 100 percent.....	100

Combining all REA telephone companies together, net worth as of December 31, 1968, was 16.5% of assets, compared to 32.6% for the electric distribution borrowers.

From the above table it should be noted that 96% of the telephone borrowers have a net worth as a percent of assets, of less than 40%. Note that 64% of them have a net worth of less than 20%. What chance have these companies got to go into the private money market and get their needed debt capital? The answer is obvious—they have little or no chance at any interest rate.

CAPITAL NEED NEXT 15 YEARS DOUBLE THAT OF PAST 15 YEARS

Now that we know what the urgent debt capital needs of today are, what about the years that lie ahead? We point out that in the previous record of this Committee three years ago, there was testimony from competent sources, including REA and the Kuhn, Loeb & Co. report, that the capital needs for the REA telephone program in the next fifteen years would be over 3 billion dollars. This is a stark contrast to the 1.2 billion dollars of loan authorizations for the REA telephone program for the first fifteen years. We concur in this appraisal of future capital needs for REA telephone borrowers. It is my personal judgment that this appraisal is on the minimum side. This need must be met. The question is how.

ANALYSIS OF DEBT CAPITAL ALTERNATIVES

After thorough study and analysis of their plight, REA telephone companies have concluded that they cannot continue to rely solely on an annual Congressional appropriation to meet the need. We verily believe it is necessary to seek a supplemental source of financing, above and beyond the 2% needs. It appears that the 1970 appropriation for direct 2% loans in the amount of \$12.5 million will scarcely meet 25% of the \$475 million need mentioned heretofore. In our judgment *all* of this \$125 million appropriation will be needed for 2% direct loans.

What about direct loans from the private money market? Can REA telephone borrowers find the answer there? It would appear not for two basic reasons.

First, the United States has a first mortgage on these companies which virtually precludes the private market from even considering such a possibility. Secondly, even though the United States would agree to subordinate itself to the position of a second mortgagee, not many REA telephone borrowers could afford to go into the private money market due to their low net worth position outlined to you a moment ago. It would appear that the problem must be solved within the framework of the Federal structure within which these REA telephone companies now receive their debt capital.

RURAL TELEPHONE BANK IS A SOUND SOLUTION

We believe that the best solution in getting into the private money market lies in the establishing of a Rural Telephone Bank within the structure of the United States Department of Agriculture. This concept is an essential ingredient in S. 1684 and S. 2202, and we support it. These bills were not hastily conceived or concocted. They represent long study and thought on the part of the Department of Agriculture, the Rural Electrification Administration and by REA borrowers and their associations.

S. 1684 and S. 2202 create a Rural Telephone Bank, initially under the supervision of the Secretary of Agriculture and ultimately to be converted to the non-Federal ownership, operation and control of its borrowers.

Equity capital for the bank will be furnished by the United States by investment in Class A bank stock (with 2 percent annual return) from the "net collection proceeds" of 2 percent REA telephone loans in amounts not exceeding \$30 million annually until the Federal investment totals \$300 million; and by borrowers from the bank who will be required to invest 5 percent of their loans in nondividend bearing Class B stock. Dividend bearing Class C stock will be available for investment by borrowers and potential borrowers. Class A stock held by the United States will be retired by the bank as soon as practicable after June 30, 1984.

The bank is authorized to obtain borrowed funds through the sale of its debentures, up to eight times the amount of paid-in capital and retained earnings of the bank. Debentures will not be guaranteed by the United States. Until conversion to borrower control, Treasury approval of debenture issues is required.

Bank loans, to be fully amortized over a period not exceeding 50 years, may be made to eligible borrowers: (1) until June 30, 1984 or until bank conversion, if earlier, at an "intermediate loan" rate, reflecting the current average market yield on marketable securities of the United States having comparable maturities, but with a four percent interest ceiling; or (2) at an interest rate reflecting the average cost of moneys to the bank, including interest on the bank's debentures, return on Class A stock, administrative expenses, reserves and estimated losses. Intermediate loan rates will not be available to borrowers which are capable of both paying the higher bank rate and achieving Federal program objectives. The purposes for which bank loans may be made include the same purposes governing REA 2 percent telephone loans, as well as improving the efficiency, effectiveness or financial stability of borrowers' systems; special limitations are specified in respect of bank loans for acquisitions.

The bill also establishes a Rural Telephone Account into which will be transferred appropriations, assets and collections of the REA 2 percent telephone loan program and from which will come funds for the 2 percent telephone loan program and for Federal investments in the telephone bank.

Both S. 1684 and S. 2202 are identical save in one respect. S. 2202 contains a new Section 412 which provides that a loan shall not be made under section 201 of this Act to any borrower whose net worth is in excess of 20 percent of its assets unless the Administrator finds that the borrower cannot obtain such a loan from the telephone bank or other reliable sources at reasonable rates of interest and terms and conditions. This new section is a Committee amendment which was added to H.R. 7 which was reported by the House Agriculture Committee on March 18, 1969. While we have no quarrel with the intent of this new section, we feel that this Committee may want to examine it and see if the 20 percent limitation ought to be raised. We call the Committee's attention to the previously cited combined net worth as percent of assets for all the telephone borrowers as of December 31, 1968, namely 16.5 percent. We feel that Section 412 of S. 2202 would be more realistic and workable if the requirement were changed to a higher figure, like 25 or 30 percent, more in keeping with the bank's capability of meeting the number of individual loan requirements.

THREE SUBSTANTIVE LEGISLATIVE OBJECTIVES NECESSARY

This legislation is of major import. In our judgment the following overriding objectives should be sought:

- (1) A telephone bank which is capable of providing adequate debt capital at usable interest rates;
- (2) Built-in incentives to encourage eventual private ownership of the telephone bank by the telephone borrowers;
- (3) Sufficient latitude for telephone borrowers to meet industry responsibilities in the future.

CONCLUSION

Before closing we would like to add our voice to those who advocate a dynamic rural development program for America. In our judgment, it has already started. Its future potential is unlimited. In such a program lies the solution to some of the problems that plague our large cities and urban centers. We believe in rural development—it is urgently needed. REA telephone companies are ready to continue to provide a basic requirement to that development, namely, modern communication, if they are furnished the tool of adequate financing. Without it, there can never be successful rural development.

Mr. Chairman and members of the Committee, we again thank you for this opportunity to appear and testify. We hope we have been helpful.

Senator ALLEN. Mr. Marvin L. McLain and Mr. Kit H. Haynes, with the American Farm Bureau Federation.

