

**SAVING AMERICA'S GREAT PLACES: THE ROLE
OF TAX INCENTIVES IN PRESERVING RURAL
COMMUNITIES**

HEARING

BEFORE THE

**COMMITTEE ON FINANCE
UNITED STATES SENATE**

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

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**SAVING AMERICA'S GREAT PLACES: THE
ROLE OF TAX INCENTIVES IN PRESERVING
RURAL COMMUNITIES**

WEDNESDAY, AUGUST 25, 2004

U.S. SENATE,
COMMITTEE ON FINANCE,
Sioux, City, IA.

The hearing was convened, pursuant to notice at 10 a.m. in the Martin Ballroom, Pierce Street, Sioux City, Iowa, Hon. Charles E. Grassley, chairman of the committee, presiding.

Also present: Senator Sam Brownback, Jean-Mari Peltier, Glen Keppy, Peter Froelich, Chuck Hassebrook, Kevin Edberg, and Shane Tiernan.

**OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S.
SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. I bet we can fill up the front seats if I announce that all the big givers can sit in the front.

Well, you can sit wherever you want to. And we appreciate all the interest there is in this most important subject of economic development in rural American and how the tax code can help that.

Before I open the meeting with the testimony and things of that nature, I want to take a moment to thank the people right here in Sioux City who help make this hearing happen.

First I want to thank the Downtown Partners, including Roger Caudron, the executive director; Dee Polak, marketing and promotion manager; Tamie Newberg, the administrative assistant; president James Johnson and vice president Tim Kromminga.

I would also like to thank the Martin Ballroom and Apartments for providing the beautiful venue for this hearing. And I think those of you from outside of Sioux City can say that they have done a good job of restoration. And in this regard, I particularly want to thank Lewis Weinberg, the owner, and the ballroom marketing coordinator.

I also want to thank our court reporter Carolyn Plueger for coming here and doing our reporting.

And finally, I want to thank Lance Ehmcke, a local attorney who is active in the Siouland Chamber of Commerce and who I figured always lived in Washington, DC because that's where I see him most often, for being here, but obviously representing Siouland Chamber of Commerce very well with his leadership.

I say all this because without the effort that is put forth here by the local people to help us have this venue and everything con-

nected with it, we wouldn't have quite as good of a meeting that we otherwise would have.

I'm very happy to be here in Sioux City to bring national focus on the issue that I find disturbing, the continuous loss of young people and our families from the rural Midwest.

I see many people in this room that I have known for years, and I met many more of you this morning, and I'm pleased to see such a collection of talented, dedicated leaders of our communities. We have people here not only from Iowa, but Nebraska and the Dakotas and even other states as well. All of you come here with a common concern, that being how to stem this tide of rural out-migration.

As chairman of the Senate Finance Committee, we have begun to examine through the committee the role of tax incentives to preserve rural communities. In some areas, tax laws are unfair to rural communities or don't do enough to build economic growth. In other areas the tax code is outdated and needs to come into the 21st Century. Today we will discuss a series of proposals that address those issues. Specifically, the witnesses that have joined us today will focus on a bill that I introduced called the Heartland Investment and Rural Employment Act, and that spells out to a very fancy acronym, HIRE, H-I-R-E. My goal with this legislation is to update tax laws and create new incentives that makes sense for rural America.

Rural America has a lot to be proud of, of course. And while the agricultural economy is showing strength that we have not seen in years, I think Congress should do its part to help bolster some of our successes with the proper incentives.

In the last 10 or 20 years, you can think about rural America has built 12 farmer-owned cooperative ethanol plants right here in Iowa, and several additional plants are under construction. Nationally we have 74 ethanol plants producing 2.9 billion gallons and 14 plants under construction that would bring our production to 3.4 billion gallons yet this year. To put this in perspective, the U.S. produced 10 billion bushels of corn in 2003. And nearly 1.1 billion, a little over 10 percent of the corn, was used to produce 2.9 billion gallons of ethanol. The ethanol industry has created rural jobs and economic diversity, not to mention decreased dependence on foreign oil. It is truly a hometown success.

And last year I had an opportunity to visit with the little town of Lakota up in north central Iowa and there found not only the ethanol plant, but a lot of well paying jobs in the community of probably I would guess under seven or eight hundred, at least. So we can do a lot for rural America. And we're in the process of doing that. So this hearing is about what more we can do.

We have more rural success stories. Iowa ranks fourth in the nation in terms of installed wind generation capacity, generating enough electricity to power 300,000 homes. Rural America is clearly on the forefront of reducing our Nation's dependence on foreign sources of energy. But we need more of these success stories, and I believe a few changes to a complex tax code could help make these stories come true.

We had some unfinished business. Today some of the things that we'll talk about will sound familiar; that's because we have been

fighting for them for years. They are good ideas that enjoy strong bipartisan support and were actually approved in 1999 as part of a bill we called the Taxpayer Relief Act, but was vetoed at that time by President Clinton, so obviously these things are not law.

The first of these is a proposal that I call FFARRM accounts, an acronym that comes out Farm, Fishing and Ranch Risk Management Accounts. Some of you might know these as farmer IRAs. These farmer savings accounts would allow farmers to contribute up to 20 percent of their income in an account deducted in the same year. FFARRM accounts would be a very important risk management tool to help farmers put away money and spread out the high and low gains of income.

The other proposal is from my good friend that is sitting here beside me, a person who came up from Kansas to help us bring not only attention to his ideas of rural economic development, but to support the activity of our Senate Finance Committee. I thank him for coming.

Senator Brownback has taken the lead on fixing this problem. It is the unfair IRS decisions of self-employment tax on farmers who participate in the Conservation Reserve Program.

And he also has ideas on bringing people back to counties that are what we call out-migration counties where they have lost population, to help people establish homesteads and bring people back home. And we will be talking about that to some extent later on.

And then, of course, there is our ongoing effort to address the Dividend Allocation Rule, and end the unfair third level of tax on cooperative dividends. This provision has been included in my Jumpstart Our Business Strength Act, and this is known as the JOBS bill in Congress, which will be in conference with the House soon after we return after Labor Day, so with any luck and a lot of hard work on the conference, we could have that bill to the President by October.

In addition, our witnesses today will be discussing the issues of out-migration and the potential effect of proposals of the Heartland Investment and Rural Employment Act, the HIRE Act I talked about.

Now, before introducing our witnesses for today's hearing, I'm going to express the fact that Senator Baucus, the ranking Democrat on this committee, couldn't be with us today because he has got business in his state of Montana and was unable to join us. So I will include that statement in the record at this point. And I will submit that to the shorthand reporter.

[The prepared statement of Senator Baucus appears in the appendix.]

The CHAIRMAN. We have included some of the important provisions from the New Homestead Act, which was originally sponsored—called the New Homestead Act which was originally sponsored by Senator Dorgan of North Dakota and 12 original cosponsors, including Senators Hagel, Grassley, Tom Daschle of South Dakota, and again my friend Sam Brownback of Kansas.

Senators Dorgan, Daschle and Hagel were unable to join us today, but their statements are on the table for your review. And take them home with you and study what these senators have to say about the important issue of rural economic development.

We have included these provisions in both the HIRE Act and the JOBS Act that I previously referred to, and these awaits conference with the House.

Under current law, there is no special assistance for businesses in counties that are losing population. Here again, Senator Brownback has joined us today to more fully explain the motivation and tax policy behind the New Homestead Act. Even though Senator Brownback is not a member of the Senate Finance Committee, he always shows a great deal of leadership for agriculture in rural areas and speaks out strongly. And I have a close working relationship with him and I welcome him here and he will be speaking to us in just a minute.

I am going to take advantage of the opportunity now, so I don't have to come back to the introduction, and introduce people here at our right and left who are witnesses for today's hearing. And we will hear from them in the order in which I introduce them. And they will start after Senator Brownback speaks. And then Senator Brownback and I will have a series of questions to bring out some things that we feel are important that maybe the witnesses didn't have time to testify on or things that maybe they don't even know we're interested in asking about.

But our first witness is Jean-Mari Peltier. And she's President and CEO of the National Council of Farmer Cooperatives. Ms. Peltier has currently joined the National Council of Farm Cooperatives as a new president and brings unique insights into the organization because prior to joining the organization, she served the Bush Administration as consulate for agricultural policy to the administrator of U.S. EPA.

Then we have a friend of mine, Glen Keppy, who is a director of the CHS Board of Directors, a fellow Iowan from Davenport. Glen will be sharing some of his organization's insight on rural economics.

Then Peter Froelich, Ph.D. Dr. Froelich is Assistant for Special Projects, Office of the President, Dickinson State University of North Dakota—Dickinson, North Dakota. And in addition to that, he has previously testified before my Finance Committee in Washington, DC, when he had just completed the Great Plains Population Symposium project. And we thank him for his ongoing efforts in that area.

And then somebody that is very famous in rural America, particularly before the Congresses rural committees, including finance, Chuck Hassebrook, who is Executive Director of the Center for Rural Affairs, Lyons, Nebraska. He will be discussing out-migration issues.

And then lastly, Kevin Edberg, who is Executive Director of Cooperative Development Services in Saint Paul, Minnesota. Mr. Edberg will review the community homeownership issues based on a proposal from the President's budget. And I understand that he also will be discussing the need of rural seniors for affordable multifamily housing choices and the role that cooperatives play.

And our last witness is Shane Tiernan, an Ag and Commercial Loan Development Officer with the Grundy National Bank, Grundy Center, Iowa—Grundy County, Iowa.

I look across the road from my farmstead and I look at Grundy County and a farm that's just across the road, it will bring \$500,000 an acre more. That's the reputation of people in Grundy County.

They do very well.

He will be bringing an interesting analysis of machinery cooperatives and their necessity in light of rural out-migration of young farmers. And I told him I don't think we've ever received testimony on that issue, so we will find that very interesting.

Now I have a chance to call on a friend and a coworker in this area. Senator BROWNBACK, will you start with your testimony.

Senator BROWNBACK. Thank you, Senator Grassley.

The CHAIRMAN. He will stay with us for the entire hearing, or at least until noon.

**OPENING STATEMENT OF HON. SAM BROWNBACK,
A U.S. SENATOR FROM KANSAS**

Senator BROWNBACK. Thanks, Senator Grassley, for holding the hearing and for convening this group of people. I'm looking forward to the testimony and hearing what folks have to say and some things we ought to do to address this.

My background is Secretary of Agriculture for Kansas, and a member of Congress, then the Senate, and so I have been working on these issues of rural development for some period of time. I am very frustrated that we continue to see the out-migration taking place. And what is it that we can do? I've got a proposal that I'm going to talk about today that I think is one that really could make a big difference in this.

I want to say at the outset, before I go on to testimony, though, is thank you, Chairman. As Chairman of the Finance Committee, you have done a great deal for rural America, most recently to the rural Medicare provisions for hospital reimbursement and Medicare reimbursement that were in the pharmaceutical drug bill last year. Senator Grassley really got through a significant increase in reimbursement for our rural hospitals, which is a key foundational unit for rural living. If you don't have good healthcare, a lot of people just aren't willing to live there. And he really worked and got a lot of things done. So I tell him often on the Senate floor, "If it's good for Iowa, it's good for Kansas." Policies that help here in Iowa help in Kansas a great deal and I really do appreciate that.

The CHAIRMAN. That's with the exception of the Jay Hawks versus the Cyclones.

Senator BROWNBACK. Well, we're in football season now, so it's Wildcats versus Cyclones. We will take you—when we go to basketball, we'll go to the Jay Hawks.

But it is great to be here.

Over 140 years ago, President Abraham Lincoln signed into law the Homestead Act, the first Homestead Act. It was a great bargain that the President and U.S. Government made with the American population. They said back in 1862, it is basically a one-time bargain. They said, "All right. If you will go out and settle this area and stay on it for 5 years, we will give you 160 acres." It was the original Homestead Act. It was the promise of free land, and a

promise of opportunity, and it was massively successful in populating the Great Plains.

Today, America's Heartland is facing massive depopulation.

If I could get you to put up that chart of the overall number of states facing out-migration, and then I'm going to show you what is happening particularly in my state, which mirrors what is occurring in Iowa.

You see basically since the large-scale magnification of agriculture, the consolidation of agribusinesses, this massive depopulation of the center of the country, the hollowing out of America. From Texas north, winging out, you see in the major—a number of states losing a large scale amount of population. The Dakotas is leading. North Dakota, you have got 89 percent of the counties suffering rural out-migration.

We define out-migration of the bill as the loss of 10 percent of the population or more over the past 20 years. A number of counties would have experienced substantially more than that.

You can see most of the leading states in that category are right in the center of the country. North Dakota, South Dakota, Nebraska, Iowa, Montana, and Kansas. Alaska is a little out of place there. Wyoming. West Virginia, a little out of place. Minnesota, Texas, Oklahoma, Illinois. These are your major states losing to out-migration of population that's taking place. And it has been strong and it has been continuous.

I want to show you next, if I could, my chart of Kansas and what is happening in our state. We have basically half of the counties in Kansas that have been experiencing significant rural out-migration. There are no more rural parts of our state. In the western, particularly northwest, north central parts of Kansas, we have some communities there where they have lost a fourth of their school-age population over the last 5 years. So not only is the out-migration happening, and it is fallen down to the school-age population, is falling precipitously in a number of these counties. And the age of the population of the counties is growing dramatically, which is a feature happening much in rural—this middle part of the country that is occurring today.

We're losing much of our small-town lifestyles. And I fear if we don't act now, you are going to get past the point of no return, and we are going to get up to a point where you lose your critical mass around which you can rebuild and it is just not going to be there. And we really are at one of those points in time where we need to act.

We saw a similar thing happen in the '70's in the urban cores of America. We're seeing huge out-migrations to suburbia from the urban cores. From downtown New York City. We saw it in Washington, DC. We saw it in Los Angeles. But the country didn't just sit back and say, okay, well, that's just the old; this is the new; we're going to let it take place. They stepped in with a series of tax policies to encourage redevelopment in the urban cores in the urban areas of our country. And we put in place a series of incentives that have by and large—not all together, but by and large have worked. And people have moved back into the urban areas.

I chaired the BG Subcommittee when I first went into the Senate and we had then and put together a plan of economic incentives

to try to get people to move back into Washington, DC. And by and large, they worked, and people have moved back in. But it has been a series of pulling incentives—not pushing, but pulling incentives that you say if you will live in this area, we will provide this set of incentives.

What I'm proposing—what we are proposing in this bipartisan package that Senator Dorgan and Senator Hagel first led with, and now a number of us have pulled us around, is a series of economic incentives we call the New Homestead Act, to try to pull people back to these rural areas, and saying to them if you will do this, if you will live here for a period of 5 years, here's a set of incentives that are available to you. And we're finding a broad interest and acceptance of it because people want to live in these areas, but they can't in many cases now because the economic incentives and the economic wherewithal is just not there. They need an incentive. They need something to be able to make it a little more of an even play between living in northwest Kansas versus in Wichita or Kansas City. They need the incentives.

So what's in the New Homestead Act? To provide a number of new and updated homestead opportunities for individuals to live, work, and prosper in these high out-migration counties.

We define an out-migration county as a rural county that has experienced 10 percent or more population loss for the last 20 years.

So offer new incentives for businesses to locate, grow, and profit in high out-migration counties; and to improve access to capital for business development.

Specific provisions. Loan repayments: Forgive up to 50 percent of college loans for recent graduates who move to these communities up to a maximum of \$15,000.

Home tax credits: Provide a \$5,000 tax credit for all home purchases in these areas.

I might say as a side bar, when we put that in place in Washington, DC, you saw a big influx of first-time home buyers to Washington, DC with this \$5,000 tax credit for home purchases.

Protecting home values: Allowing losses in home values from a principal residence to be deducted from Federal income taxes.

Individual homestead accounts: These accounts help build savings and increase access to credit for residents in high out-migration counties. Individuals could contribute a maximum of \$2,500 per year, for up to 5 years, as well as receive a government match of 25 to 100 percent.

Included in this Bill are also incentives for businesses through Rural Investment Tax Credit. This targets investments in high out-migration counties.

States—actually this provision, Mr. Chairman, and I'm very appreciative of you, you have included in your FSC/ETI Tax Bill that has passed the Senate, this provision that overall has passed the Senate 92 to 5. And this provision is actually already in the FSC/ETI Bill that is in front of the Senate—in front of the Congress now. And the Chairman has been the one that has fought to do this.

And I might note that in my recollection, this is the first time we have any tax incentives that have passed either body that have been targeted towards out-migration in rural counties. I don't know

that we've ever targeted those before, so I'm excited if we can get the front end of these in and establish the precedent for doing this.

In this particular provision that has passed the Senate, states would receive \$185,000 of tax credits for high out-migration counties. The states then allocate these credits to businesses that move to or expand in a high out-migration county.

The other provision that passed the Senate is Micro-enterprise Tax Credits. And these tax credits are for small businesses, five or fewer employees. And states may choose to allocate up to 10 percent of their rural investment tax credit allocation to qualified start-ups or expanded small businesses.

Small business is the key engine for economic growth for the country, but certainly for rural areas of our Nation.

Mr. Chairman, the final piece of this is a Venture Capital Fund that we seek to have 3 billion dollars put in a Venture Capital Fund to invest in high out-migration counties that we hope would be matched at state and local levels because Venture Capital Funds are something that is pretty rare to find targeted or existing in rural areas.

It is critical that we have a healthy and growing rural economy.

Mr. Chairman, I worked for years on the issue of rural development. And we've generally in the past tried to target the creation of programs of: Let's create a specialist here, let's try to get this person to encourage that, do this, but we have not—it has mostly been push programs. Let's try to push people to rural areas.

What's different about this, and it is modeled after the first Homestead Act, is it is a pull program. You say, "Okay, here's the incentive. If you've got heart enough to do it, come and do it."

And that's what we said in the first Homestead Act. I'm thankful that we didn't interview people in Washington to determine whether or not they were good enough to qualify for the 160 acres. We just said, "If you've got guts enough to do it, go do it." And it was a wildly successful program.

This one is a pull factor as well. These incentives are there. We don't care who you are. If you will go and live for 5 years, they're there.

And I think this is around what we can start to rebuild the hollowing out of rural America, particularly in the high plains in the center of the country. I think it is critically important we do it. You've started. And I want to urge that we pass the overall provisions of this Bill forward.

Thanks for allowing me to participate.

The CHAIRMAN. Well, and I thank you. And I think all of you in the audience can see the passion and the knowledge that Mr. Senator Brownback brings to this issue. And attention to rural America is something that is not easy to do in the Congress of the United States. It might be easy to do in the United States Senate because there are two senators for every state, but in the House of Representatives, it is very, very difficult, as I am sure each of the people testifying will testify to.

Ms. Peltier.

STATEMENT OF JEAN-MARI PELTIER, PRESIDENT, NATIONAL COUNCIL OF FARMER COOPERATIVES, WASHINGTON, DC

Ms. PELTIER. Thank you, Mr. Chairman, Senator Grassley, Senator Brownback. It is my pleasure to be here to appear before you today to—and I would like to commend you for holding this very important meeting to talk about economic growth and opportunity in rural America.

I was a little nervous, Senator Grassley, with my introduction when you point out that I work for the Environmental Protection Agency. I know that is not always a popular thing in talking with the farm community, but I would like to point out that in my prior life for 10 years, I represented the pear industry and a bargaining cooperative and sold to two other processing cooperatives. So I come to you now as the president and CEO of the National Council of Farmer Cooperatives, which is headquartered in Washington, DC. Farmer cooperatives, their farmer owners, employees and their families have a significant issue in the subject of today's hearing because rural America is where our cooperatives call home.

NCFC is a national trade association and it represents America's farmer-owned businesses. Our members represent nearly 30—excuse me, nearly 50 regional and national cooperatives businesses which market, supply, and provide credit to cooperatives, and in turn comprises more than 3,000 local cooperatives. In turn, those local cooperatives represent the majority of our Nation's 2 million farm families.

Here in Iowa, there are over 160 cooperatives, making Iowa the 7th largest home to cooperative business entities. In addition, the National Council of Farmer Cooperatives membership includes regional and state councils, including the Iowa Institute of Cooperatives.

These farmer businesses handle, process, and market virtually every type of commodity produced in the United States. They manufacture and sell farm supplies; and provide credit-related services—financial services on behalf of their own members.

Being farmer owned and controlled, these earnings from these activities are returned to farmer members on a patronage basis. This not only helps their overall income from the marketplace, but it also promotes additional economic activity in their rural communities.

Farmer cooperatives play another important role when it comes to our rural communities by providing over 200,000 full-time and part-time employees with a combined payroll of over \$8 billion—\$8 billion. These include an estimated 22,000 jobs here in the state of Iowa.

Clearly, maintaining and strengthening the ability of farmers who join together in cooperative self-help efforts is critically important to their economic well-being as well as that of rural America.

Rural America faces a number of challenges as a result of a combination of factors, including changing demographics, the advent of new technology, and globalization.

Earlier this morning, Senator Brownback pointed out over the last 20 years, rural counties have experienced out-migration of over 10 percent. Such losses have had a ripple effect on many communities in terms of their available work force and tax base, as well

as having an impact, as he pointed out, on schools and the availability of various services.

Many of these counties continue to be a home to a significant number of farmer cooperatives and their farmer owners, their employees, and their families. This has strategic importance. According to the USDA, job growth in agricultural areas is now more likely to come from rural industries related to farming rather than farming itself. Thus, farmer cooperatives and other agribusinesses involving agricultural inputs, processing and marketing of products, as well as the wholesale and retail trade of agricultural products, a significant presence is felt by cooperatives in rural communities.

Farmer cooperatives and their members have a strong commitment and vested interest in rural communities.

Addressing these challenges that are facing rural America, however, are going to take a strong commitment on the part of those—not only those who call it home, but also a combination of public policies and programs, including tax incentives and other initiatives.

And for this, we commend you, Senator Brownback—Senator—excuse me, I am stepping on my tongue. I am a little nervous—Senator Grassley, for your creation of a Heartland Investment and Rural Employment Act.

Title I of this important legislation contains a number of provisions that are really important to farmer cooperatives. And I would like to highlight those. First and foremost for the National Council of Farmer Cooperatives, is the elimination of the triple tax on cooperative—on corporate dividends paid on capital stock. Such a provision has been top priority—is one of the top priorities of farmer cooperatives as they gain access to equity capital.

Unfortunately in this case, capital stock are subject to a tax at 60 percent higher than that that is paid by their counterparts in corporate America. Eliminating this unfair tax penalty would better enable farmer cooperatives to raise the equity capital that they desperately need to modernize and expand, and it would help our farmer cooperatives to further expand their value-added business opportunities.

Additional provisions that we're very much interested in include the clarification of "cooperative marketing" to include value-added animal processing such as the conversion of corn into feed for chickens that lay eggs and then are marketed by a cooperative on behalf of its farmer owners.

Unfortunately, the IRS has held that since this involves a biological process rather than a mechanical process, it doesn't qualify. This provision addresses that issue.

Further—and this gets in an area of tax law with which I'm not terribly familiar, but Extension of Declaratory Judgment Procedures to Section 521 cooperatives on the same basis as similar types of entities would allow a cooperative whose application for Section 521 status is rejected to be able to seek judicial review of the denial first without creating a tax controversy.

Finally, and very importantly, we support the establishment of a general business credit that would allow cooperatives to pass through certain tax credits to their farmer members. This ability

to pass through these credits will give farmers and their cooperatives the opportunity to take advantage of other embedded tax incentives available to other businesses. I am going to talk about that further when we talk about some of the energy provisions and other environmental incentives that you have been a proponent of, Senator Grassley.

Many of these provisions are also included in several other bills that you mentioned that are critically important to the National Council of Farmers Cooperatives with the recent action taken in the session and the remainder of this session, including the JOBS bill, the FSI/ETI bill, as well as in the energy bill.

Finally, your HIRE Act include the provision that would create a special commission to help identify and recommend additional tax changes to encourage and promote cooperatives self-help efforts by farmers. We would welcome the opportunity to work closely with you on development of this commission and work with the commission.

Finally, I would like to just mention two additional issues that are important in addition to passage of FSC/ETI, in addition to passage of energy legislation, we would like to just highlight the importance of maintenance of the basic farm support programs.

In addition to that, we would like to consider the creation of a cooperative conservation initiative, which would allow farmer-owned cooperatives to seek to get better access to that expanded pool of funds that are available under the conservation title of the farm bill to allow farm cooperatives to help in the distribution of those benefits and help rural America meet new environmental incentives.

Thank you very much, Senator Grassley. And I will be glad to take any questions that you may have.

The CHAIRMAN. Thank you, Ms. Peltier.

Now, Mr. Keppy.

**STATEMENT OF GLEN KEPPEY, FARMER AND DIRECTOR,
CHS BOARD OF DIRECTORS, DAVENPORT, IOWA**

Mr. KEPPEY. Good morning, Senator Grassley and Senator Brownback. My name is Glen Keppy. I am a farmer from Davenport, Iowa. And I serve on the CHS Board of Directors.

CHS is a regional agricultural cooperative with over 1,100 local cooperatives representing nearly 350,000 producers centered in 28 states, which include Iowa, Montana, and Kansas. In fact, CHS continues to be the second largest employer in the state of Montana. Our company is a result of a merger of the cooperatives CENEX and Harvest States; thus the name CHS.

CHS appreciates being able to speak to several issues concerning the focus of this hearing today upon rural America. For 15 years, CHS directors and management have been coming to Washington, DC, urging help for rural America, especially for agriculture. We appreciate your efforts.

CHS has worked hard in supporting many of these items in bills produced by this Senate Finance Committee and applaud the committee, especially its leadership, in finding every means it can to advance hope to rural America.

I will highlight a few tax bills produced in 2004. In the highway bill, you have offered tax help for ethanol and biodiesel. This will help many farmers by providing another outlet for their crops. It will also help the environment by providing cleaner fuels for motor vehicles.

In the energy bill, you have offered several items to include tax credits for small petroleum refineries that dominate rural America as they try to meet the costly EPA diesel desulfurization requirements by the year 2006. These tax credits are critical to the last three remaining farmer-owned refineries in America, one of which is in Montana, Kansas, and Indiana.

In the corporate tax bill, you have offered help to ag exporters of American grain and granted farmers the right to economic tax assistance by classifying their cooperatives as manufacturers. Both of these measures will help, as the U.S. transitions away from export supports found illegal by the World Trade Organization and under which the United States is now being penalized, with tariffs increasing each month to over \$4 billion.

And this month, you introduced a bill for Heartland Investment and Rural Employment, called HIRE, that continues your efforts to help rural America. This is the topic for today.

Having supported many of the sections of HIRE legislation in previous bills, CHS knows firsthand that they are good provisions. The first part of the HIRE bill, Title I, has items we know will help cooperatives and producers. For example, you have been trying to eliminate the unfair third tax on co-ops that issue stock. Your proposed provision that allow co-ops to issue stock without reducing patronage dividends, which is known as the Dividend Allocation Rule, would certainly help cooperatives like CHS.

CHS looks at how elimination of the Dividend Allocation Rule would specifically help us in our CHS preferred stock offering nearly 2 years ago. We determined that elimination of the Dividend Allocation Rule would help us keep more patronage for our member-owners.

More importantly if the Dividend Allocation Rule is no longer in place, we believe more cooperatives would issue stock, thereby providing cash-strapped farmers and ranchers more liquidity and financial strength. There is a lot of co-op interest in this issue. In fact, our CFO and CEO have been giving briefings to other co-ops on the stock offering mechanism and the Dividend Allocation Rule's impact.

The second part of this HIRE legislation we would like—that I would like to comment on is Title III. Title III has another good group of provisions. We want to thank Senator Brownback for his work on these issues and on the New Homestead Act, along with Senators Dorgan of North Dakota and Senator Hagel of Nebraska.

We see the two provisions called "Rural Investment Tax Credits" and "Qualified Rural Small Business Investment Credits" as very useful for rural America.

Rural gas station with convenience stores and stores for crop inputs like fertilizers and crop protection items might be good candidates for these rural credits. Why? Let's take gas stations as an example.

The trend in the number of retail stores selling motor fuel in the United States has been steadily downward. Since 1994, there has been a loss of 35,532 stores, for a decline of 17.5 nationwide.

Since 1994, retail stores selling motor fuel in ten of CHS's core states, which include Iowa and Kansas, have declined by nearly 3,500 stores or 12.6 decline.

The three hardest hit states for CHS are Wyoming with a decline of 42; Kansas 21; and Montana declining by 20.9. We see that this is a serious factor in contributing to the shrinkage of rural communities.

CHS has been working hard on reversing this. It is our business program that gives co-ops the business tools to build local gas stations and convenience stores, but some are reluctant to make the financial commitment. This tax credit could help.

We are a mobile society, and as gas stations close in a given area, people move.

Our tax people have looked at the Rural Investment Tax Credit and would suggest several changes to the committee. First, reduce the number of players in the oversight of the program; and, second, set up a simple administrative process; and, third, insure the program has restraints and constraints so it does not become slanted or a who-you-know process.

Our tax people will be very happy to work with your staff on these suggestions. But all-in-all, this is a great provision.

In summary, we would commend the efforts of this committee and its leaders in pushing for tax relief for agriculture and rural America. The committee continues to do its job well. The problem is Congress.

First, Congress cannot seem to find the means to pass the energy bill or the corporate tax bill; both, which I have mentioned earlier, have some great tax help for agriculture and rural America. We need just two senators to change their filibustering vote on the energy bill, H.R. 6, and that, with its helpful ag and rural tax provisions, would become law.

Second, Congress needs to pass the corporate tax bill. It would be an embarrassment if the corporate tax bill with the tax provisions did not pass Congress this year; otherwise the WTO continues to levy more and more tariffs on our goods.

And lastly, this legislation called "HIRE" is another good bill that warrants passage. Once improved, CHS would actively urge members of Congress to give the HIRE bill their full support.

Thank you for this opportunity and thank you for your continued efforts to help rural America. I'm looking forward to answering questions later.

