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Subcommittee on Water and Power,
Committee on Natural Resources hearing on the
"Accelerated Repayment and Revenue Act"

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Good afternoon Chairman McClintock, Ranking Member Napolitano, members of the Subcommittee. Thank you for the invitation to testify on the Subcommittee's discussion draft of the Accelerated Revenue and Repayment Act, which would enable certain Reclamation water contractors to accelerate repayment of their existing Bureau of Reclamation contracts. I am Steve Ellis, Vice President of Taxpayers for Common Sense, a national non-partisan budget watchdog.

I understand that this new legislative proposal has not yet been reviewed and analyzed by all the potentially affected interests, including federal and state agencies that could be affected by the creation of permanent federal entitlements to replace current fixed-term renewable contracts that are subject to periodic renegotiation of key terms. Their thoughts on the provisions of the draft will be very helpful to understanding its implications. For my part, I will divide my brief testimony between some overarching comments about Congress revisiting Reclamation water contracts and some initial observations and questions about the draft legislation based on our preliminary review.

With regard to the overarching question, we agree that Congress should take a fresh look at the underlying contractual relationships between the federal taxpayers and the recipients of water supplies from federal Reclamation projects across the 17 western states. As Taxpayers for Common Sense and numerous government agencies and outside experts have frequently observed, the heavily subsidized Reclamation program has often led to unintended impacts in the management and use of scarce western water supplies. Those impacts extend far beyond the impacts on the federal treasury, which have also exceeded anything that could have been contemplated at the creation of the program more than a century ago.

It is amply clear that the policy justifications initially provided to launch the Bureau back in 1902, and even those used to justify various revisions of the Reclamation program in more recent decades, have often ceased to make sense under modern conditions. For example, it is

entirely clear that the goal of using subsidized water projects and other means to encourage settlement and development of arid western lands back in the early 1900's has been met and exceeded. California, for instance, has more than 30 million residents, a large and vibrant agricultural industry, and one of the largest economies in the world. Perpetuating federal taxpayer subsidies for California agribusiness based on the original Reclamation model ignores a hundred years of history and today's reality of water shortages and federal deficits.

In light of these trends and the problematic track record of the federal reclamation program, the time has come to reexamine the interest subsidy, and other intended or unintended subsidies, embedded in the federal reclamation program. Water scarcity in the arid west and the likelihood of further shortages in the future are driving numerous changes in state and local water policy. The connection between the price of a commodity like water and level of demand and efficiency of use of such a commodity based on relative pricing is well documented. With these factors in mind, it is time for Congress to examine whether taxpayer subsidies for federal irrigation water need to finally be ended in favor of more market-based pricing, where federal water prices represent the true costs of developing and providing such valuable water supplies and send price signals that would encourage higher levels of efficiency in our use of water west-wide.

In the context of these overarching general principles, our initial review of the discussion draft has identified some positive and negative aspects to the legislation, and numerous key questions that need to be addressed in determining what the effect of the bill will be. As a preliminary matter, we question whether water contractors should be allowed to alter the subsidized terms of federal water projects. Past legislation addressing subsidies and project prepayment has involved a congressional judgment regarding universal rules that would affect all Reclamation project subsidies, or project-specific changes. This draft language abdicates that congressional oversight and would leave the question of the breadth of repayment changes entirely in the hands of water users, who could opt in. For larger projects this might lead to a confusing variation among the water recipients in a single project or unit of a project.

Apart from this basic policy question, the language provides pluses and minuses for the taxpayer. For example, on the one hand, the bill appears to eliminate an outdated and often-criticized subsidy by which power customers have been forced to provide a cross-subsidy to irrigation users based on a perceived "inability to pay" by those irrigation users. This old loophole in the previous Reclamation program allowed costs to be shifted away from those who are receiving valuable irrigation water, instead of requiring them to conserve more, transfer some of their water supplies to other purchasers, or otherwise make necessary adjustments so they can meet their allocated costs. On the other hand, the bill completely fails to eliminate the largest and most broadly criticized subsidy of all: the interest-free repayment of the huge capital investments that have produced these valuable water supplies. In fact, rather than finally collect interest from irrigators who have overly benefited from this huge subsidy program, the discussion draft appears to lock in this subsidy permanently. It then compounds the subsidy by reducing the amount to be repaid by calculating it based on "net present value," as if the loan program had represented true market-based financing by private

sector entities and has not already provided major benefits to recipients.