**STATEMENT OF KIT H. HAYNES, ASSISTANT LEGISLATIVE
DIRECTOR, AMERICAN FARM BUREAU FEDERATION**

Mr. HAYNES. My name is Kit H. Haynes, assistant legislative director of the American Farm Bureau Federation.

Mr. McLain was supposed to be here today. He was unable to attend and I pass on to you members of the committee his regrets.

This statement is relatively brief and I can brief it even further.

Senator DOLE. Good.

Senator ALLEN. If you would hand it to the reporter.

Senator DOLE. Why can't you just touch on the new points you raise. You only raise about one or two new items.

Senator ALLEN. Your full statement will appear in addition to the colloquy.

Mr. HAYNES. We have supported proposed legislation to provide supplemental financing for rural telephone programs through a rural telephone bank for a long time, and we supported H.R. 7 last year in the House, as you remember, Mr. Dole. It has already been put in the record the number of subscribers who now are being served by rural telephone systems and the amount of money loaned or approved.

It has been estimated that in the next 15 years the rural telephone program will need something like twice this amount to really do the job.

S. 2202 is identical with H.R. 7, as amended by the House committee to provide that a borrower becomes ineligible for a direct loan from REA when its net worth reaches 20 percent of its assets. We had recommended an amendment along this line to graduate the borrowers to the telephone bank or to some other financial source, and we would recommend that this provision, which is in S. 2202 but not in S. 1684 at the present time, be retained.

At the end of last year only 28 percent of the telephone borrowers had net worth less than 20 percent of their assets; so those are the ones which would go to REA and the others would have to go to the bank.

As I said, Farm Bureau has been for this bank proposal for a long time. Voting delegates considered the matter again at Kansas City last year and they recommended two provisions which are not covered by the bills. One is the requirement that to be eligible for bank loans a cooperative association must provide in its bylaws for the issuance of certificates of ownership stating each member's share in the net worth of the cooperative, except where prohibited by State law.

Senator ALLEN. What is the theory of that, Mr. Haynes?

Mr. HAYNES. Well, the Farm Bureau believes, Senator Allen, that members of cooperatives should know what they own of the assets of the cooperatives. A second reason is that when an organization seeks to borrow money from the bank it would seem to me that the bank would want to know just who owns what it is accepting as security. The Farm Bureau for many years has urged that cooperative associations, both telephone and electric, provide their members with certificates showing just what they own of the total assets.

Senator ALLEN. Shouldn't that come in a separate bill? I mean wouldn't this be foreign to this matter of getting loans? I don't know whether that is desirable or not. Wouldn't that really be something to have in a separate bill?

Mr. HAYNES. It could come in a separate bill. For the purpose of this legislation, our delegates tied it to eligibility for bank loans.

Senator MILLER. Pardon me. You are not suggesting that this requirement be for other than bank loans, are you, for example, for the regular 2-percent loans now. You are only talking about bank loans?

Senator DOLE. Bank loans, it says.

Senator ALLEN. Is that the telephone bank?

Mr. HAYNES. Yes, sir. We proposed the same thing at the time we testified in the House on the bank legislation. That bill would have set up a bank for both rural electric and rural telephone loans.

The voting delegates also proposed there shall be only two classes of loans, those made by the bank at the same rate of interest for all borrowers, and those made by the Rural Electrification Administration. This has been discussed at length here today.

Senator DOLE. I believe you also have some question about the members on the board of directors.

Mr. HAYNES. Yes, sir; the goal would be eventual ownership of this credit institution by its borrowers. We would pattern it after the Farm Credit System, with a plan for the borrower ownership as provided in section 406(c) beginning in 1984.

In testimony before the House last year we recommended that the board shall initially consist of seven members. Four would be named by the President, with the advice and consent of the Senate, and three members elected by borrowers from the bank.

We also recommended that employees from the telephone systems not be permitted to serve on its board, and the chairman not be a full-time Government employee such as the administrator of REA. We also recommended that six members of the board would be elected by holders of class B and class C stock and a seventh member be appointed by the President as a representative of the Government after class B and class C stock reaches 51 percent of the total stock outstanding in the bank.

Now, the bills before you provide for a 13-member board initially, and then after the class B and class C stock reaches two-thirds of the outstanding stock they would provide for an eight-man board, six of which would be elected by the borrowers.

While we think a relatively small board would work better than a larger board, we are more concerned with the makeup of the board than we are with the actual number of members. That is in line with our basic thinking that the users of cooperative credit systems should have the maximum amount of direction of the activities of the associations.

We did not cover in our statement anything about the proposed amendment dealing with the 2 percent loans, section 201 loans, and I only offer an opinion on it.

In the first place, it would put the administrator of REA in a rather difficult position in deciding who pays what rate of interest. A second point, probably of equal importance, is that the proposed amendment deals with the basic act authorizing the loan program; and, if in the judgment of this committee, the amendment should be written into law, we would think it should be put in a separate bill for consideration on its own merits. That would be the only comment on that.

If I may just have one comment on the makeup of the bank we certainly think it should be patterned after the Farm Credit System.

The Farm Credit System has an enviable record and we think it would be a very good goal for the bank to seek to attain.

We appreciate the opportunity to present these brief views and we should be happy to work with the committee in any way in developing this legislation.

Senator ALLEN. Thank you, Mr. Haynes. We appreciate it.

Are there any questions?

If there are no questions, thank you, sir.

(The prepared statement follows:)

STATEMENT OF MARVIN L. McLAIN, LEGISLATIVE DIRECTOR AND KIT H. HAYNES, ASSISTANT LEGISLATIVE DIRECTOR, AMERICAN FARM BUREAU FEDERATION

We appreciate this opportunity to present the views of the American Farm Bureau Federation in support of proposed legislation to provide supplemental financing for the rural telephone program through establishment of a rural telephone bank.

Farm Bureau has supported and encouraged development of a sound rural telephone program since it assisted in enactment of legislation initiating the program twenty years ago. Bringing telephone service to American farms and ranches has contributed materially to increased efficiency as well as to better rural living. Less than 40 percent of American farms and ranches had any kind of telephone service as recently as twenty years ago. Today, more than 80 percent have telephone service, most of which is modern dial service.

Telephone services has become a working tool in American agriculture, and the fact that this tool is available has benefitted the nation's consumers in terms of more efficient production and marketing of the most abundant supply of food and fiber any nation ever has enjoyed.