The CHAIRMAN. Thank you, Glen.

And now we go to Dr. Froelich.

STATEMENT OF PETER K. FROELICH, Ph.D., ASSISTANT FOR SPECIAL PROJECTS, OFFICE OF THE PRESIDENT, DICKINSON STATE UNIVERSITY, DICKINSON, NORTH DAKOTA

Dr. FROELICH. Mr. Chairman, Senator Brownback, I would like to thank you for the honor of speaking here today. My name is Peter Froelich and I am from Southwestern North Dakota. I am an assistant to the President at Dickinson State University. And I was

coordinator of the Great Plains Population Symposium Project, which was sponsored by Congress to study the demographic trends in the Great Plains.

Out-migration is creating a crisis in many parts of rural America, especially in the Great Plains. The challenges facing Great Plains communities include extensive out-migration of young adults away from rural places, the aging of the population, the erosion of local agricultural economies, the concentration of a few people into a few of the region's urban areas.

During the '90's, 38 percent of Great Plains counties lost population. In the year 2000, over half of the 1,000 non-counties of the Great Plains had smaller populations than they did in the year 1950. In total, Great Plains counties have lost over a half million people during the last 50 years. That's the net with natural increase included.

The dynamics underlying these changes are complex. Out-migration is highest among young adults. The loss of young adults computes to fewer births. The loss of young residents and fewer births exacerbates the aging of the population. Aging and lower birth rates combine to lead to natural population decrease which robs communities of their biological vitality and their ability to come back from out-migration shocks.

The widespread decline of rural communities is also masked with a large extent within the region as a whole, because if you look at state or regional statistics by these standards, a relatively rapid growth in about 14 percent of the Great Plains counties which are metropolitan. During the last half century, those metropolitan counties actually grew by about 182 percent.

The decline of rural communities is often attributed to the consolidation of agriculture that has been driven by the advance of agricultural technology and the need for economies of scale.

In North Dakota, the number of farms has fallen from about 86,000 in 1940 to fewer than 30,000 today.

The change in the number of young people under the age of 18 who live on farms in North Dakota is even more alarming. From 1970 until 1997, the number of farm youth fell by 82 percent; from 63,557 to 11,662.

The changes in agriculture are undeniable. The decline of rural communities should probably be attributable to a broader failure to develop economic alternatives, in addition to production of agriculture, rather than to changes in agriculture alone.

Agriculture will always be important for rural America. By itself, it simply does not provide an adequate base for a thriving rural society.

Revitalizing rural communities will not be an easy undertaking, but the provisions for tax credits that are included in the New Homestead Act, and also in the JOBS Act and the HIRE Act, are a solid step in the right direction.

The rural investment tax credits and the micro-enterprise tax credits that are included in all three bills will be powerful incentives for entrepreneurs who are needed to rebuild, diversify, and expand rural economies.

The provisions for these tax credits in all three bills are very similar, but given the current resource constraints, probably the

HIRE Act is the one that I would prefer because it includes a higher limit for the micro-enterprise tax credits. I think in the JOBS Act, it is 9 percent, and in the HIRE Act, it was 20 percent, the amount—the total growth investment credits that could be allocated to micro-enterprise. I think that's important because that higher limit for the micro-enterprise tax credits would give states more flexibility in promoting or supporting a bigger diversity of entrepreneurs in rural places.

Ultimately it is my hope that all of the provisions of S. 602, the New Homestead Act, will be enacted.

The forgiveness of college loans, individual homestead accounts, support for homeownership, and access to venture capital will be investments in the creative capacity of rural Americans and will give young people direct incentives to build their lives in rural America.

And with that, I would like to thank you again for holding this hearing, and for your efforts in rural America, and for giving me the opportunity to speak here.

The CHAIRMAN. I want to note that Dr. Froelich has a much longer statement that I assume you want printed in the record, don't you?

Dr. FROELICH. Yes.

The CHAIRMAN. And, Amy, if you could add the longer statement than what you gave, we will print that into the record so that everybody will have access to all the information that we do.

[The complete prepared statement of Dr. Froelich appears in the appendix.]

Chuck.

STATEMENT OF MR. CHUCK HASSEBROOK, EXECUTIVE DIRECTOR OF THE CENTER FOR RURAL AFFAIRS, LYONS, NEBRASKA

Mr. HASSEBROOK. Thanks, Senator Grassley. Thanks for having me. And thanks for taking the leadership that you have taken on so many issues that are important to family farming in rural communities; and Senator Brownback on the leadership of the New Homestead Act.

We strongly support the New Homestead Act. It makes a statement. I think it makes a statement that rural communities matter. And in my judgment, communities really do matter. Communities matter in part because strong communities I think bring out the best in people. We believe that strong communities restrain our selfish impulses and I think it elevates our instinct to help others. And it's time for public policy to begin to recognize that.

We are especially supportive of the New Homestead Act provisions aimed at stimulating small business development. Rural Small Business Investment Credit provides a 30 percent credit to establish or grow owner operated small businesses with five or fewer employees.

Senator Grassley, we appreciate your leadership in getting that JOBS tax code. We urge you to work for its adoption in the Congress. However, I would like to ask you to make one refinement as it goes to the Conference Committee.

The Senate JOBS provision would provide Rural Investment Tax Credits of \$185,000 per eligible county, but no more than 10 percent of that amount could be allocated to the Rural Small Business Credit. The other 90 percent would have to go for buildings.

And we urge you to remove that 10 percent cap on small business credits and simply allow communities the flexibility to determine how best to use their credits and decide what development path makes the most sense for them.

Based on our research, I have to say that for many communities, particularly those that have generally not been able to lure the large employers from outside and create jobs, small business development and small ownership really is the most promising strategy.

In the most rural counties of our region, in Iowa, Kansas, and in southern Nebraska and the Dakotas, as a group, nonfarm self-employment, people creating their own job by starting a small business, accounts for nearly 60 percent of total job growth and 80 percent of the net job growth in these rural agricultural counties. And there are advantages to that kind of development. It keeps profits in the community. It creates opportunities for people that own assets, build assets, and to become part of the middle class by starting a successful business and it puts the future of the community in the hands of community members. And I think that is particularly important in this day and age.

The Senate was wise to include the Rural Investment Tax Credit in its JOBS bill, but could be improved by removing the 10 percent cap on its use for small business development, and allowing rural development investments to go to where the return is greatest.

I would also like to comment on the Heartland Investment and Rural Employment Act, the HIRE Act.

HIRE proposes removing First Time Farmer Bonds from the state-by-state volume caps on private activity bonds. We support that provision. It is going to make more affordable credit available to beginning farmers. And that's important to our communities. And we would suggest one additional provision with respect to First Time Farmer Bonds.

Current law prohibits Federal guarantees of beginning farm loans based on First Time Farmer Bonds, and we propose changing that, allowing USDA to use its existing loan guarantee program to guarantee loans made to beginning farmers through state programs that are based on these First Time Farmer Bonds.

USDA has had trouble meeting its targets for guaranteeing loans to beginning farmers, of providing 25 percent of their loan guarantees towards beginning farmers. They have had trouble getting that. And this change would help overcome that problem and it would open a great deal more affordable credit to beginning farmers. I think most exciting is that the incentive that this could create, an incentive to retiring farmers to sell land on contract to beginning farmers.

USDA is experimenting with a new pilot program under the terms of the last farm bill that would allow it to guarantee or to use its guarantee program on land contracts. In other words, a retiring farmer would sell land on contract to a beginning farmer. USDA now can, on a pilot basis, guarantee that that contract sale would be repaid.

And if you would—if you would add that, together with the provision that would allow those guarantees to be applied to these First Time Farmer Bonds, you could actually create a situation where if a retiring farmer would sell land on contract to a beginner, that retiring farmer could be assured of getting repaid and also get a tax exemption on all the interest paid on that land contract. In other words, all interest on that land contract would be tax-free. And that would create a powerful incentive to sell to beginning farmers.

Finally, I want to balance my comments with a caution regarding the extension of favorable tax treatment to production agriculture. Prior to the Tax Reform Act of 1986, agriculture was a significantly tax-favored industry. The experience was not good. Tax shelters induced overinvestment, and that led to tax shelters and using overproduction, and that led to lower prices for farm commodities.

And I think the most troubling thing about that was that tax shelters changed the rules of competition in agriculture to favor large farms and investors with high-bracket incomes and capital to invest over medium-sized owner-operated farms and ranches.

Farmers and ranchers recognized the problem in the 1980's and they asked Congress to help. Senator Grassley, I think you more than anyone else played the lead role back in the 1980's in fixing the problem.

It's a lesson worth remembering, though. And I just want to say that we need to exercise caution so as to avoid repeating the mistake. For example, tax incentives in the New Homestead Act for buildings and venture capital should either exclude production agriculture or be carefully targeted to small- and medium-size owner-operated farms.

And, likewise, that the tax exemption in HIRE for livestock production cooperatives should be carefully scrutinized to ensure that it does not subsidize large industrial livestock operations and give them an unfair advantage over family livestock farms that have to pay taxes.

Thanks for the opportunity to testify and I submit written testimony. I would add that there is an error in my written testimony when I say that the Rural Investment Tax Credit is 165,000 per eligible county. In fact, it is 185,000. So anybody who picks up a written copy, I'll alert you to that error.

Thank you.

The CHAIRMAN. And I note that you asked us to take a look at that provision in the bill with a 10 percent cap on it and we'll do that.

Mr. HASSEBROOK. Thank you.

The CHAIRMAN. Now you, Mr. Edberg.

**STATEMENT OF MR. KEVIN EDBERG, EXECUTIVE DIRECTOR,
COOPERATIVE DEVELOPMENT SERVICES ON BEHALF OF
THE NATIONAL COOPERATIVE BUSINESS ASSOCIATION,
SAINT PAUL, MINNESOTA**

Mr. EDBERG. Thank you, Mr. Chairman.

Chairman and Senator Brownback, I am pleased to be here today representing the National Cooperative Business Association, the only national membership association that represents co-ops across all economic sectors.

I am the executive director of a nonprofit organization called Cooperative Development Services. I am also, in my spare time, the managing partner of a farming operation in Minnesota.

CDS is a longtime NCBA member. We help farmers and others in Iowa, Minnesota, and Wisconsin form cooperatives that create jobs, increase income, and expand economic opportunity. We have several new generation agricultural projects here we are working on in Iowa.

Cooperatives have long been an underused resource and tool for rural development; and for that reason, NCBA applauds the many provisions of the Heartland Investment and Rural Employment Act that encourage cooperative development through a combination of tax code modernization and new tax incentives.

The bill represents a major improvement in Federal tax policy. NCBA strongly supports the provisions that provide greater tax equity profits. Eliminating the adverse impact of the committed allocation rule will help cooperatives raise capital by issuing nonvoting stock. Repeal of this rule is long overdue and we appreciate, Senator, your support to enact this provision.

NCBA also supports the provision that allow cooperatives to pass through tax credits to their members, and those that clarify Section 521 of the tax code, giving co-ops the ability to modernize and expand their services to members.

We welcome your interest in creating a commission to evaluate Subchapter T of the tax code, including capital and other barriers the co-ops face, but we recognize that driving this provision are state-level statutes that provide ag co-ops with greater flexibility in accessing outside capital, particular need for value-added co-ops that require capital for processing facilities.

Though many support this new approach, these hybrid statutes fundamentally alter the definition of cooperatives by redefining who their members are, and this process could potentially delude member control.

Any changes in Subchapter T, relating to these and other issues, affect every cooperative that file under its provisions, not just ag co-ops. And as a result, we ask that any Subchapter T commission include experts from a range of industries in which co-ops operate.

Turning to another section of the Bill, we thank you, Mr. Chairman, for proposing a new Community Homeownership Credit program that will for the first time provide parity for developers of affordable homes.

Homeownership is a primary way that average citizens build assets and wealth and they are the key to sustain both rural and economic development and yet there has been no Federal program to promote the development of affordable homes. Tax credits have been available only for the development of rental housing.

Housing co-ops offer great promise to rural America, particularly for elderly populations. Like any form of homeownership in rural communities where incomes tend to be lower than the national average, affordability is an issue. What developers must charge to cover construction costs and earn a return exceeds what many rural families can afford to pay. The tax credit closes that gap and puts homeownership in reach of more rural residents.

Housing costs tend to be more difficult to develop than conventional single-family homes, though they are no more expensive to construct than other forms of multi-family housing. Educating community leaders, lenders, and potential buyers about cooperatives takes time, energy, and money and these act as a disincentive to the development of co-ops. The tax credit mitigates these factors.

I would like to speak for a moment about rural seniors. Rural seniors are often faced with two choices. As they age, the quality of the home that they are in becomes less appropriate for them, they have two choices. One is to leave the community and the—because they—there is an absence of appropriate housing for them, or to move into a local, more expensive, nursing home.

Rural senior housing co-ops offer unique solutions to the problems of the elderly. They allow seniors to revolve their equity from the sale of their single-family home to access appropriate affordable housing, and they encourage seniors to remain in their communities in an environment that encourages them to remain independent, active, and involved. This solution retains their lifelong accumulation of wealth and purchasing power in their own community to the benefit of Main Street businesses and to the local economy.

NCBA recommends completing organizational costs in the eligible basis for the community homeownership credit for other types of housing—excuse me, for cooperatives because these costs are higher for housing co-ops than other types of housing.

We also suggest evaluating other tax credits that may increase investment in rural co-ops, such as farmer investments, value-added ventures, or small business investment in purchasing co-ops.

Finally, on an unrelated topic, we urge that this legislation be accompanied by strong Federal appropriations for the technical infrastructure of the co-op development. Centers, like CDS and the Iowa State Value-Added Center, rely largely on Federal funding to help support business, to help us to work with rural businesses in conducting credible feasibility analyses and the development of solid business plans. And without these two components, neither changes in tax law or co-op structure will help attract new capital to rural ventures.

Unfortunately, the Federal support for these centers have remained largely flat in recent years. And this year, the House has proposed cuts in the program known as the Rural Co-op Development Grant program. We urge more funding from Congress so that these centers can continue to help form new cooperatives that will in turn help rural America.

Mr. Chairman, on behalf of NCBA, we thank you for this opportunity to testify and for the long-standing support of cooperatives.

The CHAIRMAN. And I thank you for summarizing a very long and comprehensive statement that you've submitted for the record as well.

Now, Mr. Tiernan.

STATEMENT OF SHANE TIERNAN, AG/COMMERCIAL LOAN DEVELOPMENT OFFICER, GRUNDY NATIONAL BANK, GRUNDY CENTER, IOWA

Mr. TIERNAN. Mr. Chairman and Senator Brownback, I am honored to have this opportunity to address your committee to discuss our concern regarding the out-migration of our rural areas.

Grundy National Bank is a two bank holding company located in north central Iowa. We are owned by just over 300 shareholders, the majority of whom are local residents, business men and women and farmers surrounding the Grundy Center area.

We recently facilitated a discussion among the local producers, farm implement dealers, ag experts, legislator and legislative representatives. The purpose of this discussion was to explore the feasibility of establishing a machinery cooperative. There are several reasons we felt we needed to have this discussion.

Farm production costs continue to increase. While many producers are attempting to chase more revenue, more needs to be done to help farmers reduce costs.

The loss of farm producers in the past 20 years is staggering in our region and statewide. If we do not, (A), lower the cost of entry into the industry and, (B), lower the cost of staying in the industry, we will continue to see the out-migration of our young men and women away from production agriculture.

There are many small- to mid-size farm operations that cannot afford to update their machinery and equipment. Consequently, they are forced to work with older, inefficient equipment which is constantly in the state of repair; leaving industry because they can no longer afford to pay for their equipment; or seek off-farm employment to subsidize the farm operation.

If we do not find an economical means to reduce producer cost, we will see—we will also see the increases in contract farming arrangements with large corporations. We will also continue to see the average farm size grow in which a handful of very large producers control large lots of land.

These trends will continue to accelerate the erosion of our rural community fabric which in turn will result in the continued reduction of school districts, rural businesses and communities who are not fortunate enough to be located on the edges of metropolitan areas.

A closer look at our decline of farm operators is revealed in the graphs presented here today.

Since 1982, in a six-county region in north central Iowa, we have lost 2,256 operators. This amounts to an average loss of 113 producers per year.

Across the state of Iowa, the numbers are no better. During this same time period, Iowa lost 24,830 producers, an average of 1,242 per year.

Where are the largest losses? From 1982 to 2002, our six-county area lost 75 percent of farm producers age 25 to 34 years old. Statewide the loss was slightly higher.

As of the 2002 Census of Agriculture, the state of Iowa had an average of only 62 farm producers per county in this age bracket.

On the other hand, producers over age 65 have grown substantially. Statewide this age group has grown 56 percent from 1982 to

2002. Many of these producers will remain active longer because they can't afford to quit due to the tax consequences of having a sale or there is no one they can turn their farming operation over to.

Our questions of the roles of a community bank are: In another 10 or 15 years, who will be our customer? Who will be farming the land? And how do we help create an environment where young men and women see a profitable future in production agriculture?

We must solve two major issues: How do producers participate in the value chain without being taken advantage of? How can we help producers find ways to drive down their fixed costs so they become more viable a competitor and a world leader on industry.

Many producer groups are seeing some success in participating in the value chain. The growth of producer-owned or partially owned ethanol plants and farmer-owned cooperatives are good examples. However, creating and sustaining farmer-owned production and machinery cooperatives creates new challenges.

Canada has been successfully using machinery cooperatives since 1991. The data available suggests that producers have been able to reduce their machinery cost by 35 percent. However, because of farm program payment and some tax rules in the United States, initiating machinery cooperatives may be more difficult.

We believe a machinery cooperative may be a viable option to encourage. One fact remains clear. If we do not find ways to keep young producers and smaller to medium size family farm operations viable, we will continue to see the out-migration of these families to areas where they can sustain an affordable living. The ripple effect of this trend has major economic implications not only for rural Iowa and rural community banks, but rural areas across this country.

I believe the time has come to stop talking about this problem and provide real and tangible programs and processes to address the population losses being endured by rural and primarily agricultural America.

This machinery cooperative concept is only one small piece of the puzzle. There are many and complex issues, but if we are truly committed as a country to preserving our rural regions, then we must commit the resources necessary to make it happen.

Regional collaboration among communities, counties, farm and nonfarm groups focused on creating and sustaining viable family-owned production agriculture which also includes the growth and development of rural based job opportunities will bring a value-added needed to convince our young men and women and families that there are viable opportunities for them in rural areas.

I encourage being creative in developing the tools necessary to accomplish this. We do need to take a hard look at existing tax codes and FSA regulations and be willing to make to special exceptions for innovative and viable processes and programs that contribute to the economic growth of rural community and agricultural enterprises.

Thank you again.

The CHAIRMAN. And I would like to suggest to you that some of the charts you have given us will be charts that we can use with our issue of the death tax in final decisions on that because your

statistics show this great out-migration. And I think they showed 22 percent of our farmers over 65 years of age. So in a very short period of time, we're going to lose a lot of our farmers. And that's very much related to the ability, as both you and Chuck Hassebrook suggested, of ways of helping young farmers get started. So we might follow up with you on that point.

Now we are going to—I think what I will do here, is normally we would take 5 minutes for me and 5 minutes for you, but I think we will just alternate back and forth. So I'll ask the first question and then you can ask a question.

Here—before I do that, though, this may not happen, but sometimes when other members of the committee can't come, you might get questions in writing. And so if you get those questions in writing, we would appreciate very much your immediate response. For those of you that haven't been involved with that, my staff can help you in that process. I don't think there will be, but there could be. I suppose even from us if we don't get enough questions asked.

I'm going to start with Glen Keppy.

As you mentioned in your testimony, many of the things we have discussed today are included in this bill that I referred to as the JOBS bill. It passed the Senate 92 to 5.

I hope the final version of the bill includes manufacturing reductions for cooperative relief from dividend allocation clarification of value-added process and all of the energy tax provisions. And some of even Senator Brownback's New Homestead Act is included.

If the President—here's my question: If the President were to sign all of that into law, how do you think that it would spur economic growth in rural America?

Mr. KEPPY. Well, my simple answer would be it would be tremendous. But I want—I want to start out by—you addressed early on in your comments that the young people are leaving the state. And that indeed is true. I want to say that maybe I'm bucking the trend. I have twin boys that 6 years ago came home from college and are in the farming operation. They said they like the lifestyle of all four grandparents, my wife and I, and they wanted to be a part of that. So I'm proud of that.

But I do know, and I have the succinct problem with the last speaker, I don't know who is going to farm all the farm—all the land in the future. And so I think the issues that you have been addressing and that you addressed today are vitally important.

The other thing, as I got on the airplane to leave here—I guess before I got in the airplane, while I was waiting, there was a news article about an Illinois high school that had to cancel its football season because of lack of players. There is another case in point. So many people from that rural area have left and they can't even put a football team together. Now they can consolidate, and that is an answer, but I guess my question is: How long can we continue to consolidate?

So we need—we need to bite the bullet and find some solutions so that we can enhance the opportunities for those of us that want to stay in rural America that we can.

The energy tax. I think the tax credits that go to smaller refineries is extremely important. We as a co-op are—own one, are part owners of another refinery. There is continued upgrading that we

need to do. We are just spending 90 million now to upgrade on the sulfur requirements.

And we have—if agriculture is going to be assured diesel fuel during their production season, there has to be a co-op system because the big boys, quote, may not take care of agriculture when we need it during corn harvesting or planting. In fact, 40 percent of all of the agriculture diesel fuel comes from the co-op system today. So it is significant. And if we would ever lose that, it would be tremendous to—a tremendous drain.

One other thing I want to mention. There are so many different structures within agriculture. And I think the rural America and the co-op system needs to be there so that we can provide the services that they need, whether it is a small family farm or ultra large unit. And if there isn't a co-op system there today to provide the services, there will be one born. And I think that's where rural development can really help make sure that value-added and the opportunity for profit is out there for agriculture.

Dividend allocation. And I appreciate the efforts of so many people in Washington, DC, and especially you, Mr. Chairman, and your staff. That is an unfair triple tax that we need to get rid of. And I think that if the legislation you are proposing is signed by the President, it would be a tremendous boost to the agriculture and cooperative system.

There is not enough farmer money to go into some of these value-added projects and we need to find other ways of capitalizing the co-op system and the value-added cooperatives that are being born. And I think if we could do away with this unfair triple tax, it would be important.

HIRE. There are so many excellent points in that and positive points. The bottom line is if we have a healthy agriculture, we have jobs and taxes created. And jobs and taxes is what is good for rural America. In fact, it is good for all of America. And so I support the efforts and I am going to continue to work hard to try to get it passed. I just hope your statement that the President signs it comes true someday. It is my—my challenge to Congress, as I stated, is to get it passed.

Thank you.

The CHAIRMAN. Senator Brownback.

Senator BROWNBACK. Thank you. Excellent panel and a good discussion of the topics. I wanted to say one thing real quick, if I could, on the energy bill agreement, Mr. Keppy, we passed this thing in the Senate, two—on the third time we have passed it, we—it is being held up—it is hurting the country. It is hurting agriculture. We've really got to get this energy bill through. And it has been a great frustration to me that we haven't been able to get it on through and across the line.

And if you look at prices of energy, what they are doing with the—what is happening globally, we are really heading for problems. And it has been filibustered. We have 58 votes. We need two more. It's not that we don't have the majority; we do. But to get it on across the line has been a great frustration for me that a number of people, for whatever reasons, are holding that up.

I want to address my question to you, if I could, Mr. Hassebrook.

I've worked in the area of rural development, rural issues for 20, 30 years now and have seen this constant number and this decline taking place for a lot of years, and I have seen efforts for a lot of years.

Okay. Let's try to get more young farmers and let's try to get people back to the rural areas and create new farmer programs in our state and things we try to do nationally. And it just seems like we have not been able to stop it, in spite of a lot of people's efforts, a lot of people's thinking. You've been thinking and writing about it for years. Why have we not been successful today or what do we need to change in the design of the programs to really have an input here?

Mr. HASSEBROOK. That's a very good question. I think to some extent—when we talk about agriculture for a minute because we talked about young farmers, to some extent our larger policy framework has overwhelmed everything that we have done to try to help the young farmers.

I've often said and I truly believe that the single most important thing Congress could do to help create a future for family farms and beginning farmers is stop subsidizing the largest farms and driving out of business and put up real capital and payments. And Senator Grassley has been the leader on that and he supported that. But the most money we spent in agriculture is distributed on the basis of the bigger you get, the more money you get. The net affect is going to be to get at least as much to help the largest, most aggressively expanding farms drive their neighbors out of business, smaller farms, and particularly beginning farmers. If somebody large has got a lot of capital and can get—you know, every time they had a farm, they get more money from the farm program. It is just very hard for a young farmer with limited capital to go in and compete with them for cash rents or to buy land. So that has overwhelmed so much of what we have done because that has been a predominant policy.

The other thing is I think that from the standpoint of rural development—and I'm particularly speaking from the perspective of the smaller counties, the counties that have been losing population, that so much of what we've done in rural development has focused on the idea of luring a big employer to town. And that has worked in some places, the places with 20,000 population, places like that. But it hasn't worked in the communities that have towns of 5,000 and below, by and large, especially the smaller ones.

What's worked there is small business development. But yet I—when I look at public policy, I think there is a kind of a bias against that kind of development. I am speaking about my own state of Nebraska. In Nebraska, we spent over a billion and a half dollars over the last 15 years to provide incentives for companies to come in and create jobs. And we haven't spent 1 percent of that amount on small business development, even though that counts for most of the job growth in most rural places.

And I think that provisions like the New Homestead Act provision, that the rural small business investment credit are starting to fix that. Everybody is starting to fix that. But—so I think getting that focus back on—for lack of a better term I'll call small entrepreneurship, farmers coming together to form new cooperatives,

or people starting a small nonfarm business, or getting an agriculture policy that focuses on having people—more people make a living out there, rather than concentrating so much of their resources in fixing it. All those things can work; but that's not the way—that's not been the predominant approach in the past and I think that's why it never worked.

Senator BROWNBACK. Me, too.

The CHAIRMAN. I want to go to Jean-Mari.

You outlined in your testimony that farmer cooperatives play an important role in carrying out environmental conservation programs. I would like to have you share those thoughts in more detail and whether any existing programs would need to be modified.

And my question comes from the standpoint that we don't discuss a whole lot, but there are a lot of government action that is waiting to be taken that is going to be very detrimental to agriculture, and whether or not agriculture is going to have the resources to meet those requirements, assuming those requirements are legitimate. I don't assume that, but we've got to deal with them anyway.

Ms. PELTIER. Well, Senator Grassley, in my role as counselor to the Administrator of the EPA, I thought firsthand that there was an ever broadening scope of environmental statutes that were being applied in ways that had never earlier been contemplated.

Application of laws to the super fund, all of a sudden being applied to animal agriculture operations; new concerns about air emissions from animal feeding operations; application of—the convergence of the Endangered Species Act and use of agriculture chemicals, all of these together are putting a broader array of challenges to farmers to comply with those kinds of regulations.

And during the last discussion of the farm bill, Congress expanded by 80 percent the amount of funds that were available to producers to deal with conservation issues. But—but USDA, especially through the National Resource Conservation Service, and folks who have had historic expertise in application of water statutes aren't necessarily there and prepared to help farmers comply with new air rules or new pesticide rules. And therein lies a real potential role for farmer-owned cooperatives. An organization like CHS that is a part of ag reliance has the expertise there to help farmers put together reduced risk, cost-management strategies, and actually see those implemented at the field level.

Our organizations like CF Industries, that are salespeople of fertilizers, have the ability to help producers put together reasonable nutrient management plans and see those implemented out in the field.

And so I think that we could provide a really important role in serving in the role of technical service providers that were envisioned under those statutes, and also to play the role that we have in some of the FSA programs, unlike ones we have for cotton and for rice where the cooperatives are the conduit for which those benefits flow. We could do the same thing with conservation programs. And the cooperatives could help the staff in actually documenting what the environment benefits are.

Importantly, Senator Grassley, I think some of the proposals that you have championed, whether it is the Section 29 Credit, the Sec-

tion 45 credit, which would provide an additional 1.8 cent per kilowatt hour for generation of electricity for nontraditional sources, that's an area where we really could try to build some programs.

I know in Iowa, there have been concerns about air emissions from animal feeding operations, hydrogen sulfide, ammonia. There is also concerns under implementation of a confined animal feeding rule to reduce runoff of nutrients into the water supply. One of the potential solutions is running those nutrients through an anaerobic digester.

I might just underscore first, as I am sure that Glen Keppy would agree with me on this, one of the best uses of animal nutrients is to continue to use those in the best way possible. And that certainly is something that we would continue to promote. But there are areas where there just frankly is more manure. And in those cases, looking at advance forms of manure treatment, whether it is running anaerobic digesters, it's hard to put in place because it's hard to make them pencil. It is hard to find an ability to wheel that power back to the grid, but something like the eight—1.8 cent per kilowatt hour tax incentive that you provided could help make that pencil.

Further, the flow-through provisions that you put in place could help co-ops help farmers put those systems in place and allow them to flow that benefit back in the form of patronage. So we are really hopeful to see all of those provisions finally put into law.

We would need to see potentially some modification in the conservation programs to clarify that programs that are there to help the farmer, that cooperatives can also—as being owned by farmer members, that they would also be eligible for consideration as an individual under those conservation programs.

The CHAIRMAN. Senator Brownback.

Senator BROWNBACK. Thank you. I think for Mr. Edberg, if I could.

We had a push, over the years, on some of these new uses, finding different markets for agriculture commodities. We have had some nice successes in some of those areas. Ethanol is a noteworthy one. Biodiesel is coming on nicely. Inks out of soybean oil, things along that line. But there was—I remember we had an Expo of this a number of years back just showing some of these things. And there were some really clever ones I thought that were out there that I haven't seen come on forward, like particleboard made out of wheat or straw.

A guy had—I remember had a clay pigeon for shooting that used a target made out of starch.

