Slowly Evolving Regulatory Changes Could Significantly Affect Rural Development

Some major regulatory changes were announced or proposed in 1997, but implementation has not been a smooth process due to legal, political, and economic challenges. The most significant changes include telecommunications, electric power, air and water pollution, public land management, and banking and finance.

Regulatory changes affect development in many ways. They are often complex, with unpredictable effects that cannot be detected until significant time has elapsed. In this section, we discuss some of the more important recent regulatory changes that were announced or proposed in 1997, affecting telecommunications, electric utilities, air and water pollution, public land management, and banking and finance institutions.

Implementation of the Complex Telecommunications Act of 1996 Progressing Fitfully

In the 2 years since the Telecommunications Act of 1996 became law, the Federal Communications Commission (FCC) and the courts have been shaping its implementation. Despite the many regulations that have been established, the only provisions fully implemented are those dealing with opening up the local phone market. Those provisions, however, have come under court challenge. The 2 years since the act became law have already shown many of the challenges, pitfalls, and economic potential in opening up the telecommunication market, an $800-billion market according to FCC Chairman Kennard, to full competition.

The consolidation and restructuring going on in the industry, the continued lack of meaningful competition in local phone service, and recent court rulings have all contributed to a great deal of uncertainty in the telecommunication market. A recent ruling by a Federal judge in Texas, for example, went so far as to strike down a key portion of the act, the provisions allowing the regional Bell companies to enter the long-distance service only if they had at first proved they had opened their local telephone markets to competition. This ruling had in effect been won by the regional Bell companies, the long-distance companies lost. There have been no clear winners across all rulings. Most lower court rulings are under appeal. The issues facing the courts basically fall into two groups: (1) the legality or intent of some provisions in the law and (2) challenges to the authority of the FCC.

While all provisions of the 1996 Act will affect rural areas, the universal service provisions will have the greatest direct effect. The FCC in May 1997 passed the first regulations to implement these provisions, granting rural households support (through reduced rates) for a full range of telephone services. States, however, still determine the phone rates. The funding mechanism for universal service has not yet been determined, but is expected to take effect on January 1, 1999. States may opt out of the Federal funding mechanism. For these and other reasons, the universal service provisions are not fully implemented.

The universal service provisions also include funding for school, library, and health care providers. Eligible public and private elementary and secondary schools as well as libraries will be able to buy any telecommunication service, including the Internet, at a discount. Discounts range from 20 to 90 percent of the provider's rate, based on need and high-cost (ruralness) factors. Universal support expenditures for schools and libraries are capped at $2.25 billion per year, though unspent funds can be carried forward to subsequent years. An estimated 9,600 health care providers will be eligible to receive telecommunication services supported by the universal service mechanism. All rural health care providers are eligible with support capped at $400 million per year.

These school, library, and health care provider provisions have also come under attack. For example, the universal service contributions by long-distance companies for these provisions are meant to be offset by reductions in access charges. Reduced access charges have saved the long-distance companies, according to some estimates, over $2 billion per year. The long-distance companies, however, have claimed the savings haven't been that high and are threatening to increase their rates to cover their contributions.

Another challenge to the provisions comes in the form of questioning FCC's authority to establish the two nonprofit corporations that administer the distribution of the funds.

The next year promises to be just as turbulent for the telecommunications market as the previous 2 years have been, although the market is generally expected to gradually calm down. The real winners and losers in this market adjustment process, however, will become known only later. While there has been some discussion about opening up for Congressional reconsideration some provisions in the act, the current general consensus among analysts seems to be that this will not happen anytime soon. *[Peter Stenberg, 202-694-5366, stenberg.econ.ag.gov]*

States Are Restructuring the Electric Utility Industry to Introduce Retail Competition and Consumer Choice, So Far in the Absence of Federal Legislation on These Issues

Restructuring of the electric utility industry, to create market competition and consumer choice at the retail (distribution) end of the industry, continues to move forward in State legislatures and State public utility commissions. Once accomplished, consumers should be able to purchase electric power from the least expensive available source, and have it delivered to their electric meter by their current electric distribution company—to whom customers would pay a charge to "wheel" that power to them. Electric power companies already sell power at the wholesale market level into a competitive market place. High voltage transmission systems would continue to be regulated by Government, but paid a reasonable price to "wheel" wholesale power from generating companies to retail distribution companies. Both government regulatory pressures—and competitive market pressures—appear to be moving toward a break up of most integrated power companies where a company owns power generation, transmission facilities, and retail distribution networks. The emerging model is one in which power generation firms and retail power distribution companies may be organized independently from other segments of the business.