An important key to improving and extending telephone service for America's farmers and ranchers has been the availability of federal loans.

As of last June 30, more than 2.3 million subscribers were using telephone service furnished by systems obtaining financial support under the rural telephone program. Between the beginning of the program in 1949 and last June 30, the Rural Electrification Administration advanced or approved loans totaling \$1,623,413,120 to 873 borrowers. Of this number, 638 were commercial telephone companies and 235 were cooperative associations of users.

It has been estimated that borrowers providing service to rural areas will need something approaching twice this amount in the next fifteen years to meet demands for improved service in areas already being served and for extending service to new areas.

The aim of the bills before you is to assure continuation of the benefits of rural telephone service by enabling qualified borrowers to utilize the nation's private money markets as a source of capital.

Farm Bureau supported proposed legislation in the 90th Congress which would have provided supplemental financing for both rural telephone systems and rural electric cooperatives. Subsequently, we supported enactment of another bill (H.R. 12066) which provided supplemental financing for rural telephone systems only. Early this year, we recommended approval, with amendments, of H.R. 7, which has been approved by the House Agriculture Committee and now is before the House Rules Committee.

S. 2202 is identical with H.R. 7 as amended by the House Agriculture Committee to provide that a borrower would become ineligible for a direct loan from REA when its net worth reaches 20 percent of its assets. Farm Bureau had recommended an amendment along this line as a means of encouraging borrowers of low-interest funds from REA to "graduate" to using the telephone bank or other credit sources for its capital. This obviously would decrease the drain on REA funds by those systems which no longer require subsidized credit. At the end of last year, only 28 percent of the telephone borrowers had net worth of less than 20 percent of assets. We recommend that this provision be retained.

The continuing interest of our members in establishment of a rural telephone bank was reaffirmed at the most recent annual meeting of the American Farm Bureau Federation at Kansas City, Missouri, last December. Voting delegates to that meeting endorsed a plan for supplemental financing of the rural telephone program, patterned after the Farm Credit System.

The plan recommended by Farm Bureau includes two provisions not covered in the bill before you. These are: (1) a requirement that, to be eligible for bank loans, a cooperative association must provide in its by-laws for the issuance of certificates of ownership stating each member's share in the net worth of the cooperative, except where prohibited by state law; and (2) a provision that there shall be only two classes of loans—those made by the bank at the same rate of interest for all borrowers, and those made by the Rural Electrification Administration.

We respectfully submit these proposed revisions for your consideration in the interest of developing a sound and effective means of providing supplemental financing for rural telephone facilities from the private money market.

The policy adopted last December also recommended inclusion of positive provisions for eventual borrower ownership and control of a credit institution to serve their needs in providing telephone service. A plan for eventual borrower ownership is provided in Section 406(c), with retirement of government capital to start after June 30, 1984.

In testimony before the House Agriculture Committee in support of a rural electric and telephone bank, on April 4, 1967, we made recommendations relative to the size and selection of the bank's Board of Directors. While some revisions in the structure of the Board were made in subsequent legislative proposals, the bills under consideration today provide for an initial Board of 13 members, selected in the manner similar to that provided originally.

We respectfully reaffirm our recommendation that consideration be given to an initial Board of seven members. Four would be named by the President, with the advice and consent of the Senate; and three members would be elected to borrowers from the bank. It is also recommended that employees of the telephone systems be excluded from serving on the Board; that the chairman of the Board not be a full-time government employee such as the Administrator of REA; and that six members of the Board shall be elected by holders of Class B and Class C stock and the seventh member be appointed by the President as a representative of the government after Class B and Class C stock reaches 51 percent of the total stock outstanding in the bank.

The bills now before you provide for an eight member Board after Class B and Class C stock equals two-thirds of the total outstanding stock. Six of these would be elected by the borrowers—three by the cooperative borrowers and three by the non-cooperative borrowers. The other two would be the Governor of the Farm Credit Administration and the REA Administrator.

While we believe a relatively small Board made up of an odd number of individuals can operate more efficiently than a group in which there can be equal division of votes, we are more concerned that the Board represent the borrowers than we are with the actual number of members. The interest of the federal government would be represented on the seven-member Board we have suggested by the four Presidential appointees prior to the time that at least 51 percent of government capital is retired; and by the representative to be appointed by the President after that time.

The ability of rural users of credit to direct their credit agencies has been dramatically demonstrated by the Farm Credit Administration, which now is owned by its borrowers. The twelve district Farm Credit Boards are composed of seven members each—two elected by the PCA's, two by the land banks, and two by the cooperatives which borrow from the Banks for Cooperatives. The seventh member is appointed by the Governor of the Farm Credit Administration.

The outstanding record attained by the Farm Credit System in providing credit to farmers and ranchers and their associations on a sound basis is worthy of being the goal to be vigorously sought by other rural credit agencies, such as the telephone bank.

We appreciate the opportunity to present Farm Bureau's views on this important matter, and we shall be happy to work with this Committee in developing practical supplemental financing for rural telephone systems within the framework of our broad policy objectives.

Senator ALLEN. Mr. Shearon Harris, chairman of the Committee on Rural Electrification of the Edison Electric Institute, Raleigh, N.C.

STATEMENT OF SHEARON HARRIS, CHAIRMAN, COMMITTEE ON RURAL ELECTRIFICATION, EDISON ELECTRIC INSTITUTE, RALEIGH, N.C.

Mr. HARRIS. Mr. Chairman, I am Shearon Harris, president of Carolina Light Co., and I am here in my capacity as chairman of the Rural Electrification Committee of the Edison Electric Institute.

Mr. Chairman and Senators, with me is Dr. John Thornborrow, the assistant managing director of the Edison Electric Institute.

I would like to file with the reporter my full statement and I will try even though that has been capsuled, in consideration of the committee's time, I will try to capsule that still further and speak more to the larger points involved in our position.

Senator ALLEN. Thank you.

Mr. HARRIS. Gentlemen, last February, on the hearing in the House, the Edison Electric Institute testified in opposition to a telephone bank bill on several points.

We felt, first, that the administration and the new REA Administrator should have a little time to evaluate all of the various alternatives for moving this program out into the marketplace. That time has now passed.

We also thought that the committee ought to consider several of the other alternatives, and I point out in my statement two bills introduced in the House by Congressman John L. McMillan of South Carolina and Congressman Charles Teague of California developing a concept of insured loans under which the borrowers would go into the marketplace and have the benefit of the Government's full guarantee of those loans, which we believe would achieve a much lower interest cost with the Government's backing, with a modest premium for the Government's undertaking in this, to build up an insurance fund against possible losses,

We think this is the more desirable posture for the Federal Government to be in in sponsoring these rural electric and telephone programs.