And another person had edible plates and silverware. I thought that was an interesting concept. I guess you'd have to add that in your caloric intake where you'd eat your plate then afterwards as well.

What has happened to that series? Are those coming on the marketplace now? Have they been stepped back? What's happening?

Mr. EDBERG. There's two or three components of that. Some of those are being developed. For example, a joint venture between Cargill and DuPont is—or excuse me, Dow is currently creating that starch plastic eating utensils, disposable packages, and so forth. That's been rolling out in the last couple of years. It is not

being done through a farmer-owned cooperative, but it is being commercialized in the industry.

Senator BROWNBACK. And are those on the market now?

Mr. EDBERG. Coming on. And they are choosing their—the statements on the marketplace to enter are being chosen very carefully. It has wide possible application, to bringing the technology in certain areas that would—packaging first, and then some other places to establish a foothold, to create the manufacturing distribution infrastructure. And so some of these other applications will be coming out following that.

The example of particleboard, straw and particleboard has been attempted in some places. We do—one of the states where we do some work is Minnesota. And the challenge there has been the agricultural community has been viewed by the timber industry as competitors. The particleboard for straw being a competitor to the wood-based product. A much smarter—and for that reason, the marketing plans for how you penetrate and take on an entrenched existing industry, the timber industry, has made it very difficult for ag producers to be competitive in that.

However, a much smarter approach would be for ag producers and wood producers, particularly in the upper Midwest where they are facing fiber shortages, to view themselves as being partners or potential joint venturers so that the group of producers would in fact turn their straw into either pure particleboard into straw or mixed fiber materials with partial wood fiber and straw fiber, and being marketed through or in conjunction with the existing distribution models is a much better business model.

So in that situation, the cooperative approach hasn't found the right way of entering the marketplace in a successful way because they haven't found the right partners to do that.

To take a step back. The biggest issue facing the success on a farmer value-added venture, these new types of ventures, is strong support in the predevelopment phase. It is the support to help the local chamber, the folks who are sitting around the dice cafe—sitting around the table of the cafe before they shake dice, they say, you know, we don't like the price of X. Pick your favorite commodity. And they have an idea for something that they could do locally. But the amount of predevelopment knowledge that will assist those folks in moving through the feasibility analysis of the business planning stage, that process is long and drawn out and it kills. It kills the idea before it has an opportunity to move to the equity phase, which also will kill. Now gathering equity is a substantially long process.

So we need both. We need predevelopment and then components of a HIRE Act that would be—provide credits and gather the equity. It is a one-two combination. And we can't do one without the other.

I would also put in one other plug.

Senator Grassley, you have been a champion on the value-added booster grant program. Those dollars, which have been reduced in the past budget, have been successful in helping in that phase of doing the predevelopment hours and for getting the working capital for projects to move forward. We've seen a reduction in the investment in those areas. And that's been a challenge in recent years.

So what we need to do, in my opinion, is make sure that we are strengthening the support base of those value-added ventures through predevelopment support, and then continuation of a working capital and tax policy provisions of things like the HIRE Act.

Senator BROWNBACK. Thank you.

The CHAIRMAN. Mr. Froelich, you have, in your long statement, put a lot of emphasis upon the need for entrepreneurship for economic development in rural areas.

First of all, is that statement similar to what Chuck Hassebrook was saying about more emphasis upon small business or does it go beyond that? And what are some ways which we can help attempt to foster entrepreneurship?

Mr. FROELICH. I think I agree with Mr. Hassebrook about the importance of entrepreneurship. I think that in the past, rural development has tended to focus too much on recruitment of outside businesses and then got into competitions with their neighboring communities to try to attract companies that had got into bidding wars and stuff, which really hasn't benefited them very much. As he said, many of the smaller communities simply are not successful in that game anyway.

I think it makes a lot more sense, and I think it actually hearkens back to an earlier tradition back in the time of the Homestead Act. I mean homesteading was about being an entrepreneur. Maybe the difference between that earlier period and now is that when those entrepreneurs came out into rural areas and homesteaded, they may not have known how to do everything they needed to know how to do, but they knew what they were going to try to do.

And now we have a lot of potential entrepreneurs who would perhaps love to stay in rural America, but it is, like, well, I would have to invent some new industry. I have to—I have to have a new idea. I can't take something that is kind of readymade. I can't say, well, I am going to be a farmer, I'm going to learn how to farm and go out and create a farm business. They have to say, well, what could I do in this place?

And I think that that is a tremendous challenge for a lot of rural communities because you have young people there and they don't know what it is that they can do that will be successful in that place, and then they feel compelled to go to school to get an educational and leave. And I think that that's the pattern that has developed over the last 50 years, at least.

But, nonetheless, I think that entrepreneurship is the development strategy that is most likely to work in those smaller communities. I mean it is homegrown. I think most of the things that Mr.—well, I should rephrase—that all of the things Mr. Hassebrook said are true.

I think the tax credits and the particular micro-enterprise tax credit is going to be very important for encouraging entrepreneurs.

Before I came here, I was at a place where there were some potential—there were guys that had been starting things for the last couple of years that are inventors and they are outsourcing all their manufacturing. And I described these provisions to them just to see what their reaction would be. And I could just see the lights were coming on and they said, "Boy, let me know if this—if this stuff passes because this changes everything. This changes every-

thing about what we might do. We might actually build warehouses and create some jobs or even try to bring manufacturing capacity into this area if we can get these tax credits.”

So I think this would be a major step forward.

But I think even with the financial aspect of it, we still have to address the sort of question that comes before us. If people aren't inventors and they want to be entrepreneurs, what is it they can do? And for that, I think that we need to really—well, for one thing, we need to start enlisting our schools, the K–12 school system, with some entrepreneur training. I'm not sure exactly how that is a tax issue, but I do think that—and I have recently spoken with a number of superintendents in our area, and they are a little nervous about doing entrepreneurship training, partly because they are worried about meeting the requirements of No Child Left Behind and they think we can't do anything else.

So I think that we need to somehow find a way to get some entrepreneurship training into the K–12 schools.

And then I also think we need to tap on the universities and give them incentives to perhaps fund different kinds of research that are aimed at small businesses that can be successful in rural places, and give researchers at the university the charge of saying it is up to you, if you want this funding, to come up with commercially viable alternatives that a family out in the small town can start a business around. And I think that's possible. But we have tended to support our universities to do different kinds of research that are aimed at larger industries or for production of agriculture on a grander scale.

So I think that, you know, a number of things like that, that—the last thing, I guess, that I will mention here is that I think in the farm bill, and even though I am not an expert on the last farm bill, there was a provision for some rural business investment companies. And my understanding is that those were not funded, even though they are in the—in the act.

I think it would be a good idea, even though this is—again, it comes later as sort of the venture recreation stage, if we funded those provisions that are in the farm bill now, the rural investment companies that were created.

The CHAIRMAN. Senator Brownback.

Senator BROWNBACK. I wanted to know if I could go to one point that we had on the New Homestead Act that was pulled out. And it had some controversy with it. But in looking at my own state, Kansas, I wondered about this as a provision for us to grow the population of rural areas. And that's the issue of immigration. Always a touchy issue, always a difficult issue for the country. But when I look at my counties—I was going to show—

Brian, would you mind putting that canvas back up.

When I look at my Kansas in the rural parts of my state that have grown, they have generally been ones in the southwest portion of the state, rural areas, the population of Kansas, primarily in the eastern part of the state. We have got a population growth in the southwest has primarily been—beef packing has been the center of the business creation, but then a lot of other businesses around that, the cattle industry around that. Most of the people, though, this has been an immigrant population that has come in.

It has been Asian; it has been Latino that has come into this area. And they have been great, they have been hard workers, they have done well, they have established roots and they have established community in this area.

One of the things we talked about in the New Homestead Act was a particular immigration provision in the bill saying you create a series of visas for out-migrating counties and say to the county commissioners in the county, if you want to access these, great, God bless you; if you don't, that's fine, too, you don't have to, but as a way of creating a group of people coming into the area and working.

What do you think about an immigration strategy and that as a proponent on a rural redevelopment in the Great Plains?

Mr. FROELICH. Well, I think that in having the immigrants come into some of the out-migration counties would be a good thing if you can stay there. But, you know, regardless of where they come from, they need to have something that they can do when they get there. And they need to have a vision of what they are going to do when they get there.

So I mean if—if they come into, you know, a rural county, and they have some notion of what their life is going to be and what they can build there, and they have some tools to build that, then I think it can be very positive. I think you can get there.

But I think, on the other hand, that if they go into a lot of those places and they look around and they say, well, what is it that I could do here, that essentially they will be moving to the larger counties.

I mean I—I remember 2 years ago, the council general, I think is the title, from Armenia came and visited our university, and I gave him a tour, and we had a conversation about trying to bring some Armenian students to Dickinson to study there. He started asking me about discotheques and nightlife and restaurants and a whole host of things which I didn't realize that Armenian—the students there are quite urban and sophisticated, he said. And he told me that he thought that we could possibly do it if we brought very serious students who weren't interested in anything but their books, but he said that pretty much everybody else that he could think of that we could bring over to Dickinson would be there 2 weeks and then they would move to Los Angeles. And I think that's a problem.

I think regardless of where the people come, we have to develop a climate in those small communities that people feel happy with, where they can get the things that they want, where they can buy the things that they want, and where there are markets that they can see a way to tap into for their own prosperity.

I mean—so I think it is a complex challenge. I think if we can address some of those other issues kind of at the same time that we would bring in immigrants, then I think it might be a real success. Otherwise I think it would be a problem.

The CHAIRMAN. Mr. Edberg, you discussed senior housing co-ops. And evidently—I don't know that there's very many of them. And why haven't they developed? Or what does it take to develop it?

Mr. EDBERG. There are two or three aspects of that. The framework that you want to think about that in, it's a complement to the

strategy of attracting new people or allowing people to stay in rural places. You want to keep the existing cash flow and asset base that is there. You want to prevent leakage of the asset base by keeping the rural seniors in their place. Because when they leave, if they have to leave and go to a larger town, they are going to pull money out of the local bank, they are going to no longer frequent the local pharmacy, the local grocery store, the local doctor, you are going to put constraints on an existing strained system and exacerbate the problems of departure.

Rural—senior co-op housing is actually very popular in the upper Midwest. We have about 74 of them in Minnesota. Not all rural, many of those are urban, but we have about two dozen rural senior co-ops in Minnesota. There are about eight or nine of them here in Iowa. There are relatively few in other places.

One of the impediments of that has been on educating lenders on lending to cooperatives. It seems like there is only—in the upper Midwest, in Minnesota, to an extent in Iowa, that HUD, using Section 202 financing, has been able to figure out how to make that program work for financing these cooperatives. The rules are there, the structure is there, but there are very few other HUD offices in the country making any loans using the 202 allocations.

And I believe it was a Senate Special Committee on Aging a year ago that identified that as a problem for underutilization of the resources that are provided to it. So some education on here's how you make these resources available in conjunction with other financing opportunities becoming one part of that.

I would note that the Iowa Institute of Co-ops has talked to my organization. And this fall we are going to be doing an assessment on what would be the pathway to success for development of more rural co-ops in county seat sized community, communities about five to ten thousand individuals. And part of that is going to be finding the developers that are interested in doing that.

There are resources close by in Minnesota where people can see how this process is working so they can see how they would do it in these smaller communities.

A challenge—so one part is the developer. One part is the financing. One part is the education of the process, you know, here's how you do it and getting more familiar with that.

We find that rural co-ops are successful when they are started within about 60 miles of an existing one. People get familiar with the idea and then they want one in their community.

The last thing I had mentioned is that in smaller towns, these things are size-sensitive. In other words, where you have a smaller community, you have to be very cognizant of how many units you can put on the market. If you build too much, you can't sell them, and then that's a financial drain. But if you get that market assessment right, that's exactly where some of the provisions of the HIRE Act would fit in in helping make those projects go, by providing the tax credits for those developers.

The CHAIRMAN. Senator Brownback.

Senator BROWNBACK. Mr. Tiernan, I was looking at your charts that you had for your counties, and that mirrors a lot of my experience in what I have seen on the rural county that I am from in Kansas. And we see that throughout the Midwest.

You put forward a proposal on a machinery cooperative. And that's an interesting one to do. But you also must be figuring that as a banker of a financial institution, who is going to farm here in the future? What—without policy shifts—without major policy shifts, who do you project is going to be farming in the future? What's it going to look like?

Mr. TIERNAN. Well, I think that we are already starting to see the increase in contract farming arrangements with large grain processors where they are offering the producer a flat per acre fee to provide labor, machinery, and land to that organization in order to supply them with grain. They need to have a supply—a steady supply of grain. So without—as farm sizes grow larger, the large producers don't have a need for those contract arrangements. The smaller producers do. I mean granted there is risk, but they become a little more than contract laborers for a large corporation and are at the mercy of that corporation once they are hooked into those contracts to really have to perform under those standards, I think, and also don't have a benefit of additional profit opportunities when they become available.

Senator BROWNBACK. So do you—if I could, Mr. Tiernan, you view that, then, the agriculture production, agriculture grain production as going and following the same track as much as the livestock agriculture is a contract arrangement?

Mr. TIERNAN. Right. It's a real issue that we have seen it in the livestock industry. And it is only a matter of time before it expands into cash grain production because the people—the producers just aren't there.

And, you know, we have one producer operation in our region that farms 30,000 acres. One producer farming 30,000 acres is not beneficial to our rural communities and counties in the state of Iowa. It benefits him. And certainly it creates jobs, but some of those jobs are being created to farmers who could no longer afford to farm their own farm and so have advocated their farm operation to this type of operator and then they have worked for a wage because that's an income that they can live on and it keeps them out in the rural area.

So those types of trends are certainly going to continue if we don't find a way to lower the cost of entry and then also lower the cost of staying in the industry.

And the machinery cooperatives are only one tool. One of the biggest barriers for a young producer to enter the industry is the cost of the equipment. Obviously there is access to land, is an issue as well. But if they can be a part of this cooperative, and not have at large the initial cost, and then also share the knowledge of farmers who had been in the industry, because a lot of these young men and women are college-educated men and women, they have a lot of skills that they can bring to the table, but they are not having that opportunity because of the cost of entry.

The CHAIRMAN. The farmer you referred to tried to convince me how wrong I was that I wanted to put a limit on the amount of money that one farmer could get out of the farm program and how detrimental that was to agriculture, to these family farms that he was associated with.

Mr. TIERNAN. Right. So you know who I am talking about.

The CHAIRMAN. By the way, I believe that no one farmer should get a certain amount of money. And today, 10 percent of the farmers are getting two-thirds of the benefit from the farm program. And they were meant to help the small- and medium-sized farmers and not somebody with 30,000 acres, as I sense.

I have got one more question and then we're going to quit, unless you've got another question.

Senator BROWNBACK. It sounds good to me.

The CHAIRMAN. Okay. Mr. Tiernan, something you said in your statement, and it deals also with something that Mr. Hassebrook testified on, but you went beyond with a new venue for helping young farmers.

Do you see any transport joint venture between young beginning farmers who may be in the need of equipment and older farmers who have equipment and maybe looking to retire? Although I think Chuck's statement was about the land and not the equipment.

What are your suggestions for helping encourage young farmers to remain in rural agriculture and enter the business of agriculture to the extent of which your co-op fits into that? If it was meant—it obviously would be meant for any farmer, but it could also apply to young farmers.

Mr. TIERNAN. Yeah. In Canada, that is one of the main reasons why they started initiating machinery cooperatives was so that young producers could enter the industry at a much lower cost.

I would like to say, you know, that I'm really—personally really excited about the provisions of the HIRE Act and the New Homestead provisions because they do offer some real significant incentives that are directly tied to the rural communities, but I have not seen any kinds of joint ventures between a young farmer and an older producer other than some lease purchase arrangements between a father and a son or a granddaughter or a grandson, which does lower the cost of entry into the industry initially, but the difficulty comes when that young producer goes to replace that equipment.

Oftentimes with the—you know, in the lease purchase agreement is a little bit older equipment that has some maintenance costs, and it might be two or 3 years down the road, but when the son goes to replace that equipment, he is not financially in a position to be able to do that more times than not. So machinery cooperatives I think offers some benefits.

One thing that I would like to suggest is that machinery cooperatives, if this can move forward, does not meet the definition of a value-added agriculture enterprise. Most of the time we are talking about adding value on the revenue side, but if this adds value, which it appears they do, by lowering the cost, shouldn't it meet that definition? Even though it is on the cost end instead of a revenue end, it does clearly seem to add value, so we would like to make that suggestion.

The machinery cooperative also promotes collaboration among producers to pool their skills and pool their resources together to be more efficient, more effective.

As far as additional ideas for rural communities, probably I don't have enough time to suggest several ideas that we have, but cer-

tainly provisions of the HIRE Act and the New Homestead tax credits, those are all incentives that we need.

Reasonable collaboration has got to come in here at some point. We need—however these incentives are tied, we need to tie them so that counties and individuals, public private partnerships, are really encouraged, because we're—with everything else, we are always much stronger working together versus working alone. So somehow these incentives need to be tied to that.

We heard some really good ideas earlier this spring at the Capitalizing on Rural America symposium sponsored by the Home Loan Bank. The challenge there is again for rural communities like Grundy County, the cost of bringing that technical expertise to our county to help move some of these ideas forward is quite high. To bring one individual in for 1 day, the cost was \$15,000. And Grundy County just doesn't have those resources to bring that kind of technical assistance to bear because it needs to be there not for just 1 day. It needs to be there to guide them through the process start to finish. And so whatever incentives need are out there, it somehow needs to be tied to regional collaborations of counties, farm groups, nonfarm groups, and promote public private partnerships.

The CHAIRMAN. Well, if there is one last item that maybe was left hanging and anybody wants to do that right now, this would be—for a short statement, would be the opportunity. But if you don't, then we will just close.

Do you have anything that you want to say in closing?

Senator BROWNBACK. No. Thanks.

The CHAIRMAN. I thank all the audience who was here. And thank you for the hospitality of Sioux City, and most importantly for our witnesses that had to travel as well as work putting their statement together. Thank you all very much.

Now this doesn't end this process. You have a hearing. We have got—a lot of this legislation is pending in conference between the House and the Senate now. Hopefully get those agreements worked out, get a Bill to the President before adjournment in early October and not have to start over again when a new Congress reconvenes in January.

And what we haven't done in the legislation that is pending will be something that we will work on when we get back in January in the new Congress.

And I think we're well down the road to some of the things we want to accomplish, but more needs to be done. And in that process, folks who are witnessing today, and other people here, people that aren't here, are proud of that process. And I always like to remind my constituents that Senator Brownback and I are one half of the process of representing the government. Our constituents, you, or in Kansas, are the other one half of the process of representing the government. And you can't really have representative government if we don't have dialogue.

Now we kind of had dialogue just among six or eight of us today, but that dialogue can include hundreds, either by coming to our town meetings or by the letters that you write to us. Whatever it is, you need to participate because in America, you have got a chance to help rule and be ruled. You have the opportunity to help

government and be governed in Iowa. And you all want to help govern, and I think you all do or you wouldn't be here. But for those who aren't here, you might encourage them to get involved in the process.

Thank you very much. The meeting is adjourned.

[Whereupon, at 12 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF HON. MAX BAUCUS

Mr. Chairman, thank you for holding this important hearing. Rural America is the backbone of our nation. Montana and other rural states have contributed significantly to America's progress. Our family farms and ranches produce the food on our tables. Transportation centers in the Midwest direct delivery of agricultural products and natural resources from the breadbasket states to our coasts.

Unfortunately, new conditions, including changes in agriculture markets and drought, have left many rural areas without sufficient opportunities for their children. This dearth of opportunities has led to a population decline in many counties. We will hear testimony today about this problem, often called "rural out-migration." It is a serious problem, and I truly appreciate the attention the Chairman is focusing on this matter.

I also want to thank Senator Dorgan and the other sponsors of the New Homestead Act. Senator Grassley and I have been working together for several years now on legislation, like the Tax Empowerment and Relief for Farmers and Fishermen Act, to update the tax code for small businesses and to establish incentives for rural economic development. The work that Senator Dorgan, Senator Hagel and others have done in the New Homestead Act has truly focused our attention on the problem of rural out-migration. The most recent result of this new focus is our "Heartland Investment and Rural Employment" (HIRE) Act that we introduced in July.

The HIRE Act includes rural investment tax credits that we modeled on provisions in the New Homestead Act. These provisions are also in the Senate-passed "Jumpstart Our Business Strength" (JOBS) Act, S. 1637. The credits are designed to encourage investment in counties that have suffered significant out-migration. These investment tax credits allocate \$185,000 for each qualifying county for investments in new and existing buildings, as well as investment in new business equipment. Spurring economic activity is critical to preserving rural communities.

These provisions are only a start. Rural states are facing many challenges. Tax incentives are just one means among many to address these challenges. I am proud that we have begun this process. This hearing and our continuing focus on the needs of rural America are also steps along the way. And my goal is for that path to lead us to a national policy dedicated to the preservation and prosperity of America's wonderful rural communities.

PREPARED STATEMENT OF HON. SAM BROWNBACK

Over 140 years ago, President Abraham Lincoln signed into law the Homestead Act, landmark legislation that helped populate rural areas in the Great Plains. Back in 1862, the federal government struck a one-time bargain with people who took a chance and settled out West. In exchange for a 5-year commitment to stay and develop the land, the original Homestead Act offered these settlers 160 acres of free land and the promise of opportunity.

Today, America's Heartland is facing massive depopulation. Many rural communities are struggling to survive. This shouldn't be the case. Our rural communities are some of the strongest in the nation. But people who are from these areas know it is virtually impossible to start, maintain or grow a business in an environment where the overall economy is shrinking, where current and potential customers are leaving, and public and private investments are falling.

Many of us here in this room are products of a rural American upbringing, myself included. Some of the greatest moments in my life have been spent in rural Kansas with my family and friends. Most of you have your own memories of growing up in small towns around America that you may like sharing with your children and grandchildren, whether it be by actually living in rural America or by telling stories of life in your hometown, where you had 10 people in your graduating class. Unfortunately, the growing trend that we recognize is the depopulating of rural America and these “small town” lifestyles that we have so much respect for. With this respect in mind we must work harder to restore rural America and repopulate small communities that are suffering from a high rate of out-migration.

A high out-migration county is defined as any non-metro county that has suffered net out-migration of at least 10% over the past 20 years. The Midwest is plagued by this trend. Over 50% of the counties in the Midwest region suffer from high out migration. When compared to the national average of 21%, it's easy to see that the Nation's Heartland needs help. Some states have it much worse. In North Dakota, almost 90% of the counties have experienced out-migration. Here in Iowa, 55 of the 99 counties (or 53%) are determined to be out-migration counties. Nearly fifty percent of the counties in my state of Kansas have been the victims of this out-migration.

We have faced this type of problem before in America. In the 1970s, metropolitan urban cores across America were suffering from out-migration similar to what we are seeing today in rural America. Tax incentives were put in place to enhance economic development and it revitalized our nation's urban cores. It worked back in the 1970s for the urban core and it can work today for rural America. We are simply looking to do for rural America what we did for urban cores back in the 1970s.

There is a role that we can all play in the restoration of rural America at the Federal level that has been proven successful in the past. That is why I am honored to cosponsor the New Homestead Act, which will help to alleviate the problem we face in rural America.

The main objectives of the New Homestead Act are:

- (1) to provide new and updated homestead opportunities for individuals to live, work, and prosper in high out-migration counties;
- (2) to offer new incentives for businesses to locate, grow, and profit in high out-migration counties and
- (3) to improve access to capital for business development in high out-migration counties.

As with the original Homestead Act, this bill seeks to reward those individuals willing to take a risk and locate in a high out-migration county. It says to these new homesteaders, “If you're willing to make a 5-year commitment to live and work in a rural community that's shrinking in population, we'll give you every opportunity to get a college degree, buy a home, and build a nest egg for the future.” It does this through:

- **Loan Repayment:** forgive up to 50 percent of college loans for recent graduates who move to these communities (up to a maximum of \$15,000);
- **Home Tax Credit:** provides a \$5,000 tax credit for all home purchases in these areas (or 10% of the purchase price, whichever is lower);
- **Protecting Home Values:** allows losses in home value (from a principal residence) to be deducted from federal income taxes; and
- **Individual Homestead Accounts:** these accounts help build savings and increase access to credit for residents in high out-migration counties. Individuals could contribute a maximum of \$2,500 per year, for up to 5 years, as well as receive a government match of 25–100%, depending on their income. Savings could grow tax free and, after 5 years, be tapped into for small business and education expenses, first-time home purchases, and extraordinary medical expenses. And all funds would be available upon retirement.

Included in the bill are also Incentives for Businesses through rural investment tax credits. My colleagues in the Senate had the foresight and good judgment to attach these two provisions in the FSC/ETI Bill that passed the Senate on May 11 with a vote of 92–5. These two provisions are:

- **A Rural Investment Tax Credit (RITC):** This targets investments in high out-migration counties. Under this provision:
- States receive \$185,000 of these credits per high out-migration county. The state then allocates these credits to businesses that move to or expand in a high out-migration county. Businesses then use these credits to offset the cost of newly constructed or existing buildings. Over a ten year period, businesses can use these credits to reduce their taxes by as much as 80% of their total investment.

The other provision that passed the Senate is the:

• **Micro-enterprise Tax Credits**

These tax credits are for small businesses (5 or fewer employees). States may choose to allocate up to 10% of their rural investment tax credit allocation to qualifying start-up or expanding small businesses. These businesses would then use these credits to offset the cost of new funding needed for business expansion, which could reduce their taxes by 30% of their qualifying new investment.

The most effective and desirable economic development strategy for most agricultural communities is small entrepreneurship—development based on locally owned, owner operated small businesses. This has been proven to work in the agricultural areas that have not been successful in attracting large employers from outside areas. In the agricultural counties of the Midwest, over 70% of the net job growth stems from non-farm self-employment. These are people who create their own job by starting a business. Rural Americans have a passion for entrepreneurship. Farm and ranch counties in the nation's Heartland have several times the rate of self-employment as metropolitan counties. Given the chance, they are highly innovative. The New Homestead Act gives rural Americans that chance.

Together these two provisions are projected to cost \$641 million over ten years. However, this should not be looked at as an expenditure. This is an investment in the rural communities that we all cherish and hold close to our heart. The return on this investment is a restored rural America with expanded economic opportunities and a higher quality of life. I applaud the Senate for passing the Rural Investment Tax Credit provisions, however simply building more buildings is not our highest priority. There are too many empty buildings already. We need to put our investment in small business development and people.

The final piece of the puzzle lies in a Venture Capital Fund. Unfortunately, venture capital and other start-up funding is quite limited in rural areas with high levels of out-migration. This section would help such business ventures attract the equity funding they need by creating a \$3 billion venture capital fund that invests in high out-migration counties. This fund would be funded at \$200 million per year, for 10 years, and require a yearly match of \$50 million from states and of \$50 million for private investors.

A healthy and growing rural economy is critical to our nation's success. The New Homestead Act will help re-establish rural America on firm economic footing. All of America needs the Heartland's economy to be successful, therefore America needs this Act. I am fighting for this because this is of great concern to me and I believe it is time for us to take a look back at our roots. Please join me in the fight to restore rural America. All too often, small communities are overlooked for the hard work, strong values, and great people they produce. It is time to show our appreciation for rural America and refocus on their restoration and development. Thank you for giving me the opportunity to speak this morning.

PREPARED STATEMENT OF HON. TOM DASCHLE

Mr. Chairman, I would like to begin by offering sincere thanks to you, to the Ranking Member, Senator Baucus, and the other members of the committee for organizing and participating in this field hearing. Events like these enable us to gather firsthand knowledge about the problems facing our rural and tribal communities. I regret that I am not able to be with you today, but I appreciate this opportunity to share my views on the important issues of rural out-migration and economic development.

What do we mean when we say that rural out-migration is a problem? Is it not, as some might argue, the natural course of things for our rural areas to empty out? Granted, it is hard to find supporters of the impacts this trend imposes on our rural communities—stagnant or declining incomes, high incidences of social disorders, and separation from areas that we once called home. But are these not an inevitable consequence of the market forces that determine where our country's economic opportunities flourish or wither?

I believe the hollowing out of our rural areas is *not* inevitable and that it is within our power to shape the character of our states and our Indian reservations through the choices we make as a society and as individual consumers. Choice is, after all, a central component of the market mechanism that we rely upon to allocate our economic resources efficiently, and that some view as the driving force behind the decline of our rural and tribal economies.

In this case, though, the market is under-producing a good that many desire but too few can find: economic opportunity in rural and native America. In other words, many, if not most, of the people leaving rural areas and reservations for our cities would rather not make that journey. So many of the people I talk to in small towns

across South Dakota are upset that they are unable to make a decent living without taking on more than one job. They hate to see their main streets boarded up. They would prefer to see their children grow up with all the benefits of a tightly knit small-town community of relatives, friends, and neighbors.

How, then, can we increase the supply of good-paying jobs in rural states? The legislation sponsored by Senator Dorgan represents a step in the right direction. It recognizes that government alone cannot provide a sustainable stream of income for rural workers, and few would be inclined to accept such a handout even if it were available. What government can do, however, is provide incentives that attract private investors, who know how to run a profitable business. These incentives, along with the bill's inducements for individuals, could go a long way toward reversing the economic decline of counties that have experienced high out-migration.

Numerous other pending bills could also contribute to this effort. Individuals all over South Dakota have told me how important it is that we pass a good transportation bill as soon as possible. In the short term, this bill would give a boost to our economy as various construction projects get underway. In the longer term, those projects will provide us with the high-quality infrastructure that is the backbone of economic development.

We can also do a better job of spurring new demand for the goods produced by family farms. Mandatory country-of-origin-labeling will allow consumers to make informed decisions about the food they buy. We also need to pass an energy bill with strong incentives for the use of renewable fuels produced at home, and we need to pass the JOBS bill to end WTO sanctions on our exports and restore important incentives such as the wind production tax credit. Measures that enhance the value of our agricultural outputs can transform our rural economies by improving the standard of living of family farmers and the communities to which they belong. And while I agree that it is important for us to provide incentives targeted specifically to those counties with high out-migration, programs that would have a wider impact are also essential.

