

*Brian Dabson:* Good afternoon. My name is Brian Dabson. I'm president and CEO of the Rural Policy Research Institute or RUPRI. It was Anne Pope this morning, and Anne's not here now, and she gave me a really good byline, because I'm always struggling to describe what RUPRI does. And I think I'm going to use what she said. Our job is to "make rural cool," and I think that's a good mission to have.

The focus of the panel this afternoon is on the role of the federal government in supporting rural community development capital. We've had quite a lot of discussion this morning, and a number of topics have come forward, which are of direct relevance to the panelists here, whether we're talking about RBICs or new markets tax credits or venture capital CDFI fund, all these I'm hoping that we'll be addressing in various ways in this panel.

We have five distinguished panelists, each of whom are programmed to talk for 10 to 15 minutes, and you can believe that if you wish, before we open it up to general discussion. I think we'll follow the same sort of pattern as this morning. We'll let the speakers talk, and then we'll have the discussion afterwards, unless anyone's burning to ask a clarifying question, and we'll take that.

I'll introduce each of the panelists in turn now so that we can move straight on. First up will be Julia Sass Rubin. Professor Rubin is on the faculty of the Bloustein School of Planning and Public Policy at Rutgers University. She's an expert on community economic development and community development financing and has a special interest, I think, in New Markets Tax Credit. And we're going to hear some of her work and some of her thoughts by way of sort of a context for this discussion this afternoon.

Next up will be Linda Davenport. She's a deputy director of policy and programs at the CDFI Fund and probably knows more about new markets than anybody else. We're delighted she could join us. CDFI Fund, as you know, has been in the crosshairs of budget cuts almost since it was formed. And I, for one, am delighted that it's still here and functioning well.

Then we're very pleased that Tom Dorr, the undersecretary for rural development at the USDA, has found time to join us this afternoon. He's been a very strong and very effective advocate for rural development and in particular for the new bioenergy industry. This is a very busy time for anybody who's in USDA, particularly in rural development, and thank you for finding the time.

Then after Tom will be Claiborn Crain who is a senior professional staffer at the House Agricultural Committee, a long-time advocate for all things rural in various capacities, both in Texas and in Washington, D.C., possibly enjoying a quiet period at the moment since the passage of the House Ag Bill and waiting for something to happen on the other side. Claiborn, we're happy that you can join us.

And then acting as a sort of a wrap up will be Rich Bender, a senior assistant to Senator Harkin, and he has the particular honor, I think, of shepherding the rural development title and other things through the Farm Bill with Senator Harkin being the chair of the agricultural committee.

This is a very busy group of people, and I'm delighted that they could join us. So Julia, would you like to begin the proceedings? Thank you.

*Julia Sass Rubin:*

So good afternoon. I have the great pleasure of being the first person after lunch. I could be the last person to speak to you after lunch, so I guess it could be worse. I just want to remind you what I always tell my students. I can see when you fall asleep, so get that caffeine into you now so I don't have to make any rude comments when you're stretching.

So I'm going to mostly speak to policy issues or policy suggestions related to rural community development venture capital, but as I've been sitting here this morning and listening to some really wonderful speakers and panels, it occurred to me that some of this might feel a little contradictory to people who don't live and breathe this stuff. So let me just give a little background for my comments.

I've been doing research on this industry for about a decade, and over the last, I guess, six to nine months, I've been updating research that goes back to about 2000. So most of the comments about the industry are based on that research. I'm not going to be able to share any detailed conclusions with you, because I'm just now starting to do the analysis. I've just been collecting data, so you're going to get sort of a couple of general overview themes, and then I'm going to talk about what some of the challenges are for the industry.

So as I was sitting there listening to everybody, I thought there might have been some confusion for folks who don't live and breathe this in a sense that you're kind of hearing a little bit of

disparate themes. For example, we've heard that – or in reference to an article in this issue of the *Community Development Investment Review* which talks about what is community development venture capital? That article, which I wrote, talks about an industry that is primarily small, that has very limited deal flow, and has been facing some challenges because of those issues.

You've also heard some of the speakers reference that, as well, but we've also heard folks talk about funds that are larger and have larger geographies. So they're not \$10 million. They're not \$5 million. They're \$20- or \$30- or \$35 million, and we've heard mention of a problem with deal flow. We've heard mention of very high quality deal flow. We've heard folks talk about very profitable exits, and we've heard other folks say, "Hey, we basically treat this as something that isn't necessarily market rate." Maybe you can get 15 percent; maybe not. And then we've heard that the industry is actually growing, and the question is, if it's growing, what's the problem? Why do we need federal intervention?

So I thought there were some themes that, at least to me, appeared to point out some contradictions that I wanted to just very quickly address. And I think part of what you're hearing is that the industry is not homogenous. It's changed a lot over time, and the kind of the model of the rural community development venture capital fund that is referred to in the *Investment Review* is a little bit of the older model, that model that existed in 2000. Really, even by 2000, that model was no longer the primary one, but when the industry began in the 1970s and when the industry really started to grow in the early 1990s, that was sort of the dominant theme, where the smaller funds, because it was difficult to raise money, particularly for the rural markets, and they had a very difficult time with deal flow, principally because they focused on very restrictive geographies.

So if you think about Kentucky Highlands – Ray, excuse me for pointing out on you – it began with a number of counties in Appalachian Kentucky, really small, very locally focused, and the model was very intensive technical assistance. In fact, they just didn't assist the entrepreneurs. They brought the entrepreneurs in. They created the companies for them, in effect, and then financed them. So that was sort of the historic model very early stage, because often you're creating new opportunities that actually exist, very labor intensive, long time to exit.

But the industry has changed to some degree since then, and now it consists of a whole range of organizations, some of which were represented this morning. The two newer funds that Ray and Grady run, for example, and the fund out of Coastal Enterprises that Nat runs and the fund that Lynn runs are an example of some of the newer funds which have broader geographies, larger volumes of capital to invest, and because they have broader geographies, they have better deal flow.

That's not to say they have the kind of deal flow that folks are seeing in the venture capital centers, as Kerwin referred to, where the team comes in pretty much readymade, and you can really be selective. But they have better quality deal flow, and they probably are going to see higher financial returns as some of the early exits indicate.

So part of that kind of apparent inconsistency is that the industry has changed, and it's changed in part because it's learned from prior experience and because new fund managers have come along who've been trained. And they're raised bigger funds as a result of their own experiences. It's also changed because the funding environment has changed, and I referred to this in my comment/question earlier, and that funding environment I'm going to speak to in a few minutes. But is it not, right now, a very favorable one.

I think the thing that is consistent about the industry is its focus on benefitting low-income people and communities. Now how they do that is obviously a little bit more divergent. What the industry right now I think is struggling with is differentiating itself, and this goes back to the comment Chris earlier made, which is, "What is this industry really about? And then how do you differentiate it within this larger space of emerging domestic markets?"

If you've been following this kind of debate that's going on or this discussion that's going on, there are a lot of venture funds that are now calling themselves developmental. And as large sources of capital, like some of the pension funds in California, are starting to move into these kinds of investments, folks that probably aren't really doing, as I called it, heavy lifting are trying to classify themselves that way, because that gives them an opportunity to go after some of this capital. And so there's a bit of a tussle going on and a lot of open questions about what is developmental venture capital.

So part of the confusion you're hearing is that the parameters are a

little bit gray, and people are disputing exactly how to define what this space is. But I think if I were to define it, I would say it's a consistent focus on benefitting low-income people and geographies. The way that you do that does change quite a bit from fund to fund.

So just to give you an example, the models that I see in my research range from very mixed geography, what Nat mentioned. His fund doesn't just focus on rural. It focuses on urban and rural, and it's quite broad. It covers six states right now. You could have a fund that covers the entire east coast like Sustainable Jobs or SJF does, and then you have multi-state rural focused funds like the RBIC fund that Grady and Ray run. Then you have a strategy like partnering with a university, which is Lynn's been doing and other folks are doing where you really feed off of the technology transfer and some of the innovation that universities create. Even though you're in a rural area, you have kind of a pocket of more economic development going on and more opportunity.

