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**STATEMENT OF
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U.S. ENVIRONMENTAL PROTECTION AGENCY
BEFORE THE
COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS
UNITED STATES SENATE**

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INTRODUCTION

Good morning, Mr. Chairman and Members of the Committee. I am Ben Grumbles, Deputy Assistant Administrator for Water at the U.S. Environmental Protection Agency (EPA). First, let me convey Tracy Mehan's regrets for being unable to be here today to speak with this Committee. Second, I appreciate this opportunity to provide the Administration's views on S. 1961, the "Water Investment Act of 2002," and being able to discuss how to ensure that the Nation's drinking water and wastewater facilities can meet the challenge of protecting our public health and water quality in the 21st century.

Through a strong and evolving local, State, federal and private partnership, the United States has made great progress over the past three decades in reducing water pollution and assuring the safety of drinking water. The Clean Water Act (CWA) and the Safe Drinking Water Act (SDWA) have served us well and provide the solid foundation we need to make sure that all Americans will continue to enjoy safe drinking water and clean rivers, lakes, and coastal waters. In particular, our cooperative investment in water and wastewater treatment, and pollution prevention has paid dramatic dividends for water quality and public health.

The economic and social benefits of improved water quality are readily evident from urban waterfronts to recreational water bodies to wild rivers all across America. We have also made dramatic progress in improving the safety of our Nation's drinking water. Today, more than 90 percent of the population served by community water systems receives water from systems with no reported violations of health-based standards in place as of 1994.

CLEAN WATER AND DRINKING WATER STATE REVOLVING LOAN FUNDS

The financial demands that communities face in providing clean and safe water to all Americans are substantial, and the Administration is committed to helping find ways to meet those demands. The federal government has provided over \$80 billion in wastewater assistance since passage of the Clean Water Act, which has dramatically increased the number of Americans enjoying better water quality. The primary mechanism that EPA uses to help local communities finance water infrastructure projects is the State Revolving Fund (SRF), established in the 1987 CWA amendments and the 1996 SDWA amendments. The SRFs were designed to provide a national financial resource for clean and safe water that would be managed by States and provide a funding resource "in perpetuity." These important goals are being achieved. Other federal, State, and private sector funding sources are also available for community water infrastructure investments.

Under the SRF programs, EPA makes grants to States to capitalize their SRFs. States provide a 20% match to the federal capitalization payment. Local governments get loans for up to 100% of the project costs at below market-interest rates. After completion of the project, the community repays the loan, and these loan repayments are used to make new

loans on a perpetual basis. Because of the revolving nature of the funds, funds invested in the SRFs provide about four times the purchasing power over twenty years compared to what would occur if the funds were distributed as grants.

In addition, low interest SRF loans provide local communities with dramatic savings compared to loans with higher, market interest rates. An SRF loan at the interest rate of 2.4% (the average rate during the year 2001) saves communities 23% compared to using commercial financing at an average of 5.3%.

To date, the federal government has provided more than \$19.7 billion in capitalization funding to States for their Clean Water SRFs, more than twice the authorized level for the program. With the addition of the State match, bond proceeds, and loan repayments, States have \$37.7 billion in assets in their clean water SRFs. Since 1988, States have made nearly 11,000 individual loans for a total of about \$34.3 billion, with another \$3.4 billion either unallocated or being readied for loans as of June 2001. In FY 2001, the Clean Water SRF issued a record total of 1,370 individual loans with a value of \$3.8 billion. The Clean Water SRFs have provided between \$3-4 billion in loans each year for several years, and are widely considered a tremendous success story. For FY 2003, the President's Budget proposes funding the Clean Water SRF at \$1.212 billion.

The Drinking Water SRF was modeled after the Clean Water SRF, but States were given broader authority to use Drinking Water SRFs to help disadvantaged communities and support drinking water program implementation. Through fiscal year 2002, Congress has appropriated \$5.3 billion for the Drinking Water SRF program. Through June 30, 2001, States had received \$3.6 billion in capitalization grants, which when combined with State

match, bond proceeds and other funds, provided \$5.2 billion in total cumulative funds available for loans. Through June 30, 2001, States had made close to 1,800 loans totaling over \$3.8 billion, with another \$1.4 billion either unallocated or being readied for loans. Approximately 75% of the agreements (41% of dollars) were provided to small water systems that frequently have a more difficult time obtaining affordable financing. By the end of FY 2003, we expect the number of loans issued by State Drinking Water SRFs to reach 2,400, with about 850 SRF funded projects having initiated operations by that date. The FY 2003 President's Budget proposes to fund the Drinking Water SRF at \$850 million. The Administration will continue to fulfill prior EPA commitments to capitalize the Clean Water SRF to revolve at a \$2 billion average annual level and the Drinking Water SRF at a \$500 million average annual level.