In fact, as we consider comprehensive rural development strategies, it is important that we remember not all of our struggling counties are experiencing population decline. In my state, for example, populations are rising in all but one of the counties where our Indian reservations are located. Sadly, four of those counties are among the five poorest in America, with poverty rates around 50 percent.

This situation calls for a comprehensive rural development strategy that consists of a mix of policy incentives—some targeted at locations with high out-migration, others that will benefit the region as a whole, and still others targeted at locations facing the dual challenge of population growth and high poverty. This third category may well pose the greatest challenge of the three, since the poverty in those places has been entrenched for so long.

But even there, we know what is needed. We can face these economic challenges by providing adequate health care, so students and workers can be productive; by providing high-quality education, so children and adults alike have an opportunity to acquire the skills necessary to raise their own living standards; and by providing favorable conditions for businesses, so that a robust and self-sustaining economy can finally take hold throughout rural America.

Few of our responsibilities are as important as creating conditions in which our citizens can prosper. To date, we have not succeeded in stimulating the market to provide enough good-paying jobs in rural America. But we have no shortage of promising solutions that can revitalize our rural economies. I am confident that, with continued leadership by the members of this committee and others who are deeply concerned about rural economic development, we can implement these solutions and create a rural America that produces the goods of prosperity in much greater abundance.

Thank you.

PREPARED STATEMENT OF HON. BYRON L. DORGAN

Mr. Chairman, thank you for holding this important field hearing today in Sioux City, Iowa to examine tax policies that will help rural communities in your state, in North Dakota and across the country to grow and prosper.

As you know, I have worked several years with Senators Hagel, Brownback, Johnson and many of our colleagues on legislation we call the New Homestead Act, S. 602. This bill seeks to address one of the most serious threats to the future of America's Heartland—the loss of its people.

As a Senator from a rural state, Mr. Chairman, you know firsthand about the problems associated with the out-migration of people from our rural communities.

Over the past two decades, a majority of the counties in Iowa have lost 10 percent or more of their population. The same is true for North Dakota, Nebraska and other rural states.

Hundreds of thousands of people have left small towns in rural areas throughout the Great Plains in search of opportunities elsewhere. It is a constant struggle for those who remain just to keep their communities alive. This shouldn't be. Our rural communities are among some of the strongest in the nation. Most of them have good schools, low crime rates, and a level of civic involvement that would make any public official proud. But people who are from these areas know that you simply can't grow or run a business in an environment where the overall economy is shrinking, current and potential customers are leaving, and public and private investment is falling.

The support that you and Senator Baucus have provided for the New Homestead Act has helped call national attention to the rural out-migration crisis. Many of our rural areas have been fighting for their very survival for years, yet most Americans didn't even know about this struggle. Today, general awareness about the decimation of rural America is quickly growing.

Inspired by the Homestead Act of 1862, the New Homestead Act proposes new incentives for people and businesses to locate or stay in rural areas that are suffering from out-migration. We can't give land anymore. But our legislation provides new opportunities through the use of tax and other financial rewards to fight against rural out-migration. S. 602 has garnered 17 bipartisan cosponsors in the U.S. Senate. It also has been endorsed by many important organizations, including the National Association of Counties, the National Telecommunications Cooperative Association, National Council of Farmer Cooperatives and the National Rural Electric Cooperative Association, the National Association of Realtors, the National Farmers Union, the American Bankers Association, the Independent Community Bankers of America, the Credit Union National Association, the Center for Rural Affairs and many others.

Specifically, the New Homestead Act would give people who commit to live and work in high out-migration areas for 5 years added incentives to buy a home, pay for college, build a nest egg, and start a business . . . or just plain get ahead in life. These incentives include repaying a portion of college loans, offering a tax credit for the purchase of a new home, protecting home values by allowing losses in home value to be deducted from federal income taxes, and establishing Individual Homestead Accounts that will help people build savings and have access to credit.

S. 602 also would establish a new venture capital fund with state and local governments as partners to ensure that entrepreneurs and companies in these areas get the capital they need to start and grow their businesses.

With your help, Mr. Chairman, during its debate on the JOBS Act, S. 1637, the Senate agreed to a Managers Amendment that included two other key measures from the New Homestead Act. Virtually identical provisions were also included in the Heartland Investment and Rural Employment Act that you introduced just prior to the August recess.

First, Section 633 of S. 1637 provides for rural investment tax credits. These tax credits would encourage businesses that move to or expand in a high out-migration rural county by offsetting the cost of newly constructed or existing buildings. Let's say, for example, that investors plan to build a new structure for a light manufacturing facility, and their structure would cost \$100,000. With a rural investment tax credit from state officials, these investors could claim a tax credit of approximately \$8,000 annually over a ten-year period. In present value terms, this credit effectively makes locating the facility in a high out-migration rural county less expensive than alternative locations.

Second, Section 634 of S. 1637 provides for small business investment tax credits. Under this provision, a state may choose to apply a portion of its rural investment tax credit allocation for qualifying start-up or expanding small businesses with five or fewer employees. In this case, the credits would help offset the cost of new funding needed for business expansion, including capital costs, plant and equipment, inventory expenses and wages. A taxpayer may claim up to \$5,000 per year (\$25,000 maximum for all years) in qualified rural small business investment credits.

Together, the rural investment tax credit and small business investment credit would make available an estimated \$641 million in credits for business investment in high out-migration rural counties over the next decade. I look forward to working with you, Senator Baucus and others to ensure that these provisions are included in the final version of the JOBS Act or any other tax legislation sent to the President for his signature this fall.

It will take plenty of hard work to get these and the other provisions in the New Homestead Act enacted into law. But with your help, Mr. Chairman, we will find

a way to reverse the trend of population loss in North Dakota, Nebraska, Iowa, Kansas and the rest of America's Heartland.

PREPARED STATEMENT OF KEVIN EDBERG

Mr. Chairman, thank you for this opportunity to testify on tax related policies to spur investment in rural communities, and in particular, how cooperatives can enhance economic opportunity in America's small towns.

I am Kevin Edberg. I am the executive director of Cooperative Development Services (CDS). And I am here today representing the National Cooperative Business Association.

CDS offers technical assistance to farmers and communities seeking to form their own member-owned cooperatives. We work in Iowa, Minnesota, and Wisconsin. Our portfolio includes new generation agricultural cooperatives, including renewable fuels co-ops, landowner forestry cooperatives, housing cooperatives, food cooperatives and many others. Our current projects in Iowa include providing technical assistance to Wholesome Harvest near Ames, a startup co-op for organic livestock producers, and Upper Mississippi Meats in Decorah, a natural meats co-op that is still in the planning stages. Both of these cooperatives seek to capitalize on the rapid growth in the organic and natural foods market. We are also working with Prairie's Edge, a farmer and landowner forestry co-op near Decorah. It provides farmers with management, harvesting and marketing services that turn previously under managed woodlots into long-term, ongoing sources of revenue.

CDS was the nation's first cooperative development center, formed nearly 20 years ago. We now work with a network of some 20 similar centers—known as Co-operation Works—that provide technical cooperative development assistance across the country. This network includes the Iowa State Value-Added Agricultural Development Center. The centers conduct feasibility analyses, develop business plans, and provide organizational assistance, such as help with developing bylaws and other governing documents for cooperatives. The centers function as the only sources of expertise in cooperative development. I have attached a list of cooperative development centers as an appendix to my statement.

The National Cooperative Business Association, of which CDS has been a long-time member, has been a national partner with these centers, working to build a strong cooperative development infrastructure for rural communities, helping support those of us doing co-op development on the ground. Headquartered in Washington, NCBA is the only national cooperative membership association representing cooperatives of all types across all sectors of the economy, including agriculture, childcare, electricity, housing, telecommunications and many others. NCBA's mission is to develop, advance and protect cooperative enterprise.

First, on behalf of NCBA, I thank you for your years of support for cooperatives of all types and your interest in their role as engines of economic growth in rural communities. Your leadership is both recognized and appreciated by NCBA and its members.

Cooperatives can and do play a key role in improving quality of life and economic opportunity in rural America. Farm co-ops not only provide direct benefits to producers in the form of services, annual dividends, and often better prices; they generate jobs and income for the community. And by the very nature of co-ops, that income stays in the communities in which it was generated; it doesn't go to distant investors.

Consumer-owned co-ops also provide vital services in rural communities where other forms of business are often loath to locate. That's because co-ops can provide at-cost goods and services to their members and so don't require the returns that investor-owned businesses must generate. That's why credit unions, farm credit banks, and electric, telecommunications, food, housing and purchasing cooperatives for small businesses (such as hardware store owners and local pharmacies) offer great hope for revitalizing rural communities.

For example, many rural communities have watched their local grocery stores close as rural populations decline, small business owners retire, and no new buyers come forward. With the loss of a local source of food, comes greater economic decline. When people go elsewhere to buy groceries, they take their other business with them. Co-ops can prevent that downward spiral.

Here's one example of how innovative use of co-ops can stem that loss and promote greater economic growth. In 2001, the citizens of Barneveld, Wisconsin lost their grocery store, forcing them to drive 30 miles roundtrip for even the most basic household supplies—that was particularly hard on seniors who lack transportation.

But last month, that community celebrated the opening of a new grocery store—a co-op owned by 325 local consumers who each bought a \$100 share in the business. Members also stepped forward to make loans to the co-op for the initial investment, with additional debt financing provided by the local bank. Cooperative Development Services provided technical assistance to the co-op, including the feasibility analysis, development of the business plan and the community organizing work. The co-op will provide four to five new jobs, with projected first year sales of \$1.2 million.

Other cooperatives, such as consumer-owned healthcare clinics, childcare co-op, housing cooperatives; landowner forestry cooperatives, small business purchasing cooperatives and others offer great promise for rural communities.

Sadly, co-ops are an underutilized rural economic development tool due to the many economic and other barriers to their development.

Access to Capital

Among those barriers is access to capital—a key constraint for all types of cooperatives, but a particular problem for value-added, farmer-owned co-ops that often require the construction or modification of capital-intensive processing facilities. Generally, in a cooperative, the equity investment is provided by the members. More than one viable co-op has failed before it ever got off the ground because the equity drive failed—organizers couldn't convince enough farmers to provide the equity required.

For some cooperatives, both Section 521 of the tax code as well as Capper Volstead requirements hamper a farm cooperative's ability to bring in outside capital by capping returns on capital stock at eight percent. Section 521 farm cooperatives are further required to have substantially all of the voting stock held by producers as well as a governance structure that provides for one-member, one-vote. Therefore, to qualify for Section 521 treatment, co-ops are limited in their ability to bring in significant outside investment.

Other cooperatives, those that neither require Capper Volstead protection nor qualify as Section 521 cooperatives, face other limitations in their efforts to bring in outside capital. In order to qualify for tax pass through treatment, the Internal Revenue Service requires that cooperatives distribute profits to members based on their patronage, rather than based on ownership share and generally requires evidence of democratic member control in the form of one-member, one-vote. Though subchapter T cooperatives can bring in as much outside capital as they wish, they are limited by the existing definition of cooperatives—the so-called “subordination of capital” requirement—in how they can distribute earnings to those investors. Earnings from member business must be distributed to members based on patronage.

In response, many farmers are forming cooperatives that then become co-owners in an LLC, along with other outside investors. That is the case with virtually all of the ethanol and biofuels co-ops that have formed in the Upper Midwest. This allows the co-op to represent their farmer members en bloc in the LLC while bringing in outside partners into the processing business that farmers hope will ultimately provide greater economic returns.

Alternatively, farmers are forming the initial business as an LLC owned by the farmer-members and operate it as a cooperative, without the capital constraints. They then enjoy single tax treatment under Subchapter K.

As you know, in response to the capital challenges, some states are creating new state co-op statutes that allow cooperatives to bring in non-member capital, create both patron and non-patron “members”—that is, outside investors—and provide for both greater financial and governance rights for those non-patron members. The co-ops can elect to file under Subchapter T or Subchapter K, as limited liability companies do.

Though many have greeted these hybrid statutes with enthusiasm, NCBA would caution that they are a largely untested approach to capital generation. It is simply too soon to tell whether they serve as an effective capital generation tool.

Uniform State Statute

The growth in these new “hybrid” statutes has prompted the National Conference of Commissioners on Uniform State Laws to draft a uniform state co-op statute, confined to agricultural cooperatives, which has in turn raised questions about whether current tax law for cooperatives needs to be modernized.

NCBA has created a working group to evaluate the myriad issues associated with the draft uniform state statute, including the core question of when does a business cease being a cooperative, and to provide NCCUSL with advice and input. We will be looking at a variety of questions, including what minimum level of ownership and

return must patrons have in order for the business to truly be a cooperative: In its current form, the NCCUSL draft fundamentally changes the traditional definition of a cooperative by defining members as both those who patronize the co-op and those that invest in it. This change would be of great concern to a number of cooperatives. Key questions relate to how patrons retain control over the business to ensure that it continues to meet the needs the business was created to address.

Cooperatives enjoy significant marketplace advantages because of their member-owned status—engendering greater consumer trust. That consumer confidence in cooperatives may be eroded if members no longer truly own and control the business. NCBA will review the NCCUSL draft with an eye to strategies to enhance co-op flexibility in raising capital while maintaining member ownership and control.

Subchapter T

To that end, we welcome your interest in authorizing the creation of a Subchapter T Commission, provided for in the HIRE Act, to evaluate the many issues raised by ongoing capital challenges and the new hybrid statutes. In particular, the need to evaluate other laws that hamper cooperative development, including securities laws, is long overdue. Compliance with federal securities laws is not an insignificant thing. Currently, the Securities Act of 1933 contains an exemption for Section 521 cooperatives and the Securities Exchange Act of 1934 has an exemption for cooperative associations as defined in the 1929 Agriculture Marketing Act. The 1933 contains the basic registration requirements and exempts Section 521 cooperatives, and should be expanded to exempt all cooperatives. Secondly, the Commission may wish to re-examine the 1934 Act and consider whether it should be expanded as well.

Though the issues associated with securities laws are many, I can tell you that from my perspective as a co-op developer, the costs of complying with securities registration requirements, or merely seeking exemption from them, can be burdensome for new start-up cooperatives and majority farmer-owned LLCs.

Much of the reevaluation of cooperative structures has been driven by the significant capital barriers facing farmers seeking to develop new and expand existing cooperatives. But farmer-owned co-ops, though significant and important players in rural economies, represent just one sector affected by Subchapter T. Virtually every type of co-op, with the exception of credit unions and utility cooperatives, file under the provisions of Subchapter T. This includes large purchasing cooperatives such as ACE Hardware, with its thousands of small business owner-members in small rural towns, as well as very small food and worker-owned cooperatives—all of which make significant economic contributions to their communities. Their views and insights into Subchapter T will help the Commission effectively conduct its work. Any change in Subchapter T would have significant implications for all cooperatives.

NCBA therefore recommends that the legislation explicitly provide that members of the Commission include legal and cooperative experts from the broadest cross-section of the cooperative sector as possible, including purchasing, consumer-owned and worker-owned cooperatives. We would also recommend that the Commission be required to evaluate carefully any unintended consequences of recommendations it considers.

Eliminating Tax Inequities

NCBA cautions that statutory changes that ease capital constraints on cooperatives don't necessarily mean capital will begin to flow into rural cooperatives. Rural areas, because of their sparse population and often less developed infrastructure will always face challenges in attracting capital investment, regardless of the business form. But eliminating tax inequities in concert with the provision of new tax incentives can go far in spurring new investment in rural cooperatives.

The provisions of the HIRE Act that eliminate tax inequities on cooperatives have been long sought by cooperatives and those of us who do co-op development on the ground.

First, eliminating the negative impact of the Dividend Allocation Rule as it has been applied to cooperatives will provide significant benefits to cooperatives seeking to raise additional expansion capital. The DAR unfairly increases the tax burden on cooperatives that pay dividends on capital stock by reducing the deduction they allowed for their patronage dividends. As a result, the rule also reduces dividends paid out to members. The triple-tax penalty imposed by the dividend allocation rule impedes the co-op's ability to raise investment and expansion capital. By some estimates, the DAR results in a 73 percent tax on nonpatronage earnings if a cooperative pays dividends on capital stock.

For agricultural co-ops operating in the increasingly concentrated and competitive food industry, issuing nonvoting stock is a one avenue for raising new capital for expansion. But those that do face significant tax burdens, lessening the overall im-

fact of stock issuance. Moreover, the rule discourages cooperatives that could issue stock from doing so.

Though often thought to be most relevant to large agricultural cooperatives as they issue preferred stock on public markets, the DAR also affects any cooperative, large or small, that issues non-voting stock. And those cooperatives offer promise for rural America.

VHA, Inc., is a national purchasing cooperative for community-owned hospitals with 2,200 hospital member-owners, many in rural areas including 16 members in Iowa. VHA plays a key role in keeping rural, small-bed, nonprofit community hospitals operating in small towns across America. Like many other services, hospital care is not a profitable enterprise in sparsely populated areas. With few beds, these hospitals face higher per patient costs. VHA helps them keep those costs down while constantly improving quality.

VHA has issued non-voting stock to many of its members in order to raise capital. But because of the enormous financial hit imposed by the DAR, VHA has refrained from paying dividends on that stock. That, of course, makes that stock a less attractive investment for others.

Here's another example: A small, worker-owned cooperative in Massachusetts sells non-voting shares to its worker-members and outside investors. When it pays dividends on that stock, which it must do to keep investors happy, its employees are hard hit as the DAR necessarily reduces the size of the dividend they receive..

Yet issuing non-voting stock that provides a reasonable return to investors can be a key tool for cooperatives. But in order for it to become so, the negative impacts of the DAR must be eliminated. We thank you for your inclusion of this provision in the HIRE Act and for your successful efforts to include it in the JOBS bill. We know you have pursued every possible legislative strategy to secure its passage and we applaud your determination and commitment. We look forward to working with you to move the JOBS bill through conference and onto the President's desk this fall.

Second, Section 104 of the HIRE Act, which allows cooperatives to pass through tax credits to their members will help eliminate long standing inequities faced by cooperatives. Notably, it will provide tax parity to ethanol cooperatives, allowing them to pass tax credits through to their members, leveling the playing field for these co-ops who have, to date, not been able to take advantage of a key benefit available to other small ethanol producers.

Third, the provisions of the HIRE Act that expand Section 521 eligibility to a broader range of agricultural cooperatives will also provide needed flexibility to farmers seeking to form new cooperatives and expand business services of existing cooperatives.

The provisions of the HIRE Act that eliminate tax inequities and improve flexibility under the tax code is a key first step in enhancing cooperative viability and increasing access to capital.

Housing Cooperatives: The Promise of the Community Homeownership Credit

Creating new tax-related incentives to spur formation of new cooperatives is another key step in promoting further cooperative development in rural areas and we applaud your leadership in this area as well.

Specifically, the National Cooperative Business Association supports Section 310 of the HIRE Act, the Community Homeownership Tax Credit. Most significant about this provision is that, for the first time, the tax code would provide parity for homeownership. To date, existing tax credits for affordable housing have been limited to development of rental housing. Though these credits have done much to create new affordable rental housing, they have done little to encourage homeownership, the key avenue by which average citizens build assets and wealth. NCBA applauds the inclusion of stock in housing cooperatives under the Community Homeownership Credit provisions and the 10 percent set aside for nonprofit housing developers.

Creating affordable housing is a critical tool for revitalizing rural communities. In the short term, the very act of housing development creates significant benefits: use of local legal, architectural and consulting services; creation of construction jobs with good (and taxable) wages; increased demand for building materials and services; and increased consumption of goods when residents move in. Analysis by the National Association of Home Builders found that the first year economic impact of development of 100 multifamily housing units was substantial, generating 121 local jobs, \$3.5 million in wages and salaries, \$1.2 million in local business income, and more than \$ 400,000 in local taxes. The same analysis found significant long-term economic benefits for local communities. Though 100 units is a substantially larger development than a small rural community could support, those results inform rural housing development efforts.

There are other intangible benefits of expanding homeownership in rural communities. According to USDA's Economic Research Service, "Homeowners tend to become more involved in their communities and work toward community improvements, such as better schools."

The bottom line is that homeownership in rural areas is a critical component of rural economic development. Without local housing, the multiplier effects communities hope to create with new business development will be stymied. Workers need an affordable place to live, work and shop. And availability of housing prevents existing residents from leaving, taking with them their patronage of grocery stores, healthcare providers, daycare providers, banks and much more.

For example, in the community of Lanesboro, Minnesota, population 800, Northcountry Cooperative Development Fund is rehabilitating a landmark building and converting it to cooperative housing. That town is enjoying growth through a rapidly expanding tourism market. The population of Lanesboro, like that of most other rural towns, had been declining for years. The growth in tourism has helped stabilize the population. But Lanesboro has substantial opportunity to grow if it can provide the appropriate infrastructure, including housing. But as a small community, housing remains in short supply. Those working in Lanesboro to supply the tourism market cannot necessarily live there. NCDF, a sister cooperative development organization, secured local property tax breaks from the municipality to create the 21-unit housing cooperative. Providing those who work in Lanesboro with the opportunity to live there as well will spur even greater growth for Lanesboro.

And yet, despite the importance of housing to rural economic development, rural areas face unique affordable housing issues. Like other forms of housing development, small communities, particularly those with a population of 5,000 or less, often are not attractive investment opportunities for most housing developers. The costs of development often cannot be covered by sales costs—many rural residents simply can't afford to pay a price that compensates builders for the construction costs and provides them with a return.

Though homeownership rates in rural areas tend to be higher than that for urban areas, household income tends to be lower, making affordability a key issue. Poverty rates in rural areas exceed that of urban areas by nearly three percent. Some 14 percent of rural populations, or 7.5 million people, are poor. And poverty rates for rural minorities are even higher. As a result, homeownership for rural minorities and the rural poor significantly lags behind that of the general population.

Tax credits to both for-profit and nonprofit developers of nonrental housing make up the difference between the construction costs plus a reasonable return and a sales price that is affordable to local residents—eliminating a key barrier to the development of affordable housing and, indeed, creating financial incentives to create it.

In many rural areas, another key barrier to the development of affordable homeownership is construction capacity. Market demand does not support the assembly and continued use of sufficient construction capacity to create economies of scale. The tax credit should supplement market demand to make production at a reasonable scale possible.

Obviously, of particular interest to NCBA is the potential of the tax credit to spur greater interest in and investment in housing cooperatives in rural areas—something we believe offers significant promise for rural residents, particularly seniors, which I'll address in just a moment. Housing cooperatives, particularly those for low to middle income families, are among the most difficult co-ops to develop in rural communities.

In addition to the financial barriers common to any form of affordable homeownership mentioned above, developers of housing co-ops face some unique barriers. Though housing co-ops are common in urban areas, rural buyers and bankers have little experience with housing cooperatives. The concept is foreign. In a housing cooperative, owners buy a share of the corporation, not their individual housing unit. That requires a "share loan" from a bank rather than a typical mortgage. Housing co-ops can also take out a blanket mortgage for the entire cooperative building, with the owners paying their monthly charges to the co-op, which then makes the loan payment to the lender.

Promoting understanding and buy-in of the co-op housing concept among potential buyers and lenders takes considerable time, effort and resources. On top of that, once a critical mass of buyers is found, substantial education in the governance process of cooperatives must be conducted, bylaws and governing documents of the co-op must be drafted, and a governing board must be established and functioning even before residents move in.

And, as with condominiums, housing co-op developers often must pre-sell a large proportion of their units before they can secure debt financing. That increases development time and potentially raises costs for developers.

Despite these barriers, cooperatives offer substantial benefits to their members—owners that potentially make them not just more affordable to rural residents, but more attractive to communities.

First, because a title search is not required, closing costs are substantially lower. A cooperative that takes out a blanket loan for the entire corporation can set flexible terms for buying into the co-op. Those members who might not qualify for an individual loan can still become homeowners. The combination of these factors creates lower barriers to entry compared to other forms of homeownership—making homeownership more accessible to those who might not otherwise have access to it.

Housing cooperatives are extremely flexible, and can be designed to meet the specific needs of a given community. The co-op controls who can become a member of the co-op, allowing, for example, the creation of a housing co-op exclusively for seniors or long-time residents of the community. And generally, relative to condominiums, cooperative housing shareholders have far more control over their housing situation. If residents want the housing to remain affordable, they can create a limited-equity cooperative where the growth in the sale price of units is constrained. This can be particularly important for senior housing, where residents have fixed incomes.

Offering a tax credit to developers will substantially increase the incentive for housing cooperative development, making it more likely developers will be willing to overcome these barriers, expanding homeownership options for middle and lower income populations—particularly seniors.

Rental Housing Conversion Opportunities

A word about rental housing. The Community Homeownership Credit may help convert aging Section 515 rental housing in rural areas into cooperatives, offering low-income population homeownership opportunities. The Section 515 program, operated by USDA, is the primary source of affordable rental housing in rural America. But thousands of Section 515 units, built in the late 1970's, are aging and are in need of rehabilitation. At the same time, many of the owner-developers of these rental properties are looking to sell their buildings. The opportunity to use the community homeownership tax credit in tandem with a coordinated program to rehabilitate and convert existing Section 515 units to cooperatives offers great opportunity to increase homeownership and housing quality in rural America. USDA is currently exploring the development of a program to facilitate conversion of 515 units to cooperatives. Such a program could work hand-in-glove with the Community Homeownership Credit.

Senior Housing Cooperatives: Affordable Housing for Independent, Active Seniors

NCBA has long promoted housing cooperatives as a solution to meet the increasingly complex housing needs of rural seniors. We believe the Community Homeownership Credit has particularly strong potential to spur development of senior housing cooperatives.

The rural elderly face unique housing challenges. About 2.5 million elderly households in rural America, or 42 percent of rural seniors, have very low incomes—at or below 50 percent of their area's median income. Twenty-two percent of rural seniors live below the poverty line. Although housing costs in rural areas tend to be lower than in cities, many senior households, because they live on fixed incomes, have difficulty meeting even these lower housing costs. Twenty-five percent of rural senior households are cost burdened—that is, they pay more than 30 percent of their monthly income on housing. Affordability issues for seniors that rent are even more severe. And elderly women who live alone in rural areas are more likely than their male counterparts to be poor and face significant housing cost burdens.

Despite high ownership rates in rural areas, particularly among the elderly, the quality of housing continues to be an issue. The housing stock in which seniors live tends to be significantly older. According to the Housing Assistance Council, among all elderly households, those in rural areas tend to have the highest housing quality problems. Not only are the homes owned by seniors generally older, seniors on fixed incomes have limited ability to maintain them. HAC also reports that nearly a quarter of rural seniors report having one or more physical limitations which further limits their ability to maintain their homes and increases their need for adaptive housing.

Despite these statistics, rural seniors, including those living in substandard housing, demonstrate a strong preference for remaining in their homes, not necessarily because they prefer that living arrangement, but because they do not wish to leave

their community, lose their independence, or move into a nursing home. In most rural communities, seniors who no longer are able to or want to maintain their single family homes have one of two options if they wish to stay in the communities in which they've lived for decades and where they've raised their families: they can move into rental housing which depletes their equity, or they can move into a nursing home—an unpalatable option for seniors who don't need full care and one which decimates their lifetime savings. There simply are no multifamily homeownership options for seniors in rural communities. If they want them, seniors must leave their communities.

These issues will not go away. They will intensify as America ages. By 2030, researchers predict that seniors, as a percentage of the population, will grow from 13 percent to 20 percent, intensifying housing and care issues. Where will they live?

Housing co-ops form at least a partial answer to that question. For rural areas in particular, senior housing cooperatives have the potential to fill the housing gap. Senior housing cooperatives offer a number of attractive benefits to seniors.

First, housing co-ops allow seniors to retain their equity. Second, housing co-ops allow seniors to live independently, but with some level of supportive services. And because housing cooperatives are controlled by the member-owners, seniors can decide what level of assistive service they want for their cooperative and how much they will pay for them. Third, because the seniors serve on the co-op's governing board, they stay active and involved in the co-op. Fourth, the co-op creates a natural community of people of similar age and with similar interests, further encouraging seniors to be active even in their later years. The result is a homeownership situation that allows seniors to age in place. And finally, senior housing co-ops can organize as limited equity cooperatives—co-ops that control the rate of growth in the value of the shares in order to keep the units affordable. While on its face the inability to grow one's equity may seem unattractive, for seniors it isn't necessarily so. They do not necessarily need substantial equity growth. Moreover, by controlling the costs of the units, the units are in greater demand, making it easier for seniors to quickly sell when they need to. In some areas, senior housing co-ops have long waiting lists of potential members.

Past development of senior housing co-ops in rural areas not only demonstrates the feasibility of this housing option, but also high satisfaction among seniors for their new living arrangements. Across the country, there are nearly 60 senior housing cooperatives.

Many of them are clustered in the Midwest, developed by then-Homestead Housing Center, which formed 18 senior housing co-ops in rural Minnesota, Wisconsin and Iowa in the 1990s. Nine Homestead senior housing cooperatives are located in Iowa in the towns of Denison, Estherville, Greenfield, Hartley, Laurens, Hull, New Hampton, Roland and Spirit Lake.

A 2001 survey of 163 senior Homestead residents in Iowa and Minnesota found that their choice to buy a share in the housing cooperatives was driven by two main factors: ease of home maintenance and a desire to stay in the community. Respondents also reported high satisfaction with their housing co-op purchase, reporting a positive impact on their ability to live independently; personal safety; life satisfaction; access to activities and entertainment; happiness; amount of contact with friends; and their personal health. Other surveys have found similar results.

Senior housing co-ops are good for rural communities as well. Seniors are not only active participants in the community; they are significant consumers of goods and services. When seniors leave a community, they not only take with them their lifelong accumulation of assets, they take their banking, shopping and charitable contributions. Perhaps most important, they also take their purchasing power for healthcare and pharmaceuticals, which can have a significant impact on Main Street businesses. The loss of these important healthcare consumers can lead to a decline in the supply of overall healthcare services for the rest of the town's residents.