Or you can develop some regional sector expertise, and you can really focus resources on stimulating that expertise in a particular region, which again, creates deal flow that would not otherwise be there. And these are not mutually exclusive. Folks are combining various strategies. Obviously, providing technical assistance via grants has come up again and again. That's something that most folks are doing, because it is so critical to dealing with a deal flow issue.

And then finally, some people are still experimenting with near equity to see if potentially for rural geographies you could just not deal with venture capital at all but do loans with some kind of a patient capital feature, for example loans that you don't have to pay interest on for the first four or five years or loans that have a warrant that you're able to access after a certain period of time.

So these are all different models that the market is experimenting with, so that's pretty much what I'm going to say in terms of what's going on with community development venture capital. What I do want to talk about primarily are the challenges that I see the industry facing, and I know Kerwin talked about the whole range of challenges. I'm just going to focus on two.

One is the difficulty raising capital, and again, we have these funds who spoke to us this morning, and it seems like they had no problem reaching a certain size, but I think what their presentations didn't get at is that all of those funds rely on programs that don't

exist right now. They need to be reauthorized in order for new funds to be created. So what happens when you don't have capital, when you have a difficult time raising this kind of capital, is obviously much of the U.S. is either unserved or underserved. And what also happens is that successful firms that are begun in rural environments are lured elsewhere for that follow on round of capital or that initial round of capital.

And actually, Nat mentioned a couple of firms that they had lost because they moved elsewhere for exit opportunities. If you don't have access to capital locally, whether it's that early stage or larger follow on rounds, you lose those firms. So not only are you not developing the businesses that these kinds of funds help develop, but you're losing the ones that might develop on their own, because they're lured elsewhere for the capital.

The other thing that's happening is that the fund managers that spoke to us on the panel this morning are here because of programs that don't exist anymore. So not only do you not have the capital, you lose that stream of people that are feeding the industry, and if a certain number of years goes by, as folks become successful financially or demonstrate that they're able to manage these funds, they may move on to a different territory. They may move on to a larger fund. But if there's nobody replenishing that supply, then you end up unable to raise future funds. So there's other consequences of the fact that there's very little capital being invested.

So I want to just propose a couple of recommendations, and these are all focused on the federal government, since I'm on a panel that deals a federal government. Well, actually, what I wanted to do before that is to just talk about what programs are out there right now that fund this industry. And at the federal level, obviously there's the new markets venture capital and the rural business investment company programs. Both of these programs require reauthorization, so they actually don't exist right now in terms of being able to access capital, but I also have some concerns because these programs are based on debt.

First of all, you have to raise equity capital for the programs to match, which still leaves you with the challenge of raising that initial supply of equity capital. And let's say it's \$10 million for the RBIC program. That is a significant amount of capital to raise in a rural environment, unless you have the kind of resume that these gentlemen have already demonstrated. And I think that's largely why we weren't able to get more funds to actually get

authorized, even if you're able to do that, you then get leveraged with debt. And for venture capital, particularly for rural venture capital, that's really not ideal.

Now, you have really talented venture fund managers who are able to work around that, and these guys are apparently able to work around that from all indication. But it's really not ideal. It's a mismatch, as I think Nat pointed out, of uses and sources of capital. And it's also not ideal, because rural investments often take longer, and debt is particularly problematic when you're got a longer time horizon.

So my concern with this program, I think it's a terrific program, but that is something that is not optimal. If you could address that, it would be wonderful. The RBIC program and the new markets program both have that concern. The small business investment company, as was mentioned this morning, the participating security portion of it doesn't exist anymore, so again, you're looking at only debt, and you're looking at leverage only. None of those programs are helping you raise that initial pool of capital that you need in order to get that federal match in order to draw down on that leverage. And the SBIC program doesn't have a TA provision either, which is really critical in the rural venture capital space.

Another program that is accessible to folks is the CDFI Fund, which is a wonderful and very important source of equity capital, and thankfully, there's going to be a lot more money for the fund to distribute this year. It's been stripped bare for a few years, but the fund has a lot of CDFIs that are coming to it with different kinds of requests for capital, and so we can't possibly be the source for community development venture capital. We can be one of a range of sources, but right now, it's one of the very, very few sources of capital that exist. So a million dollars is a great start for a fund, but if you want a \$20 million institution, it's obviously not going to do the trick.

Now, the primary source of capital has historically, or at least since about 1998, been commercial banks, as Kerwin mentioned this morning. The problem with that is that if you look at the funds that were raised through about 2002, commercial banks were a huge part of their capital structure, approximately 85 percent for a two to three-year window. But after 2002, that really started to decline, and there are a number of reasons for this. I just want to mention, I think, some of the most critical ones.

First of all, as you heard folks mention, there are other ways to meet the investment test, and I'm not just talking about the provision that was changed in the last year. I'm saying, this goes back to earlier. There are many other safer and lucrative ways to meet the investment test, and unless banks have to make these kinds of investments, they would probably prefer not to, at least that's what I'm seeing in terms of actually investing in funds. You've heard that the few larger banks have rural footprints. That's certainly a factor. Another factor is bank consolidation, which has really hurt, because a lot of the banks that were making investments in community development venture capital have been acquired by larger banks who may or may not make these kinds of investments, but there are now fewer sources as a result of the consolidation.

So that has eliminated a lot of potential investors, and finally, there definitely is a perception, and I think you heard that in the prior panel, whether it's true or not for all the funds, there certainly is a perception that this is not a lucrative space financially. And I have heard repeatedly from both investors and fund managers everybody wants returns. Whether they're a socially motivated investor or a financially motivated investor, they want returns. And so if the perception is that this is not lucrative, and I don't actually think that perception is accurate, at least my research doesn't seem to point that way, but it's there. And I think that is a big inhibitor, and until that perception is reversed, they are having a very difficult time going to banks. And that's been true for about five years. There are some exceptions. I think KeyBank is an exception. There are a few others but not too many.

Foundations, unfortunately, except for Heron, again this is not a space where most folks are going right now. There were some very critical early investors on the part of Ford and MacArthur, but that has not continued in the recent past, and I don't really see that necessarily reversing. There are some regional foundations, like the Northwest Area Foundation, that has made a large commitment to this, and hopefully some new investors, but as of right now, this is really not a huge – foundations don't represent a large piece of the funding formula.

And finally, there's state governments. Now, again, these are kind of historic sources. There are some new sources that are coming online that Lynn mentioned earlier, but state governments are actually the really most prominent piece. And I think, Lynn, you mentioned that in your presentation as well that states are really stepping in where the federal government has somewhat dropped

the ball. The problem with the states is that like the federal government, they go through political cycles, and each new administration wants to do something a little bit different. You know, I can say this stuff. I'm a professor. I don't have to actually be careful. I'm at a public university, so I have to be a little bit careful, but unfortunately, it means that there's a fair amount of instability in these programs.

And some of them are tremendous programs. The national association of state venture funds did put out a report that I think Ray mentioned too. They talked about the emergence of this fund to funds model which a lot of states are moving towards, and often now these are managed by private sector investors like Credit Suisse, which is really creating a portfolio in this space, where they come in and a state will allocate a certain amount of money, and they will invest it in private venture funds, including developmental venture capital funds. So that's a really interesting and relatively new trend. The other interesting new trends are other types of institutional investors like the pension funds, but that is still very, very early. There's only been two or three investments from pension funds in community development venture capital. So it's hopefully something for the future but not so much today.

So what do you do about it? Well, I want to throw out a couple of ideas. I know you've heard a lot of ideas today, so let me add these to the mix. These are not comprehensive. I haven't gone through and written down everything that you could possibly do, but these are the ones that I, for reasons that I'll touch on briefly, think are perhaps the more powerful.