Under proposed Federal legislation, new start-up electric power generating facilities, including power generation from renewable resources, such as wind, solar, and biomass, would be free to start up and compete for business. There would be less government regulation of electric power companies at the wholesale and distribution or retail levels of the business. The Federal Energy Regulatory Commission (FERC) would continue to license electric power plants and power companies' high voltage transmission systems, but probably would have less regulatory oversight regarding pricing and access to electric service than before deregulation. State regulatory commissions typically would also have less authority over prices and access to service.

Restructuring is largely occurring at the State level, in response to the promise of substantial reductions in retail electric utility rates. High-electric-cost States in the Northeast and the Southwest, such as New York and California, have been in the forefront of deregulation, some of which has been by action of State legislatures and some by action of State public utility commissions. At the end of 1997, 11 State legislatures had enacted restructuring legislation, and 6 State public utility commissions had issued restructuring decisions. Twenty-two more States had legislative or regulatory efforts under way to study restructuring and to propose legislation for implementation. Federal action has not yet occurred, although several comprehensive and noncomprehensive bills have been introduced into the Congress addressing restructuring and consumer choice. The U.S. Congress is expected to act on electric utility restructuring; the Administration has recently announced a comprehensive approach to restructuring legislation.

As with most industry deregulation, some participants and consumers would benefit more than others. Electric rates in high-cost regions of the country, principally the Northeast, the Southwest, and in States where large-scale nuclear power plant projects are located, seem likely to decline. That would primarily be because lower cost electric energy can be imported from low-cost regions of the country. Large users of electricity would be active in negotiating preferred electric rates. Many national manufacturing and commercial firms would negotiate master contracts to supply electricity to all their locations across the Nation. On the other hand, consumers in areas of the country with currently midrange electric rates may not see much change. In some States, rates could trend upward after industry restructuring. Some rural areas could experience reduced access to service and/or find their electric rates remain relatively high, compared with urban areas. Moreover, reliability and access to new service could decline or become more costly for some more geographically remote customers. That has been the experience with airline, rail transportation, and telecommunications deregulation, where more rural areas of the country continue to face firms that exercise significant monopoly pricing power. Finally, more competitive markets should cause electric rates in different regions of the country to move closer together. That would remove an incentive for businesses to relocate or start up in more rural areas of the country that previously enjoyed lower electric rates.

While electric utility industry restructuring may bring economic benefits to the Nation, three steps are important to assure that competition actually develops in the industry and that consumers are not left facing firms that exercise monopoly pricing power. First, establishing well-functioning futures and options markets in electric power will be important to assure competitive pricing. Second, in the more rural areas, statutory or regulatory universal service and reliability requirements will be important to assure continued access to service at an affordable price. Third, Federal and State regulatory bodies must be vigilant to assure competitive pricing of electric services in all areas of the country. *[Marvin Duncan, 202-694-5019, mduncan@econ.ag.gov]*

New Air and Water Regulations Could Significantly Affect Some Rural Areas

In July 1997, the Environmental Protection Agency (EPA) finalized regulations for more restrictive controls on ground-level ozone (which contributes to smog) and airborne particles. The new rules are aimed at reducing health risks, particularly for children and the elderly. However, complying with the new regulations could be costly for some places, particularly urban areas. The Clean Air Act requires localities to meet air quality standards by given deadlines. Failure to submit or implement plans to meet the standards could result in reductions in Federal highway aid. State and local governments might have to cut back on activities that generate this form of pollution, where possible, such as by making more use of mass-transit and other means to discourage auto commuting. Some places, particularly congested urban areas facing high levels of pollution and some rural areas with large and stationary power plants that produce excessive levels of pollution, may have to adopt strategies to reduce pollution. This might help some less polluted rural and urban areas to capture a larger share of future development.

To lessen the pain of complying with the new rules, EPA is phasing in the new control strategies over a 10-year period, and various policies are proposed to reduce compliance cost. Places that already have established strategies to comply with current regulations would not have to change to meet the new standards. For others, new standards for ozone and particulates would not begin to be applied until the years 2003 and 2005, respectively. A proposed tradable pollution allowance system would be used to provide market incentives for adoption of policies to reduce pollution. For places incapable of reducing pollution below the new standards, this tradable allowance system would help to limit their cost increases. In addition, as part of its Greenhouse Initiative, the Administration in its fiscal year 1999 budget has proposed to spend $2.7 billion on research and development of new energy-efficient technologies for autos and building materials, plus $3.6 billion in tax incentives for purchase of these energy-efficient products. This follows from an Energy Department study that claimed that the cost of developing such energy-efficient technologies might be compensated by cost savings from future reductions in energy use.