Additionally, when seniors leave their single-family homes for housing co-ops, they free up that housing stock for younger families who have limited housing choices in rural communities. Among the seniors who moved into the Homestead Housing cooperatives mentioned above, nearly all moved in after selling their former homes.

Since the Homestead senior housing cooperatives were developed in the 1990s, there has been growing interest in developing senior housing cooperatives. I will be meeting with the Iowa Institute of Cooperatives later this year to talk with them about development opportunities in this state. I know their interest in this legislation will be keen.

Mr. Chairman, NCBA strongly supports the Community Homeownership Credit program because we believe it can be a key tool for expanding home ownership

through cooperative development in American's small towns. We believe it may be particularly helpful in spurring development of rural senior housing co-ops—helping fill the growing housing gap facing America's elderly population.

The only recommendation we would add for improvement of the program is to explicitly make organizational development costs part of the eligible basis for the tax credit for those developers of housing cooperatives. These costs—the community, buyer, and lender educational processes, the development of the organization's governance structure and legal governing documents and processes and so forth, all impose real costs on developers. In order to put co-ops on a level playing field with other types of housing development, co-op developers should be allowed to include these costs among the development costs for a housing co-op project. Developing a strong organizational structure for a housing cooperative, senior or otherwise, is as important to the formation of a sound cooperative as the bricks and mortar.

Other Recommendations

NCBA makes two other recommendations for your consideration.

Tax Credits for Co-op Investment

In the category of tax incentives, another significant improvement in federal tax law would be the creation of a tax credit program for farmer-members that make equity investments in majority farmer-owned, value-added agricultural enterprises. Variation of tax credit programs have been adopted in Missouri, Colorado and North Dakota, which offer a credit of between 30 to 50 percent for a farmer's investment of between \$15,000 and \$20,000. Credits can be sold or applied to existing tax liabilities. A tax credit for farmers investing in value-added ventures would reduce substantially both the risks and cost of investment in value-added cooperatives. NCBA believes this would be a valuable capital generation tool for value-added farmer cooperatives.

Similar tax credits for investment in other types of cooperatives would go far in encouraging greater cooperative development in rural communities. For example, a tax credit for small businesses in rural areas for their initial equity investment in a purchasing co-op could help reduce the financial barriers small rural businesses face in joining national purchasing cooperatives. These purchasing cooperatives help owners of independent Main Street hardware stores, pharmacies, grocery stores, and other small businesses survive and thrive by providing them with the purchasing power enjoyed by larger national chains.

We stand ready to work with you on legislation that would expand investment in all types of cooperatives that can help rural communities prosper.

Maintain and Sustain the Co-op Development Infrastructure

Finally, NCBA urges that statutory changes that spur investment in cooperatives be accompanied by a sound cooperative development infrastructure. In my experience as a cooperative developer, a solid feasibility analysis and sound business plan are among the first capital hurdles startup farmer cooperatives face. And they need access to cooperative development expertise in order to conduct them. While farmers may have access to a variety of consulting services, few business developers have expertise in analyzing markets and developing business plans specifically for member-owned cooperatives. Poor feasibility analyses and unrealistic business plans that don't account for the unique characteristics of member-ownership lead to failed businesses and significant financial losses for farmers.

Moreover without solid feasibility studies and a complete business plan, both equity investment and debt financing can be nearly impossible to come by. Even with incentives, farmers and lenders are wisely reluctant to take risks on new business ventures that lack a solid business foundation.

The nation's 20 cooperative development centers, including CDS and the Iowa State Value-Added Center, provide the technical assistance farmers and other start-up cooperatives need to develop both feasibility analyses and business plans for new member-owned businesses. The centers offer business and organizational expertise in cooperatives that other business developers lack. And they are innovators—they pioneered development of new generation, value-added agricultural cooperatives. They also provide technical assistance to other types of cooperatives, including rural senior housing co-ops and many others.

USDA's Rural Cooperative Development Grants program provides core funding for these Centers. Unfortunately, funding levels have remained largely flat over the years. And for 2005, the House of Representatives cut the funding for this valuable program by \$1 million. We urge your support for funding for the RCDG program at \$7 million in FY2005 and for ongoing growth in the program. The RCDG program is critical for maintaining and sustaining the cooperative development infrastruc-

ture. Without that infrastructure, cooperative development will be significantly hampered.

Mr. Chairman, on behalf of NCBA, we thank you for this opportunity to share our views on the Heartland Investment and Rural Employment Act. We believe that the cooperative and housing provisions of this bill will go far in advancing cooperative development and business expansion in rural communities, creating jobs, income and opportunity. And again, we thank you for your ongoing support for cooperatives and your leadership in developing and promoting the policies that advance them.

Appendix A

Cooperative Development Centers

Arkansas Rural Enterprise Center

38 Winrock Drive
Morrilton, AR 72110-9537
Phone: (501) 727-5435 ext. 229
Fax: (501) 727-5499
URL: <http://www.winrock.org/arec>
Contacts:
Donna Uptagrafft, Program Associate
dju@winrock.org

Cooperative Development Services

30 East 7th Street
Suite 1720
St. Paul, MN 55101
Phone: (651) 287-0184
Fax: (651) 265-3679
URL: <http://www.cdsus.coop>
Contacts:
Kevin Edberg, Executive Director
kedberg@aol.com

Cooperative Life/Cooperative Development Institute

277 Federal Street
Greenfield, MA 01301
Phone: (413) 774-7599 ext. 111
Fax: (413) 773-3948
URL: <http://www.cooplifecoop>
Contacts:
Lynn Benander, CEO
info@cooplifecoop
Bob Rottenberg, Executive Director
brottenberg@cooplifecoop

Dakota Development Center; North Dakota Association of Rural Electric Cooperatives

P.O. Box 727
Mandan, ND 58554
Phone: (701) 663-6501
Fax: (701) 663-3745
URL: <http://www.ndarec.com>
Contacts:
Bill Patrie, Rural Development Director
Susan L. Davis, Rural Development
Coordinator
sdavis@ndarec.com

Federation of Southern Cooperatives

P.O. Box 95
Epes, AL 35460
Phone: (205) 652-9676
Fax: (205) 652-9678
URL:
<http://www.federationsoutherncoop.com>
Contacts:
John Zippert, Director of Development
fscepes@mindspring.com
Ralph Paige, Executive Director

Indiana Cooperative Development Center

150 W. Market
Suite 414
Indianapolis, IN 46024
Phone: (317) 232-8765
Contacts:
Kathy Altman
kaltman@commerce.state.in.us

**Iowa State University Value-Added
Agriculture Program**

Iowa State University Extension
1111 NSRIC
Ames, Iowa 50011
Phone: (515) 294-0648
Contacts:
Mary Holz-Clause
mclause@iastate.edu

**Kentucky Cooperative Development
Center**

411 Ring Road
Elizabethtown, KY 40456-0267
Phone: (270) 763-8258
Fax: (270) 763-9927
URL: <http://www.kccd.org>
Contacts:
Larry Snell, Executive Director
lsnell@kccd.info

Keystone Development Center

1238 South Garner St.
State College, PA 16801
Phone: (215) 292-1461
Fax: (814) 238-5059
URL: <http://www.kdc.coop>
Contacts:
Kate Smith, Executive Director
smith@kdc.coop

**Mississippi Center for Cooperative
Development**

233 E. Hamilton Street
Jackson, MS 39202
Phone: (601) 354-2750
Fax: (601) 354-2777
URL:
<http://www.cooperativedevelopment.org>
Contacts:
Melbah Smith, Director
mscenter@mindspring.com
Ben Burkett, State Coordinator

**Missouri Farmers Union Family Farm
Opportunity Center**

325 Jefferson Street
#100 A
Jefferson City, MO 65101
Phone: (573) 659-4787
Fax: (573) 659-4787
URL: <http://www.missourifarmersunion.org>
Contacts:
Russ Kremer, President
russmfu@earthlink.net

**Montana Cooperative Development
Center**

P.O. Box 3027
Great Falls, MT 59403
Phone: (406) 268-2644
URL: <http://www.mcde.coop>
Contacts:
Ty Duncan, Director
tduncan@mcde.coop

**Nebraska Cooperative Development
Center**

217 HC Filley Hall
University of Nebraska-Lincoln
Lincoln, NE 68583-0922
Phone: (308) 995-3889
Fax: (308) 995-3889
URL: <http://www.ncdc.unl.edu>
Contacts:
Lynn Lutgen, Executive Director
llutgen1@unl.edu
Jim Crandall, Cooperative Development
Specialist
crandall3@unl.edu

**Northwest Cooperative Development
Center**

1050 Capitol Way S., Suite B
Olympia, WA 98501
Phone: (360) 943-4241
Fax: (360) 357-6085
URL: <http://nwcdc.coop>
Contacts:
Diane Gasaway, Project Manager
nwcdc@qwest.net

Ohio Cooperative Development Center

1864 Shyville Road
Piketon, OH 45661
Phone: (740) 289-2071
Fax: (740) 289-4591
URL: <http://www.ocdc.osu.edu>
Contacts:
Travis West, Co-op Development Program
Coordinator
west222@ag.osu.edu

**Rocky Mountain Farmers Union
Cooperative Development Center**

10800 E. Bethany Drive
Fourth Floor
Aurora, CO 80014-2632
Phone: (303) 752-5800
Fax: (303) 752-5810
URL: <http://www.co-ops.org>
Contacts:
Bob Mailander, Director
center.director@co-ops.org

**South Carolina Center for Cooperative
Business Development**

South Carolina State University
P.O. Box 7568
Orangeburg, SC 29117
Phone: (803) 533-3682
Fax: (803) 533-3639
Contacts:
Dr. Suresh R. Londhe, Director
londhe@scsu.edu

**South Dakota Value-Added Agriculture
Development Center**

416 Production Street, North
Aberdeen, SD 57401
Phone: (605) 352-9177
Contacts:
Dallas Tonsager, Executive Director
dptsd@hur.midco

PREPARED STATEMENT OF PETER K. FROELICH

Mr. Chairman, I would like to thank this committee for providing me with the honor of speaking with you today. I thank you for your holding this hearing and congratulate you for your wisdom in recognizing that rural issues are critical for our nation. My name is Peter Froelich and I am an assistant to the President at Dickinson State University in Dickinson North Dakota. I was also the coordinator of the Great Plains Population Symposium Project. I am a sociologist who has studied the demographic trends and communities on the Great Plains. I am also a citizen from the rural Great Plains and I have direct experience with life in the communities there. I have been invited here to describe what I have learned about the population trends affecting rural America and to briefly comment on the New Homestead Act and the Rural Investment Tax Credit provisions that are included in the JOBS Act and the HIRE Act.

The need for action to preserve the communities in much of rural America is urgent. The communities in agriculturally dependent rural areas have been slowly eroding for decades, and many are now gone or very nearly at their end. Nowhere is this erosion more evident than in the Great Plains, at the very center of the nation. As rural communities erode, rural American culture is also disappearing. I believe that the conditions leading to the loss of youth and young families through out-migration are the greatest current threat to rural America. I also believe that an absence of viable populations and healthy local societies may eventually undermine the security of America's vast rural territories along with the security for its food system and large portions of its basic infrastructure for transportation, energy production.

Rural communities are being silently destroyed by the out-migration of young people, consolidation of agriculture, and the concentration of amenities and non-agricultural opportunities in urban places. Although the problems of rural America may be manifested at the local level, the roots of those problems are often beyond the reach of local leaders. The vision, understanding, and support of our national leaders are critical for rural well being. Rural America needs a national policy that aggressively addresses rural population loss and the fundamental changes in the economic underpinnings of rural communities. Today only a small minority of rural Americans farm as their primary occupation. If rural communities are to survive, there must be a new vision for rural society that extends beyond an agricultural base. I believe such a vision can only develop through the understanding and considered action of national leaders such as yourselves. Your work here is critical and the members of this body should be commended for your continuing efforts on behalf of rural people.

It is critical that we develop a new framework for rural policy that recognizes the many rural issues that cannot be adequately addressed through farm policy. I applaud your efforts to help rural people overcome obstacles to rural well-being. I encourage you to continue pressing for a new and broader policy framework through which rural well-being can be assured and the diverse issues that affect rural communities can be comprehensively addressed. I strongly support the proposed "New Homestead Act" (S. 602) which is a promising step toward establishing such a framework.

Trends and Conditions

There has been a consistent and continual loss of a substantial portion of the population from rural, agriculturally dependent areas of the United States, particularly in the Great Plains. This loss has occurred for at least half a century in many areas and now threatens the very existence of many communities within these regions. Figure 1 shows the distribution of population declines nation wide between 1990 and 2000.

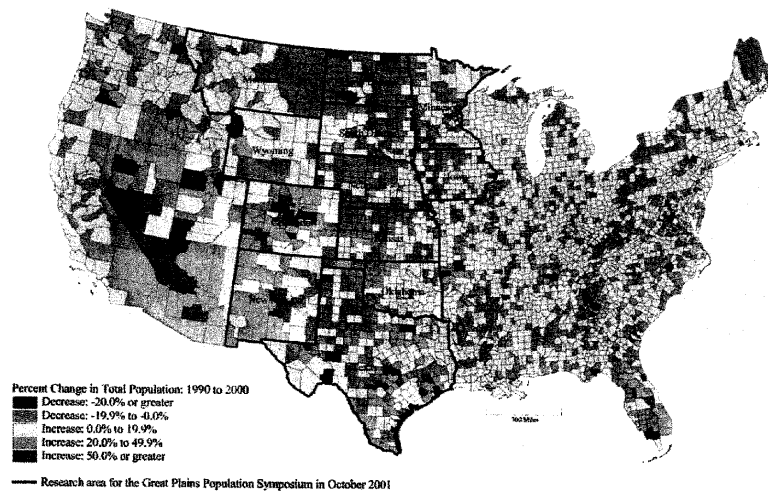


Figure 1: Population Change 1990 to 2000

Out-migration tends to be age-specific and it is younger people who are most likely to move. The loss of younger people and the aging of those who remain have shifted the age structure of rural populations with the result that there are declining birth rates and rising death rates. In an increasing number of rural counties there is natural population decrease because deaths now exceed births. Figure 2 shows counties in the Great Plains states that have experienced natural population decrease between 1980 and 1999. Because the trend for out-migration from rural areas is on-going and tends to occur most heavily among the young, we can expect that the extent of natural decrease will spread in coming years and an increasing number of rural communities will lose the biological vitality needed to reproduce themselves.

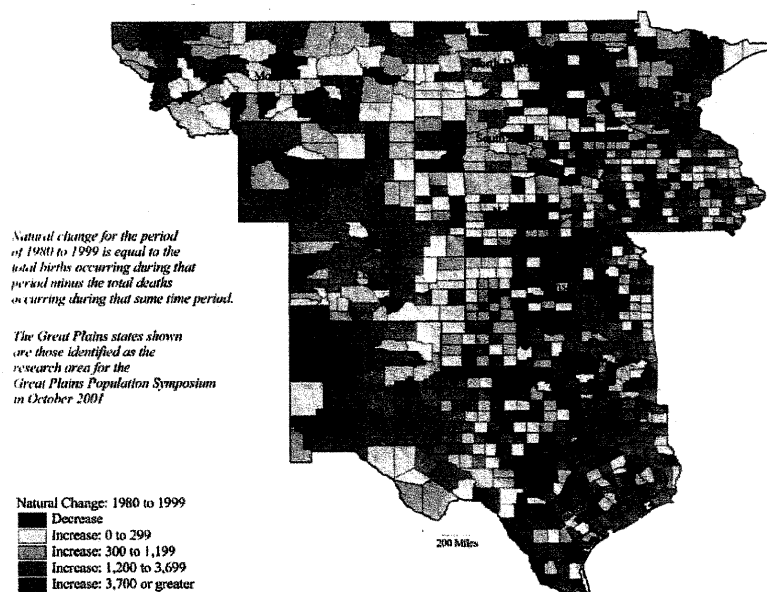


Figure 2: Natural Population Change in Great Plains States 1980 to 1999

The impact of out-migration on the populations of rural areas can also be seen when the age and sex structure of rural counties are displayed graphically in the form of population pyramids. The graph for a healthy population that is maintaining itself or growing will be shaped more or less like a pyramid and will be wider at the base where the bars for younger cohorts are displayed and narrower at the top where the bars for older cohorts are displayed. The population pyramids for many rural counties are beginning to look like inverted pyramids in that the bars for the oldest cohorts are wider than those for younger generations.

As an example, figure 3 shows a population pyramid for McIntosh county in south central North Dakota. It depicts a population with failing vital signs that is losing its potential to maintain itself without an influx of new people in their child bearing years. In addition, this county will face enormous social and economic problems. It will face a staggering burden in meeting the social and health needs of a growing population of elderly people, its schools and services for youth will be difficult to maintain, its entry level labor force is nearly depleted, and its pool of potential new leaders is almost gone. Out of 53 counties in North Dakota, the pyramids for all but 3 indicate the development of a similar pattern of loss among the younger ages, particularly young adults. The population pyramid for McIntosh county North Dakota portends an unfolding disaster. It is a pattern that is repeated in many rural areas suffering from out-migration.

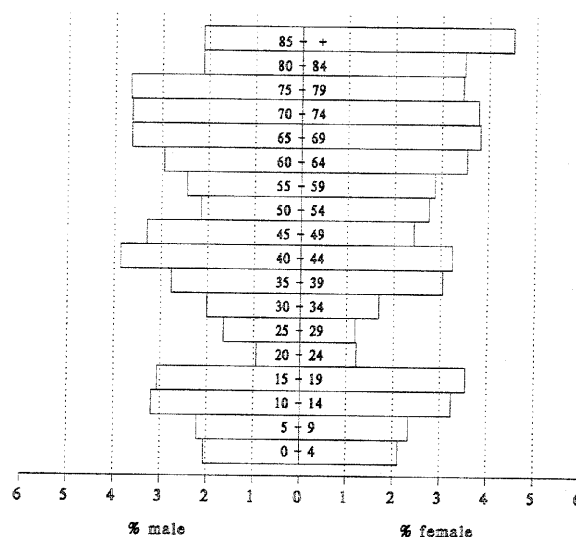


Figure 3: 2000 Age and Sex Structure - McIntosh County, North Dakota.

In October of 2001, my colleagues and I hosted a symposium conference focused on national policies for addressing the ongoing population losses from the rural Great Plains in Bismarck, North Dakota. At the symposium we heard evidence of a wide variety of problems impacting the Great Plains and rural America in general. The problems faced by McIntosh County are faced by counties across rural America. Population loss and the shifting age structure has strained the social infrastructure and makes it increasingly difficult to maintain services for younger people while also meeting the growing needs of the elderly. Out-migration is a growing constraint on the potential for rural prosperity with the loss of labor, income, leadership, and entrepreneurs.

At a time when health care is becoming a critical concern for meeting the needs of an aging population we find that our rural health care system lags behind the nation in terms of availability, cost, and quality. As might be expected, the health status of rural residents is also lower than that of non-rural residents. Rural health care receives inadequate support and reimbursement from government programs, and the insurance industry. There are fewer quality facilities, and payments for services have been lower in rural areas. It is more difficult to find and retain physicians and health professionals who want to practice in rural areas. Rural residents are more likely to be uninsured and must often travel for even basic care. There are fewer alternatives for care in areas with low population density and it is difficult to achieve economies of scale. Costs for services and for prescriptions tend to be higher. The challenge of providing even basic health care has contributed to a lack of emphasis on preventive medicine and a higher proportion of rural residents who suffer from ailments which could have been avoided.

While rural areas and communities of the Great Plains are known for high levels of certain aspects of what is called "social capital;" growing shortages of leadership, the increasing potential for conflicts of interest, continuing social inequality, exclusion of some groups from development efforts, and the inability or unwillingness of many rural people and communities to abandon small town rivalries are all identified as barriers to development of the kinds of social capital needed for successful rural development.

The rural economy in the Great Plains and elsewhere in the United States continues to be dominated by commodity agriculture and low wage employment. Communities with local economies based primarily on the availability of low cost labor and commodities which can be produced cheaply in many places around the globe

are truly involved in a global race to the bottom of the economic ladder. For those communities economic inequality and decline are likely to continue.

The flat opportunity structure of rural economies are out of step with a society that values educational achievement. There is a direct relationship between wage levels and opportunities for advancement and the number of college graduates who leave rural areas. On average, the State of North Dakota loses roughly the same number of college educated people as its colleges and universities produce. Rural businesses that could once rely on high rural fertility to supply them with cheap labor are soon likely to find that they cannot hire help at any price. Although increased wages for rural workers may be difficult for some small business enterprises, the first response to low wages by today's rural young people is often simply to leave. In North Dakota, it is rare to find a young person who says they are willing to accept low wage employment in order to stay in their community. None of these businesses are likely to survive when their local labor pools are finally emptied. The loss of our highly educated young people is also a severe obstacle to new growth and diversification of rural economies.

Rural assistance has depended heavily on government payments to the individuals involved in agriculture. In comparison with urban America, a much smaller proportion of federal funds go to rural community development projects. The emphasis on individual transfer payments over funding for community development contributes to a lack of investment in rural economic infrastructure and a continuing lag in rural well being. It is critical that our national policies recognize the need for new investment in the infrastructure and economic capacity of rural places and seek to either provide or stimulate that investment.

Eligibility for assistance through federal grants often hinges on criteria that make sense for the conditions in urban but not in rural America such as high levels of poverty or unemployment. While high rates of poverty or unemployment may indicate the distress of urban communities, high out-migration is often the rural response and is a key symptom of rural economic distress. It is critical that our policy makers consciously avoid creating policies that create unintended disadvantages to people and businesses located in rural areas because by relying on inappropriate measures and criteria that fail to give adequate weight to rural realities.

There has been job growth in some rural areas over the past decade but the economic progress of rural communities is uneven and on average rural wage earners make only about 70% of what their urban counterparts make. Approximately 60% of rural communities are seeking new "economic engines" that can provide adequate employment for their residents. New technologies are often promoted for their promise to reduce the disadvantages of rural location, however, that promise is not being realized. Rural communities continue to lag behind urbanized areas in the development of new technological infrastructure and commercial e-business enterprises. There is a digital divide between rural and urban America, and rural America lags in two key areas: access to state of the art broadband internet services and wireless services.

Although jobs are an important reason for many people to move to or stay in a community, our research shows that people are most likely to come to a rural Great Plains community because of family connections. Unless forced to leave, they are most likely to stay in a community because it is a nice place to live and because of their family connections. Rural development efforts have too often focused narrowly on primary sector economic development and ignored other aspects of the community including economic enterprises that enhance quality of life. Social and economic relationships are both important. The people most likely to leave rural communities are those who are the least connected to their communities, regardless of employment opportunities. They tend to be under the age of 30, live alone, and dislike the social climate and/or the lack of infrastructure, services, and consumer choice. People can find economic opportunities in many places, but they are most likely to stay in rural communities when they are connected to those communities by more than a job.

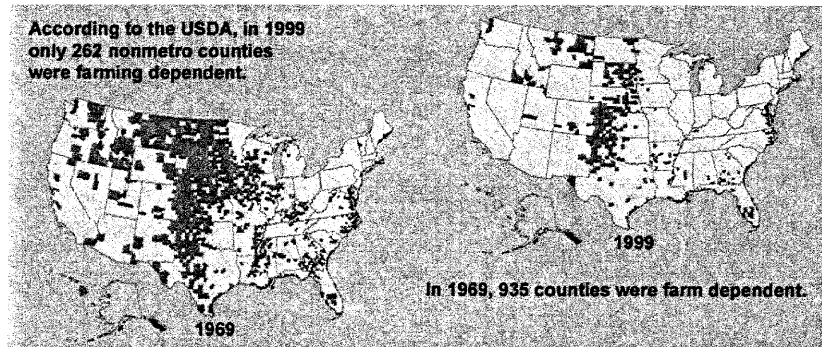


Figure 4: The Declining Number of Farm Counties.

The decline of rural America is often attributed to the consolidation of agriculture, but it can also be said that an equally important cause for rural decline has been a failure to develop new opportunities outside of agriculture in rural areas. Figure 4 illustrates the declining number of farm dependent counties in the United States. There is a striking similarity between the earlier pattern of farm dependency and the pattern of population loss depicted in Figure 1.

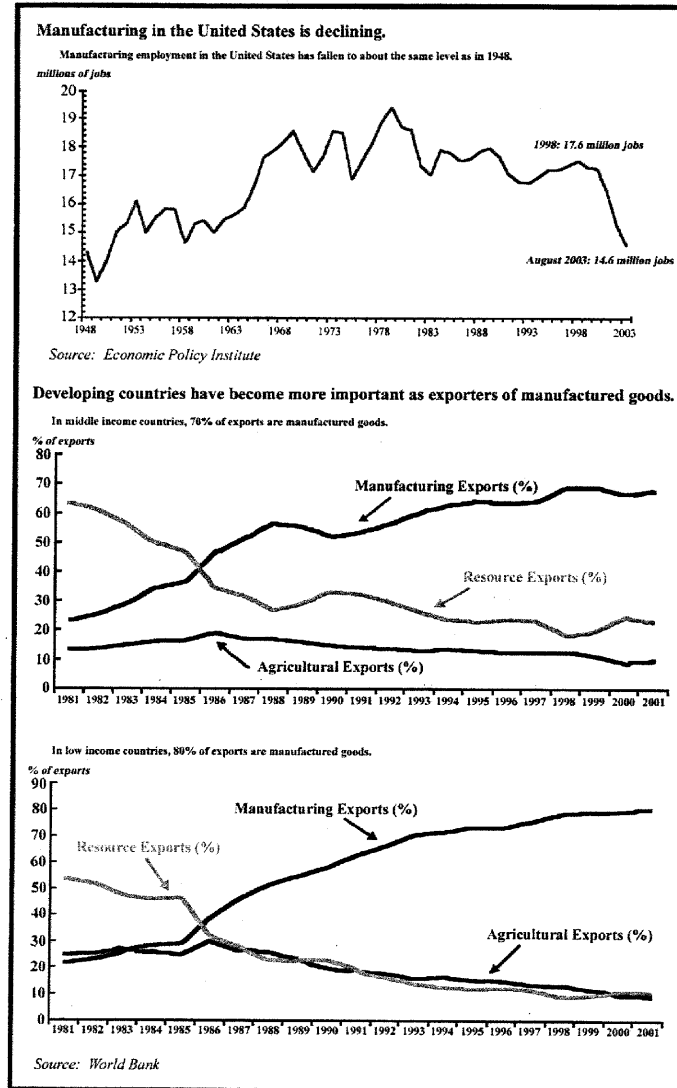


Figure 5: Manufacturing Exports and US Manufacturing Jobs

Local entrepreneurship is critical to the future of rural America. Rural economic development has also often relied on strategies aimed at attracting businesses from outside, especially branch manufacturing plants. Globalization has made this strategy more difficult as many of the businesses that are willing to relocate are now likely to move out of the country. Figure 5 illustrates how the loss of manufacturing jobs in the United States has corresponded with increased exports of manufactured goods from developing nations. In effect, globalization is causing industrial development to leap-frog over rural communities in the United States and take root in other countries where the lowest production costs can be found.

If rural places are to prosper, they must have a national rural policy that encourages rural people to be builders and that supports local institutions that can help them identify and address a diversity of opportunities and

conditions. Rural economic development is most likely to have long term success when it fosters local entrepreneurship. It must support a range of enterprises, both those in primary industries and those that lead to a high quality of life and build the economic multiplier effect within the community.

In the United States today, achieving such a policy is an immense challenge because there is no unified vision for the future of rural America and rural people are continually challenged to define the contemporary value of their communities to the nation as a whole. Rural Americans need leaders who can help them articulate a vision that brings them back into the mainstream of American life. They need policies that are sensitive to the differences between rural places, that protect and enhance rural environments, and that help rural communities develop from within in new directions.

Comments on the New Homestead Act, The JOBS Act, and the HIRE Act.

The willingness of Congress to fund programs such as the Great Plains Population Symposium, and propose legislation such as the "New Homestead Act" (S.602) show that our nation's leaders are concerned with the future of rural America. S.602 provides strong incentives for young people to stay in or relocate to the rural communities that have been most heavily impacted by the out-migration of youth. The bill counters a number of issues that may drive young people away from rural places by offering to help repay college loans, provide tax credits for the purchase of new homes, protecting from losses of real estate values. By establishing homestead savings accounts with matched deposits the bill also provides a source of financial support for aspiring entrepreneurs and a clear advantage to those who would stay in the effected areas.

The findings of the Great Plains Population Symposium project strongly suggest that the future of rural communities depends heavily on their ability to foster entrepreneurship. The tax credits for small business investments in S.602 are especially important for supporting entrepreneurs in high out-migration areas. These incentives will help rural people in high out-migration areas build and expand the businesses needed to re-establish economic vitality in their communities. The difficulties that rural entrepreneurs encounter in obtaining appropriately scaled equity investment capital was also frequently mentioned as an obstacle to rural entrepreneurship in our discussions of the impediments to rural development. The provision in S.602 for the establishment of a New Venture Capital Fund will have a major impact on rural entrepreneurship by ensuring that rural entrepreneurs and companies in high out-migration areas will have access to the equity capital they need.

I would like to thank you for moving ahead with some of the provisions of S.602. It is my understanding that both the JOBS Act (S.1637) which was passed by the Senate in May and the proposed HIRE Act include rural investment tax credits similar to those proposed in S.602. "Rural Investment Tax Credits" will encourage investments in high out-migration counties by annually allocating \$185,000 for each high out-migration county to offset business costs of up to 70% of the present value for new buildings or 30% of the present value for existing buildings over 10 years. These credits will create a clear advantage for businesses that are able to take advantage of them. "Rural Small Business Investment Credits" will also be made available to help offset up to 30% of the costs of small businesses in high out-migration counties in states that choose to allocate a portion (up to 10% in the JOBS Act or 20% in the HIRE Act) of the rural investment tax credit allocation for that purpose.