One is obviously some kind of a tax credit, because the New Markets Tax Credit it not really hitting this space. You've heard about that already. I think a tax credit would reduce perceived of a lower return, so it would directly address the concern investors have, and I think you do need to go after investors that are going to be concerned about returns, especially since it appears that everybody is concerned about returns. But in particular, institutional investors are going to be concerned.

They're familiar with tax credit. The New Markets Tax Credit and the Low-Income Housing Tax Credit have both been very successful with banks and with other institutional investors. I think a tax credit is more politically feasible than a direct appropriation, at least in the current budgetary climate. I have a note about avoiding the best effort model. I think if we go with a tax credit – well, let me skip that for now. We can come back to

that in a few minutes.

So that would be the carrot. The stick part would be to focus CRA investment test on equity more tightly versus real estate, because as I mentioned, one of the reasons the banks have moved away from this space is they really don't need to do this to make their investment. And real estate is safer, and Rosalyn mentioned this, as well, and certainly perceived as safer, and it's very lucrative.

So the other avenue, and this is perhaps a little more wishful thinking, is to expand the CRA to cover more types of financial institutions, and that would include potentially mortgage banks and insurance companies, as well as institutions that really have a stronger presence in the rural markets like the farm credit bank system and the federal home loan bank system.

The other possibility would be a way of providing leverage without relying on debt, and that would be to do an appropriation of a pool of capital that could be invested on a limited partner basis. So let's say the small business administration would be appropriated \$100 million, which is actually not as far-fetched as it might seem, because there's a bill that just made its way through the House that appropriates \$50 million to the SBA for angel investing. So it sounds like something that's unfeasible, and yet it's actually occurring in another context. I realize that's only the House but still.

So let's say they got \$100 million. They would be able to invest that in venture funds who would first have to raise, let's say, a comparable amount or maybe 70 percent from private sources or from state and private sources. And they could then go to the SBA for an equity investment as a limited partner. Part of the reason why I think it's important for the government to be a limited partner versus having preferred status is I have heard over and over again, primarily from commercial banks, that they were really burned during the meltdown after 2000 when so many participating security SBICs went under. And the SBA was able to get preferred status on the assets, and so the banks and other private investors were left cold. And they said, "We're not going to touch anything that's SBA if we don't absolutely have to because of that preferred consideration."

So if you can have the government go in as an equal partner versus some sort of a preferential status, I think that would potentially address that. And I think it gets around some of the regulatory lodging the SBA programs sometimes is perceived as having.

The other concern is that the SBIC program, the new markets venture capital program, the RBIC program, which were all managed by the SBA, took a long time for folks to get approved, and there are good reasons for that, for the selection process. And I think it's a very good selection process, but perhaps there could be something that's a little more stripped down that doesn't quite take so long and doesn't discourage people from actually participating in it.

The other challenge of rural venture capital is inadequate deal flow, and that's true whether you're covering a large geography or a small one. But if you're in a tighter geography and if you're in a poorer geography, it is a bigger challenge. And I guess that's the other thing that I should have put in that first slide. Not all rural geographies are equal. There are regions that are more distressed and that have less development, and there are rural regions that have more things going for them, such as universities or perhaps smaller cities within the region that can draw down interest from entrepreneurs.

There are areas where you hear people within the region who are managing venture funds or who were investing in venture funds say, "There's just nothing going on here," and that's a really discouraging thing to hear. So clearly there's at least the perception that there's a lot of differences in how rural regions are economically. So if you're in a region like that and you're really trying to develop that region by focusing tightly on it, the Kentucky Highlands model, then clearly you're going to have real issues with deal flow. But even if you're covering a multi-state model, you still have less deal flow than you do in a concentration of venture capital like Silicon Valley, so it continues to be a problem.

So what do you do? Well, I think one potential solution is to decouple the technical assistance component that exists in the RBIC and the new markets venture capital programs, not to take it out of those programs but to create one that is also freestanding. It could be housed in the CDFI Fund, which has tremendous expertise with both technical assistance provision, funding, and grants, and you could peg it to a certain percentage of base capital. So if a fund raises \$20 million, they would get \$2 million in technical assistance, which would have to be used like in the new markets in the RBIC program specifically for technical assistance, not to pay salaries of fund management, for example.

And you could cap it at say \$2 million, so that it doesn't become extravagant. And in fact, there is every reason to believe that you don't need an unlimited amount. It doesn't necessarily grow with the size of the fund, because a \$50 million fund is still only going to make 10, 12, 15 investments, and you don't necessarily need to invest more per company in technical assistance. But you need that sort of minimum level so that you can do what you need to do for those deals.

So the good news is I think that might be it. Yes, so thank you very much.

*Brian Dabson:* Thank you.

Linda, would you like to go?

*Linda Davenport:* Yes. Hello, everyone, and thank you for having the CDFI Fund here today. I bring greetings from our director, Kim Reed, who was in New Orleans with the deputy secretary making the announcement of this year's new markets tax credit awards, and Ray has reminded me that I failed to bring the list of who the winners are with me. And I really did fail to do that, so we'll all have to look at the conclusion of the day to see who the winners were this year. And thank you, Julia, for that setup on the fund.

Let me just place in context, I think there's four areas where the fund can be supportive of venture capital funds in rural areas. First, through our FA and TA program, next through new markets, third through our training, and fourth through research. And let me just kind of walk through each of them and where I think we are. And then I want to make sure I collect some of the comments that have been made this morning and throughout the day so that we develop an agenda of how the fund can, if possible, respond to some of the areas where you find it less workable than others. Some of our constraints are statutory. The seven years in new markets, for example, and the substantially all test. Others may not be, so let's make sure that you have aired with the fund those areas where you honestly think it would be within or purview to make it more likely that venture capital funds and those in rural areas could be successful.

First, on our financial assistance and technical assistance programs, as many of you may know, we currently have our 2008 program out. I mean, it was only two weeks ago we announced the winners of 2007, but we've already got the 2008 application out. And in the budget process right now is a number of either \$90 million or

\$100 million for our program side. That's the largest amount of funding that I think the fund has received since 2000 or 1999. I am hoping that we get a much larger number of applications than we have historically. Out of 780 CDFIs, we typically only get about 140 applications for that funding. It may be because people thought with our limited funding in the last few years that it wasn't worth their while to apply, but if there's any year when everybody should be throwing their hat in the ring, this is it.

And Kerwin, if I heard you correctly, there's what you would consider 92 community development venture capital groups. By our count, 28 of them are certified as CDFIs. That means there's a real target of opportunity, I would think, for the fund to work with you to make sure that as many of the CDVCs as possible do become certified with the fund. Somehow those 28 were able to work with whatever the issues are, but let's get those on the table, and let's get them certified. And let's get their applications in, hopefully by the end of this month.

It is true that they have been less successful in the last couple of rounds of FA and TA, and I know Kerwin has asked us to look at our application and the review of the applications. And we think the application itself does permit any type of CDFI to put forth as a comprehensive in a way that there should not be bias among the different types of CDFIs. After all, we have loan funds, credit unions, banks, VC funds, microenterprise. We've got a pretty motley crew to begin with, but we are going to look at our review process and make sure that there's nothing built into that that seems to be militating against venture funds. In the last two rounds, there were a total of, I think, eight venture funds that applied for FA or TA, and only one in 2007 did get funded. So we definitely want to take a look at that.

On the new market side, it's really hard to get our hands around the numbers, because we don't necessarily keep track of the applicants by institution type, and even if we did, they ask for multiple reasons for funding within their application. So I can promote everything from about \$100 million to almost \$2 billion, so I'm not going to put a particular number on the table that have gotten new markets other than to note that by our count 18 of the 28 CDFI venture funds also have created CDEs, and at least seven of those have gotten funded with new markets. So we want to look at ways to increase that number.