If Congress were to adopt this energy-efficiency approach and if it proved to be successful in reducing pollution costs associated with energy used in the future (neither of these if's are by any means assured), congested urban areas and their outlying rural-commuting areas, and other high-energy production and use areas (such as agriculture and mining and energy extraction areas) might benefit. Otherwise regulation-induced costs would probably rise for many of these places. However, regulation-induced pressures for less polluting autos and trucks might actually benefit some agricultural areas that produce inputs for agricultural-based ethanol, a more clean-burning fuel. Reducing ground-level ozone has the side benefit of increasing crop yields in some areas. In addition, these places would benefit from improved health associated with cleaner air. While the potential effects are great, the many uncertainties make it impossible to predict what the ultimate effects would be.

New regulatory efforts are also being proposed to restore and protect America's waterways. During the 25 years since the enactment of the Clean Water Act of 1972, the quality of the Nation's waterways has improved. Most of this has been achieved by reducing point-source pollution by communities, industries, and businesses. But nonpoint runoff pollution has escaped solution under conventional regulatory methods. Recognizing that this problem is frustrating the goal of making all waterways fit for swimming and fishing, President Clinton proposed a new Clean Water Action Plan: Restoring and Protecting America's Waters.

The Administration has asked all appropriate departments and agencies to work as a team to develop plans and set new regulations and standards for the nonpoint pollution, which is caused, to a large extent, by runoff from land and animal feeding operations. This Clean Water Action Plan has three major goals: reduce the threat to public health from water pollution; prevent polluted runoff; and achieve higher water quality on a watershed basis. EPA will provide final regulations for the runoff pollutants by March 1, 1999. National Oceanic and Atmospheric Administration (NOAA) and EPA will put in place the Nonpoint Pollution Control Programs for all 29 Coastal States by June 30, 1998.

The Action Plan calls for an additional 100,000 acres of wetlands by 2005. This plan, in concert with USDA's Buffer Initiative, will establish 2 million miles (or 35 million acres) of buffer strips that will protect waters from agricultural runoff by the year 2002. Under this plan, USDA will make sure that agricultural operations in 1,000 critical rural watersheds have the necessary technical and financial resources available to them for controlling polluted runoff. To support the Action Plan, President Clinton has asked for $568 million for fiscal year 1999, and $2.3 billion through 2003. *[Faqir Bagi, 202-694-5337, fsbagi@econ.ag.gov]*

New Public Land Use Plans Were Established for National Forests, and Legislation Amends Program Managing National Wildlife Refuge Areas

In April 1997, the Forest Service and the Bureau of Land Management announced a new land management plan covering 72 million acres of Federal forest and rangeland in eastern Oregon and Washington, most of Idaho, and small parts of Montana, Wyoming, Utah, and Nevada. According to the proposed plan, to be finalized in the spring of 1998, new, more restrictive standards would be required of anyone wishing to mine, cut timber, graze cattle, or operate recreation businesses on these lands. The new standards require examining potential effects of land use on animal and plant habitat, not only in the section of land being used, but in the entire Columbia river basin. This allows land use decisions to consider upstream and downstream effects, which may sometimes be significant. The plan would allow higher logging levels than in the past 3 years, and it proposes increases in funding that would create jobs, while helping to preserve habitat and protect endangered species.

Meanwhile, the Bureau of Land Management withdrew a policing regulation plan covering 270 million western acres that was proposed in November 1996. That plan had come under criticism for taking powers away from local authorities.

In May 1997, the Forest Service released its land management plan for the Tongass National Forest in Alaska. It would allow up to 267 million board feet of timber harvesting annually, only half the current limit but more than twice as much as actually harvested in recent years. The plan also designates portions of 32 rivers as Wild, Scenic, or Recreational and creates buffers along beaches and river mouths and increases protection for caves.

In January 1998, the Forest Service proposed a suspension on constructing and reconstructing roads that could affect 33 million acres of roadless land within 130 national forests from Idaho to southern Appalachia. The proposed suspension would last 18 months or until new analytical tools are adopted that would ensure good road construction design and better maintenance of existing roads. National Forests in the Pacific Northwest and the Tongass National Forest in Alaska were excluded from the suspension because their recently adopted forest management plans were deemed sufficient. One expected result from the road-building suspension is a small reduction in logging.

In October 1997, legislation (P.L. 105-57) amended the National Wildlife Refuge System Administration Act of 1996, providing it with a basic mission of conservation, including restoration of fish, wildlife and plants. However, hunting and recreation are also recognized as priorities. This compromise, together with new clarity of mission, is expected to engender more support for Federal management of these refuge areas, which cover 92 million acres, a larger area than the National Park System, and to play an important role in protecting plant and animal life and in providing recreation to rural and urban residents. *[Rick Reeder, 202-694-5360, rreeder@econ.ag.gov]*

Some Bank and Credit Institution Regulations Have Changed, Allowing More Branch Banking and Revising Farm Credit System Rules

Beginning June 1, 1997, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 permitted interstate branching through bank mergers. Only two States, Montana and Texas, passed legislation opting out of interstate branching. While interstate banking will increase the pace of bank consolidation, rural banks are typically too small to attract attention from the mostly large banks that actively participate in interstate banking. New data required by revisions to the regulations governing the Community Reinvestment Act are just now becoming available to help evaluate the extent to which large banks lend to farmers and to small businesses in rural areas served by offices of those banks. Bad publicity for banks that appear to neglect the credit needs of rural areas may encourage some large banks to increase rural lending.