I strongly support these tax credits because they will help support the entrepreneurs who are needed in our declining rural areas. The evidence I have reviewed suggests that for most declining rural places the best development opportunities will involve supporting local entrepreneurs and small businesses. These Rural Small Business Investment Credits are especially important because they are specifically targeted to small businesses with 5 or fewer full time employees. In southwestern North Dakota, where I live, nearly a third of all jobs are due to self-employment. Though they are seldom recognized, such small businesses are a mainstay of the local economy and will likely be a key for the revitalization of rural areas.

Given the resource constraints under which you must act, I applaud the wisdom and courage you have displayed in advancing these measures. If I were to make any adjustment to these provisions it would be to strengthen the level of support for small business development by raising the limit for the proportion of funds that can be allocated for Rural Small Business Investment Credits to at least the 20% level that is specified in the HIRE Act so that there can be more flexibility in supporting aspiring entrepreneurs who may or may not need to make investments in real estate in order to address the opportunities they have identified. I also urge you to

continue your efforts to fully enact the provisions in the New Homestead Act (S.602).

I would like to thank you again for the opportunity to be here today and I hope that my comments are useful for your important work.

PREPARED STATEMENT OF HON. CHARLES E. GRASSLEY

I am very happy to be in Sioux City, Iowa today, to bring national focus on an issue that I find disturbing—the continuous loss of our young people and our families from the rural Midwest. I see many people in this room that I have known for years. I met many more of you this morning, and I am pleased to see such a collection of talented, dedicated leaders of our communities. These are leaders not only from Iowa, but Nebraska and the Dakotas and several other surrounding states. All of you have come here with a common concern, that being how to stem this tide of rural out-migration.

Now I am the chairman of the Finance Committee of the United States Senate, and we have begun to examine the role of tax incentives in preserving rural communities. In some areas, tax laws are unfair to rural communities or don't do enough to build economic growth. In other areas the tax code is out of date and needs to come into the 21st Century. Today we will discuss a series of proposals that address those issues. Specifically, the witnesses that have joined us today will focus on a bill that I introduced called the *Heartland Investment and Rural Employment Act*, known as HIRE. My goal with this legislation is to update tax laws and create new incentives that make sense for rural America.

Now don't get me wrong, rural America has a lot to be proud of, but while the agricultural economy is showing strength that we have not seen in years, I think Congress should do its part to help bolster some of our successes. Just think, in the last 10 to 20 years, rural America has built 12 farmer-owned cooperative ethanol plants in Iowa, and several additional plants are under construction. Nationally we have 74 ethanol plants producing 2.9 billion gallons and 14 plants under construction to bring industry production to 3.4 billion gallons this year. To put this in perspective, the U.S. produced 10 billion bushels of corn in 2003. Of that, nearly 1.1 billion bushels of corn were used to produce the 2.9 billion gallons of ethanol. The ethanol industry has created rural jobs and economic diversity, not to mention decreased dependence on foreign oil. It is truly a hometown success.

What's more, we have more rural success stories. Iowa ranks fourth in the nation in terms of installed wind generation capacity, generating enough electricity to serve over 300,000 homes. Rural America is clearly on the forefront of reducing our nation's dependence on foreign sources of energy. But we need more of these success stories, and I believe a few changes to a very complex tax code could help make those stories come true.

Now let's talk about unfinished business. Today some of the things we'll talk about will sound familiar—that's because we have been fighting for them for years. They are good ideas that enjoy strong bipartisan support and were actually approved in 1999 as part of the *Taxpayer Relief Act*, which then-President Clinton vetoed.

The first is a proposal I call FFARRM Accounts—that stands for Farm, Fishing and Ranch Risk Management Accounts. These farmer savings accounts would allow farmers to contribute up to 20 percent of their income in an account, and deduct it in the same year. FFARRM accounts would be a very important risk management tool to help farmers put away money when there's actual income, so that in really bad times there would be a safety net.

The other proposal—and my good friend Senator Sam Brownback of Kansas has taken the lead on fixing this problem—is the unfair IRS decisions on self-employment tax on farmers who participate in the Conservation Reserve Program.

And of course, there is our ongoing effort to address the Dividend Allocation Rule, and end the unfair third level of tax on cooperative dividends. This provision has been included in my *Jumpstart Our Business Strength Act*, known as JOBS, which will be in conference with the House as soon as we return after Labor Day, so with any luck and a lot of hard work on the conference, we could have a bill to the President by October.

In addition, our witnesses today will be discussing the issues of out-migration and the potential effect the proposals of the *Heartland Investment and Rural Employment Act* could produce.

Now, before introducing our witnesses for today's hearing, I will be reading Senator Max Baucus' opening statement. He is in his home state of Montana and was

unable to join us today. I know cooperatives are just as important to Max as they are to me.

We have included some of the important provisions from the *New Homestead Act*, which was originally sponsored by Senator Byron Dorgan of North Dakota and 12 original co-sponsors including Senators Chuck Hagel of Nebraska, Tom Daschle from South Dakota and Sam Brownback of Kansas. Senators Dorgan, Daschle and Hagel were unable to join us today, but their statements will be included in the record and copies are on the table for the audience to review. We have included these provisions in both the HIRE Act and the JOBS Act, which awaits conference with the House. Under current law, there is no special assistance for businesses in counties that are losing population. My good friend Senator Brownback has joined us today to more fully explain the motivation and tax policy behind the *New Homestead Act*. Even though Senator Brownback is not a member of the Finance Committee, he always shows leadership and insight on agriculture and rural economic issues, and I value his insight and support in these important matters. Senator Brownback, would you like to begin?

PREPARED STATEMENT OF HON. CHUCK HAGEL

Mr. Chairman, I want to thank you for holding this important hearing concerning the preservation of America's rural communities and for your strong support of this effort. Rural America has seen a steady deterioration over the past several decades. During the last 20 years, residents of small Midwestern towns have deserted rural America in ever increasing numbers. Raised and educated in small towns throughout the Midwest, rural youth have moved to larger cities in search of opportunities unavailable in small-town America. Main Street businesses have closed, and family farms continue to be consolidated into larger, less labor-intensive, operations.

The lack of economic development and opportunities in rural areas has forced individuals and businesses to migrate from rural to urban areas at unprecedented rates. In March 2003, Senator Dorgan and I introduced the New Homestead Act in an effort to help reverse the longtime trend of population decline in rural America.

The New Homestead Act would create new economic incentives for small businesses and individuals in counties with high out-migration. Just as the original Homestead Act of 1862 enabled the settlement of the frontier, this legislation would help attract entrepreneurs and younger workers to rural areas suffering from high population loss, while giving current rural residents a better chance to preserve their heritage.

For decades, family farms and main street businesses have been disappearing from America's Heartland. As those farms and business fade away, so too do the small towns—from the Great Plains to the Deep South—from the Midwest to the Southwest. Young people move away, forced to look for jobs and opportunities in already-overcrowded metropolitan areas. As a result, hundreds of small communities now struggle for survival.

Half the rural counties in America lost population in the 2000 census. Three of every four rural counties experienced below-average economic growth—despite the record levels of farm subsidies in the 1990s.

During the past fifty years, rural America has stagnated; over the same time span, the number of people living in urban areas has more than doubled.

More than 140 years after President Lincoln signed the original Homestead Act—Nebraska is one of the states hardest hit by the trend of rural out-migration. Of Nebraska's 93 counties, 55 have lost at least ten percent of their residents over the past twenty years due to out-migration. Most of these counties will see similar population losses over the next two decades without an expansion of non-agricultural industry.

The problem is that America has no comprehensive rural development policy. We must recognize there is more to stimulating the rural economy than just providing farm price supports and that national agricultural policies have not helped farming communities reverse rural decline. As an example of our insufficient farm policies, less than one percent of the funding in the recently passed farm bill was allocated for rural development.

The New Homestead Act offers some real solutions that will help close the gap between rural America and the rest of our country. It targets three categories—individuals, businesses, and capital formation.

The first section provides incentives for individuals to migrate to rural communities. The bill would repay up to 50% of college loans for qualifying individuals in rural areas. In addition, the bill would provide tax credits for home purchases, and tax deductions for losses in home values. It would also create tax-favored Home-

stead Accounts, that could be used to build savings, to pay educational expenses, to make first-time home purchases, or to start a small business.

The second section would help provide new jobs and opportunities by encouraging business growth in high out-migration areas. Rural Investment Tax Credits, administered by the states, would provide incentives for new businesses to locate in rural areas, while existing rural businesses could expand operations.

The third section would create a \$3.3 billion Venture Capital Fund that invests in high out-migration counties. As in metropolitan areas, rural businesses need capital to exist and expand. This would bring together federal, state and private funds to help rural business ventures attract necessary equity funding.

It is in the broad interest of the country that we do not forget our rural areas. Again, I thank you, Mr. Chairman, for holding this hearing and focusing on a major problem facing rural America. I hope this hearing will help raise a new awareness of rural America's plight and the policies necessary to help restore a new vitality.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF CHUCK HASSEBROOK

Thank you for the opportunity to testify. I will speak in support of the New Homestead Act and share some thoughts on agricultural provisions of the Heartland Investment and Rural Employment (HIRE) Act.

We strongly support the New Homestead Act. It is particularly critical in the farm and ranch communities of our region. Our 2003 report, *Swept Away* analyzed the 182 counties in Iowa, Kansas, Minnesota, Nebraska and the Dakotas that directly rely on farming and ranching for at least twenty percent of income.

More than 80 percent of these counties are losing population. As a group, they suffer poverty at significantly higher rates than the region's metropolitan counties. Average earnings are a little over half of earnings in the region's metropolitan counties.

The New Homestead Act offers bold action to reverse decline in these counties. Most important, it makes a statement that the communities of rural America matter. Strong communities bring out the best in us. They restrain our most selfish impulses and elevate our instinct to help others; essential to building a strong society. It's time for public policy to recognize that. The New Homestead Act does so.

Its college loan forgiveness provisions would enable young people who want to return home to make that choice, rather than being forced to move to higher paying areas to service college loans. The tax credit for home purchases could make the difference in enabling many modest income families to buy homes and put down roots. in rural America, where they want to be, rather than being forced by economics to pursue their dreams elsewhere.

We are especially supportive of two provisions aimed at stimulating small business development and creating opportunities for modest income rural people to build assets:

1. The Rural Small Business Investment Credit provides a 30 percent credit up to \$5,000 annually and \$25,000 lifetime to establish or expand owner-operated small businesses with five or fewer employees. The credit would be for all business investments (working capital, inventory, wages, etc.).

2. Individual Homestead Accounts provide tax incentives and matching funds for saving money to start a business, buy a home, get education or pay for health care.

We strongly laud your leadership Senator Grassley in including the Rural Small Business Investment Credit in HIRE and the JOBS tax bill passed by the Senate. We encourage you to work in the JOBS Conference Committee to secure its adoption. However, we ask you to make one refinement.

The Senate JOBS provision would provide Rural Investment Tax Credits of \$165,000 per eligible county. But no more than 10 percent of that amount—\$16,500 per county—could be allocated to the Rural Small Business Investment Credit. The other 90 percent would be dedicated to credits for constructing or rehabilitating buildings.

We urge you to remove the 10 percent cap on small business credits and allow states and communities the flexibility to determine how to best use their credits and decide which development path makes most sense for them.

Our research suggests that the most effective and desirable economic development strategy for most agricultural communities is small entrepreneurship—development based on locally owned, owner operated small businesses. Often called micro-enter-

prise development, it has been proven to work in the agricultural areas that have not been successful in attracting large employers from outside.

In the farm and ranch counties of Nebraska, Iowa, Kansas, Minnesota and the Dakotas; roughly half of the *net* job growth stems from non-farm self-employment—people creating their own job by starting a business. In the most rural counties, those with no community over 2,500 people, non farm self employment accounts for nearly 60 percent of total job growth and 80 percent of net job growth.

Rural people have an entrepreneurial bent. Agricultural counties in the nation's mid-section have several times the rate of self-employment as metropolitan counties. Small entrepreneurship is especially important as companies that formerly looked to rural areas are now moving off shore for lower wages.

There are social advantages to small entrepreneurship. It keeps profits in the community. It creates a mix of opportunities—some low wage jobs but also significant opportunities for people to build assets and earn middle class incomes as business owners. When real wages are falling in many industries, creating opportunities for people who work to be business owners creates more quality opportunities. Finally, small business development puts the future of the community in the hands of its own members, people committed to its future. That builds leadership and reduces dependency on outside forces.

The Senate was wise to include the Rural Investment Tax Credit in its bill, but it could be improved by removing the ten percent cap on its use for small business development. We must allow our investment to go where the return is greatest—in small business development. It has been proven to work in rural America.

I would also like to comment on the Heartland Investment and Rural Employment (HIRE) Act. We support its call for an examination of the impact of securities law on new cooperative formation.

The Center for Rural Affairs is working with a group of farmers and ranchers from Iowa, Nebraska and South to form a cooperative to market naturally raised hogs and cattle. The greatest expense we have faced is the legal cost of meeting the securities requirements of three different states. We urge that means be examined for streamlining the securities requirements for small cooperatives operating across state lines.

Such cooperatives are essential in enabling family farms and ranches to tap the opportunities in today's markets. Markets are segmenting into groups of consumers willing to pay substantial premiums for food products with unique attributes.

For family farmers to thrive in the 21st century, they must band together to market effectively to those niches. Though the opportunities can be great, they do not necessarily start big. They often involve small numbers of producers in their initial phases who cannot afford exorbitant filing fees. Streamlining the filing process and reducing its cost would help stimulate rural entrepreneurship through cooperatives.

HIRE also proposes removing First Time Farmer Bonds from the state-by-state volume caps on private activity bonds. We support that provision. First time farmer bonds provide beginning farmers with affordable access to land and capital by providing a tax exemption on the interest earned by investors on bonds used to raise loan funds.

We suggest one additional provision with respect to first time farmer bonds. Current law prohibits federal guarantees of loans made with the proceeds of tax exempt bonds, with some exceptions. We urge that a provision be added to HIRE to also exempt first time farmer bonds from the federal loan guarantee prohibition. That would enable the USDA Farm Service Agency to guarantee loans made to beginning farmers with the proceeds of first time farmer bonds.

USDA has had difficulty in reaching its statutory targets of providing 25 percent of loan guarantees to beginning farmers. Removing the prohibition on guaranteeing first time farmer bonds would help USDA achieve the objectives set by federal law. And it would enhance the effectiveness of first time farmer bonds in opening opportunity to a new generation of farmers and ranchers.

In closing, I offer one additional thought—a caution regarding the extension of favorable tax treatment to production agriculture. Agriculture was a significantly tax favored industry prior to the Tax Reform Act of 1986. The experience was not good. Tax shelter induced over investment led to tax shelter induced over production—which lowered commodity prices.

Even more serious, tax shelters changed the rules of competition in agriculture. To compete effectively in a tax shelter industry, one must be able to competitively exploit the tax shelter. The advantage shifted to large farms and investors with the high bracket incomes and large amounts of capital needed to fully exploit tax shelters. Medium size owner operated farms and ranches were placed at a competitive disadvantage.

Farmers and ranchers recognized the problem in the 1980s and asked Congress to help. Senator Grassley played the lead role in correcting the problem.

It is a lesson worth remembering. We must exercise caution so as to avoid repeating the mistake. For example, tax incentives in the New Homestead Act for buildings and venture capital should either exclude production agriculture or be targeted to small and medium size owner operated farms.

Likewise, the tax exemption in HIRE for livestock production cooperatives should be carefully scrutinized to ensure that it does not subsidize large industrial livestock operations to drive family livestock farms out of business.

Thank you for the opportunity to testify.

PREPARED STATEMENT OF GLEN KEPPEY

Good morning Senator Grassley and Senator Brownback. My name is Glen Keppy. I am a farmer from Davenport Iowa and serve as a Director on the CHS Board. CHS is a regional agricultural cooperative with over 1,100 local co-ops representing nearly 350,000 producers centered in 28 states, to include Iowa, Montana, and Kansas, in fact CHS continues to be the second largest employer in the state of Montana. Our company is the result of the merger of the cooperatives CENEX and Harvest States, and thus the name CHS.

CHS appreciates being able to speak to several issues concerning the focus of this hearing today on rural America. For fifteen years, CHS Directors and management have been coming to Washington, DC urging help for rural America especially for agriculture.

CHS has worked hard supporting many of the items in bills produced by this Senate Finance Committee and applaud the committee, especially its leadership, in finding every means it can to advance hope to rural America.

I will highlight a few tax bills produced in 2004. In the highway bill, you have offered tax help for ethanol and biodiesel. This will help many farmers by providing another outlet for their crops, It will also help the environment by providing cleaner fuels for motor vehicles.

In the energy bill, you have offered several items to include tax credits for the small petroleum refiners that dominate rural America, as they try to meet the costly EPA diesel desulfurization requirements by 2006, These tax credits are critical to the last three remaining farmer-owned refineries in America today—one of which is in Montana and one in Kansas.

In the corporate tax bill, you have offered help to ag exporters of American grain and granted farmers the right to economic tax assistance by classifying their co-ops as manufacturers. Both of these measures will help, as the United States transitions away from export supports found illegal by the World Trade Organization and under which the United States is now being penalized, with tariffs increasing each month up to \$4 billion.

And this month, you introduced a bill for "Heartland Investment and Rural Employment," called HJRE, that continues your efforts of helping rural America. This is the topic for today.

Having supported many of the sections of HIRE legislation in previous bills, CHS knows first hand that they are good provisions. The first part of the HIRE bill, Title I, has items we know will help cooperatives and producers. For example, you have been trying to eliminate the unfair third tax on co-ops that issue stock. Your proposed provision that allows co-ops to issue stock without reducing patronage dividends—which we know as the Dividend Allocation Rule—would certainly help cooperatives like CHS.

CHS looked at how elimination of the Dividend Allocation Rule would specifically help us in our CHS preferred stock offering nearly two years ago. We determined that elimination of the Dividend Allocation Rule would help us keep more patronage for our member-owners More importantly if the Dividend Allocation Rule is no longer in place, we believe more co-ops would issue stock, thereby providing cash strapped farmers and ranchers more liquidity and financial strength. There is a lot of co-op interest in this. Our CFO and CEO have been giving briefings to other co-ops on the stock offering mechanism and the Dividend Allocation Rule's impact.

The second part of this HIRE legislation we would like to comment on is in Title III. Title III has another good group of provisions. We want to thank Senator Brownback for his work on these issues and on the New Homestead Act along with Senators Dorgan of North Dakota and Senator Bagel of Nebraska,

We see the two provisions called "Rural Investment Tax Credits" and "Qualified Rural Small Business Investment Credits" as very useful for rural America.

Rural gas stations with convenience stores and stores for crop inputs like fertilizers and crop protection items might be good candidates for these rural America credits. Why? Let's take gas stations as an example. The trend in the number of retail stores selling motor fuel in the United States has been a steady downward one. Since 1994, there has been a loss of 35,532 stores, for a decline of 17.5% nationwide. Since 1994, retail stores selling motor fuel in 10 of CHSTs core states, which include Iowa and Kansas, have declined by 3,491 stores or 12.6%. The three hardest hit states for CHS are Wyoming with a decline of 42%, Kansas declining 21% and Montana declining 20.9%. We see that as a serious factor in contributing to the shrinking of rural communities. We are a mobile society and as gas stations close in a given area, people move.

CHS has been working on reversing this. It has a business program that gives co-ops the business tools to build local gas stations and convenience stores. But some are reluctant to make the financial commitment. This tax credit could help.

Our tax people have looked at the "Rural Investment Tax Credits" and would suggest several things the committee should consider. First, reduce the numbers of players in the oversight of the program. Second, set up a simple administrative process. Third, insure the program has restraints and constraints so it does not become slanted to a "who you know process". Our tax people would be happy to work with your staffs on these suggestions. All-in-all this is a good provision.

In summary, we commend the efforts of this committee and its leaders in pushing for tax relief for agriculture and rural America. The committee continues to do its job well. The problem is the Congress.

First, Congress cannot seem to find the means to pass the energy bill or corporate tax bill—both, which I mentioned earlier, have some great tax help for agriculture and rural America. We need just two senators to change their filibustering vote on the energy bill, H.R. 6, and that, with its helpful ag and rural tax provisions, would become law.

Second, Congress needs to pass the corporate tax bill. It would be an embarrassment if the corporate tax bill with the tax provisions did not pass Congress this year; otherwise the WTO continues to levy more and more tariffs on our goods.

This legislation called HIRE is another good bill that warrants passage. Once improved, CHS will actively urge members of Congress to give the HIRE bill their full support.

Lastly, you should know that as producers, we are concerned about the potential loss of an American farmer owned and controlled cooperative lender. We urge the U.S. Congress and the Farm Credit Administration to hold oversight hearings on the proposed sale to ensure that the credit needs of mid-west farmers and ranchers will continue to be met in both good times and in bad.

Thank you for this opportunity and thank you for your continuing efforts to help rural America.

PREPARED STATEMENT OF JEAN-MARI PELTIER

Thank you, Mr. Chairman. We appreciate very much the opportunity to appear before you today and want to commend you for holding this important hearing on promoting economic growth and opportunity in rural America.

My name is Jean-Mari Peltier and I am President and CEO of the National Council of Farmer Cooperatives, which is headquartered in Washington, DC. Farmer cooperatives, their farmer owners, employees and their families all have a significant interest in the subject of today's hearing because rural America is where they call home.

NCFC is a national trade association representing America's farmer-owned cooperative businesses. Our members include nearly 50 national and regional marketing, supply and credit cooperatives that, in turn, are comprised of more than 3,000 local cooperatives whose member owners represent a majority of our nation's nearly 2 million farmers. Here in Iowa, there are over 160 farmer cooperatives, making it the 7th largest state in terms of number of cooperatives. In addition, NCFC's membership includes 26 regional and state councils, such as the Iowa Institute of Cooperatives.

These farmer cooperative businesses handle, process and market virtually every type of commodity produced in the U.S.; manufacture and sell farm supplies; and provide credit and related financial services for and on behalf of their member owners. They provide farmers with the opportunity to:

- Improve their income from the marketplace;
- Better manage their risk;

- Capitalize on potential value-added business opportunities beyond the farm gate; and
- Compete more effectively in a changing global economy.

Being farmer owned and controlled, the earnings from these activities are returned to their farmer members on a patronage basis. This not only helps improve their overall income from the marketplace, it also promotes additional economic activity in their rural communities.

Farmer cooperatives also play another important role when it comes to our rural communities by providing jobs for over 200,000 full and part-time employees with a combined payroll of more than \$8 billion. These include an estimated 22,000 jobs here in Iowa.

Clearly, maintaining and strengthening the ability of farmers to join together in cooperative self-help efforts is critically important to their economic well being as well as rural America. Rural America faces a number of challenges as a result of a combination of factors, including changing demographics, the advent of new technology, and globalization.

It has been pointed out that over the last 20 years approximately one-third of rural counties nationwide have experienced out-migration of more than 10 percent. In the Great Plains, this pattern is significantly larger and encompasses a majority of rural counties. Such losses have had a ripple effect on many communities in terms of their available work force and tax base, as well on their schools and the availability of various services.

To help illustrate this, I have included with my testimony a map (Exhibit 1) highlighting those counties that have experienced high out-migration of 10 percent or more in recent years, along with a separate map (Exhibit 2) showing the location of America's more than 3,000 farmer cooperatives. As you can see, many of these counties continue to be the home of a significant number of farmer cooperatives and their farmer owners, their employees and families.

This has strategic importance. Job growth in agricultural areas is now more likely to come from rural industries related to farming rather than farming itself. Farmer cooperatives and other agribusinesses involving agricultural inputs, processing and marketing of agricultural products, as well as the wholesale and retail trade of agricultural products, have increased their presence in rural communities.

Farmer cooperatives and their farmer owners have a strong commitment and vested interest in their communities. Again, as I indicated at the beginning of my testimony, rural America is where they call home.

Addressing the challenges facing rural America, however, will require not just a strong commitment on the part of those who call it home, but a combination of public policies and programs, including tax incentives and other initiatives.

Accordingly, we want to commend you and Senator Baucus, among others, for introducing the Heartland Investment and Rural Employment (HIRE) Act of 2004 (S. 2761). Title I of this important legislation contains a number of key provisions for farmer cooperatives and their farmer members, including:

- *Elimination of the triple tax on cooperative dividends* paid on capital stock. Such a provision is a top priority for NCFC. Currently, such dividends are taxed 60% higher than regular corporate dividends. Eliminating this unfair tax penalty would better enable farmer cooperatives to raise the equity capital they need to modernize and expand, and would help their farmers capitalize on value-added business opportunities beyond the farm gate. This, in turn, would also help maintain and create needed new jobs in many rural communities.
- *Clarification of the definition of "cooperative marketing"* to include value-added animal processing such as the conversion of corn into feed for chickens that lay eggs that are then marketed by a cooperative on behalf of its farmer owners. The IRS has held that since this involves a biological process rather than a mechanical process it doesn't qualify. This provision addresses that issue.
- *Extension of Declaratory Judgment Procedures to Section 521 cooperatives* on the same basis as other similar types of entities, which would allow a cooperative whose application for Section 521 tax status is rejected to seek judicial review of the denial without first creating a tax controversy.
- *Establishment of a general business credit* that would allow cooperatives to pass through certain tax credits to their farmer members. The ability to pass through credits will enable cooperatives to take advantage of tax incentives otherwise available to businesses.

The HIRE Act would also establish a special commission to help identify and recommend additional tax changes to encourage and promote cooperative self-help efforts by farmers. NCFC would welcome the opportunity to work with you to develop the composition of this Commission.

The HIRE Act also includes several other individual tax provisions relating to farmers, including Alternative Minimum Tax (AMT) relief, exclusion of certain income such as Conservation Reserve Program (CRP) payments from self-employment taxes, establishment of Farm, Fishing, and Ranch Risk Management (FFARRM) Accounts, along with charitable deductions for food contributions.

In addition, the bill incorporates several other provisions to help revitalize rural America and address the challenges resulting from out-migration. These include:

(1) Rural Investment Tax Credits for businesses, including farmer cooperatives, in high out-migration counties. The credits would allow businesses that construct new buildings to offset as much as 70 percent of the construction expense over a 10 year period; and

(2) Micro-Enterprise Tax Credits for small business for qualifying start-up or enterprises with 5 or fewer employees.

These initiatives, originally included in the *New Homestead Act* (S. 602) introduced by Senators Dorgan and Hagel, and also included in the *Rural Renaissance Act* (S. 1796) by Senator Coleman and others, would help provide needed capital and encourage greater investment in rural America.

Many of these provisions have been incorporated in several other bills, including the FSC/ETI or *JOBS Act* (S. 1637) as passed by the Senate, and we appreciate your continued strong leadership and support for such initiatives.

It is important for Congress to complete action on legislation relating to FSC/ETI (S. 1637/H.R. 4520). Unless Congress acts, European tariffs on many U.S. exports, including agriculture, now at 10 percent, will continue to increase 1 percent monthly until reaching a high of 17 percent.

Both the House and Senate bills address this issue by phasing out FSC/ETI benefits and providing new tax incentives and other provisions for domestic manufacturers, including farmer cooperatives and their farmer members, to help maintain and improve U.S. global competitiveness. In addition, the Senate bill provides special rules for farmer cooperatives to allow the pass-through of such tax benefits to their farmer members, which we hope will be included as part of any final agreement. It is essential that any new tax incentives for domestic manufacturers are also available to farmer cooperatives.

Since it continues to be a top priority, it should be underscored that both the Senate and House-passed FSC/ETI bills (S. 1637/H.R. 4520) also include legislation as introduced by you, Mr. Chairman, and Senator Baucus, and by Representatives Herger and Pomeroy in the House, to eliminate the triple tax on cooperative dividends on capital stock. Enactment of this legislation is critically important to farmer cooperatives and their farmer members and we appreciate your efforts to help achieve this important objective.

Congress should also complete action on comprehensive energy legislation. Many of its important tax provisions, however, are included in the Senate-passed FSC/ETI or *JOBS* bill (S. 1637). These include tax incentives for ethanol and biodiesel, along with provisions for farmer cooperatives, and to help small petroleum refiners—including farmer cooperatives—comply with costly EPA low sulfur regulations. Such provisions are important not only to meet environmental requirements, but also to help ensure U.S. agriculture and rural America have access to a dependable supply of energy at reasonable prices since farther cooperatives provide for as much as 40 percent of on-farm fuel use. Passage of these provisions would also have a positive impact on the rural economy in terms of strengthening farm income, providing new value-added business opportunities, maintaining and creating jobs, and promoting economic growth. Again, we appreciate your leadership, along with that of Senator Baucus, in support of these important provisions.

Given the important role that farmer cooperatives and their farmer members play when it comes to the overall economic health and vitality of rural America and local communities, there are a number of other actions that Congress can and should take.

These include:

1. *Strengthen USDA programs, including research, technical assistance, and education, in support of fanner cooperatives.* This includes providing full funding of \$40 million as authorized under the 2002 Farm Bill for the Value-Added Producer Grants Program. The program provides matching grants up to \$500,000 to farmer cooperatives and other eligible participants to help farmers capitalize on new value-added business opportunities and create jobs. It has been a tremendous success by any measure. Value-Added Grants awarded to Iowa businesses in 2003 totaled over \$2.8 million and included grants for pork production, bio-diesel generation, dairy processing, and other ventures.

2. *Ensure that farmers that choose to cooperatively market their commodities and related products are fully eligible to participate under USDA and other programs,*

including federal procurement programs. In addition, farmer cooperatives can play a key role when it comes to environmental and other types of programs in terms of helping improve the delivery system, encouraging participation, and providing important services to their farmer members.