Some of you may be aware that we have been asked to look at the emphasis in rural areas generally for new markets. Senator

Grassley and Senator Baucus together have required the fund to ensure that in the next round there is some way to assure that there is rural proportionality for the qualified equity investments that the fund oversees. We went out for public comment. We received, I think, over 35 comments, and we're in the process of determining how to incorporate that into the 2008 round. Now, that won't necessarily advantage venture capital in rural areas, but it is intended to ensure that more of the new markets money goes into rural areas.

We've had a pretty good record from a transaction percentage. In 2005, for example, over 20 percent of the new markets transactions were actually in rural areas. But it was just over 10 percent of the dollars. So we will be coming up with our interpretation of how to take all these comments and what the right policy approach is going to be when you see the 2008 new markets application, and that will be sometime around the first week of December of this year.

Then I mentioned training, and I say that broadly. We're looking at, with respect to the rural areas, whether the fund should build on the success that it's had in its native initiatives, where we have a contract out with First Nations Oweesta to help build the capacity of CDFIs in native communities. Should we do something similar to build the capacity of CDFIs working in rural areas? Depending on what our budget is this year, that may be something we can work in to looking at. And our director who herself comes from a rural town in West Virginia is very interested in ensuring that the fund is meeting the needs of rural communities.

And then lastly, research. A few years ago we found ourselves with a few extra dollars in the cookie jar, and so in addition to some other things, we finally got out a proposal for research papers on CDFIs. And we just announced, I think day before yesterday, the 12 papers that will be funded through the CDFI fund. I'm happy to say Julia is one of them, and it is on venture capital funds in rural communities. We employed Apton Associates to be the manager of this initiative for us, so they came up with a review process that included three reviewers looking at each proposal.

And there were some limitations, because we actually have to have the work completed, completed completely, meaning every last dime has to be paid to everybody, by September of 2008. So I think there were a number of proposals that might have needed more time. There were some that had gone on to new markets, as well, and that couldn't be funded. And then we wanted to be sure

that we covered a range of areas, including rural innovation, sustainability, and so forth, so we are pleased to see that there's a couple of rural papers in there and that one focuses on venture funds.

So that gives you an idea of the types of funding and the kinds of approaches that the fund thinks is in its purview to take. And with that, I will turn it over to the next speaker.

*Brian Dabson:* Thank you.

Tom, you have the –

*Thomas Dorr:* Thank you, Brian. Again, thank you for inviting me here. As I told some of our hosts earlier one, this room brings back a great deal of memories to me, because my first occasion in this room was literally 20 years ago in October of 1987, shortly after Chairman Greenspan had taken over, and it was after the debacle on the stock market when everybody thought the world was coming to an end. And he navigated through all of that. Subsequently, I had an opportunity to spend six years on the board of directors of the Chicago Federal Reserve Bank and got to return here periodically, and so I have a very, very soft spot in my heart for the Fed. I learned a great deal, and this is where it all story.

And the story that I tell is I was here at that time as a member of the Ag Advisory Group from the Chicago Federal Reserve Ban, and as you may or may not recall – I suspect you do – we were in the midst of an ag crisis, and so –

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*Thomas Dorr:* – hatefully, crusty old ag economist who had been here at the Fed for many years, and we were lamenting the fact that interest rates weren't coming down. The land prices had gone down substantively from where they were, and he said – and I don't know if this was politically correct at the time or not, but he said it so adroitly – he said after he had listened to about a dozen of us complain about this, and he looked at us, and he said, "Well, folks, what the Fed giveth, the Fed can taketh away." But there was a lot of truth to it and a lot of good experience. So I'm thrilled to be back up in this room.

You know, our topic today is venture capital and rural communities and especially as it relates to the role of government in this area, and I think the role of government is the important

qualifier, because – and some of you may have heard me say this before – but there's the old adages that if all you have is a hammer, then every problem looks like a nail. And my corollary to that is that if all you have is a hammer, maybe what you need is just a bit bigger toolbox, and that's what I'm going to suggest today, because in my view, I think that what government tends to do is think reflexively in terms of laws, regulations, subsidies, and programs. I think we also need to be careful that we don't let that focus become an artificial constraint, because as a primarily private sector guy, I believe that markets drive everything ultimately, including policy.

And the issue ultimately becomes bigger and bigger that government alone can tackle. Now, to be sure, I would be the first to say that government has a role to play in this. As many of you probably know, Rural Development is what we call an investment bank to rural America. Most people don't know this, but we have a \$98 billion portfolio. We have approximately 40 different programs. We have about 550 field offices all across the country. We deliver about anywhere from 14, depending on the largess and the timing of the budget and the largess of Claiborn and Richard, we have anywhere from \$14- to \$18 billion a year of program dollars to deliver, largely in loan guarantees.

And that's a significant point that I'm going to make. We invest a lot of this in infrastructure development, housing, more and more of it in energy and entrepreneurial and economic development. And I think we do it in a fairly effective way and in the context of what is evolving, I believe our delivery mechanism across rural America is probably one of the best in the country, if not the best coming out of the federal government. And I say that with all due respect to our other partners here from the federal government.

But we like to think of ourselves, as I said, of an investment bank, and when I first got to Rural Development about six years ago, I think we were going through the throes of a reorganization, and in the context of that reorganization there was a tendency for ourselves to think, or internally for the organization to think of themselves as a lender of last resort. And I have actually looked at this and the team that we've got put together, built round a core – a lot of the old core folks were there, including Claiborn, who's no longer there. We realized that we really did have the opportunity to become the first lender or the lender of first opportunity, excuse me.

So the question is what should our role be going forward? Now,

let me suggest a few subjects for discussion here. First, I suggested just a moment ago it's important to remember that government's role in providing venture capital, even in rural areas, is distinctly secondary, and I firmly believe that. If we're ultimately going to play a strategic role, our role from the federal government is going to have to be through what you've already discussed at length today, through partnerships and leverage, and not by virtue of the scale of resources we bring to the table.

An example I use on a fairly frequent basis is something called America's farm balance sheet, which is compiled by our chief economist at USDA. Many people don't know these numbers, and the most recent update was actually September 4th of this year, and it shows that the total assets, the real estate asset owned by America's farmer, ranchers, and private sector forest landholders, amounts to more than \$2.2 trillion. Interestingly enough, over \$2 trillion of that has absolutely no debt against it, and I would offer this observation. That's just the farmers and the ranchers and the forest landholders.

And bear in mind that upwards of 95 percent of total rural income is earned off the farm. So total rural wealth is much greater than farm equity. In fact, the farmers alone control a pot of resources that approximates a thousand times greater than our total annual rural development budget authority which is about \$1.9 billion. That an order of something in the neighborhood of a magnitude of three.

Now, when you look at this, it begins to give you some idea of who is the tail and who is the dog in this whole process, and the problem is, and my point is really quite simple, that for far too many years government has operated as if rural America is poor and, therefore, in many respects, program dependent. The broader truth really is this much, and that is that rural America, as a whole, is awash in potential investment capital, unequivocally. We have resources that dwarf anything that government brings to the table, but again, our success is going to be determined by our ability to develop partnerships and ultimately leverage private resources.

Secondly, we should recognize that in many respects the game has changed in very fundamental ways. Rural economic development today is being driven by something that I think we tend to overlook on a regular basis, and that is distributed computing, distributed computing or broadband, and ultimately, the resultant economic diversification that is made possible because of this, and finally, the recent build out of renewable energy in many rural areas, is a

classic example of what I'm talking about. But there are many, many more.

We're still in the very early stages of this transformation, but in my view, policy frequently hasn't caught up to the fact that distributed computing, access to process controls, management controls, knowledge, capital, arbitrage of markets in many ways we have heretofore not thought possible, and insight into global markets is at our fingertips. Politics, in my view, is often a lagging, not a leading, indicator. It's kind of the old verbiage that generals aren't the only ones who sometimes fall into the trap of fighting the last war.