THE CHALLENGE AHEAD

With the important investments made by and achievements of all levels of government and the private sector, together we have substantially improved quality of the water in every State -- even while our population sharply increased and the output of our economy more than doubled.

But the task America's intergovernmental, public-private partnership has undertaken -- to protect public health and the environment by maintaining and improving water quality -- is a continuing one. As our economy and population grow, partnership members must increase their efforts to provide clean and safe water every day. We must also periodically take a good

look at the challenges ahead, and reassess the adequacy of the tools we have to meet those emerging challenges.

EPA's most recent Drinking Water and Clean Water Needs Surveys have identified \$150.9 billion and \$150.5 billion, respectively (both in 1999 dollars), in documented needs eligible for SRF assistance in the coming decades. More recent estimates associated with correcting sanitary sewer overflows may increase the estimated total Clean Water needs, and the Agency expects to release a new Clean Water Needs Survey in August 2002.

Over the past year or so, several stakeholder groups have issued reports estimating water infrastructure needs that are substantially higher, based on different methodologies and definitions.

With that in mind, the Agency is actively working to improve information about long-term infrastructure needs, assess different analytical approaches to estimating those needs, and estimate the gap between needs and spending. Last summer, EPA presented its analysis -- known as the Gap Analysis -- to a diverse panel of industry experts. Overall, the reviewers commended the report as a reasonable effort to quantify the gap. We have made revisions to the analysis based on peer review input and we expect to release the Gap Analysis shortly.

In considering these studies and analyses, it is important to keep in mind a few points of context. First, there is no single "correct" number to describe the gap. Any gap study must be built using methodologies and definitions of need, which in turn rest on assumptions about present conditions nationwide, and desirable or appropriate policies to follow in the future. That raises the second point that while these gap numbers may be helpful to provide a broad

sense of the challenge ahead, they cannot themselves be a clear guide to policy, because they do not take into consideration how the various roles of federal, State and local governments should be balanced. Third, under any study, funding gaps are not inevitable. They occur only if capital and operations and maintenance (O&M) spending remains unchanged from present levels over the time covered by the study. What a proper analysis may suggest is that a funding gap will result if the challenge posed by an aging infrastructure network -- a significant portion of which is beginning to reach the end of its useful life -- is ignored.

I believe most partnership members would agree that the nation, through our partnership, needs to put more resources into water and wastewater infrastructure in the future than we have been doing; and, that we need to reduce costs by ensuring more efficient and productive use of such resources, through locally-tailored, fiscally sustainable management and technical approaches. We need a strategy that addresses both the fiscal demand side (how to define and manage infrastructure needs) and the fiscal supply side (how to pay for those managed needs).

While much of the projected gap is the product of deferred maintenance, inadequate capital replacement, and a generally aging infrastructure, it is in part a consequence of future trends we can anticipate today. For instance, continuing population growth means that even increasing capacity at current levels of wastewater treatment will not be enough to prevent water quality degradation, and that development pressures on unprotected drinking water sources will increase. The same tools we need to make the fiscal demand side of the gap more manageable -- like reducing the flow of wastewater and stormwater requiring treatment

through conservation and nonstructural alternatives, and protecting our drinking water sources -- will help us to deal with the water quality impacts of a growing population.

To meet these future challenges to clean and safe water the Administration believes that the touchstone of our strategy should be building fiscal sustainability. In particular, several basic principles should guide our pursuit of clean and safe water through fiscal sustainability:

- < Utilizing the private sector and existing programs: Fostering greater private sector involvement and encouraging integrated use of all local, State, and federal sources for infrastructure financing.
- < Promoting sustainable systems: Ensuring the technical, financial, and managerial capacity of water and wastewater systems, and creating incentives for service providers to avoid future gaps by adopting best management practices to improve efficiency and economies of scale, and reducing the average cost of service for providers.
- < Encouraging cost-based and affordable rates: Encouraging rate structures that cover costs and more fully reflect the cost of service, while fostering affordable water and wastewater service for low-income families.
- < Promoting technology innovation: Creating incentives to support research, development, and the use of innovative technologies for improved services at lower life-cycle costs.
- < Promoting smart water use: Encouraging States and service providers to adopt holistic strategies to manage water on a sustainable basis, including a greater emphasis on options for reuse and conservation, efficient nonstructural approaches, and coordination with state, regional, and local planning.
- < Promoting watershed-based decision-making: Encouraging States and local communities to look at water quality problems and drinking water source water protection on a watershed scale and to direct funding to the highest priority projects needed to protect public health and the environment.