3. *Modernize the Federal Farm Credit Act.* In an effort to better finance and capitalize their businesses, farmers and their cooperatives are looking at various business models and corporate structures that were not contemplated just a few years ago. In response, Minnesota and Wyoming are among the states that have adopted new cooperative laws to provide farmers and cooperatives with more organizational flexibility to meet their capital needs. Several other states, including Iowa, have similar proposals under consideration. There is also under consideration a proposal to establish a uniform cooperative statute. As a result of changing state laws, the Federal Farm Credit Act needs to be modernized to ensure that both existing and evolving new types of cooperatives continue to have access to a competitive source of credit through CoBank and the cooperative Farm Credit System.

4. *Maintain support for basic farm and export programs* to provide an adequate safety net for producers, meet subsidized foreign competition, achieve important environmental goals, and help ensure consumers a dependable supply of high quality food and fiber at reasonable prices.

5. *Create a Cooperative Conservation Initiative.* According to a recent USDA report on trends in rural America, "Natural amenities are the trump card for rural areas." Programs to enhance and protect the quality of these natural resources are in the interest of rural residents and the tourists they can attract. However, compliance on the farm with environmental regulation can be complex and costly.

In an effort to address some of these burdens and to strengthen rural environmental stewardship, the 2002 Farm Bill increased authorized expenditures for a wide range of conservation programs by over 80%. The very structure and mission of farmer cooperatives makes them ideal organizations for the efficient implementation of these green programs. Because farmer-owned cooperatives represent producers and marketers, as well as input suppliers, they are uniquely qualified to provide specialized expertise and help craft practical conservation solutions to complex environmental challenges facing rural America.

New conservation programs call for USDA (and the Natural Resource Conservation Service) to help farmers address increasingly intricate conservation issues involving soil erosion and water quality, along with air pollution issues and pest management concerns. These latter two areas of involvement are largely beyond the expertise of most NRCS staff—thus underscoring the need for a functional program for certifying third party vendors to provide these services to farmers. Cooperatives could lend much needed technical assistance to NRCS, at the same time helping their farmer members by providing technical services (such as developing nutrient management plans, or pest management plans) while accessing government funding assistance for these services. Much the same as cooperatives serve as a delivery mechanism for Farm Services Agency support programs in rice or cotton, farmer-owned cooperatives should be allowed to help deliver conservation payments, adding environmental expertise and streamlining the delivery mechanism for government conservation program payments. Instead of multiple contracts with individual farmers for conservation activities, NRCS could administer single contracts with farmer cooperatives, which could in turn help the Agency track environmental benefits of programs across a wider scale.

Given the unique farmer-focused mission of America's farmer cooperatives, they are an ideal delivery mechanism for conservation programs. Their ability to serve as an efficient interface between the federal government and farmer members will enhance the viability of current and future green programs.

Tax provisions you have championed, Mr. Chairman, could play a major role in this process. For example, dairy farmers are increasingly called to reduce potential run off of nutrients into waterways, as well as address concerns about air emissions of hydrogen sulfide and ammonia from animal feeding operations. One potential solution to both issues is to run manure through anaerobic digesters, where the methane captured could generate electricity, which would in turn be wheeled out to the power grid. One of the stumbling blocks to implementation of this technology can often be price differentials. The provision in the *JOBS* bill that would modify section 45 to allow for a 1.8 cent per kilowatt hour credit for the production of electricity from animal waste could benefit cooperatives' farmer members by off-setting these price differentials.

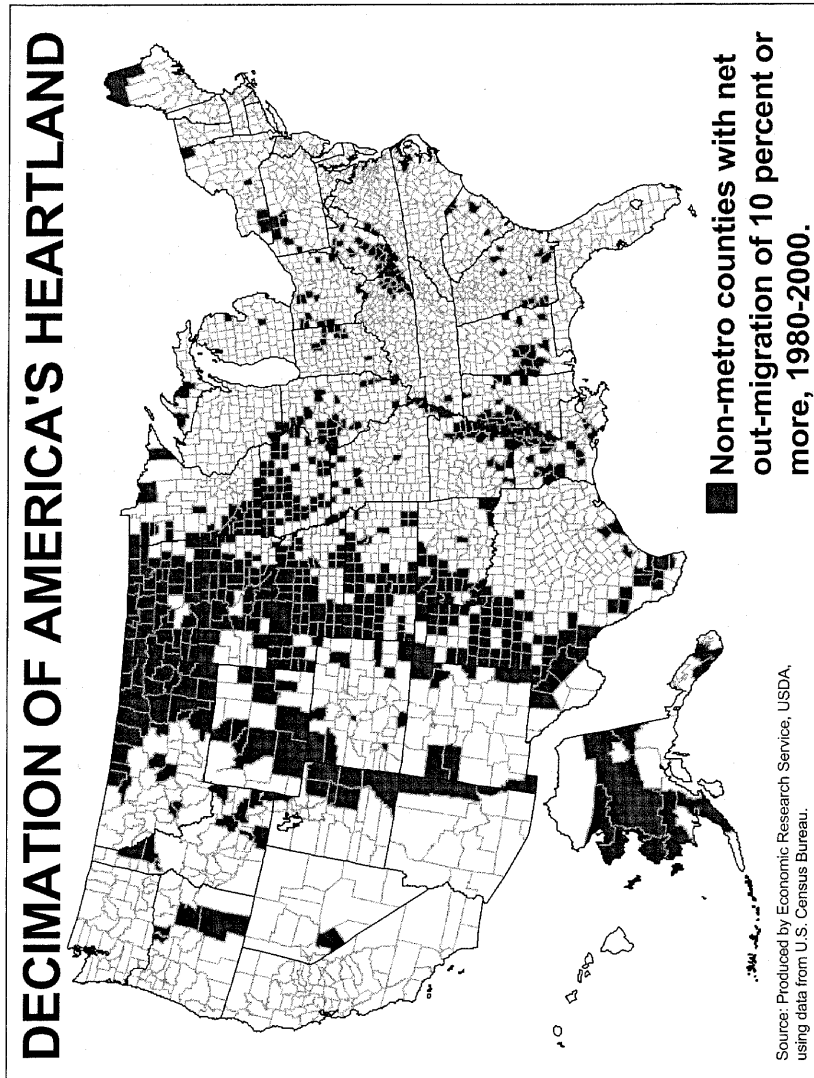
However, another significant impediment is the reluctance of farmers to undertake the role of power generator. Here, farmer cooperatives could provide the expertise to install the digester systems and help in the movement of the product to the electric grid. With the enactment of a general business credit for cooperatives, the

section 45 credit could be passed through in the form of patronage to the cooperatives' farmer members. We are happy to see that the HIRE Act includes language that would amend the IRS code to include such a general business credit.

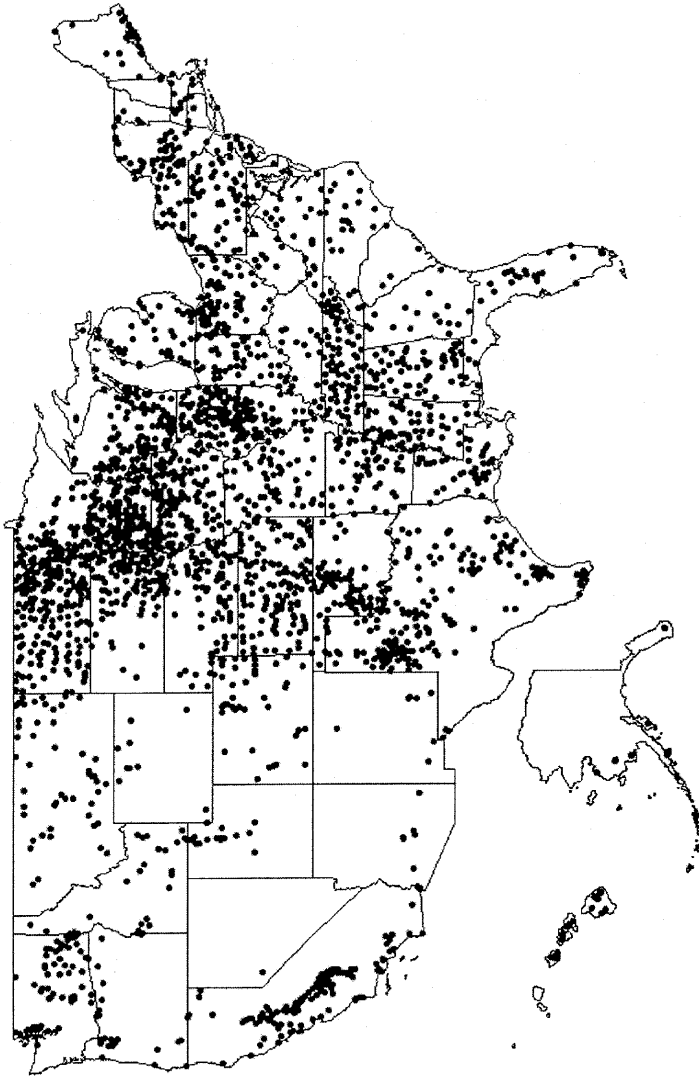
Again, Mr. Chairman, on behalf of America's farmer cooperatives and their nearly 2 million farmer owners, we appreciate this opportunity to share our views and we look forward to working with you and the members of the Senate Finance Committee to achieve these important objectives.

Attachments:

1. Map of U.S. counties with high out-migration
2. Map of U.S. farmer cooperatives



America's Farmer Cooperatives

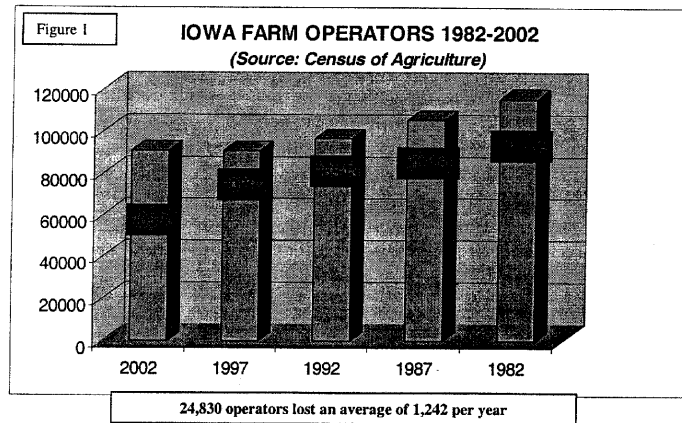


**OUT-MIGRATION OF AMERICA'S HEARTLAND
CAN MACHINERY COOPERATIVES HELP STOP THE EXODUS?
WRITTEN TESTIMONY FOR THE UNITED STATES SENATE FINANCE
COMMITTEE**

**Shane J. Tiernan Ag/Commercial Loan Development Officer
Grundy National Bank, Grundy Center, Iowa**

Rural regions across America have long been suffering with how to address the out-migration of our rural communities and farms, but have yet to come up with viable solutions that have stopped or even substantially slowed the exodus of young men, women and families from these rural areas.

Regions primarily dependent upon agriculture have been particularly hard hit. Since 1982 Iowa alone has witnessed a loss of 24,758 farm operators (Figure 1) an average loss of 1,238 per year.¹ Seventy-six percent of these losses have come from farmers age less than 25 to 34 years old. As of 2002 Iowa only had an average of 62 farm producers per county in this age category.



While there is no doubt the "Ag Crisis" of the mid 1980's took a large toll on farm producers across all age categories the loss of young producers was especially high. Since the "Ag Crisis" rural regions across rural America have not been able to recover from these losses. The ripple effect of these losses has had and will continue to have major economic implications and at some point, if not stopped could jeopardize the foundation of rural Agriculture which has always been family owned and operated farm operations.

Many questions have been raised about how to address this issue without any substantial success. The current cost of entry into production Agriculture as well as the cost of being able to stay in business will continue to force the exodus of our young farm producers. Congress has recently enacted some legislation that attempts to address some of the problems out-migration has caused. The HIRE and the New Homestead Acts do provide relief in certain areas, but do not presently specifically address production agriculture.

One concept that has had success in lowering the costs of entry and the costs of staying in production agriculture is the establishment of machinery cooperatives. Machinery cooperatives actually have their roots in France. After WW II machinery was scarce and farmers in France were forced to come up with a plan where they could share common ownership of machinery and equipment which in turn lowered their production costs and

¹ Census of Agriculture 2002-1982

helped them to become more economically viable. By the end of 2000 it was estimated that France had 13,400 machinery co-ops employing some 4,550 people.²

The machinery cooperative concept has since made its way to Canada which saw its first machinery co-op established in 1991. Co-ops in Canada have basically taken three forms:

1. CUMA's Coopérative d'Utilisation de Matériel Agricole—loosely translated as “co-operative for the use of farm implements,” and modeled after the French co-ops these enterprises are established by their farmer owners and are structured to allow the sharing of individual machines among sub-sets of members. The sharing of individual machines is facilitated through the use of activity branches and member contracts.
2. Sharing of complete farm machinery sets³. These cooperative arrangements being used primarily in Saskatchewan involve common ownership of entire machinery lines and the specialization of labor contributions where member owners have the most expertise. For instance one member may be in charge of all machinery repairs. Another may be responsible for maintaining financial records. Under these arrangements production may or may not be pooled by the membership.
3. Pooled Production. This is a system where the cooperatives members assign their entire land base to the cooperative management team who makes all production decisions. Members retain ownership and control of their land, but all production is pooled to the cooperative.

Much can be learned from the experiences of Canadian producers to fashion a cooperative arrangement that would work in the U.S. According to data available from the Center for the Study of Cooperatives at the University of Saskatchewan producers participating in these cooperative arrangements are seeing machinery cost savings of up to 35%. The additional benefits of sharing labor and talents helps encourage the producers to also become more efficient in other areas of management of their farm operations.

Machinery sharing arrangements are not uncommon in the Midwest, but there are no known formal cooperative arrangements such as are seen in Canada. A recent unpublished paper from Iowa State University Economists⁴ provides a summary of the Canadian cooperatives as well as examples of formal and less formal machinery sharing arrangements in the Midwest.

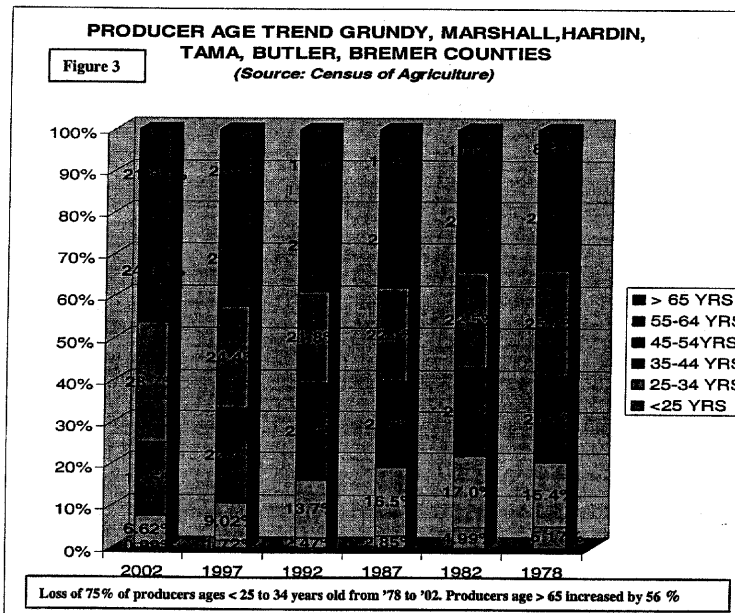
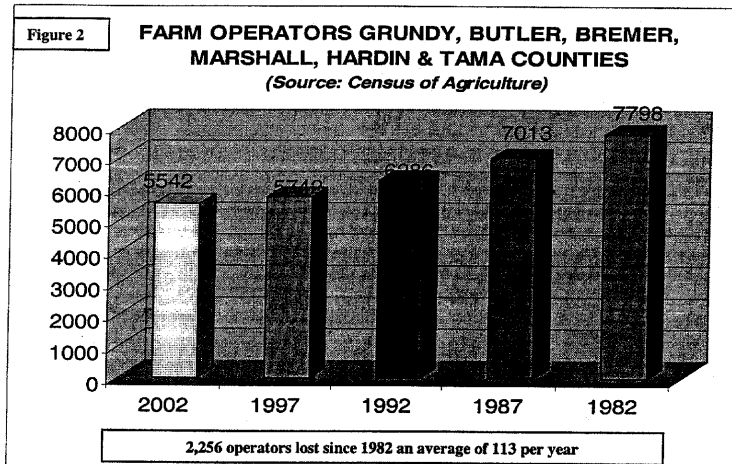
On August 5, 2004 Grundy National Bank, Grundy Center Iowa represented by myself facilitated a discussion regarding the feasibility of a machinery cooperative in north central Iowa. Also participating in the discussion were a group of farm producers, representatives from USDA Rural Development, Farm Service Agency, Iowa State University Extension, Iowa State University department of Economics, three implement dealers, a representative from the Iowa Agricultural Innovation Center, one state legislator and representatives from the state senate and the U.S. Senate. Grundy National Bank as do all rural community banks, has a significant vested interest in helping production agriculture find ways in which family owned operations can remain viable. The other driving forces behind this discussion are:

1. All farm production costs continue to increase, especially the cost of machinery upkeep and replacement. Many efforts are being made to try to increase revenue, but few programs are available that actually help farmers reduce their overall costs especially fixed costs of machinery and equipment.
2. The loss of farm producers in a six county region serviced by Grundy National Bank has seen substantial losses in farm producers in the past twenty years (Figure 2). In 1982 operators age less than 25 to 34 years old made up nearly twenty-one percent of total operators. As of 2002 that number has shrunk to less than eight percent (Figure 3)

² Harris, Andrea & Murray Fulton. *The CUMA Farm Machinery Cooperatives*, Canada: Centre for the Study of Cooperatives, University of Saskatchewan. 2000.

³ Ford, Catherine & Dr. Robert Cropp. “*An Analysis of Machinery Cooperatives for Dairy Farms in the Upper Midwest*” University of Wisconsin Center for Cooperatives., September 2002

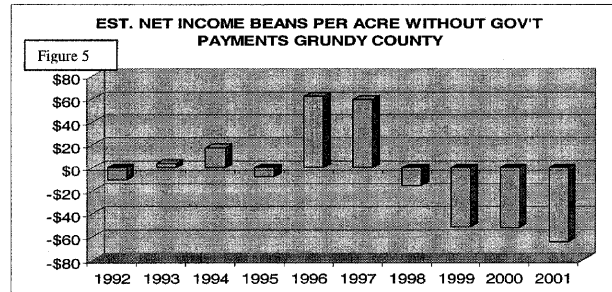
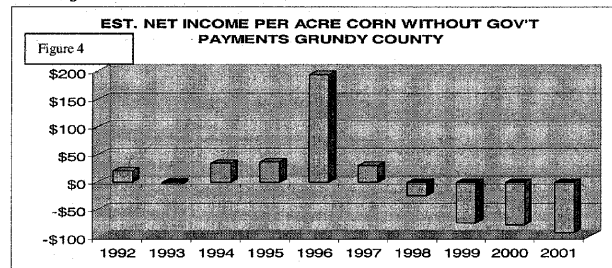
⁴ Ginder, Roger, Georgeanne Artz and Greg Colson. “*Alternative Approaches for Sharing Machinery, Labor and Other Resources Among Small and Medium Sized Producers*”, Iowa State University, August 4, 2004



3. There are many smaller to mid-sized farm operations that cannot afford to upgrade their machinery and equipment. Consequently, they are forced to either work with older inefficient equipment, which is constantly in a state of repair, leave the industry because they do not have sufficient cash flow to replace their equipment, or as many have done, seek off farm employment in order to subsidize the costs of running their farm operation. Many of these operations cannot provide sufficient collateral or

repayment margins to be able to secure loans to replace their equipment because the cost of new and used equipment has grown beyond the scope and scale of their operation.

4. If we do not find an economical means to reduce producer costs, we will see continued increases in contract farming arrangements that are already starting to appear in the Midwest. Large grain processors need to assure steady and reliable flows of product into their plants. In some areas larger processors are initiating vertically integrated contracts with producers to provide land, labor and machinery in exchange for a flat fee per acre. We do not see these arrangements as being beneficial to our rural regions as producers move from owner/operators to no more than contract laborers for large corporations who have the benefit of participating in the value chain all the way to the consumer. Aside from these arrangements we will also continue to see large blocks of land being controlled by a handful of very large producers. While government program payments have artificially supported many farm operations (Figures 4 and 5)⁵, we need to find ways in which family owned and operated farm operations remain viable in a mature industry and deal with global competition. Frankly, historical government farm programs, while providing obvious benefits have encouraged large producers to become larger. Production agriculture is not much different than many industries in that as fixed costs increase businesses must look for ways to expand their base of operations spreading their fixed costs over a larger area.



These trends will continue to accelerate the erosion of our rural community fabric which, in turn will result in the continued reduction of school districts, rural businesses and communities who are not fortunate enough to be located on the edges of recreational or metropolitan areas.

Our questions as a rural owned community bank are; in another ten to fifteen years: (1) who will be our customer, (2) who will be farming the land and how, and (3) how do we help create an environment where young men and women see a profitable future in production agriculture?

⁵ "Ag Decision Maker" Iowa State University Extension. Analysis based on historical data available from reference source combined with annual average cash rent surveys available from same source and government payment information available from Farm Service Agency.

On a more macro-scale we must be able to solve two major dilemmas facing producers.

1. How can producers participate in the value chain without being taken advantage of?
2. How can we help producers find ways to drive down their fixed costs per acre so even smaller to mid-sized operations become more viable and competitive in a globally driven industry?

Throughout the Midwest some producer groups are seeing the benefit of cooperative arrangements through producer owned or partially owned ethanol plants and farmer owned livestock cooperatives. However, even these initiatives are extremely capital intensive and often times incur substantial start-up costs before becoming viable. Many of these ventures have failed digging deeper into the already thin pockets of many farm producers. Creating and sustaining farmer owned production and machinery cooperatives creates some unique challenges that ethanol and livestock cooperatives do not encounter.

Two of these unique challenges have to do with what appear to be major economic barriers to forming a machinery cooperative that would require changes in Federal Legislation:

1. Under current tax law if a producer were to sell his/her machinery and equipment to join a cooperative they likely could incur a significant capital gains tax from the sale of this equipment. If the equipment is depreciated out the cost would be even higher as this would all be ordinary income. Given the current tax rules that govern the sale of fixed assets the consequences of selling the machinery would outweigh any benefits to be gained by joining the cooperative. Can 1031 exchange rules be adapted to machinery sales similar to the application of land sales and purchases? We think this represents a viable answer to this barrier and would provide a significant incentive for producers to join a machinery cooperative.
2. It is presently unclear whether or not current Farm Service Agency rules would consider each member of the cooperative as retaining their individual farm units, thereby putting these producers at risk of being disqualified for any production payment programs. It is believed that as long as each producer retains control of their land and materially participates on their farm unit they would not be at risk. This issue needs to be resolved before any producers will even consider formation of a cooperative arrangement.

Granted there are additional logistical issues that would need to be worked out as well such as defining work flow processes, completion of a financial feasibility study to determine of what scale the cooperative would need to be to be the most cost and labor efficient as well as others. However, it is felt that with the right structure and support systems a machinery cooperative may present a viable option to help make farm operations of all sizes more efficient and profitable.

One fact remains clear. If we do not find ways to keep young producers and smaller to medium size family farm operations viable we will continue to see the out-migration of these families to areas where they can sustain an affordable living for their families. The ripple effect of this trend has major economic and lifestyle implications for not only rural Iowa, but rural areas across this country. Many academics, economists, farm policy experts and legislatures have talked about this problem for years, yet we have failed to come up with or initiate any tangible and doable solutions. Interest rate buy-downs and beginning farmer programs provide some levels of assistance, but they do not lower the cost of entry into the industry nor do they provide any assistance to smaller and mid-sized established operations. Key to any farm operation is a reasonable cost of and access to machinery and equipment. A machinery cooperative may provide this alternative.

A machinery cooperative is only one small piece of the puzzle. There are many and complex issues surrounding the revitalization of rural America and in particular rural regions dependent upon production agriculture. If we are truly committed as a country to preserving our rural regions, then we must be willing to commit the human, technical and financial resources necessary to make this happen. While there needs to be guidelines and parameters, these resources need to be relatively free of bureaucratic processes and mountains of red tape that will only discourage participation.

I do not see this as a challenge only to be faced by the Federal Government. This issue cuts across all governmental bodies urban and rural alike. Local and Regional collaboration among communities, counties, farm and non-farm groups that is focused on creating and sustaining viable family owned

production agriculture **and includes** the growth and development of rural based job opportunities will bring the added value needed to convince our young men, women and families there are viable and lifelong opportunities for them in rural areas.

We must also be willing to be creative and non-traditional in developing the tools necessary to accomplish this. We also need to take a hard look at existing tax codes and FSA regulations and be willing to make special exceptions for innovative and viable processes and programs that contribute to the economic growth of rural community and agricultural enterprises.

While we recognize there are some challenges to forming machinery cooperatives in the United States maybe the benefits to be gained out-weigh these challenges. At a minimum these benefits would be:

1. Lower fixed costs per acre to member producers
2. Provides more sustainability for all sizes of operations
3. Brings neighbors together for a common concern and reinforces the rural community spirit and financial viability.
4. Provides an element of long term stability for rural communities and school districts.
5. Creates opportunities for young producers to enter the industry at a much lower cost, who may not otherwise have the opportunity.

The Canadian Centre for the Study of Cooperatives identifies the following elements necessary for the success of machinery cooperatives⁶:

1. *A commitment to helping one another.* Not only by sharing machinery, but also through a willingness to plan and organize work and to make oneself available during peak periods.
2. *Communication.* The ability to discuss issues and bring forth any behavior or concerns that could cause ill-will within an environment of mutual respect and trust.
3. *Discipline.* Respect of the rules to ensure the proper functioning of the organization.
4. *Cooperative Spirit.* Helping members adjust to the cooperative method and to reinforce solidarity. Strong individualism is a potential source of conflict.
5. *Training.* Sharing experience and skills especially with respect to new technology.
6. *Social Interaction.* Helping to carry out the full potential of the cooperative, while keeping it personable and of a manageable size.
7. *Partnership.* Supporting the growth and development of CUMA's not isolating one from another, encouraging the expansion of inter-CUMA practices to avoid over capitalization.

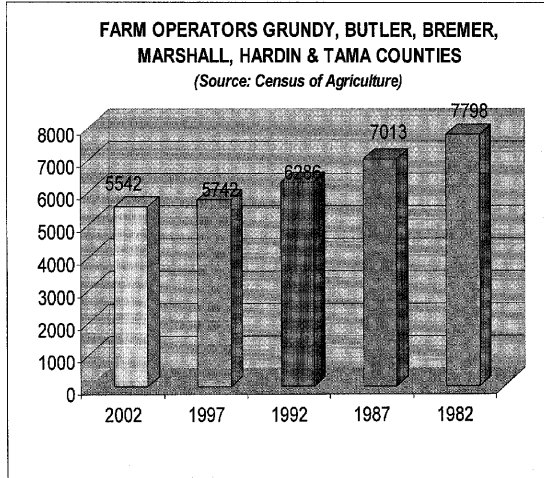
It would seem that this is a concept whose time has come in the United States. We have only to establish the proper framework and provide the proper incentives to encourage participation by producers. The benefits may be considerable and far reaching, but it will take time, patience and a true "cooperative spirit" among all parties to earn success.

Thank you for the opportunity to discuss this issue and I would be willing to do what I can to help further examine the feasibility of machinery cooperatives in the U.S.

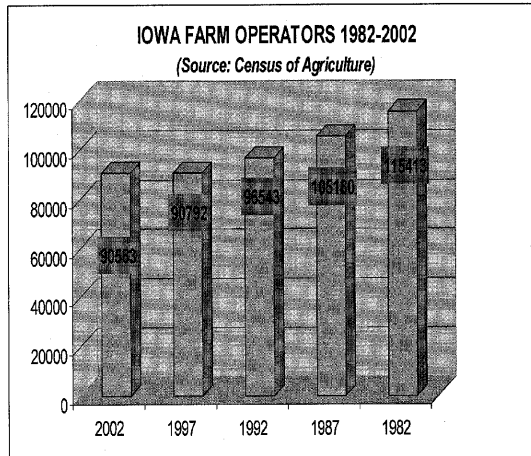
Respectfully,
Shane J. Tiernan
Ag/Commercial Loan Development Officer
Grundy National Bank, Grundy Center Iowa

⁶ Morneau, Camille, Guidebook to establishing CUMA's, Quebec Ministry of Agriculture, Fisheries and Food (MAPAQ), 1996 AND, Harris, Andrea & Murray Fulton. *The CUMA Farm Machinery Cooperatives*. Canada: Centre for the Study of Co-operatives, University of Saskatchewan. 2000.

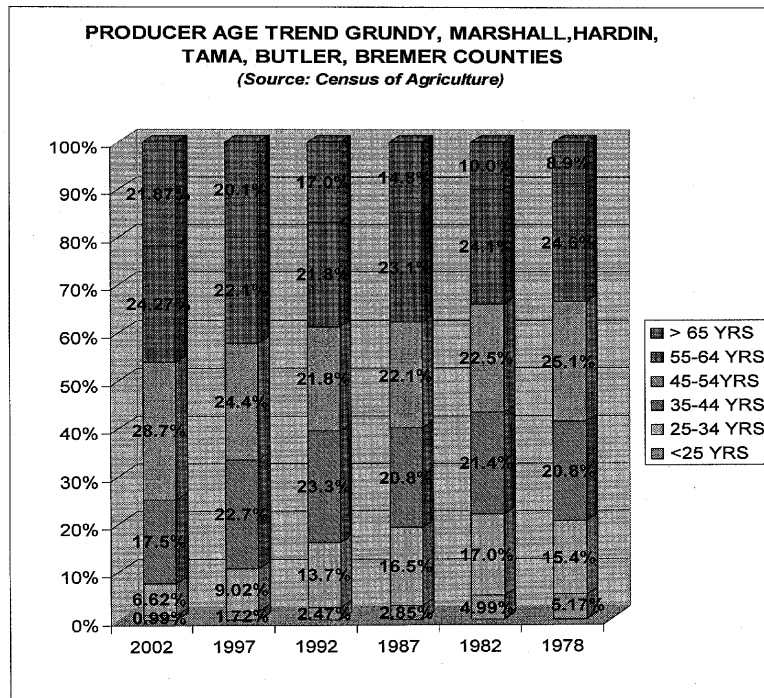
RURAL CRISIS? - WHO WILL FARM THE LAND IN 20 YEARS?