Now, a real challenge for all of us today is going to be to reorient policy to the new realities on the ground. In my view, rural America enjoys a significant series of new opportunities, as trillions of dollars literally move through the world's financial systems daily. Anyone with a modem, with a marketable idea, and a modest amount of technical know-how can tap this flow. And I would also submit that what we face is not so much a dollar shortage as it is a lack of entrepreneurial culture, which is probably compounded by a need for better business and better investment models to draw this latent capital off the sidelines and into the game.

I'm not going to dwell on this, because I know many of you probably agree and have struggled with this issue for many years, but how do we go about getting it done? And that brings me to my third point. Building an entrepreneurial culture is a complex thing, but for us at Rural Development it involves the following items that we're looking at. Since the passage of credit reform, we have literally shifted our emphasis from grants and direct loans to loan guarantees. When I got there in 2001, our direct loan B&I portfolio had a default rate of about 48 percent. The federal government could not make effective direct loans. We do now do loan guarantees. Our default rate on that portfolio is 5.75 percent. What it does is it orients our investments toward market disciplines. It gives stronger projects, because we have private parties with skin in the game, and it generates a significant multiplier.

The bottom line is that in fiscal year 2007 we turned over \$2 billion in budget authority into about \$14 billion in program loan level. Our business programs alone turned \$154 million in BA, or budget authority, into about a billion dollars of net investment across rural America. We still provide a limited number of grant

assistance and direct loans through various intermediaries, and they work well in combo loan sorts of projects. And they work very effectively to provide some startup or to buy interest rates down. We also provide, as was discussed a moment ago, a lot of technical assistance and community capacity building capability.

Let me just point out here that in my view with our people in the field, and we have, I think, approximately 5,000 people across the country in the field, what they are is residents of those individual states. Our state directors are appointed by the president. They are also, essentially, empowered to be CEOs in their state. We assume that they know more about what will work and work effectively in those states than we do from Washington within the parameters of the programs that Congress has laid out.

Consequently, all of their staff live, work, eat, go to church, recreate with, raise their kids and their grandkids with the very folks that are bubbling or surfacing these opportunities to the surface. And in my view, this makes a significant difference and has resulted in, quite honestly, our program, our deal flow, if you may, doubling from 2001 at a rate of about \$9 billion to I believe in 2006 nearly \$18 billion. Last year it was around \$14 billion, largely because we had a deal with a continuing resolution that gives you about three-fourths of a year to get the money out the door.

The other thing that we did with our organization, and it was a little bit risky – and I've had a chance over the years, because Richard is a very significant player as an appropriator, so you don't do things willy-nilly without at least making sure that Richard and his colleagues on the House side are aware of it – but we embarked on reorganizing our structure in a way that essentially became more market sensitive. First of all, nobody really knew who we were, and I would submit that in many respects across rural America nobody really knows who any of these federal programs are in the context of a true marketing and branding strategy.

We haven't done it perfectly, but we've embarked on a marketing and branding strategy. We've embarked on a reorganization strategy where we've actually probably going to end up closing about, over a period of seven years, 300 offices, not to restrict how we do business but to cross train to actually develop prod managers, if you may, in each of our shops and to put people in the customer's office in a much more aggressive manner. And consequently, it's begun to bear fruit, and we think this sort of thing is going to continue to lay the basis for an enhanced ability to

deliver these programs.

The final point I want to make is that I think one of the underlying detractors from our ability to engage and enhance the economic development opportunities that we'd like to see in rural America are based on something that started out very magnanimously, but it's tended to become a drag. And that is that for 75 years, literally going back to the original resettlement administration law, the Rural Electrification Act, the original Agricultural Adjustment Act, all of which were very needed at the time and brought a significant number of economic development opportunities to rural America.

But for 75 years, by and large, everything that's happened in rural America has been funded by the federal government. We wired it. We electrified it. I mean, we ran the telephones. We laid the water lines, plumbed the sewer lines. We've tiled the property. We've dug the ponds. We've built the terraces. We, in fact, even subsidized the development of the agribusiness technology giants that have come to bear through our various Title I programs. That was not done with malicious intent, under no circumstance. I'd be the first to admit that, and that's not a criticism. But what that has done is developed a culture of what I suggest is balance sheet lending within the rural lending community, and that rural lending community and balance sheet lending scope, by and large, has limited the ability to leverage these rural assets that I talked about early on.

And let me suggest to you – and I'll give you a couple of examples. Let me back up. Let me suggest to you that if you look at very successful rural communities and rural regions, inevitably, you will find a very dynamic, aggressive banker in those communities, a banker, not a host of other things, but a banker. American State Bank in Sioux Center, Iowa, in the middle of Sioux County, Iowa, Sioux County, Iowa is a non-metropolitan county. It's the only non-metropolitan county in the state of Iowa at the last two censuses that has grown both economically in the context of GDP along with quality of jobs or GDP per FTE, as well as in population. American State Bank is right in the middle of that county. When the existing owner took over that bank in 1980, it had \$30 million worth of deposits. By 1992, the deposits had gone to, I believe, \$135 million. Today the deposits and the footings of that bank are \$413 million.

There are a number of banks around the country that I could take to you that would show exactly the same growth. The fascinating thing was as I was thinking through this, two days ago I was in

Norfolk, Nebraska, giving a speech at the Elkhorn County Development group, and one of the gem who I've known for a long time walked in, and he had given me what he called the nickel tour of Norfolk, Nebraska, and that's a fascinating economic story over there. But what he shared with me is he said, "You know, Norfolk actually really hadn't amounted to much until we got a new banker." And I forget what the guy's name was, "And he didn't know better that the five local families that controlled the community didn't really want to add new jobs, because that would drive their labor costs up. And he went out and reflected on what was going on down the road at Columbus and what Walt Bayland had done. And he embarked on a growth plan," and he said, "All at once, everybody was amazed. The pie does, in fact, grow larger."

I would submit to all of you that one of the easiest ways to facility rural economic development is to focus on how we can best facility getting off of pure balance sheet financing, and I think if we do that, we will be amazed at the kinds of deals that we can see. In addition to that, one of the things that we did in rural development, and I'm going to conclude with this, early on when I got there and started looking at these things and actually responding to questions from Richard and his colleagues was, "What value are your programs bringing us?" And when I looked around at an array of grant and loan programs, we had no way to measure what was going on when we dumped \$100 or \$100,000 or a million dollars in this location.

We went to Brian's college at the University of Missouri at RUPRI after a competitive process, and they have finally concluded and are putting together a project or a tool for us that we call SEBAS. It's called the socioeconomic benefits assessment system. It literally has enabled us to take not only our B&I loan portfolio but also our energy loan guaranteed portfolio, and we can now actually go in and identify significant items in a very effective way that we intend to share not just with our colleagues in rural areas but on the Hill, to show them what works and what doesn't work. And what SEBAS essentially does is it gives us some significant economic and quality of life indicators. It measures growth in FTEs, growth in GDP, and growth in tax revenues, and it does this after it scrubs out all the noise.

The example is if we put \$50,000 in a new grocery store in some community, ultimately creating five new jobs, but it takes one job away from a grocery store 20 miles away, do we add five jobs in that GDP or net it out to four? Our tool nets it out to four. One of

the things that I've recently asked them to do is to give me some indication what does one dollar of budget authority reflect in terms of a multiplier effect as a result of that investment? And the easiest way for them to do it was they showed that in 2005 a dollar invested in direct farm programs ultimately resulted in \$1.40 return. A dollar into our B&I loan portfolio at a static point in time reflecting losses and a number of other things – and there are some caveats here. I mean, this isn't a perfect tool, but it reflected in a \$29.83 multiplier effect.

I would suggest that if we can figure out how to use these basic tools in conjunction with leveraging these existing rural assets, given the fact that we now have a significant new economic driver in rural America, and that's called renewable energy – and I won't spend any more time, but I will tell you, that business is here to stay. There are significant reasons for it. There are great economic growth drivers in existence in rural America, and if we can figure out how to leverage the resources in some fashion along what I've discussed, I think we'll make it.

