Testimony of Steve Ellis
Vice President, Taxpayers for Common Sense

Subcommittee on Water and Power,
Committee on Natural Resources hearing on the
"Accelerated Revenue, Repayment, and Surface Water Storage Enhancement Act"
and discussion draft of legislation creating "Surface Water Storage Enhancement Program"

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

With one notable exception, the accelerated repayment legislation is virtually identical to a committee discussion draft that I testified on in June 2012. The issues that I raised at that time – both positive and negative – remain true today. In fact, the Government Accountability Office is studying some of those issues and when that assessment is released – hopefully in the next couple of months – some questions regarding the number of potential contractors benefiting from this legislation will be answered and there will be case studies of prepayment deals that have already occurred.

The notable exception and the discussion draft legislation creating a Surface Water Storage Enhancement Program present a new set of questions. But before going to that, I would like to make some overarching comments about Congress revisiting Reclamation water contracts and comments on the accelerated repayment legislation.

*Revisiting Reclamation water contracts*

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 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. And to the extent that the legislation under consideration today could be taken to lock-in the water allocations made by existing contracts, that hundred-year-old thinking could determine California's water use for centuries.

Current conditions in California underscore the challenge created by these century-old subsidies, and the questionable policy of perpetuating them. California is suffering from a drought of historic proportions. Water availability is so limited that the State Water Project, which runs parallel to Reclamation's Central Valley Project, has announced that it will be able to make no water deliveries this year. When anything, be it water or widgets, is this scarce, subsidizing its use makes little economic sense. Market forces will normally lead to price increases and reduced use – creating new subsidies or perpetuating old ones will simply lead to increased demand and distorted allocation.

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 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. It is time for Congress to examine whether taxpayer subsidies should be ended in favor of more market-based pricing, where prices would represent the true costs of developing and delivering water supplies and send price signals that encourage efficiency in use west-wide.

*Accelerated Repayment*

On the accelerated repayment legislation, we are concerned about the one-size-fits-all approach to complicated issues that vary from water service contractor to water service contractor. 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 legislation creates a system that abdicates

congressional oversight leaves 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 legislation provides pluses and minuses for the taxpayer. At the most basic level, taxpayers would be receiving their repaid cash sooner. In my testimony from last Congress, I also noted that the bill appears to eliminate an outdated and often-criticized subsidy by which power customers have cross-subsidized irrigation based on a perceived "inability to pay" by those irrigation users. This old loophole in the Reclamation program allowed costs to be shifted away from those 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 repay their allocated costs. On closer reading of the language in the current draft, the outcome rests on what cost allocation is stated in the contract – this should be clarified to state simply that no power subsidy will be allowed.

One the other hand, the bill completely fails to eliminate the largest and most broadly criticized subsidy of all: the interest-free repayment of the capital investments. In fact, rather than finally collecting 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 had not already provided major benefits to recipients. Considering that most water contractors are local water districts entitled to federal interest-free financing, the taxpayers will end up subsidizing them again through tax-free bonds if they finance the lump-sum prepayment.

The bill appears to offer various other benefits to water contractors, such as permanently waiving all federal acreage limitations intended to limit taxpayer subsidies for large 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.

Congress in 1982 expressly prohibited 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 proposed legislation would undo the accelerated prepayment prohibition while failing to include any corresponding reforms to compensate or otherwise protect the taxpayer or mitigate this dramatic change in federal law.

Finally, 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 legislation, some of that interest that would otherwise have been paid to the government could 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.

At the June 2012 hearing, I raised several questions that should be answered before the accelerated repayment legislation should move forward. Some or all of these may be answered in the ongoing GAO study, and I would encourage the committee to get the benefit of their insight before moving this legislation forward. The questions I raised were:

- 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 on 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.

*Surface Water Storage Enhancement Program*

As I noted earlier, the major difference between the current accelerated repayment legislation and the discussion draft from 2012 is the creation of the Surface Water Storage Enhancement Program and the Reclamation Surface Storage Account, which is also the subject of the discussion draft legislation that is being considered at this hearing.

Together, these provisions direct a portion of the revenue from prepayment of contracts and $400 million per year for five years into a separate non-appropriated account in the Reclamation Fund. Taxpayers for Common Sense strongly opposes this approach to funding water storage projects.

Any revenue generated by pre-payment of contracts should be returned to the Treasury and should be subject to congressional oversight and appropriation. Especially with the country running deficits in excess of $600 billion and a more than $17 trillion debt, no spending should be simply put on auto-pilot. Furthermore, the drafts again fall into the trap of requiring repayment in accordance with existing Reclamation law. Any investments in new surface water storage projects should be structured to not subsidize water use based on the 1902 reclamation model.

In addition, aside from general purpose statements, neither piece of legislation establishes any criteria or metrics to evaluate what projects should be prioritized for construction. There is no mandated cost-benefit analysis, and no direction or limitations on what the Bureau could consider. As drafted this account appears to be little more than a slush fund for the Administration. A more than $2 billion slush fund.

Water storage projects should be subjected to vigorous administrative and congressional oversight. After a feasibility study recommendation, Congress should make the decision whether or not to authorize the projects and then whether to appropriate funds for them. TCS has long advocated that Congress establish a prioritization system with criteria and metrics that would objectively determine what projects should be authorized and funded. With this type of system Congress could hold the Administration accountable, adjust the metrics and criteria as necessary, and not cede power to the Administration or relapse into earmarking funds on the basis of political muscle rather than project merit.

Taxpayers for Common Sense supports investing in our country's infrastructure in a targeted, prioritized way. We urge the Committee to re-evaluate the legislation and address the issues and questions raised today. Again, thank you for the opportunity to testify on this legislation and I would be happy to answer any questions you might have.