This is an important and serious challenge. We would not be in this room today if we did not recognize that. That's good news in itself; and there's more, as we can see the tools, the means to realize these principles in practice, taking shape all across the country. Many

States and local governments across the country have been changing the way they do business. As a result, they've successfully managed many of these infrastructure needs, using creative, individualized approaches that are cost-effective, environmentally protective, and socially equitable -- efficient, clean, and fair.

The two SRFs have proven themselves to be effective means to help local governments address their needs. Now the task is to refine them to facilitate and encourage the use of these State and local innovations in every community in America. Indeed, your bill itself reflects the learning about SRFs that went on between 1987 and 1996, by adopting for the Clean Water SRF some of the innovations adopted in the Drinking Water SRF. It is important that communities have and use all the necessary tools to close the gap before it widens, so the tools can work together consistently and effectively in a fiscally sustainable way.

S. 1961, THE WATER INVESTMENT ACT of 2002

I would like now to turn to S. 1961, the bill introduced by the Environment and Public Works Committee leadership.

The Administration shares the Committee's goal of improving the Nation's water quality and has submitted a budget that will continue progress towards achieving that goal by targeting non-point source pollution, the largest remaining problem. However, the President clearly defined his priorities in the State of the Union as defense and homeland security. As the increased spending called for in this bill is not consistent with those priorities, the Administration does not support the funding levels contained in S. 1961. The Administration

and Congress should look for creative ways to help the water and wastewater industries meet their needs.

At this initial stage of the Committee's consideration of this bill, I will give the Administration's response to some of the bill's key approaches and major components. We would also like to take this opportunity to state the Administration's support for privatization incentives. On these, as well as other provisions that this testimony does not specifically address, we look forward to working with you and stakeholders during the Committee's deliberations in the weeks ahead.

Project Eligibilities: On the Clean Water side, the bill addresses project eligibilities, and clarifies that a broad range of projects that would improve water quality under Clean Water Act programs can be supported using the SRF. We believe that the provision authorizing assistance for projects or activities for conservation, reuse or recycling must be limited to those that have primarily a water quality benefit, or substantial SRF resources could be diverted to projects or activities whose primary objective and benefit does not further Clean Water Act goals.

Capacity Development/Priority List Funding: The bill closely adapts for the Clean Water Act two important provisions from the 1996 Safe Drinking Water Act Amendments, on capacity development and SRF priority list funding, and adds asset management requirements in both Acts.

We believe that this demonstrates once again the effectiveness and durability of the approaches Congress adopted in 1996, and welcome the Committee's use of the SDWA model here. In order for water and wastewater systems to achieve fiscal sustainability, these systems need to: have long-term technical, financial, and managerial capacity; optimize the efficient operation and useful life of their capital assets; and, direct funding to the highest priority projects needed to protect public health and the environment.

In these regards, S. 1961 moves in a generally positive and useful direction. As with any new approach, there are some questions about how aspects of these capacity development and asset management provisions would work in practice. Here again, we want to work with you and stakeholders to share and learn from our experiences with SDWA, and make sure that help in achieving these objectives can reach those who will need it, especially in smaller communities.

Disadvantaged Assistance: Regarding disadvantaged assistance, the bill makes two major modifications. First, it adds to the Clean Water SRF the disadvantaged community provisions enacted for Drinking Water in 1996, enabling States to provide additional loan subsidization, including forgiveness of principal, to such communities as defined by the States. It also includes in the Clean Water SRF the extended loan terms available to disadvantaged communities under the Drinking Water SRF.

Second, it adds to the laws governing both SRFs a new provision, authorizing States to provide this additional subsidization to treatment works or public water systems which are not disadvantaged, so long as the assistance agreement with the recipient ensures that the

subsidy will be directed to disadvantaged users within the community. We want to work with you to ensure that States or communities can use programs which are as effective as user rate systems in directing these additional subsidies to needy users. The bill's provisions for aid to disadvantaged users specify that up to 15 percent of capitalization grants can be used for additional subsidies. It is not clear whether this 15 percent is within the 30 percent limit for disadvantaged communities or on top of it, as the bill's provisions are worded differently for the two SRFs. We oppose making the 15 percent additional to the 30 percent limit in both SRFs. Placing the 15 percent within the 30 percent would protect the availability of additional subsidies for disadvantaged communities while giving the States flexibility to provide such help to disadvantaged users as well.