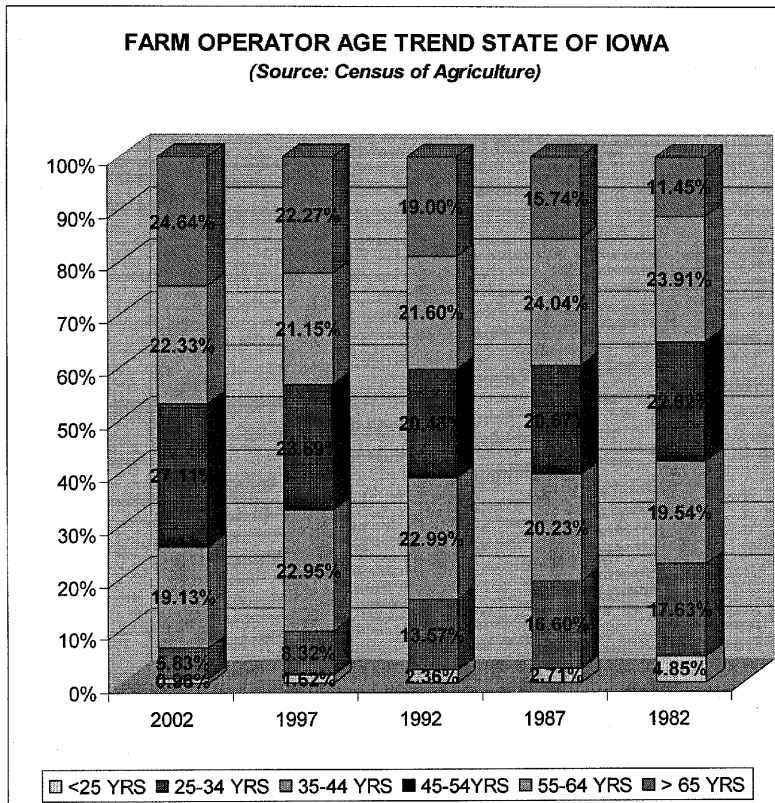
'82-02 total loss of farm operators in north central Iowa region = 2,256 an average of 113 per year.



'82-02 total loss of farm operators state of Iowa = 24,830 an average of 1,242 per year

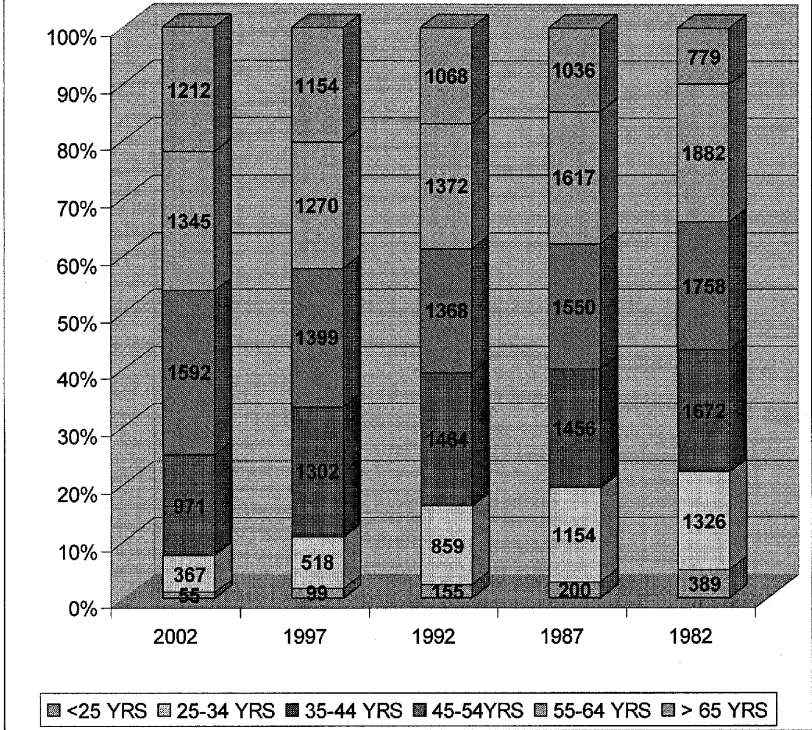


Farm operators age < 25 to 34 years old only 7.61% of total operators vs. operators > 65 years old at 21.87%. Farm operators 55 to > 65 years old total 46.14% now vs. only 33.5% 20 in 1982

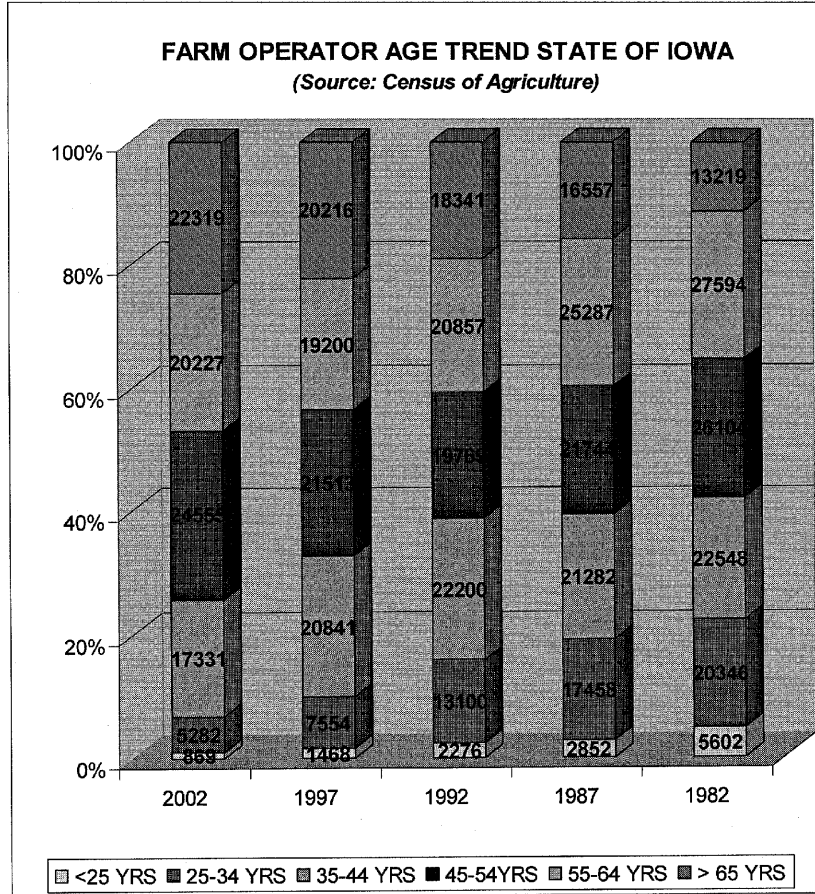


Statewide trend for average age of farm operators is slightly worse than regional trend. Operators age < 25 to 34 years old = 6.79% while those age 55 to > 65 years is 46.97% compared to 22.48% and 35.36% respectively in 1982

FARM OPERATORS BY AGE TREND
GRUNDY, MARSHALL, HARDIN, TAMA, BUTLER BREMER
COUNTIES
(Source: Census of Agriculture)



North central Iowa region lost 1293 (75%) producers age < 25 to 34 years of age in the last 20 years. If this trend continues in another 20 years there will only be 106 operators in this age bracket while those age > 65 years old will grow to 1886 operators.



Statewide of the total 24,758 farm operators lost from 1982-2002; 80% or 19,797 were among operators age < 25 to 34 years old. If this trend continues the next 20 years may see an additional loss of 4,920 young operators while operators age 65 and older may grow by 68% to 37,683 operators.

COMMUNICATIONS



Dear Chairman Grassley and Members of the Senate Finance Committee,

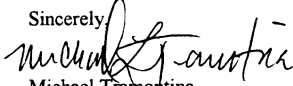
Thank you for bringing a public hearing to Sioux City on the important matter of Tax Incentives for Rural Communities. Following are comments on several provisions contained within the Heartland Investment and Rural Employment (HIRE) Act and their importance to Iowans.

Before I make brief remarks directed to the HIRE Act allow me to express the thanks of the Iowa Finance Authority and the National Council of State Housing Agencies for your outstanding leadership on the Bond and Credit Modernization Act whose provisions are contained in the JOBS Act now in a conference committee. The provision will authorize bond cap for tax-exempt bonds to assist first-time homebuyers. Over 3,300 Iowa families could benefit from this provision which has a very small cost to the Treasury but a very large benefit to first-time home buyers.

As for the HIRE Act, removing first-time farmers, or aggie bonds, from inclusion under state volume bond cap is an excellent proposal. Using this tool the Iowa Agricultural Development Authority in partnership with local farming community banks has provided low-cost financing to thousands of Iowans, primarily young families, to acquire property and equipment. This small tax exemption is one of the lowest cost, best targeted subsidies available to help families that want to stay on farms.

Creating a tax credit to encourage the development of new or substantially rehabilitated, affordable single-family housing is another excellent proposal. The need for housing production and rehabilitation is a major stumbling block to economic development in rural communities. A 2002 study by the University of Iowa Urban and Regional Planning Program identified more than 600 of Iowa's rural housing markets as *Stagnant* or *Declining*, referring to home values. In more those communities' home values actually decline between 1-3 per cent each year. In those 600 communities private mortgage lending, new housing production and even rehabilitation lending is too risk for the private sector alone. These conditions exacerbate a downward spiral in values. Government intervention is necessary to reverse the economics. It is important that assistance be tied to real economic development and a willingness of local communities and employers to invest in their own housing stock to attract or retain a workforce. Such an initiative should not be restricted only to low income buyers but also include workers. The initiative could be thought of as producing *Workforce Housing* for rural communities. I invite you to one of several demonstration projects sponsored by the Iowa Finance Authority, the Butler County Rural Electric Cooperative, banks, employers, cites and counties.

Thank you for allowing me this opportunity.

Sincerely,

Michael Tramontina
Executive Director

STATEMENT FOR THE RECORD
BY
THE NATIONAL ASSOCIATION OF HOME BUILDERS
FOR
THE SENATE COMMITTEE ON FINANCE HEARING
ON
Saving America's Great Places: The Role of Tax Incentives in
Preserving Rural Communities

S. 2167, THE *HEARTLAND INVESTMENT AND RURAL EMPLOYMENT (HIRE)*
ACT

Thank you for the opportunity to submit a statement for the record presenting the views of the National Association of Home Builders (NAHB) on S. 2167, the *Heartland Investment and Rural Employment (HIRE) Act*, and the legislation's positive impact on increasing homeownership opportunities. NAHB believes that this legislation provides needed incentives for both rural and urban development. Specifically, the building industry supports Section 310 which creates a "Community Homeownership Tax Credit."

NAHB represents more than 215,000 members involved in home building, remodeling, multifamily construction, property management, housing finance, building product manufacturing and other aspects of residential and light commercial construction. NAHB is affiliated with more than 800 state and local home builders associations around the country. Over the past 50 years, America's home builders have built more than 75 million homes and apartments, opening the door of opportunity for millions of families.

THE NEED FOR A CREDIT

NAHB believes that a homeownership tax credit (HOTC) is needed to improve the quality of life in distressed rural areas and urban neighborhoods through increased homeownership of quality housing. Existing buildings in distressed areas frequently are not renovated because the costs exceed the prices at which the housing units can be sold. Similarly, the costs of new construction may exceed the market values of the homes. Projects will not be built and distressed rural areas and urban neighborhoods will remain blighted unless the gap between development costs and market prices can be closed.

The HOTC is designed to close the gap in homeownership rates among Americans. While 82 percent of households earning 100 percent or more of the national median income now own homes, only 53 percent of households earning less than the national median are homeowners. The homeownership rate for families earning 80 percent or less of the national median is only 40 percent to 45 percent. Homeownership for whites is 75 percent while the ownership rate for African Americans is just below 48 percent and 48 percent for Hispanics.

According to the U.S. Census Bureau, there are an estimated 34.2 million renter-households in the U.S. but only about 3.5 million of them (10 percent) can afford to buy a modestly priced home, i.e. a home that is less expensive than 75 percent of owner-occupied homes in a given area.

PENDING LEGISLATIVE ACTIVITY

A top legislative priority for NAHB in the 108th Congress is legislation creating a homeownership tax credit. A homeownership tax credit program was first proposed by the Bush Administration and has been included in each of the president's last four budget proposals. In addition to the HIRE Act, NAHB has been actively supporting three bills that have been introduced in Congress: S. 198, the *New Homestead Economic Opportunity Act*; S. 875, the *Community Development Homeownership Tax Credit Act*, which, cumulatively, are supported by 54 individual Senators; and H.R. 839, the *Renewing the Dream Tax Credit Act*, which has 303 cosponsors in the House of Representatives.

Additionally, NAHB is working with forty other national organizations, which comprise the Community Homeownership Credit Coalition, to support and advocate for the passage of a homeownership credit. The coalition represents nonprofit and for-profit developers, state allocating agencies and corporate investors. Coalition members include the National Council of State Housing Agencies, Fannie May, Freddie Mac, and the National Association of Realtors.

All of the homeownership tax credit proposals pending before Congress, including the HIRE Act, provide a tax credit up to 50 percent of the construction or rehabilitation costs of building owner occupied homes in hard-to-develop areas that must be sold to low- and moderate-income buyers. The three original HOTC proposals are expected to produce 50,000 new and rehabilitated homes annually, \$2 billion of private equity investment, \$6 billion in total investment generated, 122,000 jobs, \$4 billion in wages, and \$2 billion in taxes and fees. Additionally, the Bush Administration's proposal would fund the HOTC at the same level as the Low Income Housing Tax Credit (LIHTC).

Section 310 of the HIRE Act, which creates a "Community Homeownership Tax Credit," has a one-year effective period for a 50-cent per capita tax credit. NAHB is hopeful that this proposal, as currently drafted, is designed to be a legislative marker that can be expanded as the bill moves through the committee process. NAHB believes that the credit should eventually be enacted to match the full amount of the LIHTC (\$180 per capita adjusted for inflation), as originally proposed by the Bush Administration. NAHB understands that there are revenue constraints that must be managed by the Finance Committee. NAHB intends to work with the committee to develop a bill that is not in conflict with the revenue loss limitations, while still providing certainty and economies of scale in an HOTC program to make it successful.

FUNDING AND ADMINISTRATION OF THE TAX CREDIT

The funding and administration of the HOTC under all pending tax credit proposals is modeled on the LIHTC, which is used to finance rental properties. The LIHTC program was chosen as the model because it is an effective and efficient program that annually results in the building or substantial rehabilitation of 135,000 moderate and low income homes. Each year, a state is eligible for LIHTCs of \$1.80 per capita, or a minimum of \$2 million. The state allocates credits to developers through a competitive allocation process administered by state agencies. In the HOTC program, a developer would be able to obtain a HOTCs for up to 50 percent of the development cost of each home in the same fashion that the LIHTC is used to raise capital for building rental properties. Developers would sell credits to investors to raise financing for construction or rehabilitation costs. The HOTC would be claimed against income taxes by investors over five years and would not be subject to recapture from the developer or investors, or any other obligation after the home is sold to an eligible buyer (generally a family with an income that is 80 percent or less than state or national median income).

The structural difference between the LIHTC and the HOTC is that the HOTC can only be used to provide housing in distressed areas (location based) while the LIHTC can be used in all areas (income based). The location-based HOTC is needed to increase homeownership in low- and moderate-income neighborhoods.

Additionally, the pending HOTC bills would apply the tax credit to a single-family home containing one to four housing units, a condominium unit, stock in a housing cooperative, modular housing, or manufactured housing. Qualifying residences would be located in a targeted census tract, in a chronic economic distressed area as defined in section 143(j)(3) of the Internal Revenue Code, a reservation for a federally recognized Indian tribe, or in a rural area as defined by section 520 of the Housing Act of 1949. As defined, rural areas mean any open country, or any place, town, village, or city which is not part of or associated with an urban area and which (1) has a population not in excess of 2,500 inhabitants, or (2) has a population in excess of 2,500 but not in excess of 10,000 if it is rural in character, or (3) has a population in excess of 10,000 but not in excess of 20,000, and (A) is not contained within a standard metropolitan statistical area, and (B) has a serious lack of mortgage credit for lower and moderate-income families, as determined by the Secretary of Agriculture and Secretary of Housing and Urban Development. The basis of the credit should include rehabilitation expenditures (excluding land).

Finally, although NAHB opposed a provision in S. 875 and H.R. 839 that would create a 10 percent credit set aside for tax exempt developers, NAHB supports all of the pending bills and appreciates the compromise in the HIRE Act that includes a set aside of 7.5 percent. NAHB favors giving states the maximum possible latitude in administering the HOTC program. In this regard, NAHB believes that the program will be more efficiently operated if all developers are treated equally at the federal level. The creation of a federally-required 10 percent set aside for tax exempt developers is an unnecessary intrusion on the states administrative authority. States should be allowed to choose to

administer a fully competitive HOTC program in order to build the greatest quantity of quality housing possible. A statistical analysis by the U.S. General Accounting Office entitled *Tax Credits: Reasons for Cost Differences in Housing Built by For-Profit and Nonprofit Developers*, GAO, March 1999 found that there is a better than 85 percent chance that for-profit developers will build LIHTC rental properties (the model program for the HOTC) at lower cost than tax exempt developers. It should be noted that tax exempt developers now are awarded approximately 32 percent of the LIHTC awards for rental property developments. As a result, they can be expected to have a very substantial involvement in the HOTC program even if there were no federal preference.

Conclusion

Thank you for holding this first hearing on the HIRE Act and allowing NAHB the opportunity to present testimony on S. 2167, and our support for Section 310. NAHB appreciates the committee's focus on ways to increase homeownership. NAHB believes that a homeownership tax credit is needed to bring the benefits of homeownership to the largest possible segment of our population. We look forward to working with you and the members of the Senate Finance Committee to make the dream of homeownership come true for as many people as possible.



National Cooperative Business Association

FOR IMMEDIATE RELEASE
August 25, 2004

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**NCBA ENDORSES KEY CO-OP & HOUSING PROVISIONS
OF GRASSLEY'S RURAL TAX INCENTIVE BILL**

Caution Expressed on Subchapter T Changes, New State Co-op Laws

Washington, D.C.—The National Cooperative Business Association today endorsed key cooperative and housing provisions of a new tax incentive bill for rural communities introduced by Senate Finance Committee Chairman Charles Grassley (R-Iowa).

Specifically, NCBA praised bill provisions repealing the dividend allocation rule, allowing co-ops to pass tax credits through to their members, making more agricultural co-ops eligible for tax treatment under Section 521 of the tax code, and creating tax credits that will spur housing co-op development. NCBA said these and other provisions “will go far in advancing cooperative development and business expansion in rural communities, creating jobs, income and opportunity.”

At the same time, NCBA urged caution on possible changes to Subchapter T, the section of the federal tax code governing most co-ops, and on new state laws that allow cooperatives to bring in outside investors as members.

The Heartland Investment & Rural Employment Act was introduced by Grassley last month. It is cosponsored by several prominent Democrats, including Senate Minority Leader Thomas A. Daschle (S.D.) and ranking Finance Committee Democrat Max Baucus (Mont.).

Comments Made in Hearing Testimony

NCBA's comments were made at a Finance Committee hearing on the bill in Sioux City, Iowa. Kevin Edberg, executive director of NCBA-member Cooperative Development Services of Madison, Wis., represented NCBA at the hearing.

Noting that limited capital is a key constraint for all types of co-ops, Edberg said provisions of the HIRE Act that eliminate tax inequities are a “key first step in enhancing cooperative viability and increasing access to capital.”

Repealing the dividend allocation rule, known as the co-op “triple tax,” has long been a priority of NCBA and all cooperatives. The rule imposes excessive taxes on co-ops that raise capital by issuing non-voting stock. Edberg said the DAR impedes co-ops’ ability “to raise investment and expansion capital.” By some estimates, he said, “the DAR results in a 73 percent tax on non-patronage earnings if a cooperative pays dividends on capital stock.”

HIRE Act provisions allowing a pass through of tax credits to co-op members, Edberg said, “will provide tax parity to ethanol cooperatives...leveling the playing field for these co-ops who have, to date, not been able to take advantage of a key benefit available to other small ethanol producers.” Likewise, he said, making a broader range of agricultural co-ops eligible for Section 521 will “provide need flexibility to farmers seeking to form new cooperatives and expand business services of existing cooperatives.”

Housing Provision Strongly Endorsed

Edberg also expressed NCBA’s strong support for the housing provisions in the HIRE Act, specifically a new Community Homeownership Credit broadening tax credits to developers of affordable housing in rural and urban communities, including cooperatives and other forms of homeownership.

Until now, said Edberg, affordable housing tax credits have been limited to rental housing. “NCBA applauds the inclusion of stock in housing cooperatives under the Community Homeowners Credit provisions and the 10 percent set aside for nonprofit housing developers.”

Edberg said the tax credit could help fill the affordable housing gap for rural America’s aging population by spurring development of new senior housing cooperatives. Beyond providing affordable housing that independent seniors can control, Edberg said, co-ops help keep savings and purchasing power of the elderly in small towns.

NCBA urged consideration of tax credits for investment in other types of rural co-ops, such as value-added ventures and purchasing cooperatives. Edberg said these credits could encourage additional growth in rural communities by spurring co-op investment.

Tax Code Study

Edberg said NCBA welcomes interest in a provision establishing a commission to review Subchapter T, which has not been reviewed by Congress in decades. “In particular, the need to evaluate other laws that hamper cooperative development, including securities laws, is long overdue,” he said.

But, because so many different types of co-ops file under Subchapter T, Edberg said any changes “would have significant implications for all cooperatives.” As a result, any commission should include “legal and cooperative experts from the broadest cross-section of the cooperative sector...including purchasing, consumer-owned and workers-owned cooperatives.”

Edberg also expressed NCBA’s reservations about new state co-op statutes and a uniform state co-op law being written by the National Conference of Commissioners on Uniform State Laws. The model law allows farm cooperatives to bring in more capital by creating both patron and investor members. The statutes represent a fundamental change in the definition of a cooperative.

“Though many have greeted these hybrid statutes with enthusiasm...they are a largely untested approach to capital generation,” he said. “It is simply too soon to tell whether they serve as an effective capital generation tool.”

Maintaining the Development Infrastructure

NCBA also urged the Committee to back federal funding for the Rural Cooperative Development Grants program, which supports 20 cooperative development centers across the country. The centers assist farmers and others seeking to start their own cooperatives.

Edberg, who heads one of the centers, cautioned that even with tax incentives and flexibility to bring in outside capital, without credible feasibility analyses and sound business plans, cooperatives will not overcome the first hurdle for debt financing. The House of Representatives cut the grant program’s funding for 2005. The Senate has not yet taken action.

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Headquartered in Washington, D.C., the National Cooperative Business Association represents cooperatives across all economic sectors, including agriculture, food distribution and retailing, childcare, credit unions, housing, healthcare, energy, and telecommunications.



What are Cooperatives?

Cooperatives are Businesses

Cooperatives are businesses that—

- are owned and democratically controlled by their members—the people who use the co-op's services or buy its goods.
- return surplus revenues (income over expenses and investment) to members proportionate to their use of the cooperative, not proportionate to their ownership share.
- are motivated by service to their members, not by profit.

Types of Co-ops

Cooperatives fall into four categories: consumer, producer, worker and purchasing/shared services.

Facts & Figures

Cooperatives are bustling hubs of commerce that operate in virtually every industry:

- U.S. co-ops serve some **120 million members**, or 4 in 10 Americans.
- Cooperatives operate in **every industry** including agriculture, childcare, energy, financial services, food retailing and distribution, health care, insurance, housing, purchasing and shared services, telecommunications, and others.
- Cooperatives range in size from large enterprises, including U.S. Fortune 500 companies, to single, small local storefronts.
- About 30 percent of farmers' products in the U.S. are marketed through **3,400 farmer-owned cooperatives**.
- More than 30 cooperatives have **annual revenues in excess of \$1 billion**, including such well-known names as Land O' Lakes, Inc., and ACE Hardware. The top 100 co-ops have a combined \$125 billion in revenues.
- **10,000 U.S. credit unions** have **84 million members** and assets in excess of \$600 billion.
- Nearly **1,000 rural electric cooperatives** own and maintain nearly half of the electric distribution lines in the United States, cover 75 percent of the land mass and provide electricity to 37 million people.
- 270 telephone co-ops provide service to 2 million households.
- More than **6,400 housing cooperatives** provide homes for more than one million households.
- Some **250 purchasing cooperatives** offer group buying and shared services to more than 50,000 independent businesses.

Consumer-owned Cooperatives

Consumer cooperatives are owned by the people who buy the goods or use the services of the cooperative. Examples:

Realife Cooperative, Burnsville, Minn., a senior housing co-op offering an exercise room, craft center, billiard room, garden plots & other amenities.

Sumter Electric Cooperative, Inc., Sumter, Fla.—one of the nation's leading distribution electric cooperatives, which serves 125,000 consumer-owners at homes and businesses in central Florida. www.secoenergy.com

Group Health Cooperative of Puget Sound, Seattle, Wash.— a consumer-owned HMO with more 560,000 members. www.ghc.com

Hanover Consumers Cooperative, Hanover, N.H.— a conventional foods, consumer-owned grocery co-op, with two stores in the rural Hanover area. www.coopfoodstore.coop.

Navy Federal Credit Union, Merrifield, Va. — with more than 2.4 million members, Navy FCU is the nation's largest credit union. www.navyfcu.org

PCC Natural Markets, Seattle, Wash., — a consumer-owned, natural foods co-op with seven locations in the Seattle area. www.pccnaturalmarkets.coop

Producer-owned Cooperatives

Producer cooperatives are owned by producers of farm commodities or crafts that band together to process and/or market their products. Examples:

Land O'Lakes, Inc., Arden Hills, Minn.— a food and agricultural cooperative owned by 7,000 farmer-members and 1,300 local community cooperatives. www.landolakesinc.coop

Florida's Natural Growers, New Wales, Fla. —a grower owned juice cooperative that has built a nationally recognized, leading juice brand. www.floridasnatural.com

Other well-known farmer-owned cooperatives include **SunKist**, **SunMaid**, **Blue Diamond**, **Ocean Spray**, and **Riceland**.

Worker-owned Cooperatives

Worker co-ops are owned and governed by their employees. Examples:

Cooperative Care, Wautoma, Wis.— a worker-owned cooperative providing home care services to elderly and disabled persons in rural Wisconsin.

Equal Exchange, Boston, Mass.—a worker-owned fair trade products buying and distribution cooperative that pioneered fair trade in the U.S. www.equalexchange.coop

Purchasing Cooperatives

Purchasing cooperatives are owned by small, independent businesses that band together to enhance their purchasing power. Examples:

ACE Hardware and TruServ, Chicago, Ill.—national buying cooperatives of independent hardware store owners that use a national co-op brand.

Carpet One, St. Louis, Mo. —a national cooperative of 1,000 independent floor covering retailers that is the largest floor covering retailer in the world.

NONPROFIT

Coordinating Committee of New York

August 26, 2004

To: Senate Finance Committee
Mr. Dean Zerbe
Mr. Jonathan Selib

From: Julie Floch, Eisner LLP, and Jon Small, Nonprofit Coordinating Committee of NY

Re: Possible extension of private foundation self-dealing rules to public charities

We are writing this joint memo to follow up on recommendations made to you by various interested parties that the Senate Finance Committee not pursue the imposition of the private foundation self-dealing rules on other 501(c)(3) organizations, as presented in the June 21, 2004 Senate Finance Discussion Draft, section B(1).

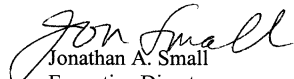
As we are sure you realize, in the public charity environment, it is not uncommon for board members (who, as part of their "day jobs", possess professional skills as attorneys, consultants, architects, investment advisors and the like) to provide professional services to the organizations they serve for reduced or sometimes pro-bono fees. While there is always the fear that this relationship could be exploited by these individuals, the intermediate sanctions regulations enacted by the IRS in 1996 were designed to address these concerns.

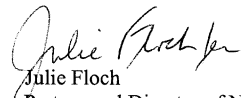
We have great concern that imposing the self-dealing rules that govern private foundations (where the provision of these services is generally not integral, as these organizations are in a financial position to purchase them in the marketplace, and where the board might consist of a few family members and thus might be more influenced by these relationships) to the public charity environment would curtail the professional skills and resources that board members and other interested parties would be able to direct towards the organizations they serve. In our view, therefore, this would be detrimental and costly to public charities. While it is true that there will always be circumstances where there are attempts to exploit this relationship, we believe that the dollars saved by nonprofits by allowing these relationships to continue will overwhelmingly outweigh the costs of excessive charges.

We both work within the New York City nonprofit community - as the Executive Director of the Nonprofit Coordinating Committee of New York, an umbrella organization devoted to representing the 501(c)(3) community, and as Director of Not-for-Profit Services at Eisner LLP, a local accounting and advisory firm that audits a great many nonprofits. In our respective roles we advise and consult with many organizations - both large and small - and have seen few instances of abuse of insider relationships. We both applauded the enactment of the Intermediate Sanctions legislation that addresses these abuses, and have seen policies for both conflicts of interests and codes of ethics for both board and staff be widely adopted. We therefore believe that further legislation or restriction is unwarranted.

Thank you for your consideration of our views.

Very truly yours,


Jonathan A. Small
Executive Director
Nonprofit Coordinating Committee
of New York


Julie Floch
Partner and Director of Not-for-Profit Services
Eisner LLP

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