Thank you very much.

*Brian Dabson:*

Thank you, Tom.

Claiborn, you're on.

*Claiborn Crain:*

Thank you. It's always fun to follow Mr. Dorr, because I get to shoot back at him, but the he will come back and straighten me out afterwards, so I end up losing on the long run either way.

*Thomas Dorr:*

He finally learned.

*Claiborn Crain:*

Yeah, but it doesn't mean I quit. *(Laughter)*

It's always interesting having been around as long as I have, as Mr. Dorr will tell you, I haven't learned a lot, but I have seen a lot. And every administration comes in with new inventions. A number of years ago, I was put on detail as acting state director down in Texas to do a reorganization, downsize them, so it wouldn't be the political appointees fault when he came in and took it over. And we argued about three days, hadn't come to many conclusions. I finally said, "Okay, we've got a half-a-day left. The doors are locked. You've got all the coffee and Cokes you want but no restroom privileges." I said, "This is going to be your entity to work with. I'm not going to be here. What do you want?" They said, "Well, what do you want?" And so I sketched out what I

thought would work considering the numbers and everything that we were going through. They said, "Oh, that's just like the plan we had in 1978." So I, too, didn't invent anything new.

This past Sunday, a preacher at the church I belong to got up in front of the congregation and said, "I've got good news and bad news. The good news is that we've got enough for our building plan that we've been struggling with." He said, "The bad news is it's still in your pockets." I think that's part of what Mr. Dorr was referring to talking about the equity out there. The key is how do you make it attractive enough to get it out?

I don't know that the federal government is a venture capital entity. Venture capital by its nature is taking additional risk for additional reward. It was very interesting listening to the discussion this morning on the exit strategies, because to get the money that you've invested in these companies and projects, you have to exit at some point in time. Either that or you become a long-time partner with it and end up running it yourself.

Rural development is much in the same way. Rural develop, as Mr. Dorr has referred to, is a toolbox of programs that can be used in differing way. One will fit one place. One will fit another, but they go in partnership. The other thing that I agree with Mr. Dorr on is local leadership is vital. It may be a banker. It may be a school superintendent. It may be a retired person that has time to mess with the issues of getting a new water system in or attracting a new business or finding investors to save a business that's fixing to go under. But if you don't have that local leadership, it won't happen.

Mark Draven Scott, some time ago, talked to a group in Austin, Texas, a group of entrepreneurs down there, talking about you can't do it one county at a time anymore. And I'm sure he's correct, but you need to have that local leadership, and you need the buy-in in that local community, or it's not going to work.

The principle reason that I'm here is to talk a little bit about the Farm Bill. As I told another group that the three of us served on a panel on, the House bill has passed. It is not a perfect bill. There's things – I bring greeting from both Chairman Peterson and Ranking member Bob Goodlatte from Virginia and rural development subcommittee chairman Mike McIntyre from North Carolina. There were things that they wanted in that bill. We've got a tougher budget this year than we've had in many years, as far as the Farm Bill is concerned, and this is my seventh farm bill and

I hope my last one.

But you need to look at it, and you need to be in contact with Mr. Bender and the members of the Senate on what you want changed. I heard of couple of references this morning to the small business investment initiative left out and don't have the mandatory money. We don't have any mandatory money in the House bill, because it's not available. But let me tell you something. We learned in 2002 that if you don't have the appropriators bought off on something, and you put mandatory money in, they can find a way to block you from spending that money anyway.

One of the pieces I read, and it may have been Mr. Erickson's forward, they talked about patient capital, and I think that's what you need for venture capital in rural America. It's probably not going to be quick, but I think the potential for growth is phenomenal. In our export markets in agriculture we talk about investing – I mean we want to fight Europeans for their market share over there. We want part of the Japanese market. The fact is there's more growth potential in developing countries, in China, in India, than there is anywhere else. We win one year with Europeans. We lose the next year. The long-term growth is where there's market development that can occur that has some breadth. That's rural America.

Sun Diamond out in California called on the Soviet Union for over 11 years to sell them almonds. Last year when they finally made a sale it was for over \$10 million, and their members, I know, were giving their board all kinds of fits because that investment they were making going over there calling on that country wasn't paying off. But it finally did. We've got some of the good energy programs, the 9006, 9008, that we talked about that were in the 2002 Farm Bill reauthorized. We have a new micromanager, microenterprise program in the House Bill. We've reauthorized the Broadband Bill. First responders, the value-added program, is another good example.

Let me go give you a little bit of history. Some of you may have been familiar with AARC. I can't remember – it's applied agricultural research –

*Male:* Commercialization.

*Claiborn Crain:* – of products. Really struggled. Had some management problems. Had board problems. Tried to be designed like a venture capital firm. It really wasn't, but the good news is that 25 percent of

investments they made are still paying off today. They saw all kinds of interesting projects.

We also need patient bean counters with OMB and our own budget people at USDA and with Congress, because you have to give these things time to work. Another thing that was mentioned this morning is you have to have the ability to fail. You've got to try some of these things and see if they work. That comes from letting your members of Congress, members of the House, members of the Senate know what's important to you. The fact is this year we saw less push for rural development within the Congress than we've seen in previous years. Now, that wasn't true of Secretary Johan's hearings that he did. He heard a lot about rural development out there, but that message didn't come through to the people who are beating on the doors of members of Congress.

Writing these laws at the federal level to be applied at the local level is extremely difficult. We're always dealing with the square peg and round hole syndrome. I've got two projects that I've got calls about right now, one in Lubbock, Texas, where a farmer-owned cooperative processes oil seed, wants to put up ten wind generators. It would be a perfect fit for rural development, except they want to put them up within the city limits of Lubbock because that's where their mill is. Their members are spread all over the south plains. It won't fit, even though it's an excellent idea. It's going to happen and probably without the federal government. Probably CoBank is going to handle a major part of it. They will handle the majority of it now, but that ought to be the type of thing that we could participate in, because that's helping rural citizens. But Lubbock's over 200,000 people.

I got a call this Wednesday from a member of the North Carolina delegation that they got a chicken processor plant down there, that because of the drought has been having to haul 200,000 gallons of water a day to put in the town reservoir so they could get the water to run the plant. The plant employs 1,500 people. That's big in that little community. He wanted to know what we could do to stop the city from cutting them off from water on this Monday. I said, "Well, one, you need to call a little earlier." But I bucked it to John Cooper down there in North Carolina, because if anybody can figure out a way to help it out, John can.

But those are the types of issues that we deal with. You can't foresee these things. I see all kinds of good projects that come in. You have more flexibility with the types of organizations we've been talking about this morning, but as Mr. Dorr said, rural

development plays a significant part in that and can put a lot of money out there. But you have to find the tools. The leadership at the local level – the leadership that we've got in this room is impressive. The Federal Reserve should be commended and the Bank of San Francisco for putting on this meeting. Your funds that you're out there finding money for, finding projects that work, and helping make them work are vital to all this. But you always need to keep in perspective what you're doing and that you're at the right place at the right time.

One more preacher story and then I'll be quiet. A young preacher new in the rural community, didn't know his way around, got a call. A man had died. Didn't have any friends or family. They wanted him to do the service. He couldn't find the location, drove all over, got there an hour late. The hearse was gone. The lid had already been put on the vault. The workers had stopped to have lunch, but he thought he had a moral duty to send this man off. And he gave a stem-winding sermon. Pretty pleased with himself going back to the car until he heard one of the workers say, "In 20 years of putting in septic tanks, I've never seen anything like that."  
*(Laughter)*

Make sure we're helping. But we need you to communicate with people like me, people like Richard, and more importantly our bosses as to what's needed, what works, and what doesn't work. Thank you.