We also made the point, Mr. Chairman, and gentlemen, that we felt that the electric program being the older and the larger program and the one after which the telephone program was patterned, that you should give some consideration to doing them together or doing whatever you are going to do about the problems in the electric program first and pattern the telephone program after that.

Now, having had this time pass and the administration having taken a position that was indicated through the Administrator here today, our Institute comes before you with a revised position to say that if in the wisdom of the administration and this committee that notwithstanding our preference for the insured loan approach you felt in your wisdom that this represents an available opportunity to move some part of this program into the marketplace, then with the revisions of the bill as submitted by the administration and with some other revisions which I detail in my statement, that we think merit your consideration to improve the program in the interest of the taxpayer and in the interest of the government and the borrowers, that with the adoption of those revisions we would no longer be in a position of objection.

So if you count those who are not against you as being with you, you might even translate that into a position of support.

Now, let me address myself to one or two points that I have developed in the statement. The first one is with respect to the revision of the 2-percent interest rate in section 201. I know this is a very difficult and sticky political problem but I think this committee and I think the Congress would be dealing forthrightly with the people involved in this program if you dealt with both the section 201 interest rate and a new financial institution to supplement or add to or be the instrumentality for transition over to market financing than you would to create this bank and then come along separately and bring another issue up.

It is admitted, Admiral Mott sat here and said it was unconscionable, for the people he represented to continue to pay 2 percent for money when they are not only able to pay more but have been saying for years that they, as good citizens, as good businessmen, they want and have the ability to pay more.

Now, if in our present money market the bank's cost of money is going to be so great that this inhibits the transition I say to you that the administration's recommendation to go to the government's cost of money in the section 201 program, is in itself an important step in that transition and we concur in the retention of 2-percent money where needed.

If I were the Administrator I don't think I would want the job if I had to do all of this grading, I think I would want the Congress to fix the criteria and I wouldn't want every Member of Congress and every Senator to come over and knocking on the door as to which applicants should be handled differently.

We suggest in our statement that the real need for 2-percent money that exists today is in taking the service out to the areas not yet served. When you deal with upgrading as in the telephone or in heavying up

lines as in electric companies, you are dealing with established business that is able to carry the slight increase in cost or increase in rates that would be involved in paying for market money. So we support the administration but we suggest a different way of measuring the availability of 2-percent money.

Now, let me hit one other point rather quickly and that is with respect to the intermediate money provision in the bank.

I think Mr. Hamil expressed it correctly when he said that the marketability of these securities will be determined over a period of time with the market evaluating the management and the operation of this concern. I would personally question whether in the first 2 or 3 years that the multiplier would be greater than $1\frac{1}{2}$ or 2 in marketing debentures. I think you have a real difficult equity problem with an intermediate provision in there. If somebody pays less than the bank's full cost then somebody else has got to pay more than the bank's full cost in order to make up for the deficit for the recipients of the intermediate loan, and I think you would have a much more workable instrumentality if you had one rate in the bank.

Senator ALLEN. Yes, I agree with you on the rate. But as was suggested there, the entire income from the \$30 million from the Government would be a hedge and the bans over that amount would be at the prevailing market rate. That was the explanation given, I believe by one of these people.

Mr. HARRIS. I think you would have greater use of the bank by the borrowers—you see we don't have a lot of difference between any of these people but we have come to a time when we ought to move this program into the marketplace. We differ only as to the vehicle, and we will probably always differ as to the speed with which we do it. This is maybe the stickiest of all these political problems involved. But I think you would have an instrumentality that would be greatly used if the bank operated on a one-rate basis, and it would be the full cost of money to the bank and the cost of the administration. You would have then relatively no subsidy in this free enterprise institution which was born and nurtured by the Government but became independent. You leave the subsidy in the 2-percent program and slide between those who are extending service in the areas now unserved, and charge the Government's full cost of money for all those who are already in business and are heavying up.

Senator DOLE. But if you can mix them up then you really don't accomplish anything, do you? If you can loan me so much out of the 201 pot and get the rest out of the other pot—

Mr. HARRIS. Senator, I would do this under my theory of business if I were the Administrator and the application came in. Here is a \$2 million loan and \$1,800,000 of it is for heavying up new lines, putting in bigger transformer or in the case of the telephone system it is moving, say, from four-party system to one-party service, and \$200,000 of it is to build new lines out to farms that haven't yet been reached; then I would treat the \$200,000 over here in the direct loan at the 2 percent and I would treat the rest of it either at the Government's full cost in the direct program or in the bank depending on the ability of the borrower to pay. Here again I don't think you ever get away from having to decide, I think, by congressional man-

date who qualifies in the direct program and who goes to the bank. I still think you need to delineate that.

Senator ALLEN. Any further questions?

Senator MILLER. Thank you very much.

Senator DOLE. Just let me say as always you are a very fine witness. I have had the pleasure of hearing you on the House side many times and you make some good suggestions.

Mr. HARRIS. Thank you, you are very kind. I appreciate the courtesy and the time.

(The prepared statement of Mr. Harris is as follows:)

STATEMENT OF SHEARON HARRIS, CHAIRMAN, COMMITTEE ON RURAL ELECTRIFICATION, EDISON ELECTRIC INSTITUTE, RALEIGH, N.C.

I am Shearon Harris, President of Carolina Power & Light Company. I appear today on behalf of the Edison Electric Institute, the national trade association of investor-owned electric light and power companies, as Chairman of its Committee on Rural Electrification. The 181 member companies of the Institute serve approximately 78 percent of the consumers of electric power in the United States, including over 40 percent of the Nation's farms. Approximately 35 percent of the electricity supplied by REA distribution cooperatives is generated by electric companies.

In February of this year the Edison Electric Institute presented testimony in opposition to H.R. 7, a Rural Telephone Bank bill similar to S. 1684 and S. 2202. At that time we expressed the view that the new Administration should be given time to consider various alternatives for financing the rural telephone program. We were then and are now concerned about the kind of precedent that may be established in the telephone program that would affect the electric program. We stated that the electric program was the older and larger of the two programs and when its future course is determined, the telephone program could follow it.