As if this new discount were not generous enough to these recipients, the bill appears to offer various other benefits, such as permanently waiving all federal acreage limitations that are used to reduce taxpayer subsidies to large profitable agribusinesses. The Reclamation program was initially intended to benefit small family farms of 160 acres or less. After numerous documented abuses of that limit Congress expanded the limit to 960 acres in the 1980s, while insisting on firmer enforcement and higher water prices to farms above that size. This draft would eliminate the acreage limit altogether for those opting for pre-payment.

It appears that this effect may be one reason the Congress in 1982 expressly prohibited this sort of accelerated prepayment of capital, since it could completely undo the policy goal of preventing large scale operations from gaining access to fully subsidized water. The Reclamation Reform Act of 1982 (RRA) included numerous pricing reforms to protect taxpayers, discourage large scale operations from receiving subsidies intended for small farms, encourage increased water conservation, and increase revenues to the government. The draft legislation would undo the accelerated prepayment prohibition while failing to include any corresponding reforms to compensate the taxpayer or mitigate this dramatic change in federal law.

Finally, existing interest payment requirements in the Reclamation program could be permanently lost to taxpayers under this draft legislation. In the case of municipal and industrial Reclamation contracts where some modest interest rates have been charged over the past several decades, it is not completely clear how the “net present value” formulation in the bill will handle the interest charges that would otherwise be paid. As we read the draft, some of that interest that would otherwise have been paid to the government could now be lost. In addition, for the largest and therefore wealthiest of the farm operations in the Reclamation program, those who were required by Congress in 1982 to start paying interest charges for all water delivered above the 960 acres, the prepayment of capital costs and elimination of all acreage limits could mean that the taxpayers permanently forgo those interest payments. The large-scale operations would get to keep their full supply of subsidized water, and the intended protections for smaller businesses with less than 960 acres would be removed permanently without any countervailing benefits or new protections.

As we review this new discussion draft, a number of related questions emerge that we believe must be addressed and discussed before action is taken to move this bill since the answers could have significant bearing on whether this legislation is a step forward or backward in protecting the public interest. For example:

- How many projects in the Reclamation Program would be affected? Under Reclamation law, water is most often delivered to irrigators under section 9(d) contracts, which include terms to repay allocated project costs (without interest) or under section 9(e) contracts, which provide water based on the cost of service on an interim basis before project completion. The bill refers to “water service contracts” which is a term of art in Reclamation law and is defined in the draft bill to refer only to section 9(e) of the 1939 Reclamation Act (i.e. for

irrigation water). But only a limited number of Reclamation projects actually use 9(e) contracts instead of the more widespread 9(d) repayment contracts.

- What will be the likely effect of the bill in the Central Valley Project in California? The CVP is the largest Reclamation Project and the site of some of the largest farms and biggest subsidy controversies in the program. But it also has one of the largest concentrations of 9(e) contracts. Would the bill enable 9(e) contractors to convert to 9(d) contracts, accelerate payment of capital, and buy their way out of all acreage limitations by taking advantage of current commercial borrowing rates that are at all-time lows?

- How will projects be operated going forward? Does this draft contemplate a permanent commitment to water delivery to existing contractors without renegotiation of key contract terms?

- Specifically, what happens to the negotiation of water quantity terms if shorter-term water service contracts become permanent contracts simply by conversion and prepayment? In the CVP, the Reclamation program is faced with over-appropriated rivers and intense competition for supplies. When contracts expire, the government has the opportunity to reduce the quantity term of the new renewal contracts and, in fact, the Bush Administration did just that when some of the CVP contracts expired in recent years. But when will such right-sizing of contract amounts occur if there is no such negotiation for renewal contracts and instead existing contracts are simply converted to permanent agreements? While the "reasonable use" requirements of federal and state law allow such reductions, the Bureau of Reclamation rarely (if ever) has used that authority to reduce the quantity term in an existing contract.

- In light of these questions, how do the Congressional Budget Office (CBO), the Office of Management and Budget (OMB), and Reclamation assess the relative costs of this new draft legislation as opposed to the status quo? And if we are to update the rules governing Reclamation's water supply program, shouldn't we start with addressing the outdated subsidies and skewed incentives of the below-cost pricing system before enabling prepayment of repayment contracts?

Taxpayers for Common Sense believes these are some of the initial questions that need to be addressed as this new draft approach is reviewed and considered. Again, thank you for the opportunity to testify on this legislation and I would be happy to answer any questions you might have.