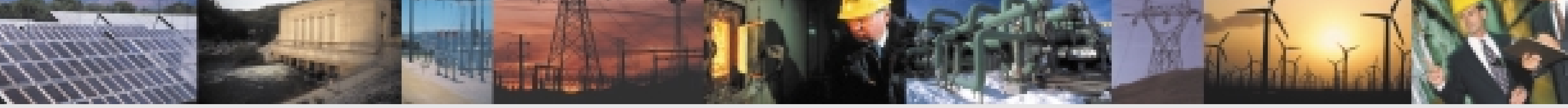

Reason Public Policy Institute Pocket Points

Electric Cooperatives in a Restructuring Industry

"Between 1994 and 1997, five cooperatives declared bankruptcy, forcing the federal government to write off $1.7 billion dollars in loans. Moreover, the General Accounting Office estimated that the ongoing financial difficulties of many cooperatives could leave taxpayers at risk of $10 billion in losses."

Outdated Policy in a Changing Industry

Electric cooperatives have evolved in ways that no longer reflect the original objectives of the Rural Electrification Act of 1936. Much of the decades-old public policy governing electricity cooperatives has become obsolete due to changes in technology, incomes and demographics in the American economy. Originally intended to help provide electrical service to rural areas, cooperatives now serve suburban regions as well as high-income resort areas at taxpayer expense.

Tax and Loan Subsidies

- Electricity cooperatives are exempt from many federal and state taxes to which for-profit businesses are subject.
- Electricity cooperatives can also borrow at below-market interest rates and receive loan guarantees that enhance their credit ratings. Unlike investor-owned utilities where financial risks are shouldered by investors, this loan program places the risk of default squarely on the shoulders of taxpayers.
- Cooperatives also receive low-cost, taxpayer-subsidized power generated from federally owned sources. Providing this cheap, taxpayer-subsidized power to some competitors and not to others distorts the market and interferes with the goal of robust competition.

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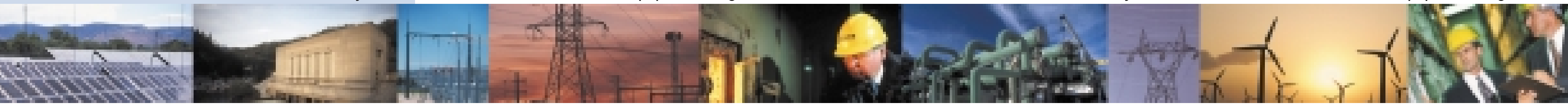

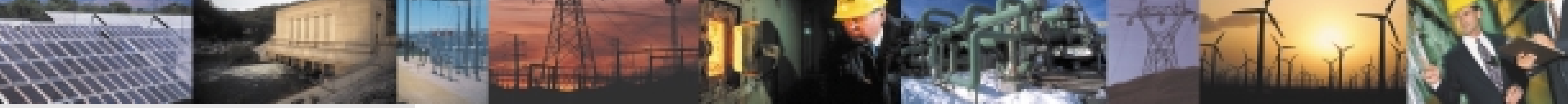

Cooperative Subsidies Redistribute Income

All taxpayers fund the numerous subsidies received by electricity cooperatives. Unfortunately, only a small proportion of the U.S. population enjoys the benefits. Many of the beneficiaries have higher household incomes than the taxpayers who subsidize them.

For example, some cooperatives provide taxpayer-subsidized electricity to resort areas with high average incomes like Aspen, Colorado, Manassas, Virginia, and Hilton Head, South Carolina. In contrast, most urban areas, many with high rates of poverty and lower average incomes, like New York City, Washington, DC and Detroit, Michigan, do not receive these subsidies. This point raises serious questions about the propriety of this federal program.

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Policy Implications

The legislative and regulatory framework in which electricity cooperatives operate has not evolved to keep up with the changes in the electricity industry and the way that cooperatives do business now. To address the inequities in the current system:

- Congress should revise the tax code so cooperatives are treated like any other for-profit taxable corporation for the non-member portion of their revenue.
- If continued, loans and loan guarantees should be determined by a combination of population density and average household income in the metropolitan statistical area, not by "once eligible, always eligible" as it is now.
- Congress should remove the preference power hierarchy from the sales of federal power to cooperatives. Sell to all qualified buyers on equal footing using an open auction framework.

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These Pocket Points were adapted from Policy Study No. 296, *Electric Cooperatives and a Changing Power Industry: How Outdated Statues Short-circuit Competitive Markets* (http://ww.rppi.org/ps296.html).

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