ALTERNATIVE METHODS OF FUTURE REA FINANCING

H.R. 7013 and H.R. 7073 have been introduced in the House by Representatives John L. McMillan (D-S.C.) and Charles Teague (R-Calif.), senior members of the House Committee on Agriculture, to provide a program of insured loans for both REA electric and telephone borrowers. The Edison Electric Institute supports these bills because they would permit REA borrowers to obtain private financing, assisted where necessary by government insurance or guarantee.

It has also been suggested that a new lending agency be established under the direction of the Farm Credit Administration. Such an agency would be a fourth banking system, in addition to the Federal Land Bank, the Bank for Cooperatives, and the Intermediate Credit Banks. In view of the Farm Credit Administration's fine record of accomplishment, this approach deserves serious consideration by this Committee.

Another possibility is that an independent financial institution be established outside the federal government to provide future financing for REA borrowers. Congress should, of course, require that any such new institution stand on its own feet without any federal financial assistance. If federal assistance (such as subordination of REA liens) is provided, then it should be clear that loans from the institution could be made only for the same purposes authorized by the Rural Electrification Act—i.e., to finance service in rural areas.

Each of these approaches deserves serious consideration. Each of them could be adapted to the telephone program, as well as the electric program. Therefore, the Institute urges this Committee not to recommend legislation for the telephone program alone until it has carefully considered the merits and demerits of all the alternatives.

The Administration has now indicated that these bills, when modified as stated in Secretary Hardin's letter to Senator Ellender, dated October 29, 1969, are considered appropriate. We still feel that the insured loan concept would better serve the public interest. Nevertheless, it would seem that all are agreed that the rural electric and rural telephone programs should be moved away from dependence upon government financing and into the commercial financial market. We differ only as to the method and the speed. Therefore, if in the

wisdom of the Committee, it is determined that these bills represent the more acceptable vehicle, we suggest the revisions proposed by the Administration be adopted and that further revisions should be made in order that these bills better serve the interests of the taxpayers, the government and the telephone borrowers.

RECOMMENDED REVISIONS TO THE BILLS

In addition to the changes recommended by the Administration we recommend the following revisions to the bills:

(1) *The 2% loan program should be revised.*—S. 1684 and S. 2202, as introduced, both assume that the 2% loan program would continue unabated. In these times of high interest rates for practically all other commercial businesses and private citizens, the 2% rate is unconscionable.

It is true that the Administration has recommended a long overdue revision to the 2% rate, but even this revision contains an exception in allowing the Administrator to continue rates as low as 2% “. . . in any case where the Administrator determines that a rate lower than the interest rate determined under (1) is necessary to enable the borrower to provide service without an excessive increase in the rates charged by the borrower to its customers.”

We support the Administration's recommendation that the interest rate be amended to cover the government's costs, but we suggest a more appropriate measure for the restricted availability of 2% funds.

Investor-owned electric and telephone companies are facing interest rates of 8% and higher, and are being forced to request regulatory approval of increased rates to their customers because of this and other factors.

The Institute recommends that the alternative rate (2) in the Administration proposal be eliminated, and that all loans be made at the unsubsidized rate, except that 2% loans may be made available only for financially weak borrowers, and only for extending new lines for service for the first time or for converting from manual to automatic switching.

A spokesman for the National REA Telephone Association testified before the House Committee as follows:

“As a result of this desire on the part of rural people for more and better service, it is interesting to note that over 60 percent of all loan fund requirements for the REA telephone program for fiscal year 1969 will be used for upgrading of service. . . . It is estimated that 52 percent of all REA telephones will be one party by 1975 compared to 29 percent today.”

(Hearings before Committee on Agriculture, House of Representatives, 91st Congress, 1st Session, on “Rural Telephone Supplemental Financing”, p. 12)

When modern telephone service has been established and the requested loan is for upgrading existing facilities, the project is able to bear at least the government's cost of money. There is no reason for the taxpayers to subsidize upgrading of service.

(2) *The bank should reimburse the government for services of federal employees.*—Section 403(b) of S. 1684 and S. 2202 (page 8) would permit the bank to utilize “the facilities and services of employees of the Rural Electrification Administration, or of any other agency of the Department of Agriculture, without cost to the telephone bank . . .” Any bank, if established, should reimburse the federal government for the services of all federal employees, regardless of whether they are full or part time employees. The federal land bank system has operated on the basis of providing its own administrative services at its own costs from its beginning.

(3) *The bank should pay an adequate return on the \$300 million federal contribution.*—Section 406(a) provides that the United States shall furnish \$300 million capital to the bank, and section 406(c) (pages 14–15) provides only a 2% rate of return to the United States on this \$300 million contribution. The rate of return to the government on its contribution should be no less than the cost of money to the United States Treasury.

(4) *The federal contribution should be repaid on a regular basis.*—Section 406(c) (page 14) does not require a firm schedule for prompt repayment of the federal contribution. The \$300 million Class A stock should be retired on a regular repayment schedule, correlated with repayment of loans by borrowers from the bank.

(5) *Bank loans should be made only for the same purposes authorized by the Act.*—Section 408(a) (page 18) would permit the bank to make loans for three different purposes, including the “financing, or refinancing, the construction, improvement, expansion, acquisition, and operation of telephone lines, facilities,

or systems, in order to improve the efficiency, effectiveness, or financial stability of borrowers under Sections 201 and 408 of this Act." These are broader purposes than now authorized under Section 201. So long as any government assistance, such as the \$300 million "seed" money, is provided, bank loans should be permitted only for the same purposes and under the same limitations for which loans may be made under Section 201 of the Act.

(6) *The maximum loan period should not exceed 35 years.*—Section 408(b) authorizes the bank to make loans for periods up to 50 years (page 19). The maximum loan period should not exceed the depreciable life of the equipment, or 35 years, whichever occurs first.

(7) *The "Intermediate" loan program should be eliminated.*—Section 408(b) (3) (pages 19–20) would permit "intermediate" loans at a subsidized 4% interest rate. The Administration has recommended removal of the 4% limit, but loans could still be made at a subsidized rate not including costs of administration and a reserve for losses. There should be only a single rate of interest reflecting all bank costs, including costs of administration, and a reserve for losses. The subsidized intermediate loan program should be eliminated.

We support the revisions recommended by the Administration that the bank should not be turned over to borrower control until all government capital has been repaid, and that the activities of the bank should be made subject to the provisions of the Government Corporation Control Act including annual budget review by the President and the Congress and audit by GAO so long as any federal investment remains in the bank.