The revolving loan funds will always face the challenge of striking a balance between important values -- of offering additional support for low-income residents, small communities, and state programs on the one hand, and preserving the corpus of the fund so it can assist communities far into the future on the other. If new assistance to disadvantaged users is added on top of the 30 percent, it would allow about half of the capitalization grant to be removed before it ever enters the States' revolving funds. This would undercut the funds' capacity to serve as a viable resource for communities in perpetuity, and would disrupt a vital balance that the Administration believes we must maintain. We would like to collaborate with the Committee to achieve disadvantaged assistance provisions that strike this important balance.

Loan Conditions: For both the Clean Water and Drinking Water SRFs, the bill creates new provisions requiring several things of loan applicants as a condition of project approval. Taken together, these loan conditions are among the key provisions in the bill, and the Administration supports the objectives behind them as according with basic principles that should guide our infrastructure revitalization efforts. At the same time, we want to make sure that the conditions operate in ways that loan applicants can learn to handle, and that the SRFs can continue to function to provide the needed kinds of assistance.

One condition is a requirement that prospective loan recipients consult and coordinate with local, regional, or state agencies that may adopt land use, transportation, or watershed plans. S. 1961 also requires loan recipients: to develop and implement asset management plans; to have plans to achieve rate structures that reflect, as far as possible, the cost of service and include capital replacement costs; and to consider, throughout preconstruction phases, consolidation, partnerships, or alternative, nonstructural approaches.

We agree that local governments should undertake, and States must supervise, management and planning changes to ensure fiscally-sustainable solutions. All of the studies indicate that the potential gap in water and wastewater infrastructure comes largely from replacement of aging pipes and O&M costs -- both, historically, a responsibility primarily of local government (although pipe replacement is eligible under both SRFs). Through its loan conditions, S. 1961 encourages States and communities to look at water quality problems and drinking water source water protection on a watershed scale, and to adopt comprehensive strategies that integrate water management into whatever planning for sustainable communities they may be doing. And, it creates incentives for service providers

to adopt best management practices to improve efficiency and economies of scale, reduce the cost of service, and avoid future gaps, while encouraging rate structures that cover costs.

These new conditions on assistance to communities are among the most important innovations in this legislation. Promoting a comprehensive examination of all cost-effective tools and options, on both the fiscal demand and supply sides, is key to building fiscal sustainability. The Administration believes that the potential gaps will become more manageable if these conditions can be designed and implemented effectively.

Having said that, we must all recognize that these new conditions are going to increase substantially the level of effort required to obtain an SRF loan. We must make sure that these conditions are framed in a workable way; that we provide a transition to the new conditions that equips applicants to address them in a timely way; that those who need special help in meeting the conditions can get it; and that small loans can continue to be provided without a level of analysis that's disproportionate to the investment sought. Here as elsewhere, we look forward to working with the Committee to pursue these shared objectives in a practical manner.

SRF Fund Transfer Authority: In addition, the bill would make permanent the States' authority to transfer funds between the Clean Water and Drinking Water SRFs. This is an important enhancement of State flexibility to address their highest priority needs, and we welcome the Committee's proposal to turn what began in 1996 as a short-term experiment into a well-established tool to promote cost-effective investment.

Promoting technology innovation: This strategy to renew our water and wastewater infrastructure for the 21st century puts a high premium on optimizing the efficient use of our current capital assets and the new investments we must make. That will require the use of innovative technologies for improved services at lower life-cycle costs, which in turn means supporting research and development on these innovative technologies and practices.

Substantial reductions in life cycle costs are possible through the use of innovations such as: (1) new construction and repair practices; (2) remote monitoring and real-time control of water and wastewater systems; and (3) advanced sensors for contaminants and structural integrity. Research and development, in coordination with demonstration efforts, is needed to assure that these and other advancements are available to community decision-makers. We want to work with the Committee on ways to promote this objective.

Legal Issues: EPA has legal concerns regarding two provisions of S. 1961. On judicial review, the provisions amending both Acts are written so broadly they could prevent judicial enforcement of virtually all provisions of the SRF statute and other applicable federal statutes as well. On State water rights, one subsection essentially duplicates existing language in the Clean Water Act, while the second raises several issues of legal applicability and potentially problematic unintended consequences. However, we do recognize and want to work with all interested members of the Committee to see that the underlying concerns reflected in these provisions are addressed.

CONCLUSION

In summary, notwithstanding our continuing concerns with the funding authorization levels proposed in this bill, we appreciate the Committee's initiative in taking up this important issue, and particularly in its efforts to build fiscal sustainability in water and wastewater infrastructure. We look forward to continuing our constructive participation in your efforts to refine this legislation. Thank you for the opportunity to present the Administration's views on this bill. That concludes my prepared remarks, and I would be happy to answer any questions.

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