*Brian Dabson:* Richard, follow that.

*Richard Bender:* I'll try to be reasonably brief. I expect the Senate Farm Bill will have the markup to the Agricultural Committee on the 21st or the 22nd of this month. The last farm bill, we had \$73.5 billion above what we had in our, what's called, baseline, what it takes to continue to flow the existing programs. This time, depending upon how you count, we will have maybe \$3- to \$8 billion extra dollars, and the reality is the farm bill after this one is going to be a real tragedy, because people of my age are going to be a little older, and we're going to start going on Medicare. And the ability to even do baseline in the bill after this one is going to be very tough. So the ability of the federal government to be helpful is going to have to have more and more creativity, because dollars are going to become more and more limited, and that is a reality.

On venture capital, I just would like to say my boss has fought for venture capital for a long time. Ark, which Claiborn mentioned, was my boss's proposal. I think he put it in the 1990 farm bill. I've

only done six, not seven like Claiborn, and I think pretty well have come to the conclusion that we're not going to have any federal government employees making their decisions on where to put venture capital money specifically. We did the rural business investment program last time. We had \$240 million in debentures automatically flow into that program. Effectively it got wiped out with excessive fees and other things that I saw no reason for but passed history.

Last time the rural business investment program, RBIC, had, through a miracle, all the banking organizations and the farm credit system actively supporting it. That's a violation of natural law, but it happened. This time, those two wonderful alliances have one thing that they're focused on, and that is a proposal by the farm credit system to expand its jurisdiction, one being for it, and one being against it. And there's no oxygen for any other activity by either of those two coalitions. And frankly, we have had it in our proposal, but I frankly haven't heard anyone, other than my boss, indicate a favorable orientation to it on the committee. So it's going to be very tough.

We have a new idea. It's actually not a new idea. Last farm bill, we had to think the entire raw strategic program, which was funded. We have modified it. It was funded in the bill, but its funds were ripped off. We're going to try that again. It's called the rural collaborative initiative program, and basically what it is is that it's like – everyone here knows what enterprise \_\_\_\_\_ in \_\_\_\_\_?

Okay, what we'd say is, "We're going to do the enterprise type model, except we're not going to try to figure out who are the porous folks around who can get a decent proposal together?" We're simply going to say, "In rural areas, self identified geographies get the local government officials, business leaders, nonprofits, like community colleges and stuff, get together. Figure out, okay, you develop ideas. We're going to try to help you with some funding, but we're going to try to pick out those of you that have figured out the best way to get capital, venture capital and other kinds of capital. And those with the best ideas that looks like you really have it together, how you're going to create an ability to get capital into your area and have a decent way you're going to use that capital to generate quality jobs, we're going to give you a chunk of money."

And frankly, part of the reason for the program is to get people to come together from not just one particular town but a group of

communities and figure out what is it that they need, not that they see this notice from their local councils of government. There might be some money for a sewer or this or that. Maybe we should apply for that, but what is it to create a real strategic plan for them, and the best folks, we'll give them a chunk of money to help them do it, hopefully in some cases without the federal money because they developed the plans, they will have some ideas to drive venture capital towards them.

One of the components of that is to really shove on the idea of community and foundations. As Secretary Dorr mentioned, there's a lot of money in rural America, a lot of it. And frankly, a lot of those folks who love their local communities, and they might be convinced if somebody really displayed some reasons why it was logical to put money into a community foundation that could be a source of dough, because – sometimes a very substantial source of dough, because I wouldn't bet there's going to be a huge amount of money in the federal government to spend on much economic develop 10 or 15 years from now. And we have got to take the money that the federal government is now using the maximize the ability of local communities to do the most they possibly can on their own to build structure that will allow them to really function and improve their ways of getting capital, venture capital and regular capital, because it's going to be very tough 10 or 20 years from now. It really is.

We've got a big problem, and the two political parties will have all different kinds of ideas about solve it this way and that, but it's going to be a very difficult problem. We ought to start recognizing that we need to build structure, and one of the things we really think might be helpful is a rural collaborative initiative program like I've described. My boss also would very much like to do venture capital along the lines of the rural business investment company model, business I will say, when you have \$3- to \$8 billion, as opposed to \$73 billion, things are going to get tougher, and the reality of that is going to be shown pretty much on October 21 or 22. So if any of you have any views on any of this, I suggest you see members of the committee well prior to that date, because that's the time when we really see where we're at.

And I will say that there's a very strong orientation in this town to give the money where the money has historically gone, which is into the commodity programs, which I think Secretary Dorr could easily tell you is not the most effective way to generate economic growth. I mean, we love farmers on the ag committee. But giving them cash payments may not be the most effective way to have

economic development compared to some other ideas.

Obviously, we need to do broadband. We want to do broadband, which an essential utility without which businesses just aren't going to be there. We'd like to put money into hospitals, improvements in hospitals, daycare, all those kinds of things. I don't think there's very much time to talk about each of those. I hope to leave a few minutes so maybe we can get to hear from you folks about some of your thoughts, your hopes, and maybe some mild criticism perhaps.

*Claiborn Crain:* Very mild.

*Richard Bender:* Thank you.

*Brian Dabson:* According to the clock we just have five, but is it possible to have a little longer?

*Male:* Yeah, let's see how the first –

*Brian Dabson:* Let's see how it goes. Let me just throw it open now. I have some thoughts in response, but I think it's more important that we get some questions and comments from the gathered here. Rich in particular is very keen to –

*[End of Part4SideA, Beginning of Part4SideB]*

*Brian Dabson:* – views as we move into this final stages of the Farm Bill. So who would like to step up, please?

*Kerwin Tesdell:* I'll start off. Kerwin Tesdell from the Community Development Venture Capital Alliance. First off, I just thank you all for coming and also wish you could have some of the stories – I know some of you were here in the morning; some of you didn't quite make it – the stories of the rural business investment program and new markets venture capital funds that are really doing a terrific job and particularly the important role that the operational assistance money plays and really the vital role of that program in bringing venture capital into rural areas.

I just had one very specific question. We heard this morning, I think particularly for the folks on the Hill, we heard from some of the bankers and bank regulators about this issue of the public investment issue of allowing banks to do a larger portion of their investment in areas that aren't strictly – you know, don't meet all the strict low-income guidelines but give them enough flexibility

to do venture capital and other kinds of activities under this public investment test. I'm not sure whether either of you are familiar with that.

*Richard Bender:* Yeah, let me just say the RBIC program basically provides that regulated financial institutions could put up to five percent of their money. That's what we say. Whether the bank regulators have a similar view is another question and would be, my perception is there is a willingness, I understand, that way. We can touch that in the Farm Bill because of our jurisdictional boundary line. But the banks have been concerned about what the regulators would say about it. I think my perception is there would be some flexibility there, and I would certainly work to try to have that happen.

*Kerwin Tesdell:* Yeah, maybe it's something we can follow up with afterwards on that point.

*Male:* I've got a question. Some of those subsidy programs in the Farm Bill keep prices supported, and now that those prices are beginning to rise on their own based on the high demand, there should be some saving generated. Is there a possibility that that could be redirected?

*Richard Bender:* Yeah. Actually, the mechanical problem is the way our – when I said baseline, what happens as the prices rose, the assumption on how much paths, other than the automatic path because you've got an acre in a certain category, would call the direct payments. The other kinds of payments, as the prices rose, that amount dropped, and CBO calculates how much money we can spend over the next five and ten-year periods on the basis of what prior law says the sums will be that will be paid out. Because under the prior law the sums are dropping, we have less money.

We will spend about \$18 billion less on commodity payments over the last five years than the original baseline assumption. Because prices are rising, it's \$18 billion lower. Our base amount of money has dropped by that \$18 billion. So we don't have it. It's already been reshuffled elsewhere, which we are very sorry about.