Our review indicates that there may be some additional technical amendments which would improve the bills. With the Chair's permission, we would like to submit a technical memorandum in the near future for the consideration of the Committee and its staff.

ACQUESCENCE IN RURAL TELEPHONE BANK NOT TO BE CONSTRUED THAT ELECTRIC BANK IS ACCEPTABLE

While Edison Electric Institute has indicated its acquiescence in S. 1684 and S. 2202, when revised as suggested, we would like to state that our position on these bills should not be construed as acceptance of a rural electric bank. There have been additional problems in the electric program, primarily because it has included some highly questionable loans for generation and transmission facilities as well as loans for distribution facilities. We have not herein addressed ourselves to a rural electric bank and reserve to a more appropriate occasion our comments on that subject.

Senator ALLEN. That completes the testimony.

Senator Talmadge had to go to another meeting and he asked me to express his appreciation for the interest that all of you have shown in this bill, and for your presence here and your testimony, and asked me further to state that the record will be held open until the 10th of November if anyone cares to file statements.

The meeting is adjourned.

(Whereupon, at 1 p.m., the hearing was adjourned.)

(Additional statements filed for the record are as follows:)

STATEMENT OF HON. FRED R. HARRIS, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Mr. Chairman and Members of the Committee, As a co-sponsor of S. 1684, a bill to provide an additional source of financing for the Rural Telephone Program, it is a pleasure for me to have this opportunity to present testimony in support of enactment of this legislation. Extensive hearings were held in the 90th Congress on the subject of providing an additional source of financing for the rural telephone program under the Rural Electrification Act, and as I recall, very little controversy developed over the enactment of this particular legislation.

The rural telephone cooperatives have demonstrated their ability to provide a vital service in the more sparsely populated areas of rural America. Residents of small towns and those who live on farms now have telephone service because of the outstanding accomplishments of the rural telephone cooperatives operat-

ing with loans obtained from the Rural Electrification Administration. In fact, the demands for modern telephone service in rural America have become so great that the need for growth capital by the rural telephone cooperatives far exceeds the amounts appropriated each year to the Rural Electrification Administration to make loans for construction of rural telephone facilities. It is for this reason that the rural telephone cooperatives and other borrowers have devised a plan which will provide additional sources of financing for the rural telephone program. I feel it is absolutely necessary that we assure the continuation of a strong rural telephone program, and it is for that reason that I hope that the provisions encompassed in S. 1684 will be considered favorably by this committee and enacted in the Senate.

It is my understanding, Mr. Chairman, that the Administration has suggested amendments to the Rural Telephone Bank Bill which, if enacted, would, in effect, bring about the phasing out of the 2 per cent telephone loan program under the Rural Electrification Administration. I, as a co-sponsor of S. 1684, am certainly concerned about the adverse effects which the proposal of the Administration to phase out the 2 per cent telephone loans would have on the future of the rural telephone program. It should be pointed out that without the availability of these low-interest, long-term loans, rural telephone service might never be available in many of the suburban and rural areas of this country.

A great deal has been said recently about the need to stabilize our rural population, and if possible, reverse the migration of people from the rural areas to the cities. If we are, in fact, going to attract urban residents back to the more sparsely populated rural sections of this country we must assure them of the same conveniences which they have available in the metropolitan areas. Telephone service, of course, is no longer considered merely a luxury but can, in fact, be considered a necessity, and if this service is to be provided in sparsely populated, economically depressed areas over our country, we must assure the continuation of low-interest, long-term loans for rural telephone cooperatives. Mr. Chairman, I hope that the legislation, S. 1684, can be adopted, and I hope that the committee will not consider favorably the amendment as suggested by the Administration.

STATEMENT OF HON. WALTER F. MONDALE, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Mr. Chairman, it is my distinct pleasure to appear before this committee of which I was once a member to urge your support and prompt passage of the telephone supplemental financing bill, S. 1684.

I don't think it is generally recognized that my own State of Minnesota is predominantly rural in makeup. According to a recent study by the Library of Congress, there remain only 83 truly rural Congressional districts in the United States. Four of these remaining rural areas are in my state of Minnesota. No other State contains more.

Because of this background I fully realize the outstanding job the REA telephone loan program has done in bringing modern, efficient telephone service to rural America.

The reasons which caused the REA telephone borrowers to design the supplemental bank are evident to even superficial examination of the loan program. The annual appropriation for 2 percent money has been approximately \$125 million for the last several years while the annual applications for new loans have been in the neighborhood of \$200 million. Thus, the unsatisfied backlog of loan applications has grown from \$122 million in 1965 to \$364 million on 30 September, 1969.

This means the built-in delay in satisfying any loan request has just about reached three years.

The telephone supplemental bank as embodied in S. 1684 and S. 2202, will solve several of the serious problems afflicting the REA telephone borrowers. First, it will make an additional source of capital available, ending their total dependence on the REA 2 percent loan program. Secondly, the legislation does provide for eventual disinvolvement of the Government from the telephone financing program.

This approach has been used before, notably in the Farm Land Bank program, and has worked successfully.

I am impressed by the unanimity the telephone industry has exhibited in support of this legislation. Not only have the REA borrowers, both commercial and

cooperative companies, supported the bill as might have been expected, but also the major segments of the independent industry, the General System, Continental, and United Utilities. In fact, the Bell System has gone on record as being in support of the supplemental bank concept. I fail to see, frankly, wherein the controversy lies concerning the bill.

Several years of consideration and debate have gone into framing S. 1684 in its current form and I think it merits the Congress' serious consideration.

The bill as designed will offer several effective interest rates for borrowers based equitably on their financial stability and maturity. Those companies that are able to, will borrow directly from the telephone bank at the full bank rate established by the cost-of-money to the bank. Companies not able to afford money at that rate may use a "stepping stone" approach away from total dependence on 2% money by borrowing at an intermediate rate, based upon the cost of equivalent securities to the government.

The 2% 35-year loan program will be maintained for those companies which are unable to offer service in their areas without this low-cost debt capital. If we are to amalgamate this 2% money with either of the higher cost interest rates, as I believe the Administration is suggesting, we are, in effect, eliminating the only source of debt capital which is available for the economically less viable telephone systems among the REA borrowers. The support for this legislation is predicated on continuance of the 2% lending program. The stepping stone approach is a sound one and mandatory to the objectives of this legislation.

Without an additional source of capital, the rural telephone systems which have done such a magnificent job over the past two decades will undoubtedly wither and die. The most conservative estimate available of the capital needs of these systems over the next 15 years is approximately \$2 billion more than will be available from REA direct loans at the present level. The bank is designed to provide this additional capital.