In 1997, Congress again came close to revising the Glass-Steagall Act, which limits bank activity in the insurance and securities industries. During the current session, the House narrowly passed legislation, but the Senate has yet to act on this issue. Prospects for a comprehensive legislative solution are complicated by conflicts between the banking, insurance, and securities industries, and between small and large banks. Many rural and other small banks fear that removing all Glass-Steagall barriers would concentrate economic power in a few giant firms. The resulting institutions would offer a wide array of financial services, but some wonder whether they would neglect the farm and small business sectors in rural areas.

In February 1998, the banking industry won a Supreme Court decision preventing what it perceives as unfair extensions of credit union common bond requirements. However, Congress may restore much of this authority to credit unions through new legislation. Several other issues remain open from prior years. At a minimum, banks want equal tax treatment for large credit unions that serve wide portions of their communities. Banks will definitely lobby against any new attempts to gain expanded powers for Farm Credit System (FCS) institutions. Legislative proposals to improve commercial bank access to funds from the Federal Home Loan Banks and from FCS banks did not succeed in 1997. The upward trend in loan-to-deposit ratios makes it likely that similar proposals will move forward this year. It appears that rural banks generally have sufficient loanable funds, whether from deposits or from other sources, but if that situation were to change, additional sources of funds could benefit rural borrowers.

The Farm Credit Administration (FCA) is an independent agency of the Federal Government that regulates the Farm Credit System. FCA's board of directors has established regulatory reform as a major priority. Reduction of regulatory burden continued during the year. Regulatory burden was reduced through the elimination or proposed elimination of several prior-approval requirements and the deletion of several obsolete regulatory provisions identified through public comment or internal agency review. If these initiatives are successful, FCS lenders will have lower business costs and be more customer oriented while maintaining safe and sound operations. Perhaps the two 1997 initiatives of broadest interest were final regulations concerning eligibility and scope of financing and proposed regulations on general financing agreements (GFA's) between FCS banks and the lending institutions that borrow from them.

The most controversial changes have involved final rules for eligibility and scope of financing. The changes affect loans to farmers, financing of processing or marketing operations, loans to farm-related businesses, nonfarm rural home loans, and eligibility and scope of financing for Banks for Cooperatives and Agricultural Credit Banks. The regulations place fewer restrictions on financing to legal entities, to certain foreign nationals, and for marketing, processing, and farm-related business loans. Also, definitions related to nonfarm rural home lending are tightened and harmonized with Federal Agricultural Mortgage Corporation (Farmer Mac) standards. The American Bankers Association and the Independent Bankers Association of America sued the FCA, alleging the regulations conferred powers on the FCS not intended by Congress. In November, a Federal Court dismissed the suit, but an appeal has been filed.

The final rule on GFA's revises regulations governing funding relations between FCS banks and FCS direct lender associations or non-FCS financing institutions (OFI's). OFI's, including commercial banks, could enjoy greater access to FCS financing for eligible short- and intermediate-term loans to eligible borrowers. The proposed rule reduces to two the minimum conditions under which a creditworthy OFI would be eligible for access to FCS financing. First, the OFI must make at least 15 percent of its loans to agricultural producers. Second, it must commit to establishing a funding relationship with an FCS bank for at least 2 years. The rule may also encourage more equitable treatment of FCS associations and OFI's by FCS banks. In part, this is accomplished by allowing OFI's to seek funding under certain conditions from FCS banks not chartered to serve their service area. To protect FCS safety and soundness, OFI's funding must be fully secured and full recourse to OFI capital is required.

The overall impact of these FCS changes on rural borrowers is likely to be small. Those who have been eligible to borrow from FCS lenders may notice a slight decrease in FCS rates relative to competing bank rates, although bankers are also enjoying a similar regulatory reform. Some borrowers who were formerly considered ineligible to borrow from the FCS will now be allowed to do so. Commercial banks, some of which have had trouble maintaining their deposit base, should find it easier to qualify to borrow nondeposit funds from FCS banks. However, it remains to be seen whether many commercial banks, particularly small rural ones, will overcome their traditional aversion to dealing with the FCS. *[Daniel Milkove, 202-694-5357, dmilkove@econ.ag.gov and Robert Collender, 202-694-5343, rnc@econ.ag.gov]*