*Claiborn Crain:* Let me add one thing to that. In the '96 Farm Bill, at the time it was passed, commodity prices were in good shape, not as good as they are right now but in good shape. That Farm Bill was set up to where the payment supports would go down on a gradual basis. Unfortunately, the prices went down on a gradual basis, so by the time we got to the 2002 Farm Bill, farmers were in a very bad mood about the quality of the farm bill.

The fact is I've seen two very interesting stories in the past week, both from people that I think should know better. A very well respected grain analyst in Chicago said, "The day of cheap grain prices is over." You put a price on grain or any commodity; you're going to see a ton of it produced. Earl Butts, who was as smart and able an ag secretary as we've ever had, told us the same thing in 1974, and it's been up and down since then.

Another man that knew better said, "The ethanol boom is over, because it was \$4.00 in the spring." It's down to what, Mr. Dorr, about \$1.70?

*Thomas Dorr:* \$1.50.

*Claiborn Crain:* \$1.50 now. It's going to go up and down. There's going to be a leveling out. We've got to figure out better ways to get it to market. All these things are cyclical, and don't take the snapshot of what's going on today as compared to yesterday as that that's the way it's going to be from now on, because it's not.

*Richard Bender:* Yeah, I would just add one thing. My boss has suggested that we take a portion of these automatic payments and shift them to things like rural development, energy, and conservation. There's not a lot of spirit along those lines in the committee.

*Thomas Dorr:* If I could, I'd take a crack at that. I tend to agree in a general sense about the cyclical nature of these things with Claiborn, but I do think it's important – and I have not figured out how to populate this graph – but I do think there are some fundamental policy changes taking place that we need to identify, and bear with me if you can. But if you just look at typical bar graph and assume that this point down here is essentially the end of World War II and reflect on what occurred then when the policies were made that we would produce increasing quantities of food, fiber, and meat and protein, dairy products because we could, as opposed to what occurred after World War I, and we had a demand curve that went pretty aggressively up like this on the food, fiber, and feed curve until about the mid-1960s.

And it began to flatten out, and the increase in incline was substantively less than it was in the first 15 to 20 years out of World War II. That drove a policy, and if you looked at it in a context of an S-curve, which was kind of a technology curve, you would see the technology curve came up. It lagged. That early aggressive growth in demand period between the technology curve

and the growth was obviously profit, but by the mid'60s, the technology curve ascended above the demand curve. That became farm program payments in a fairly significant way.

The big difference today with securing a new energy base, a new energy security, is that liquid fuel and power demand is linear, and that part of the policy we have not effectively thought through and begun to plug in this debate. That policy will not be built on dry milled, corn-based ethanol consumption forever. But dry milled, corn-based derived ethanol, technology is what has allowed us to aggregate enough of a quantity to begin to build and develop an industry. It will migrate to cellulosic. It will migrate to other forms of renewable energy, including wind, landfill, gas recovery, anaerobic digestion, geothermal, and whatever the case might be.

But all of these renewable energy opportunities are largely rural in origin, and that demand curve is substantively different than the demand curve that we built our farm policies on going back to the mid-1930s. And if we don't remember that and factor that in as we think through policy, we're going to give ourself a bit of short shrift. Let me frame it in this quip, because it's not an energy issue in my view, so much as it is to understand the scope of this opportunity and what it does to, for lack of a better term, almost gentrification of all of rural areas if you want, particularly in the area of broadband and access to this kind of technology.

And what this amounts to is in '06, we imported \$313 billion worth of crude or crude oil equivalents. It's the first time we've ever exceeded gross domestic agricultural production, which is about \$250 billion. If you displace one billion barrels of imported crude oil or crude oil equivalent, that is the same as the rolling average of net farm income. And for the most part, that is all rural in origin. It's all possible because of distributed computing, and the real issue is are you going to figure out quickly how to adapt and accommodate the investment opportunities and aggregate as much of that in rural areas? Or are you not going to mitigate the transaction cost to investment, the burdens, the securities, the antiquated securities laws transaction, the transaction clause, and ultimately relegate that to someone from outside the community who will come in and invest in it, because they can bring quicker transaction activities to it and capture the value? That's the real core of this issue in my view.

*Male:*

Can we have a microphone on this side of the room?

- Female:* That was interesting. You talk about the Farm Bill inclusive of a microenterprise system, and I also heard that it wasn't mandated funding. Is that correct? It's not mandated funding?
- Richard Bender:* It's not mandatory money in the House bill. I expect we will see mandatory money in the Senate bill for microenterprise.
- Female:* Okay, my question is have you had any thought or is there anything in the bill language that talks about the structure from that program?
- Richard Bender:* Oh, yes, quite a bit.
- Female:* Can you talk about that a little bit?
- Richard Bender:* It's complicated, but it's relatively close to the – what you do is you form intermediary entities. USDA gives money to an intermediary entity. The intermediary entity then provides technical assistance and, in some cases, the loan to the microentrepreneur, in some cases the loan hopefully will follow the Iowa model or the ISED model where they actually go to a banker with their plan, and the banker would provide or not provide the loan, which I think is a better model. Because if you actually have to go to a banker who's not doing it because they're going to make money on a \$30,000 loan but is doing it because it's the right thing to do but examines it on true banking criteria, if they can get the loan through that banker on that ground, they've got a solid foundation. But most of the money will be for technical assistance. But that's basically the model. It's relatively similar to the SBA model.
- Male:* I was involved with the startup of the RBIC program while working at the new markets program in the SBA, and I would urge you or urge everyone here to try to understand why that program took so long to get off the ground that it was ultimately then cut away. The money was taken away. And you have to understand the silo principle, not only in farming, but in bureaucracies, also. The program was significantly delayed, and I mean by more than 12 months, by the inability of the USDA and the SBA to reconcile their policies, their procedures, and their operations. It was also complicated by the fact of a relatively poor information system within the SBA that was not adaptable to a new program such as RBIC.
- Therefore, if you're going to assign responsibility to SBA to share with the agricultural department, you've got to make sure that there's not only the political disposition to make the program work

but in fact the capability of administering the program. And if all else fails, put it all in the USDA and have them do it. They have the systems. They have the capacity. Splitting the responsibility between two agencies is always difficult, and in the case of the RBIC program, it ensured their failure.

*Richard Bender:* Well, I would just say that it's my perception that SBA worked to purposely kill the program. It wasn't that there were bureaucratic inefficiencies. There were purposeful inefficiencies. Now, Tom may have a different view. But the Senate draft basically does leave it all within USDA. The question is will we have money to make that possible?

*Thomas Dorr:* I would just comment that we've had some discussions on this, and I think your observations are correct. And I think what Richard is proposing makes sense, and I would tend to agree with you.

*Brian Dabson:* Any more final questions?

Just a couple of takeaways for me which I just want to share before we close is one thing is that – and these are sort of contextual in many ways – is that when you listen to the speakers, there's an enormous amount of positivity about the future of rural America, both in terms of the economic opportunities and in the untapped wealth that there is there. That's a really good starting point. We're not starting from deficit.

The second is that the stark reality is that there isn't a great deal of federal money out there, and it's going to get less over time, so that we need to be thinking quite seriously about different ways in which the federal money can be used more creatively and can be better leveraged. It seems as though, particularly from a venture capital point of view, it will be possible for some fine-tuning to take place around some of the issues that were raised both in Julia's presentations and earlier, but really, the challenge that I hear is there is quite a lot of resource to be found already in the federal government, the description of the programs which Tom Dorr talked about, what's available within the CDFI Fund. We've got to figure out better how we actually use and apply those resources so that we can move forward with the venture capital industry in rural America. So it's a question of, "Well, this is what we've got. How can we make better use of it?"

So with that, I think my colleague from across the water, Malcolm will take us forward into the next thing after a break of how long?

*Male:* Can we make it ten minutes? And grab a cookie. Get some coffee, everybody. We'll push through the rest of the day here.

*Brian Dabson:* Okay, well, would you join me in thanking our terrific panel?