I strongly believe that the telephone supplemental bank bill, as embodied in S. 1684 and S. 2202, represents the soundest approach to achieving the goals of rural telephony—to make adequate capital available for the continued service and expansion of rural telephone systems, to proceed towards the goal of eventual full borrower ownership and control of their financing resources, and to immediately achieve the ability to end total dependence on the 2% program by establishing a multi-leveled capability based upon legislative guidelines established by the Congress.

As you are all doubtlessly aware, the Bell System has been experiencing a good deal of criticism lately about its service quality. It has been said that poor planning is responsible for many of these difficulties. If the telephone systems of rural America are guilty of failing to meet the expected service standards of their subscribers, the fault must be largely ours. Let's assure that these telephone systems have the means to continue the fine work they have carried on for the past two decades.

STATEMENT OF HON. JOSEPH M. MONTOYA, A U.S. SENATOR FROM THE STATE OF NEW MEXICO

Mr. Chairman, you and the members of this committee are well aware—in view of the fact that I am a sponsor of S. 1684—that I strongly favor legislation to provide an additional source of financing for the rural telephone program. However I want you and all other interested persons to know the reasons which impel me to call so urgently for support for this legislation.

To the people in the rural parts of New Mexico, few, if any, of the modern necessities of life are as important as telephone service. Despite the difficulties involved, this service must be maintained and improved as rapidly as possible. This is not merely a matter of convenience—it is a necessity. Good telephone service often can mean the difference between life and death of a person or a family. It can also mean life or death to economic opportunity in a community.

You will see why additional capital at low cost is required to improve service, or even to maintain service, in New Mexico when I tell you about some of our telephone systems.

In New Mexico we have seven systems participating in the telephone program administered by the Rural Electrification program. Five are cooperatives and two are companies. The co-ops are the Leaco Rural Telephone Co-op, headquartered at Lovington; Roosevelt County Rural Telephone Co-op, Portales; E.N.M.R. Telephone Cooperative, Clovis; the Penasco Valley Telephone Co-op, Artesia; and La Jicarita Rural Telephone Cooperative, Mora. The companies are

the Lindrith Telephone Company at Cuba and the Ruidoso Telephone Company at Ruidoso. Altogether they have borrowed \$8,057,000 from REA.

In 1967, the last year for which figures are available, these REA borrowers had 7,673 subscribers on 4,352 miles of line. This averages something less than two subscribers per mile and ranges from 8.69 subscribers per mile down to .65 per mile. A great many subscribers, including some business establishments, had service on eight-party lines.

In 1967, four of the seven borrowers operated "in the black" and three operated "in the red."

From these figures, you can begin to understand what I mean when I say our telephone co-ops and small companies need the REA program. They must borrow capital, and they cannot afford to pay high interest rates. Congress started the rural telephone program because of conditions in many parts of the country which are much like those existing in New Mexico. The basic program should be expanded. The least that should be done is to provide more capital through a rural telephone bank as our pending bill would do.

Unfortunately, however, a new policy has been proposed by the Nixon Administration under the guise of amendments to S. 1684 and similar bills.

The Administration has proposed changes that would gradually wipe out the rural telephone program as we have known it. For the first time since the program was put into effect, the executive branch has proposed to eliminate the basic two percent interest rate.

The new policy that the Nixon Administration would have us substitute is a policy of charging borrowers what it would cost for the government to borrow money and cover administrative costs and probable losses. Information I have received from reliable sources indicates the result of this provision now would be an interest rate of more than 6¼ percent. This is unrealistic in view of the fact that the government borrows only a small part of the money it spends and lends. When it lends money that has been collected by the Internal Revenue Service, it is lending money for which it is paying no interest at all. There is no point in contending that all of the money for the rural telephone program has to be borrowed and therefore has to be paid for at going market rates.

The Administration does say that a lower rate of interest could be charged—but not less than two percent—where necessary to prevent an excessive increase in rates charged to rural telephone subscribers.

Personally, I don't know what the definition of excessive might be. Considering the service that some rural subscribers get, any rate increase would be excessive.

In any case, the Administration has not told us how it proposes to draw the line between those systems that could pay higher interest without having to raise their service charges and those that could not. Some systems perhaps would have to pay an increased rate of interest and then be prevented by the public service commission from raising the tariff.

I do not believe it is necessary to comment further on the Administration substitute. I do not wish to beat a dead horse, which I believe the Administration proposal is. Furthermore, I prefer to put my case on the basis of fundamental public policy.

Why do we have a basic two percent loan program for rural telephones?

Congress authorized this program, as it had earlier authorized the basic two percent loan program for rural electrification, because the Congress believed the whole people should help the rural people obtain for themselves certain modern services which could not be obtained through commercial market operations.

This is the same kind of decision that Congress has made time after time. The whole nation helped develop the railroads because we the people thought it was essential to have railroads. The whole nation has helped develop the merchant marine and the airlines. The whole nation has paid for big dams to develop power, help control floods, and make the rivers more navigable. We dredge out the harbors and river channels for shipping. We make grants to cities for urban development projects.

And we do a lot of talking about rural economic development.

Do we mean it or not?

The people of rural America cannot build strong communities, attract industries, build new businesses, create new jobs, turn the tide of farm-to-city migration—unless they can provide for themselves the necessities of modern life: water and sewer systems, health and education facilities, telephone and electric utilities.

The people of rural America want to do the job. The people of the overcrowded cities know that they too will benefit.

The people who live in the rural areas and those who live in the cities look to the Congress to help bring about rural development in the public interest.

We must maintain the basic two percent loan program. And we must supplement his program by establishing a Rural Telephone Bank, capitalized with government funds which would gradually be retired until the bank is owned by those who use it.

The bill you are considering combines successful features of the Rural Electrification Program and the Farm Credit System. I sincerely recommend adoption of the bill.

STATEMENT OF JOHN W. SCOTT, MASTER, NATIONAL GRANGE

Mr. Chairman and Members of the Committee: I am John W. Scott, Master of the National Grange, with offices at 1616 H Street, NW., Washington, D.C.

The National Grange is more than a farm organization. Its purpose is to serve the total interest of the rural community and the Nation.

Self-help programs planned, controlled, conducted and financed at the local level are a primary objective of Grange policy; the Grange has held—and now holds—that Government involvement in all such programs should be the minimum necessary to provide equitable opportunities for all Americans.

The National Grange represents 7000 local community Granges from Maine to Florida and from the Eastern Shore to the great West and Northwest. Throughout rural America, Grange halls can be found servicing the 600,000 members living in rural communities.

As responsible members of rural America, the Grange has had a vital interest in an adequate rural telephone system and has been a strong supporter of the REA telephone programs from their inception in 1949.

In 1951, at the 85th Annual Session of the National Grange, in Atlantic City, New Jersey, the Delegate Body passed the following resolution:

"The development of an adequate rural telephone system is just beginning. We commend the Rural Electrification Administration and the telephone companies for the progress made. The principle of area coverage on a uniform class rate basis should be adopted for all rural telephone projects. We recommend that Congress make sufficient appropriations to meet the loan requirements for the development of adequate telephone service throughout the rural areas of America."

As early as 1958, the Grange, seeing that there was need for additional supplemental financing for REA to meet the necessary loan requirements, supported by resolution the request for such financing.

1. Continue the present statute-set 2 percent interest rate on REA loans.
2. Provide sufficient REA loan and administrative funds necessary to meet *all* the needs for additional borrowed capital on the part of telephone cooperative borrowers.

This still remains basic Grange policy. An adequate, dependable and reasonably-priced telephone service is essential to the social and economic well-being of the nation's rural residents. Many REA-financed cooperatives serve thinly-settled areas and are not yet able to provide service at rates on a parity with those of urban people. For such systems, we urge that REA loans be made available at the present 2 percent interest rate. We further urge an early establishment of a suitable and fair supplemental banking program for the rural telephone systems with the necessary federal financing assistance and the right of future ownership and control by participating systems and a continuation of adequate federal appropriations at an interest rate which will permit continued telephone service in the very sparse customer areas.

The legislation you are considering during this session of the 91st Congress regarding supplemental financing of REA telephone systems has the vigorous support of the National Grange. S. 1684 and S. 2202 meet all of the objectives of the National Grange policy; therefore, we urge speedy action by this Committee and request that this Committee provide the leadership to bring about affirmative action by both Congressional bodies of the Federal Government.

It would be presumptuous of us to sit as experts on telephone systems. In fact, at times we have great difficulty in just direct dialing; however—you have heard from many expert witnesses who represent the rural telephone companies that are servicing rural America and who are in a far better position than we to document the urgent need for supplemental financing and the best method of structur-

ing the telephone bank. Therefore, we will rely on the wisdom of this Committee and its staff to present to the Senate a bill containing the features necessary to meet the financial needs of the REA Telephone Bank.

This Committee is very much aware of the tremendous strides made in improving the telephone service in rural America. In fact, it has been because of this Committee that such progress has been possible. We commend you for your foresight and concern in providing legislation to enable rural America to keep abreast in telephone communications.

We ask that you continue your good judgment and provide the supplemental financing necessary to enable the rural telephone systems to enter the second phase of the great transformation in rural telephony; namely, upgrading of service and extending such service to the most remote areas of rural America.

In conclusion, please allow me to stress the urgent need for accelerating the drive for recreational, commercial and industrial development in rural areas. Improved telephone service must assume new significance, if we are to reach the goals of a redeveloped rural America and slow down the mass migration to our overpopulated urban centers.

Having served as the State Master of the Pennsylvania State Grange for six years, I am well acquainted with the needs of rural residents. Steady progress is being made toward our goal of modern, all-dial rural telephone service under rates and conditions comparable to those available to urban subscribers. For example, in my own home state of Pennsylvania, the Otto Telephone Company, Duke Center, Pa., a small independent company, is upgrading telephone service for all its subscribers. The hand-crank wall box telephone, once a familiar sight in farm and rural homes, is now a collector's item. The last of these antiquated instruments came down from a farm wall in October 1968, marking the beginning of a new era for the company's 437 subscribers. When the upgrading is complete, 80 percent of the subscribers will have single-party service and the rest will have two-party service. Direct distance dialing will be available to all.

This type of service is needed if we are going to keep people in rural areas. It is needed for the family farm, rural residents and most of all, to attract small and light industry to rural areas. To provide such telephone service to rural areas an REA Telephone Bank is a must.

Mr. Chairman and members of the Committee, the National Grange is pleased to be able to support this legislation and is appreciative of the opportunity to thank you and the Rural Electrification Administration for the excellent leadership you both have provided in bringing modern communication to the residents of rural areas. Thank you.

STATEMENT OF ANGUS McDONALD, DIRECTOR OF RESEARCH, NATIONAL FARMERS UNION

Mr. Chairman and Members of the Committee: I am appearing here in support of S. 1684 and S. 2202, bills which would provide an additional source of financing for the rural telephone program. Members of this Committee, as well as others in the Congress, will recall that the National Farmers Union has, over the years, opposed any tampering with the two-percent interest rate. We support these bills on the condition that those in sparsely populated areas and other areas if necessary, still have access to the two-percent rate.

These are trying times for farmers. Farmers are affected more than any other segment of the population by inflation. Inflation has added tremendously to the cost of production, as well as the things farmers must buy for the support of their families. In addition, the farmer has not been able to realize prices which keep up with the rising prices of consumption and production. The farmer must take whatever is offered in the market place for the products he has to sell.

Members of Congress, I am sure, realize that the price of some commodities such as wheat, have been considerably lower than they were twenty years ago. The farmer's net income has consequently been affected. He is pushed to the wall by high interest charges, by competition from tax farmers and by low net income. To tamper with the two-percent interest rate would be adding injury to injury. The farmer cannot bear additional burdens at this time.

We have no objection to additional sources of financing. If certain cooperatives and private telephone companies find it possible to go to the market for money we will not stand in their way. However, the fact is that the supplying of telephone service and electricity to such areas as North Dakota is a losing proposition. If the farmers in such areas are to have telephones and electric service they must be in part subsidized by low interest rates.

I think that this issue will become more important as the days go by since the Nixon Administration has announced that it will seek higher interest rates on practically every program administered by the Federal Government. I am particularly referring to the announcement of Secretary of Interior Walter Hickel that he will raise interest rates on all water projects from $3\frac{1}{4}$ to $4\frac{1}{8}$ percent. We oppose the Secretary's order. We feel strongly that due to a number of resource problems which, of course, are not a consideration here, that all increases in the costs of resource development should be opposed. This includes the development of water projects for the production of electric power.

We put the Administration on notice that the Farmers Union will oppose with all its power any increase in interest rates on federally-administered programs.

